

August 3, 2023

## **New Tax Benefits for the Israeli Hi-tech Industry**

### **Client Updates**

On July 25, 2023, the Israeli Parliament (the Knesset) approved the Law for Encouragement of Knowledge-Intensive Industry (temporary order) (the "Law"). The purpose of the Law is to encourage the growth of Israeli hi-tech companies at the beginning of their journey (start-up companies) whose intellectual property is registered in Israel and have their center of activity in the country, by promoting investment in these companies.

### **The Law grants five tax benefits:**

1. Tax credit for individuals who invest in Israeli start-up companies, equal to the amount of the investment multiplied by the capital gains tax rate of the investor.
2. Deferral of capital gains tax on the sale of shares of an Israeli technology company when the selling shareholder reinvests the proceeds from the sale for the purpose of investing in another Israeli start-up company.
3. Allowing large Israeli technological companies who acquire other technological companies (Israeli or foreign) to deduct the amount of investment for tax purposes over a 5-year period.
4. Tax exemption to foreign financial institutions on interest income paid to it on a loan extended to an Israeli technology company.
5. Extending the validity (and amending certain conditions) of the tax benefits regarding investment in shares of public technology companies, which allows investors to recognize a capital loss equal to their investment amount (up to ILS 5 million).

Initially, the Law will be in effect until the end of 2026 and at that time its extension will be examined. The Law was enacted following the expiration at the end of 2019 of certain tax benefits provided for the same reason – promoting investment in Israeli hi-tech companies (also known as the "Angels Law").

Note that all the above-mentioned tax benefits are subject to different conditions and requirements specified in the Law, not all of which are detailed in this client update. Such tax benefits may result in significant tax savings for certain investors, hi-tech companies, and financial institutions. Our tax team will be happy to assist with any questions regarding this Law and the benefits provided by it.

General explanation of the tax benefits provided by the Law:

## **1. Tax Credit for Individual Investors in Israeli Hi-Tech Companies**

- The tax benefit is applicable only to investments in research and development companies ("R&D Company") as defined in the Law. Among other criteria, the R&D Company must be a private Israeli company with its main activity in Israel. The company's technological income and total income cannot exceed ILS 4.5 million and ILS 12 million, respectively, and the amount of funds raised by the company since its inception cannot exceed ILS 12 million.
- The tax credit for the investor is the amount of the investment (up to a maximum investment of ILS 4 million per investor in a specific company), multiplied by the capital gains tax rate (plus an additional 3% excess tax, if applicable) that the investor would have paid if they had sold the shares at a profit.
- To benefit from the tax credit, the investor must hold the shares (or rights to purchase shares) until the end of three years from the beginning of tax year on which the investment was made.
- A credit that cannot be utilized in the tax year in which the investment was made can be carried forward and utilized in subsequent tax years.
- Upon sale of the shares, the cost basis of the shares is reduced by the amount of investment with respect to which a tax credit was allowed, resulting in a higher capital gains tax if the shares are sold at a profit

## **2. Exemption for Individual Investors from Capital Gains Tax on Rollover of Shares of Certain Hi-Tech Companies to Shares of an R&D Company**

- An individual who sells shares in a Preferred Company, which has a Technological Enterprise (as such terms are defined in the Law for the Encouragement of Capital Investments), and within one year from the date of the sale or in the four months prior to it invests in an R&D Company, is eligible to defer the capital gains tax on the profit from the sale of such shares up to the amount of their investment in the R&D Company until the sale of the shares (including rights to shares) in the R&D Company.
- The investment amount eligible for the benefit is limited to ILS 5.5 million per investor per company, and the investor must hold the shares of the R&D Company for at least six months (and if they sell the shares in the R&D Company to a "relative", until the end of three years from the beginning of tax year on which the investment was made).
- An investor cannot benefit from both this exemption and the tax credit mentioned above in connection with the same investment, and if eligible for both, they may choose one of the benefits.

## **3. Recognition of Investment in Shares of Hi-Tech Company as a Deduction for Tax Purposes**

- The tax benefit is granted to a Preferred Company which has a Technological Enterprise that acquires control of either an R&D Company, another Preferred Company which has a Technological Enterprise, or a foreign hi-tech company that meets certain conditions.

- An acquiring company that meets the conditions of the Law will be entitled to recognize the purchase amount as a tax deduction against the preferred technological income of the acquiring company, spread equally during a period of five tax years, starting from the year following the year on which the company acquired control.
- When the acquired company is non-Israeli, the Law imposes more strict conditions compared to the ones required upon acquisition of an Israeli company. For example, when the acquired company is non-Israeli, the acquisition must be for a minimum amount of USD 20 million in cash, and all the assets of the acquired company (including intangible assets) must be transferred to the acquiring company within 12 months of the acquisition.

#### **4. Exemption from Tax on Interest from Loans Paid by an Israeli Hi-tech Company to a Foreign Financial Institution**

- A foreign financial institution is exempt from tax on interest, original issue discount, and linkage differences paid by a Preferred Company which has a Technological Enterprise with respect to a loan received from the foreign financial institution.
- The exemption is applicable under several conditions, including the requirement that the Preferred Company's technological income in the tax year preceding the loan exceeds ILS 30 million, the loan amount given in cash is at least USD 10 million, there are no special relationships between the company and the lender during the four years preceding the loan and during the loan period, and the company did not significantly reduce its activity in Israel during the period of the loan.
- According to the legislative explanatory statement, this exemption is designed to help Israeli technology companies reduce the costs of obtaining credit from foreign financial institutions specializing in providing credit to hi-tech companies and will enable such companies to raise foreign capital without diluting the holdings of existing shareholders.

#### **5. Extension of the Validity of Tax Benefits regarding Investment in Shares of Public Technology Companies**

- Between July 2016 and June 2022, a provisional tax benefit allowed an investor who made an investment in an R&D Company as part of the company's IPO on the Israeli stock exchange, to recognize capital loss equal to the investment amount (but no more than ILS 5 million) in the tax year in which the investment was made, provided that the IPO took place between July 1, 2016, and June 30, 2019.
- The Law extends the validity of this provisional tax benefit, such that the benefit will apply to an investment in an IPO of an R&D Company that would take place from the effective date of the law until the end of 2026. The tax benefit would be applicable to investments made in companies with a valuation between ILS 100 million to ILS 1 billion.

Note that all the above-mentioned tax benefits are subject to different conditions and requirements specified in the Law, not all of which are detailed in this client update. Such tax benefits may result in

significant tax savings for certain investors, hi-tech companies, and financial institutions. Our tax team will be happy to assist with any questions regarding this Law and the benefits provided by it.

Please feel free to contact us with any questions that you have on this matter.

This client update is designed to provide general information only, is not a full or complete analysis of the matters presented, and may not be relied upon as legal advice.

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