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New Proposed Legislative Tax Reform regarding Corporate Reorganizations

Client Updates

On November 4 a Legislative Memorandum amending the Income Tax Ordinance was published (the "**Memorandum**") as part of a series of amendments that are expected to be legislated as part of the State budget for the year 2025. The Memorandum that was published concerns, inter alia, the provision of reliefs for the performance of corporate reorganizations, and its amendments are groundbreaking in this field.

Background

Restructurings are an important tool in the business sector, and allow companies to develop, raise capital and expand their operations.

The Israeli Income Tax Ordinance allows, upon the fulfillment of certain conditions, to perform certain restructurings that will not be chargeable with tax at the time of their performance, including mergers, splits, and transfer of assets.

The conditions that are set out in the law at present are intended to ensure that the reorganizations will not result in financial realization of the assets that are part of the reorganizations, and only upon their fulfillment the taxation is deferred until the date the said assets are realized to third parties.

The Legislative Memorandum is intended to make these conditions much more lenient, for the purpose of eliminating barriers and allowing more freedom in the performance of restructurings.

Outlined below are the key principles of the proposed legislative amendments:

1. **Canceling the limitation on holding of rights for a period of two years as of the restructuring date** – according to the present law, when a restructuring is performed, the right holders participating in the restructuring are required to hold a minimum of 25% of the rights in the company after the restructuring for a period of two years as of the restructuring. This condition its intended to uphold the principle of preserving beneficial ownership of assets and rights in the company, which is a basic principle in the provision of the said benefits. The Memorandum explains that this limitation is a negative incentive for the performance of restructuring and limits the ability of investors to raise funds after the restructuring, and over the years this limitation has become no longer necessary. Accordingly, the Memorandum cancels this limitation with respect to any restructuring, in such manner that in fact the right holders shortly before the restructuring will be able to sell, immediately after the restructuring, their entire holdings. This relief will also apply to a restructuring that was performed prior to the publication of the law and in respect of which

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the limitation period has not expired yet.

2. **Relief in the transfer of an asset to a company** – according to the present law, an assessee shall be entitled to transfer an asset to a company under its control without being charged with tax, provided that immediately after the transfer the assessee will hold no less than 90% of the rights in the company to which the asset was transferred. Similar to the previous issue discussed above, the Memorandum cancels this condition, i.e., the transferor may transfer an asset to a company in which it has any rate of holding, provided that the assessee is allocated shares in that company based on the market value of the transferred asset.

3. **Reliefs in the requirement for proportional ratios in a merger** – according to the present law, the merger of companies is conditional on certain proportional ratios between the merging companies. The Memorandum makes these required proportional ratios more lenient:

(a) In lieu of the limitation on proportional ratios of 1:9 in a merger (except for certain circumstances in a merger between a subsidiary and its parent company), the Memorandum sets a limitation of proportional ratios of 1:19.

(b) Instead of a situation in which each of the parties to the merger will hold at least 10% in the surviving company after the merger (i.e., up to 10 merging companies), the Memorandum lays down a holding rate of at least 5% of the rights only (i.e., up to 20 merging companies).

The reliefs will apply to restructurings that will be performed after the publication of the law, and are subject to the prior approval of the Director of the Tax Authority.

4. **Relief in a merger by way of exchange of shares** – according to the present law, it is possible to perform a merger by way of an exchange of shares, provided that the right holders in the merging company will transfer at least 80% of the shares in the company. The Memorandum reduces the required rate of holding to 70% only.

5. **Cancellation of the limitation demanding that if land was transferred, it is mandatory to build on this land within a period of 5 years** – according to the present law, if, following a restructuring, a land is transferred to a company that is a real estate association, it is necessary to complete the construction of a building on this land within a period of 5 years. The Memorandum explains that this condition impedes the performance of a restructuring and it is not necessary, and it is canceled, for the purpose of allowing companies to separate their real estate activities. This relief will also apply to restructurings that were performed prior to the publication of the law and in respect of which the 5-year period has not expired yet.

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The proposed legislative amendments create a fundamental change of the underlying rationale of the provisions of the law on reorganizations, and facilitate considerably the performance of reorganizations by Israeli companies.

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