March 23, 2025

Israel Tax Authority Publishes Updated Guidelines Regarding SAFE Investments

Client Updates

On January 29, 2025, the Israel Tax Authority (ITA) issued an updated guidance letter regarding the tax implications of investments made through a SAFE (Simple Agreement for Future Equity). This update follows the ITA's previous guidelines published on May 16, 2023, which remained in effect for investments executed until the end of 2024 (see our firm's prior update on this matter here).

The ITA's updated guidance letter clarifies ambiguities left by the previous guidelines, introduces additional conditions, and enhances certainty regarding the taxation of SAFE investments.

As is commonly known, in a SAFE transaction shares are not immediately issued in exchange for the investor's capital infusion. Instead, shares are issued at a later stage when the company establishes a valuation through a significant and broad capital raise. At that point, the SAFE investor is issued shares at a discount relative to this valuation.

The primary issue addressed by the ITA in this context concerns the classification of the discount component in a SAFE investment — that is, the difference between the SAFE investment amount and the fair market value of the shares issued to the investor upon conversion at a later date, and specifically, whether such difference should be classified as interest income.

Both the previous and the updated guidance letters set out a "Safe Harbor" – specific circumstances under which a SAFE investment will be classified solely as a capital transaction. If all Safe Harbor conditions are met, no taxable event will occur upon the conversion of the SAFE into shares, and the company will not be subject to any withholding tax obligation with respect thereto.

Below is a summary of the key conditions from the guidance letters, highlighting the changes and clarifications introduced in the updated version:

- The SAFE investment amount for any single investor shall not exceed USD 20 million;[1]
- The SAFE investment is intended solely for the issuance of shares (including "rights to shares"), strictly in accordance with a predetermined mechanism, and must take place upon the earlier of the following events:[2]
  - A capital raise defined in the SAFE agreement as a **"**qualified financing**"** (or a similar term) that mandates share issuance. For this purpose, each of the following shall be considered a capital raise requiring share issuance : (i) a capital raise exceeding 40% of

© All Rights Reserved to Gornitzky & Co. – Israeli Law Firm

the company's fully diluted share capital (prior to the raise and before the issuance of shares); or (ii) a capital raise exceeding 10 times the aggregate amount of all outstanding SAFE agreements of the company. Furthermore, at least 25% of the raised capital must come from investors who are not SAFE investors "as such" (i.e., as a new investment and not an investment made pursuant to the conversion provisions of the SAFE agreements), and no SAFE investor may hold more than 50% of the capital of the company—whether on a fully diluted or non-diluted basis—either before or after the additional capital raise;[3]

- An initial public offering (IPO) on a stock exchange;
- A transaction involving the sale of the majority or all of the company's assets;
- A predetermined date specified in the SAFE agreement, where the issuance shall be based on a pre-agreed valuation, which can be either: (i) A fixed amount; or (i) the share value in the most recent or upcoming financing round, either without a discount or with a predetermined fixed discount.[4]

- The discount rate does not vary as a function of the time elapsed between the SAFE investment date and the issuance date. As an exception, the discount may be structured as a function of time or linked to the achievement of milestones, provided that it is determined in up to three tiers, each representing a distinct discount rate, and that the maximum discount rate is granted no later than three years from the date of signing the SAFE agreement;[5]
- The SAFE investor does not have the right to receive their investment back by the company, except through the issuance of company shares, unless one of the following events occurs (in which case the investor may only be entitled to receive the principal investment amount, with no additional returns):
  - Sale of shares by the majority of the company's shareholders, where the purchase consideration is paid by the share purchaser and not by the company ("**Acquisition Transaction**"). For this purpose, the purchaser must be a third party unrelated to the company or a shareholder holding no more than 25% of the company's shares,[6]
  - Voluntary or involuntary liquidation, the appointment of a receiver or a special administrator appointed by the receiver, the court, or the enforcement authority, or a general assignment for the benefit of creditors.[7]
- The company shall not claim a deduction for tax purposes of any expenses directly or indirectly related to the SAFE;[8]
- The shares issued in connection with the SAFE investment may be sold no earlier than 12 months from the date of signing the SAFE agreement or 9 months from the date of the issuance of the shares (unless the sale is part of an Acquisition Transaction or the company's liquidation).[9]

The remaining conditions and the profile of companies utilizing SAFE transactions remain similar to the previous guidelines. Accordingly, the list above does not include all the conditions outlined in the ITA's guidance. The full text of the ITA's guidance (in Hebrew) can be found at this link.

© All Rights Reserved to Gornitzky & Co. – Israeli Law Firm

As noted, the ITA's guidance applies to SAFE investments with specific characteristics and those provided to companies with a certain profile. SAFE investments that do not meet all the specified conditions will be assessed based on the overall facts and circumstances, and its classification for tax purposes will be determined accordingly—whether as an advance payment for shares, debt repayment that may include interest income for the investor, or another classification. Based on these circumstances, the tax assessor will determine the applicable tax treatment.

Our firm's tax department has extensive experience in this field and we would be happy to assist in analyzing the tax implications of investing in Israeli companies through SAFEs.

---

[1] In the previous guidance letter, the investment amount was limited to ILS 40 million.

[2] The previous guidance letter did not address rights to shares and did not specify that the trigger for issuance would be the earlier of the specified events.

[3] The previous guidance letter did not include a classification of a capital raise as a "qualified financing" and did not mandate share issuance in the aforementioned cases.

[4] The previous guidance letter did not allow issuance to be triggered based solely on a predetermined date.

[5] The previous guidance letter did not allow a discount that varies as a linear function of time.

[6] For purposes of this requirement, the "majority of shareholders" shall be determined based on the number of shareholders rather than the number of shares, and without considering option holders, the sale of options, or shares derived from their exercise. Under the previous guidance letter, in the event of an Acquisition Transaction, only an early sale, as outlined in the final bullet point below, was permitted, and a return of the principal investment amount was not allowed.

[7] In such an event, the SAFE instrument ranks subordinate to the company's debt holders, except in the case of liquidation, where SAFE investors' rights are equivalent to those of preferred shareholders (i.e., subordinate to all debt but senior to common shareholders).

[8] The previous guidance letter addressed only financing expenses.

[9] The previous guidance letter permitted early sale only in the case of an Acquisition Transaction.

Key Contacts

Daniel Paserman
Head of Tax

Dr. Assaf Y. Prussak
Partner

Nir Moses
Partner

© All Rights Reserved to Gornitzky & Co. – Israeli Law Firm