

LEGAL UPDATE – MAY 2012 CAPITAL GAINS TRACK EQUITY GRANTS (SECTION 102)

New ITA Policy

Israeli Tax Authority ("ITA") officials have recently expressed a stricter interpretation of the provisions of the law that has the potential to disqualify the tax advantaged status of grants purporting to qualify as Section 102 Capital Gains Track equity grants ("Section 102 Grants"). If actually implemented, this new interpretation could result in the tax burden for such grants being increased by more than 100%.

Since the legislation of the amended Section 102 of the Income Tax Ordinance, no rules or guidance from the ITA was provided by the ITA to explicitly define what the general requirement that Section 102 Grants be "deposited" with a qualifying trustee as defined in Section 102 (the "Section 102 Trustee"). Nor have provisions of the law requiring periodic filing of reports of Section 102 Grants to the ITA been followed up with actual regulations that would permit their implementation. In the absence of guidance, different practices have developed, with companies notifying the Section 102 Trustee of Section 102 Grants and/or providing copies of executed grant letters in physical or electronic form, and sometimes with a significant delay between the date of corporate approval of the grants and the date of actual notification to the Section 102 Trustee.

Even though historically the ITA did not take an explicit position, it has recently been stated by ITA officials that Section 102 Grants not reported to the Section 102 Trustee within a "reasonable time" from the date of grant will not be recognized as qualifying grants – with the date of grant now being defined as the date on which employees have accepted the grants (and not the date of corporate approval, which has been the prevailing interpretation implicitly recognized by the ITA in the past) and with a "reasonable time" for deposit now being interpreted as within 30 days of such date of grant.

Unfortunately the ITA position has not put forth as applying on a prospective basis only, but rather has been raised in the context of the treatment of grants made in the past. We also note that there has also been as yet no official determination or publication of the ITA's position in this matter, and changes are therefore possible.

Practical Implications

Notwithstanding the prevailing uncertainty in the absence of official guidance in the form of regulations or a published directive, companies making Section 102 Grants should in any event be vigilant about complying with the following "best practice" recommendations:

- (i) The Board of Directors (or other administrator of the relevant equity incentive plan) should expressly document all details of Section 102 Grants (including as applicable, exercise price, vesting, acceleration provisions etc.) and define the date of grant;
- (ii) Recipients of Section 102 Grants should be required to execute a form of confirmation of the grants (or otherwise approve the grants in a manner that can be easily documented) as soon as practicable after the corporate approval of the grants;
- (iii) The awarding company should as soon as possible, and in any event no later than 30 days following the date of grant, provide copies of the executed confirmation and

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notice of grant (or other form of documented confirmation) to the Section 102 Trustee, and

- (iv) The awarding company should maintain accurate and complete records of all Section 102 Grants, including evidence of the deposit of such grants to the Section 102 Trustee.

We also strongly urge that companies review the current status of previously awarded Section 102 Grants with their Section 102 Trustee and advisors to confirm that all grants have been appropriately documented.

Please direct any queries you may have regarding these matters to: Ben Sandler (bens@arnon.co.il) and Ofir Levy (ofirl@arnon.co.il)