New Significant District Court Ruling – Compliance with Section 102

On July 4, 2019, the Israeli District Court in Nazareth issued a noteworthy court ruling which addressed compliance with Section 102 of the Israeli Income Tax Ordinance [New Version] 5721-1961 and in specific requirements for compliance with the Trustee Capital Gains Route under Section 102(b). Though the case addressed a specific employee equity plan and the position taken by the Israeli Tax Authority according to which the plan did not comply with the requirements of Section 102, the court ruling included general determinations concerning compliance with Section 102. This significant ruling is still subject to possible appeal to the Supreme Court.

The circumstances of this case were as follows**:** A company adopted an equity plan under which various employees were issued a special class of shares. These shares had only dividend rights and could not be transferred. Upon termination of employment the shares were to be converted into dormant shares. Dividends distributed to the employees were taxed at dividend tax rates. The Israel Tax Authority **cl**aimed that the dividends should have been taxed as ordinary income and not as a dividend. The appeal was filed by one of the employees of the company.

The initial determination made by the District Court was that the equity plan was intended to provide the company and the employee with certainty with respect to the grants made under the equity plan and their tax implications. Consequently, it was ruled that once an equity plan has been approved by the Israel Tax Authority, including when the plan is deemed approved due to the lapse of nighty days from submission without objection**,** the Israel Tax Authority will generally not be able to claim the plan is not compliant with Section 102

The ruling continues and determines that Section 102 applies to any class of share in the share capital of the company. The Court determined that cash dividends paid on shares taxed pursuant to the Trustee Capital Gains Route of Section 102 will be subject to tax at 25%, including when the dividends are paid during the two year holding period. The Court further ruled that the existence of a put option or call option does not necessarily disqualify awards from beneficial tax treatment, including where shares are converted into dormant shares upon termination of employment, as long as the equity plan and the awards fulfil the purposes underling Section 102.

This is the most significant and extensive court ruling with respect to Section 102 which has been published since it was introduced in its new version in 2003 and will likely have material impact on employee equity plans in Israel.

This document provides a general summary and is for information purposes only. It is not intended to be comprehensive nor does it constitute legal advice. If you are interested in obtaining further information please contact our office at:

Schuman & Co. Law Offices
9 Hartom Street, P.O.Box 45392
Har Hotzvim, Jerusalem 97774 Israel
Tel: +972-2-581-3760, Shalev@schumanlaw.co.il
http://www.schumanlaw.co.il/