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To: Clients

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Re: ITA Policy on Equity Compensation of Relocation Employees

The Employee Options Department of the Professional Division of the Tax Authority has published a summary of a recently issued Tax Ruling, which sets out its current policy on the Israeli tax treatment of stock options and RSUs granted to inbound and outbound Israeli relocation employees. The decision, which relates to a NASDAQ traded Israeli company, is noteworthy both because it provides disparate treatment for inbound and outbound relocation employees and because it conflicts with previous guidance on the tax classification of grants to relocation employees.

The facts of the ruling are as follows: The issuer is an Israeli resident company whose shares are traded on NASDAQ. Over the years, the issuer granted options and RSUs under the capital gains track of Section 102 of the Israeli Income Tax Ordinance to its employees and officers in Israel, which were deposited with a Trustee. The issuer also granted options and RSUs to its employees in subsidiary companies outside of Israel. Some employees with 102 CG track grants have been relocated to group subsidiaries outside of Israel, and some employees that received grants while working in group foreign subsidiaries have been relocated to Israel (both "**Relocation Employees**").

The ruling treats these two different Relocation Employees differently:

Grants to Israeli employees relocated to foreign group companies will continue to be held by the Trustee as 102 CG track grants, and gain will be withheld on sale as if the Relocation Employee continued to be Israeli Tax Resident; however, credit will be provided for foreign tax paid. Specifically, upon sale of the shares (when the Relocation Employee is residing in a foreign jurisdiction and arguably no longer an Israeli tax resident), the Trustee will withhold Israeli tax against all of the gain, and will only allow credit for foreign tax paid against the "Non-Israeli Portion" of the gain (representing the Non-Israeli holding period of the shares). The Relocation Employee will not be entitled to a refund of Israeli tax on the Non-Israeli Portion even if the foreign tax withheld exceeds the Israeli tax due. The Israeli Portion of gain is computed by multiplying the total gain by the ratio of the number of days between the departure date and the grant date (or vesting if earlier) divided by the number of days between the sale date and the grant date. The Relocation Employee will not be entitled to any foreign tax credits or domestic tax benefits on the Israeli Portion of Gain.

Grants to employees of foreign group companies prior to their relocation to Israel will be characterized as Section 3(i) awards. This means that upon exercise of the option, the employee will be subject to Israeli tax at his marginal tax rate, and that upon sale of the underlying share, the employee will be subject to Israeli capital gain tax on the difference between the sale price and the exercise price. Nevertheless, the Tax Decision provides for withholding by the Israeli company only on the exercise date. Further, the foreign Relocation Employees are reserved the right to take the position that they are foreign residents or entitled to certain domestic tax benefits for returning residents and new immigrants.

In addition to essentially discriminating between inbound and outbound employees, the Tax Decision characterizes the Inbound Relocation Employees' grants as Section 3(i) awards rather than grants under the Non-Trustee track under section 102(c)(2). This is significant both because of the acceleration of the tax event under section 3(i) – which occurs on exercise, unlike Section 102 grants which are only taxed at sale - and because of the inability to automatically reduce the Israeli tax on the gain in relation to the vesting period of the awards outside of Israel.

Note that while published tax rulings are generally a good indication of current ITA policies on the relevant issues, we recommend that any company wishing to implement this ruling apply to the ITA. Our office is happy to assist on this matter.