Client Update: Income Tax Regulations on Tax Benefits for Employee Share Allocations

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The allocation of shares to employees under Section 102 of the Israeli Income Tax Ordinance provides a unique tax framework that offers significant tax advantages. Under this framework, the benefit from the share allocation is taxed as a capital gain, rather than being subject to the ordinary income tax rates that typically apply to employment income.

Income Tax Regulations (Tax Benefits in Allocating Shares to Employees), 2003, establish rules for implementing share allocation plans, including guidelines for tax withholding, the appointment of trustees, and reporting obligations for both the employer and the trustee along with relevant submission deadlines.

However, the regulations, enacted nearly 20 years ago, have not been updated. Recently, the 2024 Amendment to the Income Tax Regulations (Tax Benefits in Allocating Shares to Employees) was published. According to the explanatory notes on the government's legislative website, the amendment is intended to enable the Israeli Tax Authority to more effectively monitor the granting of tax benefits under employee share plans.

The new regulations will take effect on January 1, 2025. A key change is that the previous requirement to notify the tax assessor about share allocations has been replaced with a mandatory application for approval of the share allocation plan. This application must include a completed questionnaire as specified in the regulations. Any modifications to the responses during the plan's duration will necessitate resubmission and reapproval by the Tax Authority.

Additionally, the reporting deadline for share allocations has been extended from 90 to 120 days following the end of the quarter in which the allocation took place. Generally, reporting for the prior tax year must be completed by April 30.

Furthermore, in addition to previous reporting requirements, companies must now provide details on the type of equity compensation granted and report amounts paid by the employee, along with payment dates, such as the exercise or purchase price for the shares. If the employee has made payments for the shares, a breakdown of the amounts and dates must be included. The application must also specify the expiration date of the shares, including the timeframes for converting rights into shares in the event of employment termination. Vesting conditions must also be outlined in the application.

References: Income Tax Regulations (Tax Benefits in Allocating Shares to Employees) (Amendment), 2024

For more information or any questions regarding this subject or related matters, please contact Keshet Sirota-Leviner or Hadar Mauda.

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