



Israel IP Issues and Business Restructuring

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Overview

- Israel Transfer Pricing Background.
- Israel IP Trends on Acquisitions and Business Restructurings.
- Integration of Strategies with Recent Business Restructuring Paper.

Israel Transfer Pricing Background

- Historically, acquisitions of Israeli companies and subsequent business restructuring negotiated based on discounts from market value.
- Transfer Pricing Regulations introduced in 2007.
 - Broad-based.
 - Addressing IP Issues?

Israel Transfer Pricing Background

- Israel Tax Authority's (ITA) transfer pricing department is in the division that performs tax audits.
 - Four distinct specialists.
 - OECD-trained (Israel recently admitted to the OECD).
 - Must be called in by a tax examiner auditor.
- ITA has begun to audit transfer pricing issues for 2007 and 2008.
 - Taxpayer needs to assess who is dealing with the TP issue:
 - Specialist from TP department; or
 - General tax examiner.

Israel Transfer Pricing Background – IP

- Over the past three to four years, there have been a number of publicly-disclosed “agreements” with the ITA pertaining to acquisitions of Israeli companies.
 - IP is Israel-based.
 - Acquisitions worth hundreds of millions of dollars.
 - Apparently, the IP transfer agreed to at less than 25% of the entity’s acquisition price.
 - Not known whether Israeli transfer pricing department has been involved or not.

Israel Transfer Pricing Background – IP

- Israeli companies acquired 2000 to 2008:
 - Mercury acquired by HP for \$4.5 billion.
 - M-Systems acquired by SanDisk for \$1.6 billion.
 - Iscar Metalworking acquired by Warren Buffet for \$4 billion.
 - Atrica acquired by Siemens for \$100 million.
 - Omrix acquired by Johnson and Johnson for \$438 million.
- Many other acquisitions of mature companies and start-ups.
 - Sometimes, the acquisitions yield a loss or small return to VCs; at other times, they yield substantive profits.
- Some of the acquisitions pull out the IP – and, sometimes, they are public pronouncements.

Israel Transfer Pricing IP Historical Approaches

- One third rule.
- Technology dilapidation.
- Outright sale.
- Discounts off of market value.
- Transfer Pricing Regulations and entry into the OECD have caused the ITA to issue its business restructuring paper.

Israel Business Restructuring Paper

- Need to coordinate with OECD but maintain traditional Israeli approaches/arguments.
 - Workforce is the value of the technology.
 - Where management sits is where the value is.
 - For hi-tech companies, little to no value in the marketing performed outside of Israel.

Israel Business Restructuring Paper

- Main ideas of the Business Restructuring Paper:
 - Outwardly argues that the arm's-length principle is what rules – Israel Section 85-A
 - Note that one can turn to the transfer pricing department or the economics department (Will there be conflicts depending on whom one turns to?).
 - Notes that there will be a form issued that will need to be filled out pertaining to business restructurings.
 - Present Israel TP form 1385 apparently not deemed adequate for business restructuring issues.
 - Understanding of the need to assess business risks in the transfer.

Israel Business Restructuring Paper

- Discussion of the Restructuring Paper:
 - Definition of Restructuring (asset transfer, license, or ownership transfer):
 - Capital gains tax or ordinary income tax.
 - Issues with Approved Enterprise status.
 - Discussion of methodologies to assess the value.
 - What are intangibles?
 - What is missing?

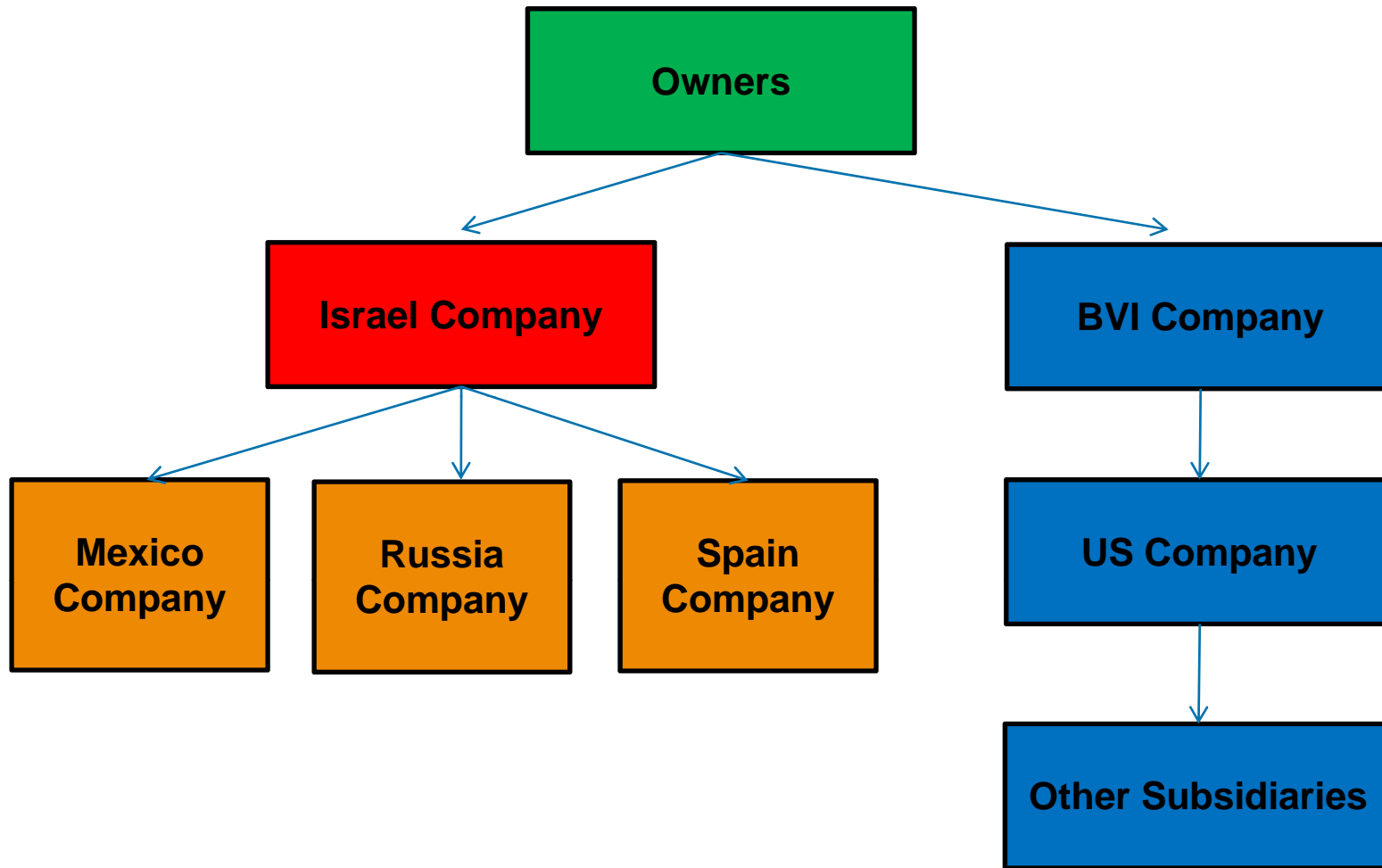
Israel Business Restructuring Paper

- Factors that will be assessed:
 - Changes in the holding structure (directly/indirectly), including transactions of business conversions arising as a result of the entry of an outside investor.
 - Changing the method of settling intercompany accounts.
 - The shift from a company that operates as a technological company – which includes all the functions required for the development, marketing and sales of its products, and providing support for its products – to an operating company that provides research and development services.
 - Change in ownership of the intangible assets, cessation of registration of the intangible assets in Israel.
 - A reduction in the number of employees in Israel that work in: development, marketing, sales, support, and production.
 - A decline in the overall revenue of the Israeli company.
 - Material changes in the gross profit and operating profit.
 - A decrease in the deferred income balance from sales and/or related services and/or support services.
 - A reduction in the cash flows of the Israeli company.

Case Example

- Israel Company in hi-tech sector owns IP.
 - Has acquired other entities over time.
 - Other small amounts of IP now located in Spain, Mexico, and Russia.
 - From the time of acquisition, IP not transferred but began to work on a cost plus basis for future development.
 - 22 sales/marketing affiliates throughout the world.
 - 15 of them lost money for the past three years including Spain, Mexico, and Russia.

Case Example



Case Example

- Strategies:
 - Product by product valuations.
 - Top down valuation into value drivers.
 - Overall company valuations.

- Highlights of these strategies versus the Recent Business Restructuring Paper:
 - Product by product.
 - Goodwill.
 - Value of technology on product basis versus other intangibles.
 - Loss making in many countries so perhaps no value?
 - Top down.
 - Overall company.