



Employee Stock Options and the Coronavirus Crisis

Dear Clients and Colleagues,

In view of numerous inquiries from clients on changes that companies wish to make to their equity award programs as a result of the coronavirus crisis, we set out below answers to specific issues relating to grants allocated to employees under section 102 of the Israeli Income Tax Ordinance 5721-1961 ("Section 102").

Lowering Exercise Price

Several years ago, the Israeli Tax Authority published a form for taxpayers to apply for a ruling on the "green route" for the repricing of employee stock options. The form is intended for companies that wish to lower the exercise price of "out-of-the-money" options granted to employees under the Section 102 Capital Gains Track. The ruling would establish that the repricing creates a lock-up period which commences on the later of: (a) the date of the company's board of directors' resolution on the repricing; or (b) the date when the tax ruling is requested (the "Repricing Date"). In addition, for public companies the income component of options subject to taxation under section 102(b)(3) would be calculated in accordance with the difference between the average value of the share in the 30 days preceding the Repricing Date and the exercise price of the option. The repricing itself would not be treated as a taxable event.

Vesting Period Changes

The Tax Authority recently circulated a new form (which has not yet been published) for companies' "green route" requests for a change of their option vesting period. A company that wishes to shorten its employees' vesting period in order to create an incentive for the employees during the current crisis can use this form to request a tax ruling. In accordance with the tax ruling, the date of the ruling request will be deemed to be the "new" allocation date for purposes of Section 102. Although the change of the vesting period itself will not be taxable, the employees will have a new lock-up period, which will commence on the date when the change is made; in addition, for public companies the income component of options subject to

taxation will be calculated in accordance with the difference between the average value of the share in the 30 days preceding the date of the change and the exercise price of the option.

Expiration Date Extension

A company that wishes to extend the expiration date of the options because of the decline in the company's value during the crisis, making the options out-of-the money, can extend the expiration date without requesting a tax ruling, provided that the expiration extension is intended to enable the company not to effect a new issuance. The extension must apply "across the board" to all employees actually working, and there can be no connection between the extension and employment severance packages or the termination of employment relationships.

Leave Without Pay

Placing an employee on leave without pay raises an important question regarding the application of Section 102 during the leave without pay period – is leave without pay deemed to be the termination of the employment relationship, or do rights continue to be accumulated during this period. We recommend reviewing the provisions of the company's equity grant plan to see whether it addresses the leave without pay period. In the absence of a specific provision, a company's board of directors or its compensation committee may have residual authority to establish rules on this matter.

There is currently no official published directive on the tax consequences of this issue.

If vesting ceases during the leave without pay period, we believe that leave without pay should not affect the application of Section 102, and that an employee who returns to work following leave without pay will be able to continue to benefit from the provisions of Section 102. If the options continue to vest during the leave without pay period, we believe that each case must be reviewed individually in order to assess the application of Section 102 to the options that continue to vest during this period. We expect the Tax Authority to demonstrate flexibility on this issue during the present crisis, and we intend to request clarification from the Tax Authority in this regard.

Changes of Option Terms Upon Termination of the Employment Relationship

The Tax Authority's position is that a change in the terms of options in the framework of termination of an employment relationship changes the tax route which applies to the options from Section 102 to Section 3(i) route. We expect that in this regard as well, the Tax Authority will demonstrate some flexibility to enable companies to request to reach a tax arrangement on this issue.

In summary, companies can provide or enhance equity-based incentives for their employees

during the coronavirus crisis in a number of ways. Companies should plan carefully the changes they wish to effect in order to achieve optimal tax consequences for the employees. We also anticipate that the Tax Authority will show flexibility in view of the coronavirus crisis, and hence the circumstances of each situation should be considered individually.

We will update on future developments regarding the matters discussed above and are available to answer any questions you have.

Sincerely,
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