ISRAEL PRACTICE **NEWSLETTER**

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ISRAEL PRACTICE NEWSLETTER

Holland & Knight is a U.S.-based global law firm with a strong commitment to the state of Israel. We focus on providing guidance to Israeli investors and companies interested in doing business or making investments in the United States and Latin America. With more than 1,250 professionals in 27 offices, our lawyers and professionals are highly experienced in all the interdisciplinary areas necessary to guide entrepreneurs, investors, and startup or established companies through the opportunities and challenges that arise throughout the business or investment life cycles.

Areas of legal guidance that are typically provided to our Israel Practice clients include real estate, mergers and acquisitions, private equity, international tax, cross border and customs, Internet privacy and cybersecurity, intellectual property, government lobbying, regulations and compliance, U.S. Foreign Corrupt Practices Act (FCPA), U.S. Foreign Account Tax Compliance Act (FATCA), and litigation and dispute resolution.

We invite you to read our inaugural Israel Practice newsletter, in which our authors discuss pertinent American-Israeli topics. As Israel has been a crossroads and a prolific source of new ideas for more than 3,000 years, a natural tradition of inventiveness finds its most recent expression in the creation of a technology startup ecosystem with global impact. This newsletter addresses, among other relevant topics, how the innovative technologies and ideas generated in Israel can be deployed in the United States and globally. We invite you to discuss your thoughts on this inaugural issue with our authors listed within the document.

Taming the Blockchain Badlands

By David Sofge

To the wild and lawless lands of the blockchain, settlers are coming. A sign is the R3 Consortium's recent announcement that it raised more than $100 million in funding from a group of banks and technology companies, sending a powerful signal of support for its effort to fence off and cultivate sections of the new environment created by blockchain technology.[1]

Early pioneers beginning with "Satoshi Nakamoto"[2] in 2008 were drawn by a vision – the prospect of a distributed ledger software running simultaneously on thousands of computers around the world, with information formed into mathematical "blocks" that, when linked into a chain, would be computationally unbreakable and therefore free from tampering or fraud. This "blockchain" would be transparent to all nodes on the network, verifiable immediately at all times and incorruptible.

Payments could be immediate and essentially cost-free (no banks or financial intermediaries necessary), so Bitcoin, Ethereum and other 'cryptocurrencies' representing economic value could replace monetary systems controlled by governments and central banks. Tokens representing ownership of land, vehicles, commodities, copyrights and any other asset could be held and transferred without official registries or ledgers. With the "disintermediation" of central authority – governmental and corporate – conditions would exist for the creation of new forms of business and society.

In practice, the new world created by blockchain was not without hazard. Along with the visionaries and social reformers also arrived a cast of rogues, bandits and desperadoes familiar to any fan of American horse opera. Mt. Gox, the largest "Bitcoin bank," went bust and collapsed in bankruptcy and scandal. Pirate Bay and Silk Road operated "dark net" online bazaars for illegal and illicit commerce, and their founders were pursued and locked up by real-world authorities. The Decentralized Autonomous Organization (DAO), a European experiment in establishing a venture capital fund running entirely on blockchain software without human governance, made a highly successful offering, quickly raising the equivalent of $160 million in Ethereum (a cryptocurrency rival to Bitcoin). Within days, the fund was attacked by hackers who found a vulnerability in the DAO software and drained off about $60 million, leading to suspension of the project.[3]

The Wagons Roll

Undaunted by blockchain's rough and rowdy past, global banks and tech firms have begun moving into the territory. R3's new funding will reportedly be used to place into operation a new system for trade finance in conjunction with Japan's Mizuho. Other groups are also pushing in (with overlapping membership, as banks and tech firms hedge their bets). These include the Enterprise Ethereum Alliance (EEA), the largest consortium by headcount, with backing from Microsoft; Ripple, which among other things is advising the Depository Trust & Clearing Corporation (DTCC) on settlement of derivatives transactions; the Hyperledger Project, which has powerful support from IBM; and Digital Asset Holdings (DAH), formed by Wall Street veterans and deeply involved with the world's largest banks. All are committing resources to discover ways that blockchain approaches can be used to cut costs, increase speed and provide transparency.

Chalutzim / חלוצים

Israeli pioneers have joined the movement. Wave, a start-up based in Kfar Saba, joined forces with Barclays Bank last year to do the first real-world blockchain trade finance deal, using a distributed ledger version of a commercial letter of credit to replace a centuries-old, document-based system that is notoriously susceptible to complexity, delays, error and fraud.

Hearkening back to the old days on the frontier, a powerful lure was the prospect of the open range, with no boundaries or barriers.

But despite the Israeli financial technology (fintech) sector's formidable presence in cybersecurity, consumer-facing applications and even the related area of cryptocurrency transactions[4], developing new blockchain use cases for mainstream global finance is a relatively underdeveloped area in the Israeli tech ecosystem. The Floor, a fintech hub backed by the Tel Aviv Stock Exchange (TASE), Intel, Banco Santander, China's Pando Group and others, has plans to drain this particular swamp. Its organizers aim to introduce local fintech developers to global institutions in Europe, North America and Asia, which for the most part do not have a commercial presence in Israel, and also help Israeli entrepreneurs obtain a better understanding of the operations and needs of global banking systems.

Don't Fence Me In

The new arrivals in blockchain territory bring with them new regulatory issues (since many participants are regulated institutions), the related requirement of human oversight and control to fix technical errors or block fraud, and fences – especially fences.

Hearkening back to the old days on the frontier, a powerful lure was the prospect of the open range, with no boundaries or barriers. Cryptocurrencies and related projects can generally be accessed freely by anyone choosing to download the software. Access to such systems is anonymous and requires no consent from any authority as a condition of participation (hence the appeal to libertarians and those mistrustful of governments and central bankers). In network jargon, those projects are "permissionless."

The new corporate-backed projects are by contrast "permissioned." They are accessible only by the consent of system authorities for the closed private networks, which means that, in the case of R3, for instance, all of the members with access will be major financial institutions. In broader private networks such as those working in trade finance, participants are admitted based on their specific function in a transaction.[5] Anyone breaking the rules or causing a ruckus will be run out of town. Creators of the new permissioned systems say this provides the one element that is essential for any commercial intermediary: trust.

Those who hope to preserve the wide open spaces of the original vision feel that they are being hemmed in. They argue that the new commercial initiatives will lead to re-imposition of centralized authority in the hands of a few large firms, and that when the new arrivals say "alliance," we should hear "cartel." In their view, what could have been a societal revolution may turn out to be "just a boring upgrade" to existing technical systems.[6]

Eventually the American frontier was staked out, fenced in and made safe for settlers, but its myths and values survived to become pervasive memes in global culture. Domestication for commercial development may well turn out to be the fate of large portions of the blockchain, but it will be of more value if the new protocols and systems – even as they are progressively integrated into mainstream financial architecture – retain something of the vision and social purpose that motivated the early pioneers.[7]

Holland & Knight is currently engaged in a variety of research and development projects with clients and others relating to the improvement of business processes, legal informatics, machine learning and distributed ledger technology.

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1. Free-and-easy use of the terms "blockchain" and "distributed ledger" as synonyms has riled up many who believe that R3's Corda distributed ledger system has gone far beyond the bounds of the original blockchain concept, putting some in a mind to dispense a bit of frontier justice. Risking public obloquy or worse, this article uses the terms interchangeably.
2. A pseudonym. His or her true identity has never been ascertained.
3. The purloined funds were largely recovered or frozen in place. Organizers of the project overcame the objections of blockchain purists and re-established human control over the network, intervening in ways not contemplated by the original software – i.e., a "hard fork."
4. June 2017 saw the launch of a new protocol located in Switzerland that has Israeli roots and is based on the Ethereum public blockchain. The new protocol sold smart tokens, valued at more than $150 million, that are claimed to provide their own cross-chain liquidity and price discovery using smart contracts, with information on the token sales evaluated and reported through a collaboration with a Tel Aviv-based "digital autonomous organization" platform. The transaction may fairly be said to push out on a number of frontiers in cryptocurrency, crowdfunding and securities regulation.
5. A freight forwarder, for instance, will have access for the specific actions it is to perform in connection with a specific shipment.
6. In what may be seen as a gesture of goodwill to dissidents, portions of the new systems have been made "open source" to allow some amount of space for independent development.
7. In the meantime, the frontier Wild West show has moved on to Initial Coin Offerings (ICOs).

The Disruption Wave Hits Insurance

By David Sofge and Tom Morante


The wave of technological disruption is reaching the insurance business, long protected by social, regulatory and organizational barriers. New competitors buoyed by their familiarity with consumer-facing mobile technology, artificial intelligence (AI) and data manipulation are moving rapidly to exploit opportunities presented by the incumbents' ponderous size and lagging technology, as well as decades of popular resentment for the insurers themselves.

Some of the changes underway are based on opportunities for increased efficiency – faster and better underwriting, more consumer-friendly applications (often with a chatbot on a mobile device) and a less aggravating procedure for claims. Others, however, are going further, and seek nothing less than a fundamental restructuring of the business models for insurance which have dominated the landscape for more than a century.

Startups are focusing on niches in the new economy or specific markets underserved by the existing insurance industry.

Israeli-based startups are leading the way in many areas. All (it goes without saying) use various combinations of the latest innovations in data analytics, AI, cloud computing, the Internet of Things and other current technologies. One of them reported earlier this year that it had paid a claim (for a stolen coat) in three seconds, claiming by that act to have set a new record in the 3,000-year history of the insurance industry. Some are focusing on niches in the new economy or specific markets underserved by the existing insurance industry, such as Hippo's products for underinsured U.S. homeowners with specific emphasis on using distributed sensors and the Internet of Things to prevent mishaps and claims. Others, such as Next Insurance, are reaching out to the beleaguered small business market, traditionally confronted with lengthy, complex "one-size-fits-all" applications and policies. Next Insurance offers coverage tailored to specific types of small and medium-sized business, with processing on the web. (If you're stretching, for example, to find coverage for your yoga business, you may be in luck.)

The highest-profile challenge to date is presented by Lemonade. This startup hearkens back to the roots of modern commercial insurance in the 17th century, when sea captains and financial backers met regularly at Lloyd's Coffee House in London to talk over sharing the risks of maritime commerce, with backers writing their names underneath others on a sheet ("underwriting") to signify participation in the risk of a particular voyage. Syndicates formed by the regulars to insure a number of ships created the pooling and diversification of risk that is at the core of the modern insurance business.

The model shifted in the late 19th century with large-scale urbanization, when millions of people moved into cities to take factory jobs, and new insurance companies (many of them are the same companies as those that still dominate the industry today) were formed to offer insurance to the multitudes of urban dwellers. The new corporations employed and insured vast numbers of people not personally acquainted with one another and operated through massive impersonal bureaucracies. Since the new insurance companies increased their profits primarily by controlling and minimizing claims, an intrinsic conflict of interest (it is argued) was created between customers and their insurers, leading to confrontation and mutual suspicion.[1]

Lemonade, which has a behavioral economist on its staff, thinks it has found a way to remove this conflict of interest. Discarding the industry's benchmark "combined ratio"[2], the company takes a fixed 20 percent of premiums paid as its fee. After the payment of the fixed fee and any claims, the remaining funds are periodically contributed to a charity designated by the customer. The idea is that inflated claims do not harm a faceless insurance company, but instead adversely affect the whales, medical research or some other cause supported by the customer. The company thinks that this change in incentives (combined with big data analytics and AI for underwriting and claims) will bring down false claims and the related expenses of investigation and adjustment.

Will it float? It's early days, and the new models are just beginning to be tested. Many questions lie ahead, including who will dominate the new digital channels – incumbents or insurgents – and how that will change regulation, and whether the "pooling" of risk can survive an increasing personalization of risk based on data analytics. What is nearly certain is that the insurance business, whether it wants to or not, is entering a turbulent age of discovery.

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1. Studies for the industry consistently show significant numbers of consumers who consider it legitimate to inflate insurance claims, based on expectations that insurers will try to unfairly reduce them.
2. (Losses + expenses) divided by earned premium

U.S. Grant Program Incentivizes U.S.-Israel Desalination Technology Cooperation

By Meital Stavinsky

As California emerges from its drought, the damages caused to the state that accounts for 50 percent of U.S. fresh produce, as well as neighboring Western states, will take long to overcome as well as the realization that the reoccurrence of severe drought is unavoidable.

By 2030, half of the world population could face water scarcity, with demand outstripping supply by 40 percent.

One of the major food risk factors is water scarcity. Twenty percent of the world's population already lives in areas of water scarcity. By 2030, half of the world population could face water scarcity, with demand outstripping supply by 40 percent. This is particularly relevant for food production that uses roughly 80 percent of freshwater globally. And yet, while only 20 percent of global farmland is irrigated, that irrigated land accounts for 40 percent of food production.

Israel is indubitably a global leader in water irrigation, recycling, treatment and delivery solutions. Israel's world-leading drip irrigation solutions are saving up to 30 percent of water used for agriculture, while substantially increasing yield by more than 100 percent. About half of Israel's drinking water is sourced from seawater desalination, and 70 percent of Israel's wastewater is recycled for agriculture.

Congress passed a funding bill on May 4, 2017, for fiscal year 2017 that includes a number of important pro-Israel measures, one of which is $11.8 million for a water desalination grant program that incentivizes cooperation with Israel. The grant program authorization is for $3 million per year over five years, plus an additional one-time $30 million authorization to be expended at the U.S. Secretary of the Interior's discretion.

Enacted in December 2016, the Water Infrastructure Improvement for the Nation Act (WIIN) (PL 114-322) created a number of new avenues for U.S.-Israel cooperation.

WIIN created an incentive mechanism for grantees of federal desalination programs to collaborate with Israeli technologies and solutions providers. Through WIIN, Congress authorized $45 million over the next five years for direct support for desalination projects, as well as for desalination demonstration and development grants. The law requires that the Secretary of the Interior, when considering which projects and institutions to fund, prioritize those that "demonstrably leverage the experience of international partners with considerable expertise in desalination, such as the State of Israel." (Sec. 3801(c)(4)).

WIIN also established a government mechanism for U.S.-Israel cooperation in desalination research and development. Through WIIN, Congress required that the White House Office of Science and Technology Policy (OSTP) develop a coordinated strategic plan to advance desalination in the U.S. WIIN provided that this plan "strengthen[s] research and development cooperation with international partners, such as the State of Israel, in the area of desalination technology." (Sec. 3801/Sec. 9(b)(3)).

Moreover, to ensure that the U.S. Army Corps of Engineers can access the best technologies in its efforts to improve water resources management in the U.S., Congress authorized the U.S. Secretary of the Army to engage foreign partners in the development of water technologies. Such engagement includes, among other things, "research, development, training, and other forms of technology transfer and exchange." (Sec. 1138). In separate legislation in 2016, Congress authorized the U.S. Secretary of Defense to partner with allies in the development of water-technology solutions for military operations and in the development of military-to-military water resources generally. (PL 114-328, Sec. 1291). While not specifically listing Israel as a possible ally on this effort, given Israel's water expertise and the strength of the U.S.-Israel relationship, the internationalization of the water technology programs at the Army Corps of Engineers and the U.S. Department of Defense presents significant opportunities for the Israeli water industry.

With the breakthrough experience, innovation and know-how developed in Israel to date, an acceleration of existing collaboration efforts is warranted and timely. A further robust collaboration between U.S. and Israel on breakthrough water and agricultural technologies innovation – in similar or even more extensive ways to the one discussed here – would help expand the innovative food and agricultural industry growth in the U.S., and may offer an answer to the looming global food crisis.

Holland & Knight has hosted seminars on how Israel's water technology can help specific U.S. markets, such as Florida. We work with clients and others in the water-tech industry. For information on upcoming events, please contact Meital Stavinsky.

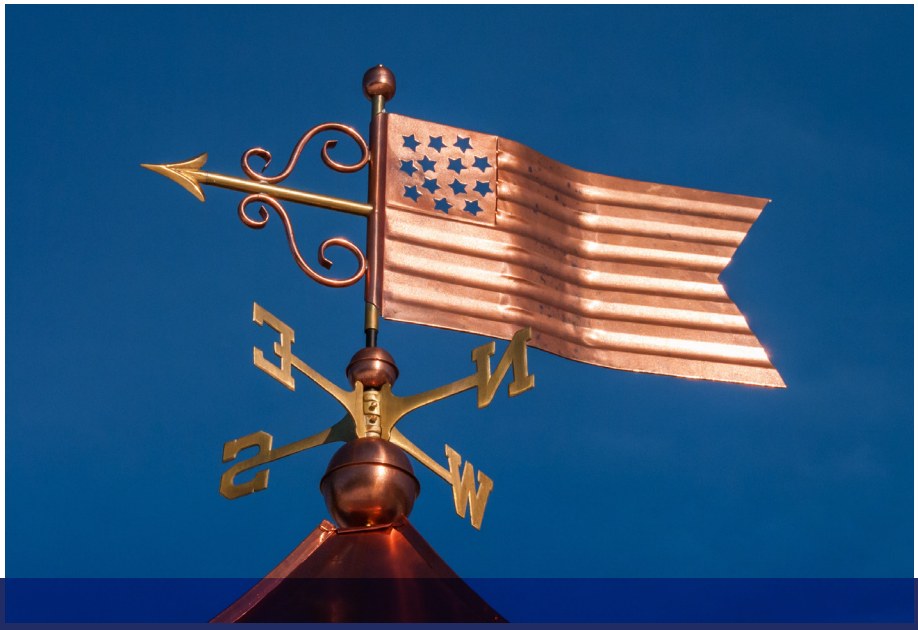
Winds of Change: What Israeli Investors in U.S. Real Property Need to Know About Recent and Proposed U.S. Tax Reforms

By Erez Tucner

The tax landscape in the United States is facing winds of change, specifically due to the new tax policies advanced by the Trump Administration and the increasing calls and proposals for comprehensive U.S. tax reform.

This article summarizes the material U.S. tax reform proposals – as well as certain recently enacted changes to the U.S. federal income tax rules – that Israeli investors need to know when structuring investments in U.S. real property.

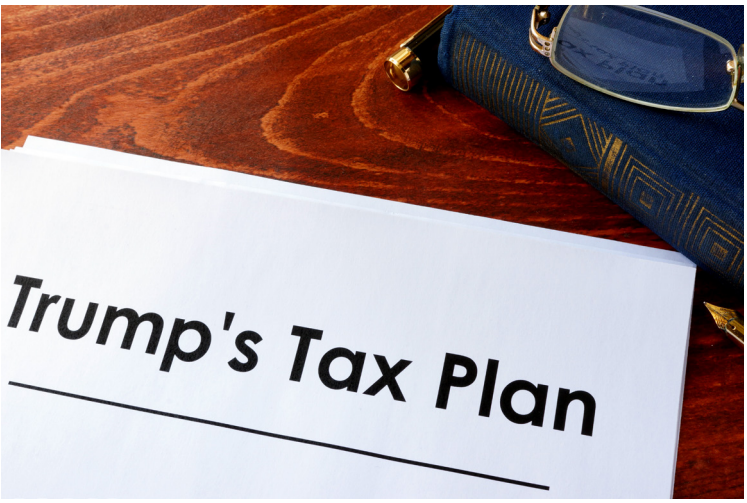
Investors should note that investments in U.S. real property are also subject to applicable state and local income taxes (and possibly state and local real property transfer taxes upon a sale). Those taxes are not addressed in this article.



These tax reform proposals, if enacted, together with certain recent changes to the U.S. tax rules, will affect the U.S. taxation of Israeli companies and individuals investing or operating in the United States.

U.S. Tax Reform Proposals

Comprehensive U.S. tax reform is increasingly possible over the next two years with Republicans having control of the U.S. House of Representatives, Senate and White House. The most significant and relevant tax reform proposals as of this publication are:



a) The Trump Administration's tax reform proposal published on April 26, 2017 (the Trump tax reform proposal)

b) The House Republican tax reform Blueprint published on June 24, 2016, by the House of Representatives Republican Tax Reform Task Force (the House GOP tax reform proposal)

c) The tax reform proposal released on Feb. 26, 2014, by then-House Ways and Means Committee Chairman Dave Camp, a Republican from Michigan (the Camp tax reform proposal)

The Trump tax reform proposal was released on a one-page White House handout with no explanations. As a result, many expect that the House GOP tax reform proposal (and to a lesser extent, the Camp tax reform proposal) would serve as a starting point for tax reform legislative language.

These tax reform proposals, if enacted, together with certain recent changes to the U.S. tax rules, will affect the U.S. taxation of Israeli companies and individuals investing or operating in the United States.

Investment in U.S. Real Property by Israeli Corporations: Reduction in U.S. Corporate Federal Income Tax Rate?

One of the key items in each of the tax reform proposals is a reduction of the U.S. federal corporate income tax rate from its current rate of 35 percent to 15 percent under the Trump tax reform proposal, 20 percent under the House GOP tax reform proposal or 25 percent under the Camp tax reform proposal.

Israeli corporations investing in U.S. real property are facing an effective U.S. federal income tax rate of 43.125 percent under current law on net operating income from U.S. real property. This effective U.S. federal income tax rate is comprised of 1) the 35 percent U.S. federal corporate income tax (i.e., a corporate-level tax), plus 2) a 12.5 percent shareholder-level tax (reduced from 30 percent under the Israel-U.S. income tax treaty, assuming it applies) in the form of a U.S. dividend withholding tax or U.S. "branch profits" tax on the 65 percent after-tax profits.

The U.S. corporate income tax rate reduction, if enacted and applied to non-U.S. corporations, would bring this effective U.S. federal income tax rate on net operating income of Israeli corporations from U.S. real property to 25.625 percent if the U.S. corporate income tax rate is reduced to 15 percent, 30 percent if the corporate rate is reduced to 20 percent, or 34.375 percent if the corporate rate is reduced to 25 percent.

The U.S. corporate income tax rate reduction, if enacted, would also mean that Israeli corporations that invest in U.S. real property or U.S. real property holding corporations will be able to sell their investment at a lower U.S. federal income tax rate than under current law.

For example, an Israeli corporation that invests in U.S. real property through a U.S. corporation can, under current law, sell the investment with the gain being taxed at the 35 percent U.S. federal corporate income tax rate with no additional shareholder-level tax by either having the Israeli corporation sell the U.S. corporation's shares or by having the U.S. corporation sell the U.S. real property and distribute the proceeds in liquidation of the U.S. corporation.

The proposed tax reforms, if enacted, will reduce this U.S. federal income tax upon such sale of the U.S. real property investment from 35 percent to 15 percent, 20 percent or 25 percent, depending on which proposed corporate income tax rate is adopted.

Investment in U.S. Real Property by Israeli Individuals: Reduction in U.S. Individual Federal Income Tax Rates?

Israeli individuals investing in U.S. real property directly, or indirectly through a U.S. limited liability company (LLC), U.S. or non-U.S. partnership or other tax-transparent entity, are typically subject to U.S. federal income tax on net operating income from U.S. real property at the graduated ordinary U.S. federal income tax rates for individuals. The maximum U.S. federal income tax rate for individuals under current law is 39.6 percent, which would be reduced to 33 percent under the Trump tax reform proposal and the House GOP tax reform proposal, or to 35 percent under the Camp tax reform proposal.

In addition, the tax reform proposals propose to apply a lower U.S. federal income tax rate of 15 percent under the Trump tax reform proposal and 25 percent under the House GOP tax reform proposal on business income, including income from real property, derived by individuals through U.S. LLCs, partnerships and other tax-transparent entities, subject to certain exceptions and anti-avoidance rules. If these proposals are enacted and they apply to non-U.S. investors, Israeli individuals may be able to structure their investments in U.S. real property in a manner that achieves a U.S. federal income tax rate on income from U.S. real property that is lower than the 33 percent or 35 percent maximum U.S. federal income tax rates that are proposed under the tax reform proposals.

Israeli individuals investing in U.S. real property are generally subject, under current law, to a preferential 20 percent U.S. federal income tax rate on capital gains from the sale of U.S. real property after a holding period of more than 1 year (i.e., long-term capital gain). The Trump tax reform proposal would not change this long-term capital gains tax rate. The House GOP tax reform proposal and the Camp tax reform proposal would exempt from U.S. federal income tax 50 percent or 40 percent, respectively, of such long-term capital gain, resulting in an effective U.S. federal income tax rate on such long-term capital gain of 16.5 percent or 21 percent, respectively.

Investment in U.S. Real Property by Israeli Individuals: Elimination of U.S. Estate Tax?

The most problematic U.S. tax issue that Israeli individuals face when investing in U.S. real property is exposure to the U.S. estate tax upon death. Under current law, the U.S. estate tax of 40 percent applies to the value (typically, gross value) of "U.S.-situs assets" held by an Israeli individual upon death, subject to an exemption of only $60,000 of value of U.S.-situs assets.

For this purpose, U.S.-situs assets include interests in U.S. real property, including U.S. real property held by the non-U.S. individual through a U.S. corporation. On the other hand, an interest of a non-U.S. individual in shares of a non-U.S. corporation is not a U.S.-situs asset for U.S. estate tax purposes even if the non-U.S. corporation owns U.S. real property or other U.S.-situs assets. Current law is not clear as to whether U.S.-situs assets include interests in entities that are treated as partnerships for U.S. federal income tax purposes (including non-U.S. corporations that elect to be treated as partnerships for U.S. federal income tax purposes), which in turn own interests in U.S. real property.

History shows that eliminating the U.S. estate tax is a very difficult task.

The U.S. estate tax exposure causes many Israeli individuals to structure their investments in U.S. real property through non-U.S. corporations (or through specifically designed "estate-proof" trusts, which are typically complex and expensive to establish and maintain).

The principal disadvantage of the non-U.S. corporation structure is that the Israeli individual loses the access to the preferential 20 percent U.S. federal income tax rate on long-term capital gains upon the sale of the U.S. real property investment by the non-U.S. corporation.

The Trump tax reform proposal and the House GOP tax reform proposal would eliminate the U.S. estate tax, which would avoid the issue of losing the 20 percent U.S. federal income tax rate on long-term capital gains as a result of having to invest through a non-U.S. corporation to avoid the exposure to the U.S. estate tax.

However, history shows that eliminating the U.S. estate tax is a very difficult task. In addition, it is not certain that a repeal of the U.S. estate tax would include a repeal with respect to non-U.S. persons.

But even if the U.S. estate tax remains in place (at least for non-U.S. persons), the reduction in the U.S. corporate income tax rate under the proposed tax reforms, if enacted and applied to non-U.S. corporations, would still help immensely. In that case, Israeli individuals would be able to structure their investments in U.S. real property through non-U.S. corporations, thereby shielding themselves from U.S. estate tax exposure. The non-U.S. corporations will be able to sell U.S. real property investments with the gains being subject to only the corporate-level U.S. federal income tax (as explained in Section 2 above) at the reduced rate of 15 percent, 20 percent or 25 percent, depending on which proposed corporate income tax rate is adopted.

Funding of Investment in U.S. Real Property by Israeli Investors: Further Limitations on Tax Benefits of Debt Funding?

Israeli investors (specifically Israeli corporations) typically prefer to invest in U.S. real property through U.S. corporations (i.e., U.S. real property holding corporations) principally to avoid the need for the Israeli investors to file annual U.S. federal income tax returns (except for if and when the U.S. corporation shares are being sold) and avoid U.S. "branch profits" tax rules.

Such U.S. corporations are typically funded, at least partially, via shareholder loans from Israeli investors, which enables repatriation of funds to the Israeli investors tax free via repayment of debt (instead of distributions of taxable dividends) and possible reduction of the taxable income of the U.S. corporations by interest deductions.

Under current law, deductions for interest payable by a U.S. corporation to a related non-U.S. lender (or interest payable by a U.S. corporation on certain loans that are guaranteed by a non-U.S. related parties) may be deferred pursuant to certain "anti-interest stripping" rules. These anti-interest stripping rules apply only if the U.S. corporation has a debt-to-equity ratio of more than 60/40 as of the end of the taxable year and the U.S. corporation does not generate sufficient "adjusted taxable income," a term that resembles the concept of earnings before interest, tax, depreciation and amortization (EBITDA).

Pursuant to U.S. tax regulations issued by the Obama Administration in October 2016 (the Section 385 Regulations), the U.S. Internal Revenue Service (IRS) may recast a related party's loan to a U.S. corporation as equity for U.S. federal income tax purposes to the extent that the related party's loan funds, or is treated under the regulations as funding, certain distributions from or acquisitions by the U.S. corporation issuing the debt (the first $50 million of debt that otherwise would be recast is exempt from the recast rule). The IRS also may do so for debt instruments issued on or after Jan. 1, 2018, by U.S. corporations whose income or assets exceed certain minimum thresholds (or by certain publicly traded corporations) if the loan does not meet certain rigorous due diligence, documentation and filing requirements (including documentation regarding the creditor's rights, a reasonable expectation of repayment, evidence of ongoing debtor-creditor relationship, etc.).

A loan that is recast as equity for U.S. federal income tax purposes will not generate interest deduction for the U.S. corporation, and payments under the loan (including payments of principal) may be taxed as a dividend from the U.S. corporation to the related non-U.S. lender (i.e., subject to U.S. withholding tax of 30 percent unless reduced by operation of an income tax treaty).

The Trump Administration is currently reviewing these complex regulations pursuant to an executive order issued in April 2017. In addition, the Trump tax reform proposal and the House GOP tax reform proposal would eliminate deductibility of net interest expense for U.S. corporations altogether (but would allow for complete expensing of U.S. real property upon acquisition).

The result of such regulatory review and the implementation of all or part of such proposed tax reform proposals will have a significant effect on the structuring of financing of U.S. real property investments by Israeli investors.

Exemptions from U.S. Federal Income Tax on Sale of Shares of a U.S. Corporation or REIT Holding U.S. Real Property

Under law enacted by the Obama Administration in December 2015, "qualified foreign pension funds" (as specifically defined) are exempt from U.S. federal income tax on gains they derive from sale of an interest in a U.S. real property holding corporation or a U.S. real estate investment trust (REIT).

In addition, current U.S. tax law generally exempts from U.S. federal income tax capital gains derived by a non-U.S. shareholder from 1) a sale of an interest of 5 percent or less in a publicly traded U.S. real property holding corporation, 2) a sale of an interest of 10 percent or less in a publicly traded U.S. REIT, or 3) a sale of an interest in a domestically controlled REIT.

While none of the U.S. tax reform proposals mentioned above address these U.S. tax exemptions, the need for "revenue raisers" in prospective U.S. tax reform may cause some of them to be restricted or eliminated.

Changes to U.S. Tax Audit Rules of U.S. LLCs and Partnerships

Israeli investors investing in U.S. real property through multi-member U.S. LLCs (which are treated as U.S. partnerships for U.S. federal income tax purposes) or through U.S. or non-U.S. partnerships need to know that, pursuant to new U.S. tax rules starting in 2018, the IRS can assess U.S. federal income tax liabilities, as well as interest and penalties, on the U.S. LLC or partnership itself, subject to certain exceptions.

This is a change from current law, which only allows the IRS to assess U.S. federal income tax liabilities, interest and penalties on the members or partners of U.S. LLCs or partnerships.

The new rules also provide for a designation by the U.S. LLC or partnership of a "partnership representative," who shall have the sole authority to act on behalf of the U.S. LLC or partnership regarding IRS tax audits and related proceedings. The partnership representative can bind the members or partners in respect of any such audits or proceedings (including binding former members or partners).

FDA Announces New Initiatives to Regulate Digital Health Technologies

By Michael Werner

U.S. Food and Drug Administration (FDA) Commissioner Dr. Scott Gottlieb, M.D., posted a blog on June 15, 2017, announcing new FDA initiatives to be piloted this fall regarding the regulation of digital health technologies. Gottlieb said that the agency is considering whether and how it can establish a third-party certification program "under which lower risk digital health products could be marketed without FDA premarket review and higher risk products could be marketed with a streamlined FDA premarket review." Details are still being worked out, but Gottlieb noted that certification could be used to assess whether a company "consistently and reliably" engages in high quality software design and testing as well as ongoing maintenance of its software products.

Gottlieb also said the FDA will use collection and analysis of real-world data (data gathered outside of clinical trials or controlled studies) by product developers to meet post-market commitments. He also noted that FDA is working to implement the digital health provisions of the 21st Century Cures Act and will be publishing guidance to further clarify what falls outside the scope of FDA regulation as well as to explain how the new statutory provisions affect pre-existing FDA policies.

In addition, Gottlieb gave a status report on other relevant guidance, saying that FDA is developing guidance to clarify its position on products that contain multiple software functions, where some fall outside the scope of FDA regulation but others do not. Gottlieb said that the agency also will develop new guidance on other technologies that present low enough risks that FDA does not intend to subject them to certain premarket regulatory requirements.

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About This Newsletter

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