



District Court of Tel Aviv – Jaffa

October 28, 2025

Administrative Appeal 59306-01-23
Hexadite Ltd. v. Tel Aviv 3 Tax Assessor

Before:

Hon. Judge Yarden Sarusi

Appellant:

Hexadite Ltd.

Represented by Attorneys Dr. Yuval Navot, Ofer Granot,
Amir Kuper
Herzog, Fox, Neeman & Co.

Versus

Respondent:

Tel Aviv 3 Tax Assessor

Represented by Attorneys Adi Chen, Danit Alfasi-Potsman
State Attorney's Office (Civil)

Judgment

A company acquires the shares of another company in a "regular" transaction between unrelated parties. Shortly thereafter, the acquired company transfers all its activities and assets to the acquiring company (or, in other words, a sale of Functions, Assets and Risks – FAR). The acquired company must pay tax for the sale of its activities and assets. Since the transfer of activities is a sale between related parties (subsidiary to parent company), the question arises: how is the value of the activities and assets sold assessed?

Generally, in such cases, the valuation of the activities and assets is based on the consideration paid by the acquiring company for the shares of the acquired company, as the share transaction was between unrelated parties and reflects the value of the acquired company, with certain adjustments. This income tax appeal concerns the adjustments to be made to the share consideration to assess the value of the sale of assets and activities, and includes two main issues:

First, should the valuation of the activities and assets include the tax imposed on their sale?
Second, should the valuation include deferred payments to founders conditioned on future employment (Holdback payments)?

Relevant Background for the Appeal

1. The appellant is an Israeli resident company engaged in research and development in the cyber field. The appellant was established in Israel in March 2014 by three founders. The appellant established a subsidiary in the USA, intended to handle marketing and sales for the appellant in the USA.
2. On June 6, 2017, Microsoft Israel Research and Development (2002) Ltd. ("the purchaser") signed an agreement to purchase 100% of the appellant's share capital for \$75 million USD.



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3. The share purchase agreement stipulated that certain amounts of the total consideration for the shares would be withheld and not paid to the shareholders immediately. Thus, the consideration for each of the three founders included a future payment component of approximately \$3.1 million (totaling about \$9.3 million), conditional on the founder's continued employment for three years (except in cases of death, disability, dismissal, or justified departure of any founder, hereinafter: "the holdback").
4. The holdback was deducted from the consideration the three founders received for their shares. It should be noted that the consideration for the other shareholders did not include a similar restriction. In other words, unlike the other shareholders, for the founders to receive the full consideration for their shares, they had to continue working for three more years. The share consideration without the holdback component amounted to about \$65.8 million.
5. The transaction was completed on July 7, 2017. The day after completion, the appellant underwent a business restructuring. The appellant signed two agreements effective July 8, 2017, for the sale of intellectual property and shares in the subsidiary to Microsoft Corporation ("Microsoft"), and another agreement effective August 1, 2017, for the sale of its human resources function to the purchaser ("the sale").
6. The appellant reported to the respondent that the consideration for the sale was about \$65.4 million, based on the consideration paid in the share sale for the appellant's shares, deducting the holdback component from the share consideration.
7. The respondent did not accept the appellant's reports and determined that the value of the sale was \$95.933 million. According to the respondent, the holdback component should be included as part of the consideration paid for the shares. Additionally, the respondent included the tax the appellant must pay as part of the sale value ("tax gross-up").
8. The respondent further determined that since the appellant did not actually receive the full compensation for the transaction, the amounts not received should be considered a loan given to Microsoft, and therefore the appellant should be taxed on imputed interest income from Microsoft ("the secondary adjustment"). During the evidentiary hearing, the respondent reduced the imputed interest rate set in the orders to 1.01%.



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9. The appellant disputes the respondent's claims, hence this appeal.

Summary of the Appellant's Claims

10. The flaws in the respondent's conduct require acceptance of the appeal. The Tax Authority had a policy not to collect tax on tax gross-up, and the current assessment deviates from this policy. The Tax Authority set a policy on the taxation of business restructuring in Income Tax Circular 15/2018 "Business Restructuring in Multinational Groups" ("Circular 15/18"). Section 6.3.4 of Circular 15/18 sets out the necessary adjustments in a share purchase transaction for assessing the value of the FAR. It states that for determining the value of the FAR, excess liabilities at the closing date of the share purchase transaction should be added, such as provisions for taxes. However, the provision for capital gains tax on asset sales is not listed among the excess liabilities, nor is it mentioned in the examples attached to the circular. The tax gross-up adjustment is the largest made to the sale value and cannot be considered a negligible example omitted by mistake from a detailed 34-page circular intended to determine asset values in such circumstances. \

The Tax Authority's policy is reflected not only in written guidelines but also in its conduct. The Tax Authority did not collect tax on tax gross-up.

11. Even if the respondent changed the policy on tax gross-up, this change was not made lawfully. First, a policy change should be prospective and apply only from the date of the decision onward. The respondent cannot treat an assessment procedure as an opportunity to change policy. Changing policy in a specific assessment procedure, without amending Circular 15/18 and without publicizing the policy change, severely harmed the appellant's expectation interest. Second, a policy change cannot be arbitrary. The respondent did not explain the basis for the policy change. Third, a policy change must be made without discrimination.
12. The respondent denied the appellant's right to argue. The tax gross-up claim was not raised in the initial assessment, so no objection was filed against it. The valuation on which the orders were based was sent to the appellant only days before the orders were issued, without giving the appellant an opportunity to respond. Even regarding the holdback issue, the right to argue was not granted. The respondent did not examine the documents of the Gteko transaction, on which it relied, and ignored explanations and refrained from reviewing relevant documents offered to it. In doing so, the respondent breached its duty to listen openly to the appellant's claims. When the respondent ignores the appellant's explanations and raises a novel claim for the first time at the end of the objection period without meeting with the appellant's representatives, the right to argue was not granted.
13. The respondent did not justify its position. The orders and the valuation on which the orders were based do not mention the holdback issue at all. The holdback issue



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was the only issue for which the appellant filed an objection. The tax gross-up issue is also not explained. There is no justification or explanation in the orders for the gross-up issue, except for a reference to the valuation work, which was not attached. Similarly, the valuation and the respondent's expert opinion do not explain why a gross-up is required.

14. The respondent must bear the burden of proof in this appeal. Section 85A(c) of the [Income Tax Ordinance (New Version), 1961] ("the Ordinance") states that if the taxpayer has provided the required documents, including transfer pricing studies, the "burden of proof" falls on the tax assessor. The appellant provided the respondent with all documents. There is no dispute regarding the nature of the transaction, its scope, or the nature of the assets sold. There is no dispute regarding the transfer pricing method and the comparable transaction. Therefore, the burden of proof must fall on the respondent.
15. Even on the merits, there is no reason to gross up the sale consideration for tax. The respondent did not dispute the identity of the assets sold, the nature of the transaction, or the valuation method for the sale, which derives the value of the assets from a comparable transaction – the sale of the appellant's shares.
16. According to the appellant's transfer pricing study, the sale consideration was determined using the Acquisition Price Method ("APM"), in which the value of the sale, which was sold shortly after the appellant's share purchase transaction, is derived from the consideration paid for the shares. The transfer pricing study detailed the reasons for excluding the holdback from the calculation of the sale value. The APM is an application of the "Comparable Uncontrolled Price" method mentioned in Circular 15/18. No claim was made that another method should be used to determine the sale value.
17. The starting point in the Comparable Uncontrolled Price method is that no tax gross-up should be performed. In section D.2.6.1 of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD, 2017), which is the relevant part for our matter, there is no provision regarding tax gross-up. Examples 22, 23, and 26 in the guidelines, which deal with the Comparable Uncontrolled Price method in circumstances where assets are sold at a profit after a share purchase transaction, also do not apply tax gross-up. In the Comparable Uncontrolled Price method, where the value of the sale is indirectly assessed based on the share purchase transaction, it is presumed that unrelated parties considered all relevant factors, including tax considerations after the transaction. Individual tax considerations do not determine the market price of the asset.
18. The respondent seeks to introduce the purchaser's subjective considerations into the calculation of the objective value of the seller's assets. This approach has been



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rejected by the Tax Authority and the courts in the past. In this case, the capital gains tax liability was not taken into account.

19. The holdback should not be included in the calculation of the sale value. The holdback mechanism is part of the consideration, the payment of which is conditional on continued employment, and it will only be paid if the founders provide employment services after the transaction. This is a payment with mixed characteristics of capital and income, where the employment condition is the main condition for receiving the payment in practice, and it describes the dominant nature of the payment. In all substantive respects, the holdback arrangement and its terms describe a retention bonus arrangement.
20. In Central District Court (Administrative Appeal 49444-01-13 Gteko Ltd. v. Kfar Saba Tax Assessor, 6.6.2017) ("the Gteko case"), where the commercial terms underlying the transaction were identical to those here, the claim was already rejected that the manner of taxing the founders for the holdback consideration could affect the value of the company's assets. The continued employment condition applied to the holdback payments is a restriction imposed on the founders personally. But the sale is an asset held by the appellant at the corporate level. The respondent classifies payments conditional on the founders' continued personal employment as part of the value of an asset held by the appellant.
21. The holdback is a payment conditional on providing employment services after the transaction date. It is not possible to derive from a payment conditional on future employment the value of the appellant's assets today.
22. Accounting also recognizes that the holdback consideration, even if paid as part of a share purchase transaction, should be classified as a liability for future employment services.
23. Alternatively, the respondent's expert opinion is flawed in that it did not determine the fair value of the holdback at the date of the share transaction. A payment that is conditional and paid over a period of three years is not equal in value to a payment made immediately without the condition of continued employment. The value of the holdback should be discounted not only for the alternative yield of the money, but also for the risk that it will not actually be paid.
24. The respondent's determinations regarding the secondary adjustment cannot be accepted. There is no legal basis in Israel for taxing notional income arising from a secondary adjustment. The approval of the secondary adjustment in CA 943/16 Kontera Technologies Ltd. v. Tel Aviv 3 Tax Assessor (22.4.2018) ("the Kontera case") was made without discussion of the authority for it. A secondary adjustment also leads to double economic taxation.



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25. Alternatively, the respondent erred in determining the interest rate for the notional loan. The interest rate should be the intercompany rate actually paid on real loans given by the appellant to companies in the Microsoft group, as reported in its tax returns and not disputed (an interest rate of 0.1%–0.25%), or alternatively, the lower rate in Microsoft's public financial statements (0.43%), or the rate set in the stage A assessment (0.882%). In any case, there is no basis for an interest rate of 1.01%. Also, the interest should be calculated as simple interest, not compound interest as the respondent did in this case.
26. The appellant submitted reply arguments in which it specifically addressed the respondent's claims in its submissions.

Summary of the Respondent's Claims

27. Regarding the holdback issue, the share purchase agreement explicitly states that the amounts withheld for the founders are part of the consideration for the purchase of the shares; and that these amounts cannot be interpreted as changing their nature and will not be considered as paid for salary, wages, or other regular income. The amounts withheld for the founders are derived from the total consideration for the appellant's shares, identical to the total consideration received by the other shareholders according to their holding percentage.
28. It is not reasonable that the founders received a lower consideration for their shares, and they are entitled to the full consideration for the shares they held, as long as they meet the terms of the agreements (the share purchase agreement and the holdback agreement). This mechanism should be seen as one intended to compensate Microsoft if the founders do not fulfill their obligations and representations according to the agreements between the parties.
29. The founders' right to the holdback payment was created from the outset by virtue of their being the founders of the appellant and shareholders in it, and by virtue of the share purchase agreement, where the withheld amounts are part of the total consideration for the appellant's shares and not a right created solely due to their continued employment at Microsoft.
30. The amounts withheld for the founders were immediately deposited with the trustee and transferred to a trust account established for the benefit of the founders, with the funds invested according to the investment channels chosen by the founders, all in accordance with section 2.8 of the share purchase agreement. Thus, when the founders become entitled to the withheld funds, they will also be entitled to the returns accrued during the period of withholding. This also refutes the alternative claim of the appellant's expert that the withheld amounts should be discounted for the founders. As is known, the purpose of discounting funds is to



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translate the value of money to a specific date. When the funds retain their value through investment, there is no need for a discounting mechanism.

31. In our case, and unlike the Gteko case, the holdback amounts were deposited in trust for investment in channels chosen by the founders themselves. In Gteko, the holdback amounts remained the property of Microsoft until the payment date. The issue of control over the funds is not trivial and is a substantive matter indicating the parties' intentions. This is sufficient to distinguish between the Gteko case and our case and to reject the appellant's claim that the share purchase agreement in this case and the agreement in Gteko are similar in their commercial terms.
32. Regarding the tax gross-up issue, the respondent's position is based on the guidelines. Section 6.157 of the guidelines explicitly states that when determining the transfer price, the impact of taxes on the transaction must be taken into account.
33. The appellant's documents clearly show that, for the purpose of determining the transfer price of the sale by the appellant, the tax effects were taken into account.
34. The price set for the acquired company's shares is not the transfer price of the sale, and it is not the same matter. The share price reflects all the values of assets and liabilities in the acquired company, those appearing on the company's balance sheet and those not reflected on the balance sheet – the intangible assets (technologies, know-how, trademarks, and other goodwill), and off-balance sheet assets and liabilities, such as accumulated losses in the acquired company that create a tax benefit, various provisions for expected expenses, such as a provision for payment of a grant to the Chief Scientist, a provision for a lawsuit, a bonus promised to employees, provisions for taxes expected due to the intention to sell an asset of the company. When determining the transfer price (arm's length price) of the sale, all these components must be taken into account, as relevant to the case, and according to the principle that no value disappears or is destroyed in an internal business restructuring within a multinational group. Therefore, contrary to the appellant's claim, it is not possible to consider only the tax asset inherent in the share purchase and reflect it in the arm's length price determination, and the expected tax expenses following the business restructuring must also be reflected.
35. The appellant's claims regarding the policy change made by the respondent concerning the impact of taxes should be rejected. The respondent erred in applying the guidelines, and once the respondent realized the error, during 2020 (and at the latest in 2021), the respondent corrected the error and began applying the tax effects. Similarly, since at the time of publication of Circular 15/18 the respondent had not yet realized the error, this was not reflected in that circular. However, the circular did not include a closed list of adjustments to be made, and by referring to the "tax asset," it is possible to see reference also to a negative asset, or more



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precisely – a liability. Since the respondent applies the guidelines, it is difficult to accept the claim that the respondent changed policy or adopted a new policy. The respondent applied and continues to apply the guidelines.

36. The respondent did not change policy, but corrected the way the policy was incorrectly applied, and the appellant is not the first case in which the impact of taxes was reflected in determining the arm's length price of the sale.
37. Considering that the issue of the impact of taxes was already known to the appellant's representatives since 2013 and to the Microsoft group since 2014, there is considerable doubt as to the extent of their reliance on the alleged policy of the Tax Authority. It is no coincidence that the appellant did not bring even one representative on its behalf or on behalf of Microsoft to testify on this matter.
38. The issue of the secondary adjustment was discussed in the Kontera case, where it was determined that if the full consideration was not reported to the tax assessor, the unreported amount should be considered a debt bearing interest, and the taxpayer should be taxed on the imputed income arising from this income. This rule also applies to our case.
39. The interest rate proposed by the appellant is not supported by any document.
40. The document on which the respondent based its assessment was provided to the appellant during the assessment discussions and before the issuance of the order, so the appellant's claim of lack of justification is unfounded, and its detailed arguments in this appeal speak for themselves. Even if there were merit to the appellant's claim in this regard, this defect was cured in this appeal, as well as by placing the burden of proof on the respondent.
41. The burden of proof in this proceeding should remain, as in any other proceeding, on the appellant. The respondent has shown in these submissions that the appellant was well aware of the respondent's arguments and justifications, and that the appellant was the one who delayed the respondent in all matters relating to the assessment proceedings and the delivery of the share purchase agreement appendices. Such conduct by taxpayers should not be encouraged, and the wrongdoer should not benefit.



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Discussion

42. As stated, this appeal involves two main issues: the tax gross-up issue and the holdback issue. I will note in advance that regarding the first issue I found to accept the appeal, while regarding the second issue I found to reject it. I will discuss both issues in order.

No Need to Gross Up for Future Tax Liability When Determining the Sale Value According to the Comparable Uncontrolled Price Method

43. There is no dispute between the parties that the appellant's share purchase transaction was a transaction between unrelated parties, and the consideration set in it reflects the value of the appellant (except for the dispute regarding the holdback). There is also no dispute between the parties that the Comparable Uncontrolled Price method, which compares the price of the assets and activities transferred to Microsoft to the price set in the share purchase transaction, is the best method to assess the sale value (see section 6.3.1 of Circular 15/18 and Regulation 2 of the Income Tax Regulations (Determination of Market Conditions), 2006). However, the parties disagree regarding the adjustments to be made to that price set in the share transaction, and in particular, whether the sale value should include the tax the appellant is expected to pay as a result of the sale.
44. The respondent argues at the outset of its submissions, regarding the tax gross-up issue, that **"this issue is not intuitive but should be examined according to and in light of the guidelines regarding transfer pricing."** In sections 44–46 of its submissions, the respondent repeats the claim that its position is based on the guidelines. Indeed, a review of its arguments shows that the respondent's only justification for the tax gross-up is the provisions of the guidelines. However, an examination shows that there is no need to gross up for future tax when determining the sale value.
45. Both in the expert opinion and in its submissions, the respondent refers to only two sections in the guidelines that ostensibly indicate that the expected tax on the sale of intangible assets should be grossed up — sections 6.157 and 6.178 of the guidelines. However, both of these sections deal with valuation according to the discounted cash flow method (DCF), which is fundamentally different from the Comparable Uncontrolled Price method.
46. While valuation according to the Comparable Uncontrolled Price method relies on a transaction that took place between two unrelated parties, so that the price there reflects the price at which parties actually contract, valuation according to the discounted cash flow method is a theoretical valuation that purports to measure the monetary value of intangible assets based on their projected cash value according to various forecasts. It is self-evident that it is preferable to rely on an actual



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transaction that took place in the market, rather than on a theoretical valuation that is not reflected in the market. Indeed, there is no dispute that the Comparable Uncontrolled Price method is the method by which the sale should be valued in our case.

47. Section 6.157 of the guidelines explicitly states that it deals with the valuation method based on expected cash flow. This method, as explained in the section, measures the value of intangible assets according to the projected cash flow those assets can generate over their lifetime:

"Valuation techniques that estimate the discounted value of projected future cash flows derived from the exploitation of the transferred intangible or intangibles can be particularly useful when properly applied. There are many variations of these valuation techniques. In general terms, such techniques measure the value of an intangible by the estimated value of future cash flows it may generate over its expected remaining lifetime. The value can be calculated by discounting the expected future cash flows to present value. Under this approach valuation requires, among other things, defining realistic and reliable financial projections, growth rates, discount rates, the useful life of intangibles, and the tax effects of the transaction."

48. Similarly, section 6.178 of the guidelines states:

"Where the purpose of the valuation technique is to isolate the projected cash flows associated with an intangible, it may be necessary to evaluate and quantify the effect of projected future income taxes on the projected cash flows. Tax effects to be considered include: (i) taxes projected to be imposed on future cash flows, (ii) tax amortisation benefits projected to be available to the transferee, if any, and (iii) taxes projected to be imposed on the transferor as a result of the transfer, if any."

49. It is also worth noting that section 6.153 of the guidelines emphasizes that the use of the cash flow-based valuation method is made when there is no comparable uncontrolled transaction available:

"In situations where reliable comparable uncontrolled transactions for a transfer of one or more intangibles cannot be identified, it may also be possible to use valuation techniques to estimate the arm's length price for intangibles transferred between associated enterprises. In particular, the application of income based valuation techniques, especially valuation techniques premised on the calculation of the discounted value of projected future income streams or cash flows derived from the exploitation of the intangible being valued, may be particularly useful when properly applied."

50. See also section 6.147 of the guidelines, which states that when a related party transfers intangible assets after acquiring them from an unrelated party, including through a share purchase, the purchase price will be relevant and serve as a comparable transaction:



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"In some situations, intangibles acquired by an MNE group from independent enterprises are transferred to a member of the MNE group in a controlled transaction immediately following the acquisition. In such a case the price paid for the acquired intangibles will often (after any appropriate adjustments, including adjustments for acquired assets not re-transferred) represent a useful comparable for determining the arm's length price for the controlled transaction under a CUP method. Depending on the facts and circumstances, the third party acquisition price in such situations will have relevance in determining arm's length prices and other conditions for the controlled transaction, even where the intangibles are acquired indirectly through an acquisition of shares or where the price paid to the third party for shares or assets exceeds the book value of the acquired assets. Examples 23 and 26 in the Annex to Chapter VI illustrate the principles of this paragraph."

51. It should be clarified that the distinction between the methods is crucial regarding tax gross-up. In cases where intangible assets are valued according to the discounted cash flow method, it is certainly necessary to take into account taxes that are expected to be paid, since they directly affect the future cash flow and the expected profit, which determine the value of the assets. In contrast, similar logic does not apply in the Comparable Uncontrolled Price method, which does not require forecasting the value of the assets, since it already exists and is based on the price paid for the shares (see also sections 5.2.3.2–5.2.3.5 of the Gonen opinion). All that needs to be done in the Comparable Uncontrolled Price method are adjustments to the share consideration.
52. In other words, when seeking to find the value of intangible assets using the projected cash flow they are expected to generate, it is appropriate to take into account every possible variable that may affect the expected cash flow, including future taxes. In contrast, when seeking to derive the value from a comparable transaction, there is no place to add possible future variables, since the basic assumption is that the price set between two unrelated parties already takes all these variables into account, including expected taxes, and this is done practically, not just theoretically (see, for example, section 7.8.3 of the respondent's expert opinion: **"When determining the consideration for the purchase of a company's share capital, the purchaser takes into account all the company's assets and liabilities — on and off the balance sheet, at their economic value. When examining the transaction, the existence of a tax asset is reflected on the one hand, and on the other hand — exposure to possible taxes, such as, as a result of capital gain that may arise upon the sale of the assets, while estimating the extent of the tax provision."**).
53. Section 54 of the respondent's submissions is telling in this regard. The respondent claims in that section: **"The share price reflects all the values of assets and liabilities in the acquired company, those appearing on the company's balance sheet and those not reflected on the balance sheet..."** That is, the respondent admits that



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when determining the share price, the expected liabilities were already taken into account. It is therefore unclear why, in the respondent's view, the price set for the acquired company's shares is not equivalent to the transfer price of the sale, with adjustments between the different assets. It should be clarified that the respondent did not make adjustments between the assets, but rather increased the sale value.

54. In general, it is necessary to distinguish between data used to adjust the price within the Comparable Uncontrolled Price method and data used for forecasting within the discounted cash flow method. While in an adjustment, the goal is to match the price paid to the assets acquired (for example, if \$75 million was paid for the shares of a company holding assets and also has \$5 million in cash, then the value of the assets is \$70 million), in a forecast, the goal is to estimate the price itself (see sections 3.3.4 and 3.3.5 of the Gonen opinion).

The discounted cash flow method is intended to assess the value of the company's activity when there is no comparable transaction. In contrast, in the Comparable Uncontrolled Price method, there is no need to assess the value of the activity, since there is a transaction between unrelated parties that has already assessed the value of the activity. That is, the forecast of the expected cash flow is already included in the price set in the comparable transaction. An additional adjustment according to the discounted cash flow method is actually a double adjustment.

In the tax gross-up and the respondent's references to the guidelines, the respondent improperly mixes the discounted cash flow method and the Comparable Uncontrolled Price method. For example, does the respondent believe that in the Comparable Uncontrolled Price method, taxes on the future cash flow as set out in section 6.178 of the guidelines should also be taken into account? And if all future variables should be considered in the Comparable Uncontrolled Price method, then it is no longer a price comparison, but rather a valuation based on expected cash flow. With all due respect, the respondent's reference to and reliance on the guidelines is, at best, negligence, and at worst, deliberate misrepresentation. This is a valuation based on expected cash flow, which is fundamentally different in nature, as stated.

55. It should be clarified that throughout the guidelines, there is no mention of the claim that tax should be grossed up according to the Comparable Uncontrolled Price method. Thus, in section D.2.6.1, which deals with the Comparable Uncontrolled Price method, there is no provision regarding tax gross-up. Examples 23 and 26 in the annex to Chapter VI, to which section 6.147 of the guidelines refers, which apply the Comparable Uncontrolled Price method in circumstances where assets were sold at a profit after a share purchase transaction, also do not mention tax gross-up. Example 22 in the annex to Chapter VI, which the respondent chose to include in Circular 15/18 along with examples 23 and 26, also does not apply tax gross-up. It



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should be emphasized that this is not a negligible gross-up, but one with enormous financial significance, which is supposed to be reflected in almost every transaction of this type. It is difficult to believe that such a central and common adjustment with significant financial implications would not be mentioned or noted in the guidelines, even in passing. This is especially so when tax gross-up in a sale is explicitly mentioned where the guidelines discuss the discounted cash flow method (see section 6.157 of the guidelines: "Under this approach valuation requires, among other things, defining realistic and reliable financial projections, growth rates, discount rates, the tax effects of the transaction and the useful life of intangibles," and section 6.178 of the guidelines: "Tax effects to be considered include ... (iii) taxes projected to be imposed on the transferor as a result of the transfer, if any.").

56. In the context of the Comparable Uncontrolled Price method, I note to the respondent that, despite its claim that the APM (Acquisition Price Method) used by the appellant is not recognized in Israel or the OECD (see transcript pp. 77 line 10 – p. 79 line 15 and section 55 of the respondent's submissions), there is no practical difference between the Comparable Uncontrolled Price method as set out in the guidelines and Circular 15/18 and the APM. In both methods, the starting point is the value set in the comparable transaction, and the APM is a concrete application of the Comparable Uncontrolled Price method in cases where a business restructuring is carried out shortly after a share purchase transaction (see also section 3.3.2 of the Gonen opinion). The fundamental question in our case — whether tax should be grossed up — is relevant to both methods, without any difference. Not for nothing, apart from general claims, the respondent did not point to any practical difference between the two methods.
57. This is sufficient to reject the respondent's claim for tax gross-up, which, as stated, is based on the guidelines. However, even substantively, I do not believe that tax should be grossed up in the valuation.
58. To discuss whether tax should be grossed up in determining the value, it is first necessary to understand what value we are seeking. In general, the value of an asset is not a defined and fixed thing, and it can range across a whole spectrum, with the value from the purchaser's perspective at one end and the value from the seller's perspective at the other (see, for example, section 7.8.3 of the respondent's expert opinion). In cases like the present, when seeking to determine the value of the assets, what is the reference point? Is it the value to the purchaser or the value to the seller? Should the parties' expenses be taken into account, or on the other hand, their profit potential?
59. By way of illustration, suppose Company A holds a patent in which it invested 70. If Company A does not sell the patent, it will likely earn 80 until its expiration. Company B knows that if it invests 100 in implementing the patent in its products,



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the patent will be worth 200 to it. Accordingly, Company B will be willing to pay up to 100 to purchase the patent. In such a case, is the value of the patent 70? 80? 100? The sum of the purchase and implementation costs? Or perhaps 200?

60. Precisely because there is a range of possible prices, with no unequivocal answer, the starting point is that the price set or that would have been set in a transaction between unrelated parties is the value of the asset. Thus, section 85A(a) of the Ordinance states that **"in an international transaction in which there are special relationships between the parties to the transaction by reason of which a price for an asset, right, service, or credit is set, or other terms for the transaction are set, so that less profit is derived from it than would have been derived in the circumstances had the price or terms been set between parties with no special relationship (hereinafter – market conditions), the transaction shall be reported according to market conditions and taxed accordingly."**
61. Reading the section shows that the aim is to find the value that would have been set in the meeting of the parties' wishes, that is, not the value to the purchaser nor the value to the seller, but the agreed price between them — what the purchaser would have paid **"had the price or terms been set between parties with no special relationship."**
62. Similarly, section 88 of the Ordinance states that **"'consideration' — the price to be expected from the sale of an asset by a willing seller to a willing buyer when the asset is free of any lien securing a debt, mortgage, or other right securing payment; but if the tax assessor is convinced that the price for the asset was set in good faith and without being influenced directly or indirectly by the existence of special relationships between the seller and the buyer — and in real estate also provided the sale was made in writing — the consideration shall be the price set."** It is also stated that the consideration will be **"less the selling expenses incurred by the taxpayer in that sale."**
63. Likewise, section 1 of the Real Estate Taxation Law (Appreciation and Purchase), 1963, defines **"'value' of a particular right — the amount to be expected from the sale of that right by a willing seller to a willing buyer, provided that in sales made in writing and where the director is convinced that the consideration for the right in the real estate or for a right in a company was set in good faith and without being influenced by the existence of special relationships between the seller and the buyer, whether directly or indirectly — the consideration as stated."**
64. In our case, the price set in the meeting of the parties' wishes, which reflects the value of the appellant with all its assets, is \$75 million.
65. As stated, the respondent refrained from explaining why, in its view, tax should be grossed up substantively (and even claims that "this issue is not intuitive"). The



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respondent's approach can be attempted to be justified from two different directions:

The first, from the purchaser's perspective, who already knew at the time of purchasing the appellant's shares that it intended to transfer the sale shortly thereafter. Since the purchaser knew that the transfer of the sale would entail capital gains tax, the value of the sale for it is the share consideration plus the capital gains tax to be paid, and therefore the price paid for the shares should also include the tax known to be paid upon the sale. A hint of this can be found in section 50 of the respondent's submissions:

"But the respondent's claim ... Microsoft knew it intended to close the appellant's activity ... and transfer it to group companies, and therefore necessarily considered all considerations, including the tax consideration in the sale of the activity from the appellant – in its deliberations," and in appendix 23 to the respondent's affidavit:

"For example, if I buy shares for 100 NIS and the day after the purchase I plan to sell all the functions, I know that on the day of the sale I will pay tax on the capital gain from the sale of the functions, so I will pay for the shares an amount that takes into account the tax I will pay for their removal, meaning I will pay for the shares a lower amount than the value of the functions themselves (just as I take into account the tax asset, which is accumulated losses, etc.)."

The second, from the appellant's (seller's) perspective, which is somewhat the opposite of the first direction, and according to which the share price is set under the assumption that the appellant will not have to pay tax on the sale. For if the appellant had sold the sale, without the shares being sold first, it would have also demanded compensation for the tax it would have had to pay upon the sale. According to this, in calculating the value of the sale, the share consideration should also include the tax that would have been paid upon the sale. A hint of this can be found in appendix 29 to the respondent's affidavit:

"And it was explained, from the seller's side, that if it sells the company's activity and not the shares, when it wants to take the money home it will have to pay tax on the dividend, 33%, and therefore for the sake of selling the shares and not the activity directly, it will not be willing to accept an amount that is lower than the direct value of the activity," and see also section 1.13 of the Gonen opinion.

66. Beyond the fact that the respondent did not argue this and therefore these are only assumptions (the respondent's expert even stated in his testimony that **"in determining the shares of Hexadite Ltd. we are not claiming that tax was taken into account,"** transcript p. 28 line 7, and section 50 of the respondent's submissions: **"The respondent's claim is not that tax was taken into account in determining the share price of the appellant."**), I do not find that any of these arguments are persuasive that, substantively, tax should be grossed up.



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67. As for the claim that Microsoft intended to purchase the sale with a willingness to pay the tax, here the respondent is not following the price or the amount to be expected from the sale, since the price of the appellant with all its assets and activities was already set at \$75 million, but rather is following Microsoft's subjective perspective, which is willing to invest additional funds, including paying tax, to exploit the sale and profit from it. For this matter, and referring to the example in section 59 above, the respondent believes that the value of the patent in that example is the price paid for it plus the implementation costs.
68. If the respondent were consistent in its position, it would also have to add to the value of the sale other expenses that Microsoft was willing to pay in order to use the sale, which could also have been used to lower the price in negotiations for the share purchase. For what is the difference between tax that must be paid and any other expense required to generate profits from the sale?
69. Moreover, this position of the respondent is inconsistent with the end of section 7.5 of its expert's opinion. There, the respondent's expert claims that **"for the purpose of comparison and estimation of the value of the FAR, the total purchase price in the share purchase transaction should be considered. No deduction should be made from the purchase price for claims such as synergy, control premium, or any other deduction (claims such as a 'liquidity premium,' 'winner's curse' premium, etc.)."** Why should values that are subjective to the purchaser not be deducted from the purchase price, but the purchase price should be increased by a tax gross-up, which is also subjective to the purchaser? The respondent and its expert have the answers. Also, if the purchaser were exempt from tax, would that change the value of the sale? Similarly, should unique tax benefits for the purchaser determine the value of the sale?
70. As for the argument that if the appellant had sold the sale without first selling the shares and borne the tax burden, it would have grossed it up in the share price — again, the respondent is deriving the value from the perspective of one party — the seller. Moreover, this contradicts the rule that the chosen transaction structure is followed, not other potential structures (CA 1839/19 **Kfar Saba Tax Assessor v. Rizman**, judgment of Justice Solberg, 14.6.2021). In any case, selling the sale and withdrawing a dividend while the owners remain in the company is not the same as selling the shares and leaving the company (see section 65 above). In addition, this is a speculative assumption by the respondent that may be true in some cases, but certainly cannot be established as a rule. Not for nothing, in section 7.8.3 of his opinion, the respondent's expert claims that **"the minimum price for the seller must take into account the expected capital gains tax due to the business restructuring, and the seller will seek compensation for this."**



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71. Similarly, section 47 of the respondent's submissions illustrates the error in its approach: **"In calculating the value of the sale, the amount of tax the seller may bear upon the transfer of the sale must be taken into account."** Beyond the fact that there is no place to take into account the amount the seller may bear, and there is no certainty that it will bear it, as stated, the value of the sale is the price paid for it or that would have been paid for it, not the price plus the amount of tax the seller bears.
72. The respondent's approach also means that the entire tax burden falls on the shareholders already in the share transaction. For if the value of the sale is about \$96 million as the respondent claims, and the appellant's shares were sold for \$75 million, then the shareholders have already taken upon themselves the payment of the tax. Otherwise, they would have sold the shares for \$96 million. This is a far-reaching assumption. It should be recalled that the respondent's position is principled and, in its view, correct for all business restructuring transactions.
73. In general, by nature, a seller will sell its assets to whoever makes the highest offer for them. If the sale were worth \$96 million, it is presumed that an offer in that amount would have been made by another party willing to pay the value of the sale. And if there is no such offer, then there is no one willing to pay that amount for the sale, and that is not its value.
74. It may be argued that the value of the sale is about \$96 million, but due to the expected tax payment, in the special circumstances where it is already known at the time of the share transaction that the sale will be sold shortly thereafter, companies would not agree to purchase the sale except with a tax deduction. However, if so, the tax payment in this case is an inherent part of the sale, a kind of "hump," and therefore the value of the sale includes the deduction for the tax payment, just like all deductions that must be made for making it usable. For example, suppose there is real estate worth 100, and next to it is identical real estate that requires certain work to make it usable, at a cost of 50. In such a case, the price of the adjacent real estate is 50 — the "hump" is inherent to it, and no rational party would buy it for a higher price.
75. It should be noted that even in a case where the tax payment is not an inherent part of the sale, the price set is still the price that reflects its market value. Suppose there are buyers who will not be liable for tax on the transfer of the sale. If they were interested in the sale, they would offer a higher price. For this matter, and borrowing from the example above, if there is a specific party that can make the adjacent real estate usable at no cost, it would offer more than 50 for the adjacent real estate, and that would be its price. However, if no higher amount is offered, then that is its value, since there is no one willing to buy it for more.



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76. That is, whether it is an inherent expense, a kind of “hump,” or not, the price set in the market is what reflects the value, without adding external expenses. In our case, the fact that no one offered more than \$75 million for the shares proves that this is the value of the appellant, with all its components. If the sale were worth what the respondent claims, it is presumed that the shares would have been sold for a higher price.
77. The respondent’s position is also inconsistent regarding the taxation of other, tangible assets. There can be no dispute that the value of real estate does not include the purchase tax or the appreciation tax that the parties must pay as part of the transaction. The value of the real estate is the price agreed upon by the parties, with each party bearing the tax it owes. Indeed, each party will seek to maximize its benefit, including shifting the tax burden to the other party, but precisely for this reason, the price set by the parties is what reflects the value — the assumption is that the parties did everything they could to maximize their benefit, and the price set best reflects all the parties’ considerations.
78. Moreover, the respondent’s argument is circular and endless. If the tax gross-up increases the value of the sale, for example to \$96 million in our case, then ostensibly tax must be paid on the increased value, and so it must be grossed up again for the value of \$96 million, which in turn increases the value of the sale again, and so on ad infinitum.
79. The respondent claims in section 54 of its submissions that **“it is not possible to consider only the tax asset inherent in the share purchase and reflect it in the arm’s length price determination, and the expected tax expenses following the business restructuring must also be reflected.”** However, this is an unsupported claim, with no logic, in light of the beginning of that section regarding **“the share price reflects all the values of assets and liabilities in the acquired company.”** The respondent failed to explain why external tax considerations should be taken into account, and this is not the same as a tax asset that already exists at the time of the transaction and is part of the assets, just like cash.
80. Not for nothing, the respondent did not dare to claim why, substantively, tax gross-up should be considered. The respondent admitted that tax gross-up is not intuitive, and still did not see fit to justify its position substantively. All the respondent claimed is that the guidelines require tax gross-up. However, as stated, the guidelines do not require this.
81. Before concluding, I find it appropriate to comment that there is a flaw in the conduct of the Tax Authority regarding the tax gross-up issue, both in this proceeding and in general. Regarding the respondent’s conduct in this proceeding, the tax gross-up issue did not appear in the initial assessment and was added at the last minute in the objection decision, when the valuation that supported it was sent



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to the appellant only days before the orders were issued, without any justification for the gross-up. The issue was not properly discussed in the assessment process, and certainly not clarified, and it would have been appropriate for such a central and significant issue not to be added at the last minute.

The respondent complains in this context that it requested certain documents for the valuation work as early as 2.6.2022, and only on 30.11.2022 did it receive all the documents. However, beyond the fact that the respondent discussed the tax gross-up and calculated the value of the activity even before receiving all the documents (sections 30, 35, and 36 of the respondent's affidavit), the respondent cannot complain about the described timetable when the request for documents regarding the tax gross-up issue was made only about seven months before the deadline for the objection decision. The respondent should have acted on the matter already in 2020 and 2021, when, according to it, the Tax Authority grossed up tax, but it refrained from doing so. The respondent had many years to issue a proper assessment and deliberate, but chose to act on the matter only towards the end of the period.

82. In terms of the respondent's general conduct, it is not appropriate for such a substantive matter, which constitutes a real policy change, to be done in the dark, and not in an orderly and broad manner, with an amendment to Circular 15/18 and the appropriate procedures. With all due respect, the attempt to present the tax gross-up issue as a correction of a mistake, and not as a policy change, cannot stand. This is an issue that appears in almost every business restructuring, and it has enormous financial significance. Tax gross-up does not appear in Circular 15/18 or in any other professional procedure, and when much less significant matters are extensively addressed in the guidelines, it could be expected that this issue would be clearly addressed. The Tax Authority, as an administrative authority, is expected to act from the outset with transparency and in an orderly and fair manner towards the public of taxpayers, and not to try to "smooth things over" and justify itself retroactively, while distorting and twisting what is stated in its own circular. If it indeed believes that tax should be grossed up, there is a way to bring this to the attention of taxpayers and act accordingly, and not in the way it was done. The fact that the respondent itself cannot point to the exact year in which it began to gross up tax ("2020 or at the latest 2021," section 57 of the respondent's submissions) proves that this was not a structured and orderly process, but a change made on the fly. Tax gross-up should have been done in an orderly and transparent manner, and not in secret and by word of mouth, and one can only guess why the Tax Authority acted as it did.

In this context, I accept the appellant's claim that the respondent claims, on the one hand, that the expected tax on the sale affects the determination of the consideration for the appellant's shares (p. 27 of the respondent's expert opinion),



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but, on the other hand, under the same assumption that tax considerations affected the determination of the consideration made in 2017, it sees no difficulty in retroactively changing the tax calculation rules in the sale and applying rules from 2020 to a transaction made in 2017. According to the respondent itself, if Microsoft and the appellant had known in 2017 about the respondent's position, which arose at the earliest in 2020, they would have acted differently, and therefore, this constitutes a kind of reliance. The Tax Authority's conduct regarding the tax gross-up issue is so flawed that even if I were to reject the appeal on this issue in principle, I would still find to accept it in this particular case. The Tax Authority did not act properly and should take this into account.

83. In summary of this part, I do not believe that a future tax payment should be grossed up in determining value according to the Comparable Uncontrolled Price method. The guidelines do not require this, and it is not appropriate substantively. The following words from the summary chapter of the Gonen opinion are apt for our case: **"It is not possible to accept the claim of the Tax Authority's appraiser that while an unrelated party was willing to pay about \$75 million for the acquired shares, a related party should pay about \$96 million (or an addition of about 28%) for the assets. This position is contrary to economic logic, contrary to transfer pricing rules, and not for nothing did the Tax Authority's appraiser have to refer to irrelevant sections for applying the Comparable Uncontrolled Price method."**

The Holdback Payments Must Be Included in the Sale Value

84. As stated, another question arises regarding the holdback component: Was it paid for the appellant's assets, so that the consideration from which the sale value is derived is \$75 million, or was it paid for the founders' work, so that the share consideration to which the sale should be compared is about \$65 million?
85. It should be emphasized in this context that the share consideration is \$75 million, and the consideration received by all shareholders for their shares is derived from this amount, pro rata. However, only for the founder shareholders was the holdback component deducted from the share consideration. For illustration, a non-founder shareholder who held 10% of the appellant's shares received \$7.5 million for their shares (ignoring the Escrow component, as detailed below). In contrast, for example, a founder shareholder who held 10% received at the time of sale about \$6.5 million (\$7.5 million less \$1 million for the holdback).

See section 7 of the appellant's reply submissions: **"The respondent's claims that the holdback was paid as part of the share transaction as consideration for shares – are agreed."**

That is, there is no dispute that the holdback component is from the share consideration, not an external component, and the question is, as stated, whether



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this component represents the appellant's assets or the founders' future work, with the holdback only paid if that work is performed.

86. This is not a simple question at all. On the one hand, it is a payment received only if the three founders continue working at the appellant or at Microsoft. That is, it is a payment conditional on work. There is difficulty in claiming that a payment conditional on future work is paid for part of the company's assets and activities. This was also ruled in the **Gteko** case, that such a claim blurs the distinction between the personal and corporate levels, and the logic of the judgment is sound. Accounting rules also classify such a payment as payment for work.
87. On the other hand, the holdback component is not paid for the work, but for the shares, as stated. The holdback was deducted from the consideration the three founders received for their shares, unlike the other shareholders, who received the full consideration for their shares (except for payment held in trust to secure obligations to the purchaser – Escrow). For this matter, the above question would not arise if it were an excess payment over the share consideration. But this is not the case, and it is a payment that is part of the share consideration and paid for them.
88. After considering the matter, and not without hesitation, I believe that the holdback component reflects the value of the appellant's assets and activities and must be included in the sale value.
89. The holdback component is part of the consideration the founders received proportionally for their shares. It is not an excess payment over what the other shareholders received. If the founders do not meet the holdback conditions, they will receive reduced payment for their shares. See sections 2.8 and 2.8.2 of the share purchase agreement:

"Management Consideration. At Closing, thirty-five percent (35%) of the Purchase Price otherwise payable to the Management Shareholders at Closing... (the "**Management Consideration**") will be deposited with the Management Escrow Agent and shall be held and released on the terms set forth in this Section 2.8... Each payment of the Management Consideration is subject to the condition that at the time of such payment the respective Management Shareholder has not terminated his employment with the Company, the Purchaser or its designated Affiliate (other than for Good Reason) or been terminated by the Company, the Purchaser or its designated Affiliate for Cause."

See also the testimony of the appellant's witness, Mr. Haggai:

"... **So the holdback consideration is simply the payment for their share in the company, isn't it? It is part of the purchase price in the transaction, it is part of the price per share**" (transcript p. 71 line 33 – p. 72 line 1. See also section 7 of the reply submissions).



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90. As recalled, in the Comparable Uncontrolled Price method, the value of the company in the free market is projected onto the value of its assets and activities. That is, the share value is the value of the company with all its activities and assets. In this regard, the guidelines state that, as a rule, value does not disappear in an internal business restructuring (see examples 22 and 23 in the annex to Chapter VI: "It should generally be assumed that value does not disappear, nor is it destroyed, as part of an internal business restructuring," and section 6.1 and examples 1 and 2 in Circular 15/18). Not including the holdback component means deviating from this rule, without any satisfactory explanation.
91. As stated, there is no dispute that the holdback component was paid as consideration for the shares. The share consideration reflects the value of all the appellant's assets and activities. There is no dispute about the identity of the sale transferred from the appellant to Microsoft and that it includes all the company's activities and assets (section 55 of the appellant's submissions). Accordingly, the value of the sale transferred to Microsoft should be equal to the share consideration, and the sale value should be derived from a value of \$75 million (before adjustments). The conclusion that the value of the sale is about \$65 million means that about \$10 million in value was lost during the transfer of activity and business restructuring.
92. Regarding continued employment as a condition for receiving the payment, it is necessary to distinguish between payment **for** work and payment **conditional on** or **subject to** work. Payment for work reflects the work done or to be done and is the reason for the payment. In contrast, payment conditional on work does not necessarily reflect work done or to be done, but is a condition for receiving payment that may be for other assets. Not for nothing, section 2.8.5 of the share purchase agreement explicitly states that the holdback payment is not a salary or substitute for salary:
- "It is acknowledged and agreed that the Management Consideration is part of the consideration payable in respect of the Purchase Shares as part of the Agreement and that the salary and compensation package otherwise paid to the Managing Shareholders following the Closing Date by the Company offered by the Purchaser or its designated Affiliate is substantially similar in the aggregate to their current salary and compensation package. The intention of the parties is that payment of the Management Consideration hereunder shall not be construed so as to change the character of the sale-based payments under the Agreement and shall not be considered wages, compensatory or other ordinary income."



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93. Also, the negative wording of section 2.8.2 of the share purchase agreement, stating that the holdback will not be paid if the founder's employment ends without good reason, indicates that this is a payment conditional on work, not a payment for work. A section dealing with payment for work would naturally be worded positively — if the employee works for a certain period, they will receive a certain amount. It goes without saying that salary does not derive from the sale of an asset like shares, but from the work itself. Also, the fact that the agreement does not specify where the founders must work — at Microsoft, the appellant, or any other entity — indicates that the main thing here is not the work itself, but the founders' continued presence in the system, alongside the intellectual property they developed, to provide support going forward.
94. The appellant claims in section 100 of its submissions that "the employment condition is the main condition for receiving the payment in practice, and it describes **the dominant nature** of the payment (emphasis in original – Y.S.)." I cannot accept this. The payment is given only for the shares, and they are "the dominant nature of the payment." If the founders' shares had not been sold, the payment would not have been received, whether or not the founders continued to work.
95. There is no dispute (section 55 of the appellant's submissions) that the appellant sold all its activities and assets. Although this was not anchored in a separate and clear agreement, just as there is no dispute that the appellant's human resources function was transferred to Microsoft, it can also be assumed that the appellant transferred the founders' human resources function, whose value is the holdback payment. This is another function of the appellant — high-quality personnel who control the intellectual property sold.
96. It can also be assumed that the value of the appellant's activities and assets with the founders' commitment to remain working at the appellant or at Microsoft is \$75 million, while the value of the appellant's activities and assets without the founders' agreement is about \$65 million. The value of intellectual property with the founders' support is not the same as its value without them. In this case, activities and assets were transferred to Microsoft, including the founders' agreement to remain working at the company, and therefore, the sale value should be determined according to the first option.
97. The sale was made taking into account that the founders would remain working at the appellant or at Microsoft. The holdback component was added as a condition to the share transaction to ensure, from Microsoft's perspective, the value of the appellant with all its activities and assets, and it is not an additional and separate payment for the work itself. Accordingly, if the founders choose not to continue working, the value of the sale will indeed be lower. This is similar to a case where if



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any of the representations made to the purchaser were not correct, the Escrow payment would be withheld. That is, the value of the sale does not stand alone, but is determined taking into account that the founders remain working at one of the companies for three years. If the founders were not willing to remain working and provide all necessary support, the price of the transaction would have been lower.

98. Thus, the holdback payment is essentially similar to the Escrow payment — a deferred payment intended to secure certain obligations, and in this case, the obligation to remain working at the appellant or at Microsoft. Not for nothing, it was agreed between the parties that if the founder leaves not through their own fault, the holdback payment will still be paid to them. That is, this is not a payment for work, which would not have been paid if no work was actually done, but a payment intended to secure an obligation. If the obligation is not fulfilled for a justified reason, then no penalty should be imposed.
99. Indeed, regarding the founders, there is overlap between the holdback component and the Escrow. See section 8 of the reply submissions: **“Additionally, 10% of the holdback also served as part of the trust to secure the accuracy of the appellant’s representations, as an additional restriction.”**
100. The appellant also rightly claims that the conclusion that this is part of the sale value blurs the distinction between the personal and corporate levels. But it is not this court that blurs the levels, but Microsoft, the appellant, and the founders, who determined in the share purchase agreement that the consideration due to the founders based on the appellant’s assets and activities would be conditional on their personal work. Making the share value payment conditional on the founder’s work is what blurs the levels, and it cannot be inferred from this that it is not part of the sale value. The parties are the ones who blurred the personal and corporate levels, and they cannot later claim that, for tax purposes, this is problematic.
101. The appellant also claims that it is not possible to derive from a payment conditional on future work the value of the appellant’s assets today. So, if in the end the founders do not remain working, will the value of the assets decrease retroactively? I believe the answer is yes. As stated, in such a case, the sale does not include the founders’ support for the intangible assets, and therefore its value is reduced. It is not unusual for consideration for shares to be conditional on future events, such as meeting certain business targets, and just as a company’s value can rise or fall retroactively according to future business performance, so too according to the fulfillment of certain conditions.
102. Also, if, for example, all the share consideration were conditional on the founders remaining working at the company or at Microsoft for six months, would the appellant then claim that there is no value to the company’s activities and



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assets, and all the payment is for the work? This could even open the door to manipulation.

103. Contrary to the appellant's claim and unlike what was decided in the Gteko case, in our case, according to what is explicitly stated in the share purchase agreement, the holdback payment is clearly and unequivocally paid for the shares themselves and in connection with their ownership. It is not an excess payment, but part of the share consideration, paid in the same proportion to the founders as to the other shareholders. The appellant's position is that there is a different price for the founders' shares and the other shareholders' shares, which affects the value of the company's assets, with the founders' shares being worth less. I cannot accept this.

104. Also, contrary to the appellant's claim, I did not find that the holdback payment should be discounted. In principle, the appellant is correct that future payments should be discounted to the date of the agreement. However, the holdback component is invested in investment channels chosen by the founders, so it does not lose its value, and may even yield returns. Even if the payment should be discounted, the value of the holdback payment to be received should be discounted, which, as stated, is a higher value.

105. The appellant also claims that the payment should be discounted due to the risk that the payment will not ultimately be transferred. However, that risk depends solely on the founders, and this is not the same as a decrease in the value of money, which depends on objective circumstances. As stated, the sale value is derived from the share consideration. When the share consideration is \$75 million, with no deduction for risk, that is also the sale value.

106. Regarding the secondary adjustment, the rule on this matter was decided by the Supreme Court in **the Kontera** case, and the appeal on this matter cannot be accepted. Without detracting from the above, as I noted in (District Court Tel Aviv) Administrative Appeal 61226-06-17 **C.I. Software Israel Ltd. v. Tel Aviv 3 Tax Assessor**, para. 88 (25.10.2022), it may be appropriate to examine the matter more deeply regarding the source of authority under section 85A of the Ordinance.

107. However, I found to accept the appellant's claims regarding the interest rate. The appellant proved that documents showing the interest rate it actually charged Microsoft group companies were presented during the assessment proceedings and approved (Exhibits 1, 7, 9 and transcript p. 25 lines 6–29). It is unclear why the respondent ignores this, and its claim in section 69 of its submissions that the appellant did not present any document is misleading. Once actual data were presented, both the interest rate and the method of calculation (straight-line or compound interest) will be determined according to the terms of the loans actually agreed between the appellant and other Microsoft group



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companies (District Court Tel Aviv Administrative Appeal 49933-03-20 **Western Digital Israel Ltd. v. Tel Aviv 3 Tax Assessor**, paras. 95–96 (30.6.2024)). As a rule, it is preferable to rely on data set in the market, similar to the Comparable Uncontrolled Price method, rather than theoretical data. Regarding the interest rate, since the appellant claimed interest rates of 0.1%–0.25% without specifying an exact rate, the interest rate will be set at 0.175%, which is the average of the claimed rates.

108. In summary, I accept the appeal on the tax gross-up issue and reject it on the holdback issue. Therefore, according to the **Kontera** rule, a secondary adjustment must be made. However, I accept the appeal regarding the interest rate.

109. The respondent will bear the appellant's costs in the amount of NIS 150,000. This is both because the majority of the appeal was accepted; because, as stated, the respondent did not act as expected of an administrative authority in determining the assessment and hearing the objection; and because the respondent did not meet the deadlines allocated to it and submitted its submissions late, without an approved extension. I debated whether to reject the respondent's submissions, which were submitted after the final deadline and after it was made clear in the decision of 7.7.2025 that **"if the respondent's submissions are not submitted by the extended deadline, this will be considered a waiver by it of their submission with all that this implies, without any further decision being necessary."** As a rule, it would have been appropriate to write the judgment based solely on the appellant's submissions. However, given that this is a broad issue of considerable weight, I found to accept the respondent's submissions, but to reflect its conduct in the award of increased costs. The respondent should take this into account.

Given today, 6 Heshvan 5786, October 28, 2025, in the absence of the parties.

Yardena Sarusi, Judge

[Signature and court stamp]