

# Israel

*George A. Rosenberg  
Rosenberg, Abramovich, Schneller, Advocates  
Tel-Aviv, Israel*

## **Introduction**

In Israel, the term ‘joint venture’ is a vague general description of almost every kind of cooperation between independent enterprises or persons for attaining a common commercial goal.<sup>1</sup> Under this definition, it may be said that joint ventures are extensively utilized in Israel, especially in the fields of electronics, high technology, scientific research, and construction for tourism.

Projects where foreign investors cooperate with local business are encouraged, and investment incentives are provided for export-oriented industries and for job creation in development areas. The Investment Authority was established to encourage potential investors in Israel to coordinate between various government departments and agencies, and to assist foreign investors.

The attitude of labor towards cooperation with foreign investors also is favorable. In fact, companies owned by the largest union federation, the general Federation of Labor (*Histadrut*), and by the *kibbutz* (collective settlements) industries, cooperate extensively with foreign investors to create more jobs.

## **Alternative Legal Forms in Structuring Joint Venture**

### **In General**

There are no specific provisions of law that regulate the creation, requirements, functioning, or limitations of joint ventures in Israel. The closest reference to a joint venture is in Section 41 of the Partnerships Ordinance of 1975, where one of the causes for the dissolution of a partnership is the termination of the ‘venture’ (which literally means ‘occasional business’ in Hebrew) for which it was formed.

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<sup>1</sup> The purpose of this chapter is to provide a general review and acquaint the foreign business person with some of the more important aspects of international joint ventures in Israel. The treatment of the various subjects discussed here is not exhaustive. The chapter is not a legal opinion, and the author disclaims all responsibility for it as such. Anyone wishing to enter into a joint venture in Israel should seek competent professional advice before doing so and should not rely on the contents of this chapter alone. The author gives special thanks to his son, Ari Rosenberg, for his kind assistance.

In effect, all legal forms which provide a vehicle for cooperation between independent enterprises or persons to attain a common commercial goal may be used in structuring joint ventures. As this cooperation is always contractual, the terms of such contracts will determine how the joint venture is to be structured and what legal form it will take.

The formation, interpretation, and execution of each contract will be governed by the laws relating to contracts. The most common types of legal forms used to carry on business in Israel include limited-liability companies, partnerships, limited partnerships, and cooperative societies.

Banking, insurance, and shipping companies are in a special class and are subject to particular regulations which do not apply to other companies.

### **Limited-Liability Companies**

#### *In General*

A limited-liability company limits the shareholder's liability to the amount contributed by each shareholder for the shares it owns. It may be a public company, whose shares are either registered on a Stock Exchange or offered to the public through a prospectus and held by the public,<sup>2</sup> or a private company, which should have at least one but not more than 50 members.

A private company may not offer or sell debentures or shares to the public, and its articles of incorporation may contain restrictions on the transferability of its shares.

#### *Formation Procedures*

To be incorporated, companies should be registered with the Registrar of Companies. The company comes into legal existence from the date of issuance of a Certificate of Incorporation by the Registrar.

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<sup>2</sup> Limited public companies which are listed on the Tel Aviv Stock Exchange (TASE) are required to fulfill a number of obligations, such as: (1) the publication of annual audited financial statements, not later than three months after year-end, for distribution to all registered shareholders and members of the TASE; (2) the publication of quarterly condensed financial reports reviewed by the auditors within two months of quarter-end, for filing with the TASE, the Israeli Securities Authority, and the Registrar of Companies; (3) the immediate notification to the Israeli Securities Authority and the TASE of any material information affecting the company's position, *inter alia*, impending dividend payments, redemption, cancellation, or change in the company's share ledger; (4) the appointment of an audit committee, comprised of at least three persons not substantially involved in the running of the company and including at least one outside director; and (5) the annual returns filed with the Registrar of Companies relating to shareholders, directors, and charges, which should disclose sums paid to each of the five highest paid directors.

All of its shareholders and directors may be non-residents, although the tax authorities require the appointment of an Israeli resident agent for value-added tax (VAT) registration and tax liability purposes.

Under the Companies Law of 1999, a declaration by the directors of their intent to serve as directors is needed. There are no restrictions regarding the registration of company capital in foreign currency.

#### *Capital Structure*

A company will state in its bylaws<sup>3</sup> the registered share capital and the number of shares to be issued. There are no minimum capital requirements, and the shares can be all par value or all non-par value.

The company may purchase its own shares as long as it pays their price out of profits which could have been distributed as dividend—providing, however, that an accountant shall approve that such purchase does not decrease the company's capital. Such shares are kept 'dormant', and all of the rights attached to them are canceled. When these shares are sold, they regain their rights in the company.

#### *Dividends*

Dividends are to be distributed from the company's profits, provided the distribution will not prevent the company from fulfilling its obligations. Prior to the resolution to distribute dividends, the directors should consider its consequences on the ability of the company to fulfill its financial obligations.

#### *Shareholders*

Shareholders may be corporate or individual, and all shareholders of a company may be foreign residents. The general meeting of shareholders is the supreme governing body of the company.

At this meeting, the shareholders elect directors, approve annual balance sheets and distribution of profits, and elect the company's external auditors. The procedure at shareholders' meetings is outlined in the bylaws.

#### *Directors*

The business of the company is managed by its directors, who represent the company in transactions with third parties. Directors are bound to act in a fiduciary capacity *vis-à-vis* the company.

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<sup>3</sup> The bylaws regulate the internal business of the company, and usually contain the name of the company, its goals, and details concerning the capital and liability of the company, and indemnification of the company's directors and officers. They also consist of the agreement entered into by the shareholders and the company and between the shareholders themselves.

The number of directors is generally fixed in the bylaws, but a private company should have at least one director. Directors may be corporate or individual, and all directors may be non-residents.

Public company directors should appoint a general manager who is responsible for the management and execution of the company's interests according to the policy determined by the directors. The general manager should provide reports concerning the business to the directors upon their request.

Meetings of the board of directors will be held according to the needs of the company, but should be conducted at least once a year in a private company, and once every three months in a public company.

#### *Liquidation and Receivership*

The Companies Law 1999 and the Companies Ordinance of 1983, certain parts of which have remained in force, prescribe detailed procedures for compulsory and voluntary liquidations, receiverships, moratoria, and schemes of arrangement. The bylaws generally also deal with these subjects.

#### *Reporting Procedures*

All companies should keep books, records, and audited balance sheets, while income statements should be annually submitted to shareholders.

Auditing standards in Israel are subject to the IFRS accounting standards, in comparison to the GAAP accounting standards applied in the United States. A company should open a file with the income tax authorities, and should file an annual tax return in addition to that filed with the Registrar of Companies.

#### **Partnerships**

Partnerships, except for attorney and audit partnerships, should not have more than 20 partners. Such partners may be legal entities, and should be registered if they carry on a business. Foreigners can be partners, unless precluded by laws relating to specific professions where local qualifications are prerequisites to membership. Each partner is taxed separately on his share of profits.

The partners in a general partnership are solidarily liable, and each partner has the implied authority to act on behalf of the partnership. Foreign partnerships may operate in Israel provided they furnish the Registrar of Partnerships with details of the partners and of at least one Israeli resident who is authorized to accept legal notices on their behalf.

#### **Limited Partnerships**

A limited partnership should have at least one general partner who is liable for all the debts of the partnership, and at least one limited partner who is not liable beyond the amounts contributed by him as capital. Only general partners manage the affairs of the partnership.

Legal entities may be general or limited partners. Normally, joint ventures which are set up contractually as partnerships are not intended to be general partnership entities as such, and the obligations of each participant will be limited in accordance with the terms of the contract.

### **Cooperative Societies**

Cooperative societies have as their objective the promotion of thrift and mutual aid and are found mainly in agriculture, marketing, retailing, bus transport, and trucking. A member's share may not exceed 20 per cent of the society's capital.

### **Choice of Legal Form**

#### **Commercial and Legal Considerations**

The following aspects should be considered when choosing between a limited company and a partnership for doing business in Israel:

- Shareholders in a company have limited liability while partners in most partnerships have unlimited liability.
- Minimum capital requirements for private companies are nominal, unless they are operating in banking or insurance.
- Companies' share capital may be in ordinary and preferred shares.
- Proxy voting is permitted at shareholders' annual general meetings.
- All new issues to the public by listed companies require the permission of the Israeli Securities Authority and the Tel Aviv Stock Exchange (TASE), which determine specific quotation requirements.
- There are no general restrictions on foreign ownership of Israeli companies or securities listed on the TASE, and there are no nationality or residency requirements for directors or management. Certain preferential treatment is given to Israeli industrial companies with foreign shareholdings exceeding 25 per cent, but all foreign investment should be effected through an authorized dealer to ensure ease of repatriation of capital and earnings.
- Under the Encouragement of Capital Investments Law of 1959 (ECI Law), entities that are granted investment incentives are generally limited companies.
- The company is characterized by the separation between its assets and those of its members, and the members have rights on the company's assets through their shareholdings. On the other hand, the assets of the partnership belong to all of its members.
- The company's separate legal entity will continue to exist even in the case of a sale of shares or the death of all of its members.

### **Tax Considerations**

A limited company is taxed as an entity, while shareholders are taxed individually upon distribution of dividends. A partnership is not treated as a separate legal entity for tax purposes. Its income is computed on a partnership level and then allocated to the partners in relation to their shares in the partnership.

A 'transparent company', which was a concept introduced in 2003, would benefit from the incorporation advantages of a limited-liability company and the tax features of a partnership if certain conditions are met. All shareholders of transparent companies should be resident individuals.

Foreign partners are taxable on their share of taxable income and capital gains arising in Israel, subject to any relevant double taxation treaties. Limited partnerships have been used effectively as tax shelters for foreign investments, especially in the area of research and development.

Tax incentives have been granted to unit holders in limited partnerships which are permitted to offer public issues on the TASE for financing specific projects. Joint ventures are treated as partnerships for tax purposes.

### **Governing Law and Language**

#### **Law**

In general, parties are free to decide which law or legal system will govern the joint venture contract, its nature, and its effects.

Where no foreign element exists in the contract, i.e., the parties are residents and the contract is signed and/or executed in Israel, the governing law will be Israeli law unless otherwise stipulated. Where a foreign element exists, the parties should stipulate the governing law to avoid a conflict-of-law problem.

A contract made in some other country may validly stipulate that it be governed by Israeli law, while a contract made in Israel may validly stipulate that it be governed by a specified foreign law. However, this general rule is limited by some restrictions:

- The choice of a foreign law is subject to the provisions of public policy in Israel. Public policy will be enforced under all circumstances by the courts, thus the proper law of the contract should not contradict it.
- The choice of a foreign law is subject to the provisions of any Israeli prohibitive law.
- If there is no connection at all between the law chosen by the parties and the contract itself, the courts will consider the choice of law not to have been made in good faith, and will not recognize the chosen law as the proper law of the contract.

If the parties do not explicitly agree on the law governing their contract, the court will turn to the law intended by the parties. This is determined according

to the nature and circumstances of the contract. For instance, if the contract mentions a specific forum in an arbitration clause, the courts tend to conclude that the territorial law of the forum is the proper law of the contract.

If it is not evident from the nature of the contract and the circumstances which law was intended by the parties, the courts will turn to the law which the parties may be fairly presumed to have intended to govern. The court will then look for the territorial law which bears the greatest affinity to the contract.

Thus, if the joint venture is to be executed in Israel, the proper law of the contract will probably be Israeli law, even if it is not clear from the contract that this was the parties' intention, and assuming that no territorial law was explicitly stipulated.

The law of the place where the contract was signed also may be considered by the courts, although it is not given as much weight as the law of the place of execution. The former is especially significant when the issue at hand is the form of the contract rather than its validity, interpretation, or effect.

Joint ventures that are structured under a specific Israeli statute, such as limited companies under the Companies Ordinance, or partnerships under the Partnerships Law, will be governed by the law of the relevant statute regardless of the residence or domicile status of the parties.

### **Language**

Generally, the language of the joint venture agreement is not restricted by law, and the use of the Hebrew language is not compulsory under the Law of Contracts.

Nevertheless, generally speaking, documentation which is to be filed with official authorities should be drawn up in either Hebrew or Arabic, the two official languages of Israel.

### **Scope of Business Activity**

Where the joint venture is to be structured in the form of a company, it is normally preceded by a pre-incorporation agreement between the parties. The parties will consider stating in the pre-incorporation agreement the specific objectives for which the company is being formed, and a more general form of such objectives will be included in the objectives clause of the articles of association of the company.

Where the joint venture is in the form of a partnership, more careful consideration should be given in defining the scope of the joint venture in the partnership agreement to avoid creating a general partnership.

A joint venture is really a 'special' partnership and, whether it is structured as a partnership or simply formed by an ordinary contract, it is limited in its scope of business.

## **Formation Agreement**

### **In General**

As there is no exclusive legal structure for joint ventures in Israel, different provisions of law may apply in their formation. Each joint venture is governed by the terms of the joint venture agreement, the general laws of contracts, and the statutory provisions applicable to the particular vehicle through which the parties have chosen to operate the joint venture.

Thus, where the parties have chosen to operate by means of a partnership, they will be governed by the Partnerships Ordinance, and where they have chosen to carry on business by means of a company, they will be governed by the Companies Law and the Companies Ordinance.

The Contracts (General Part) Law of 1973 adopts the purely consensual contract, and is primarily concerned with the intention of the parties. The contract is formed by way of offer and acceptance, and mutuality of consideration is not required. It need not be in any particular form and, failing a specific statutory provision to the contrary, need not even be in writing.

Unless otherwise agreed, the law provides the rules as to the place, time, and quality of fulfillment of the obligation, priorities of concurrent claims, potential obligations contingent on the performance of third parties, waiver of compensation in lieu of performance, set-off, and liability of several obligors.

Under the Contracts (Remedies for Breach of Contract) Law of 1970, a person harmed by a breach of contract may sue for specific performance, withdraw from the contract, or sue for damages. In certain circumstances, these remedies are cumulative. The parties may stipulate as to the nature and consequences of a breach.

### **Partnerships**

Once registered, the partnership takes on the characteristics of a legal entity and is then capable of suing and being sued. However, the registration of the partnership is not constitutive.

Although the Partnerships Ordinance does not require a written partnership contract, it is customary to have such a contract signed by the different partners. The contract should refer to the partnership objectives, investment obligations and roles of each partner, division of profits, rights of each partner to represent and bind the partnership, term of the partnership, and provisions for winding up, among others.

A partnership will cease to exist upon the death of one of the partners unless the contract contains explicit provisions to the contrary.

Where the contract does not provide for the rights and obligations of the partners, such will be determined in accordance with the Partnerships Ordinance.

## **Companies**

The joint venture agreement deals with the rights and duties of the partners as individuals. Their undertaking to form a company may be enforced by any of them, and failure of a partner to promote the formation of the company may be considered a breach of the agreement.

The nature of the bylaws also is contractual. The bylaws represent a contract between the company as an entity and its members (shareholders) and a contract among the shareholders themselves.

As long as the bylaws are not in conflict with the provisions of the agreement, the original partners to the agreement who also are shareholders in the company may exercise their rights in either capacity and may benefit from remedies available under the laws of contract and/or the Companies Law.

However, once the shares are transferred by one of the original partners to a third party who is not a party to the agreement, the legal relationship between such third party and the other partners is governed by the terms of the bylaws only, and is subject only to remedies available under the Companies Law.

The agreement will often contain a provision that one of the conditions for the transfer of shares by the partners is that the transferee should become a party to the agreement with the remaining partners.

Where there is a conflict between the provisions of the agreement and the bylaws, the latter will prevail, although the original partners (or a subsequent shareholder who also has become party to the agreement) may be in a position to exercise their rights *vis-à-vis* each other in virtue of the provisions of the agreement.

As the bylaws are public documents, anyone may rely on their provisions in all dealings with the company regardless of the provisions of the agreement which preceded the formation of the company.

## **Establishing Corporate Vehicle**

### **Incorporation Formalities**

Under Israeli law, special approval for a joint venture is not necessary. The joint venture as an enterprise is subject to general restrictions which apply to any form of business carried on in Israel.<sup>4</sup>

Thus, the formation procedure for a company which is to serve as a vehicle for a joint venture is the same as that of any other company, and should be in accordance with the Companies Law.

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<sup>4</sup> For instance, there are certain industries in Israel which are closed to private ownership, such as the defense industry.

**Foreign Exchange**

As a result of the liberalization of the currency control regime in 1998, all of the restrictions imposed by the Bank of Israel on transactions between residents and non-residents, whether in Israeli or foreign currency, have been removed.

**Permits**

There are no special permit requirements applicable to international joint ventures, thus the general provisions on permits apply.

The Business Licensing Law of 1968 empowers the Minister of Interior, in consultation with the Minister of Health, to require certain businesses to obtain licenses for proper environmental and health conditions, prevention of public nuisance, observation of town planning regulations, public safety, and prevention of pollution and diseases in livestock. Certain conditions also are laid down for the licensing of the sale of intoxicating liquors and public entertainment.

If the execution of the joint venture requires non-resident foreign personnel, work permits should first be obtained before they can be employed. Application to the Ministry of Economy (formerly known as the Ministry of Trade and Commerce) has to be made in writing by the intended employer giving details of the prospective employee and explaining why a foreign citizen is required. Once the approval of the Ministry of Economy is granted, the intended employer needs to apply to the Ministry of Interior for the issuance of a working visa for the prospective foreign employee.

The process starts with the prospective employer submitting a request to the Ministry of Interior for the issuance of the B-1 Visa and a multiple entry permit. If possible, the process for applying for the work permit should begin before the employee enters Israel. Work permits are normally issued for up to one year, but can be extended. Foreign personnel also can be accompanied by their families.

**Preparation of Ancillary Documents****Distribution and Supply Agreements**

In general, distribution and supply agreements present no particular legal difficulties. The parties are free to enter into all types of contractual agreements regarding supply and distribution in accordance with the contract laws of Israel.

If the parties do not specify in these agreements the dates for termination of manufacturer or distributor relations, a reasonable notice period is required to terminate the agreement. Reasonableness is determined according to the circumstances and varies from product to product. It is recommended that parties clearly specify provisions for termination in these agreements to avoid future disputes.

### **Licensing Agreements**

Israel is a member of the various conventions relating to patents, trademarks, and copyrights. Patents in Israel are regulated by the Patent Law of 1967 and are protected for 20 years from the date of application, while protection for five additional years may be granted to patents related to medical products or medical systems. Patent application forms may be filed in Hebrew, Arabic, or English. Foreign applicants who are unrepresented in Israel should indicate a local address for service.

Licenses may be granted by a patentee. A license under a patent is effective only in respect of the parties to the license, unless it is registered. Patents are assignable and also may be encumbered by a lien. The assignment and lien are only valid if registered.

Where the minister in charge decides that the exploitation of a patent is required for defense interests or the maintenance of certain essential supplies and services, he may permit the exploitation of the patent by the government subject to payment of compensation to the patentee. Compulsory licenses also may be ordered to assure the availability of reasonable quantities of medical supplies.

The registration of trademarks is governed by the Trademarks Ordinance of 1972 and the Trade Marks Rules. Applications may be made by the owner of the trademark or by an Israeli lawyer or patent attorney appointed in writing to act as agent for the owner. Trademarks are transferable, and the owner of a trademark also may license its use. Such license should be registered with the Registrar of Trademarks.

Copyright protection is provided without application under the Copyright Law of 2007 for any original literary, dramatic, musical, or artistic work for the life of the creator plus 70 years (50 years for musical and artistic works).

### **Employment Agreements**

#### *Legal Basis*

Employer or employee rights and obligations stem from labor laws, the collective agreement between an employees' association and an employer or employers' association, and the employment contract.

At present, there is no Israeli statute dealing with the law of the employment contract as such. Thus, the general laws of contract apply in all matters dealing with personal agreements of employment, subject to the provisions of the collective agreement and the relevant labor laws.

#### *Labor Relations*

Wages and other conditions of employment are generally determined by free collective bargaining between the employers' organizations, the trade unions, and the government (regarding public service employees). While there are basic rights to strike and lockout, private industry in Israel is, on the whole, relatively free from labor disputes.

Many legal procedures exist to avoid disruption of work. In practice, the law is unlikely to be invoked as all parties prefer negotiated settlements. Government 'back to work' orders are sometimes issued in times of dispute in essential services.

#### *Wages and Social Benefits*

The Minimum Wage Law of 1987 provides for a uniform minimum wage fixed at 45 per cent of the national average wage as determined periodically by the government. In 2010, the average minimum monthly wage was approximately US \$1,000. In July 2011, the minimum monthly wage was set at NIS 4,100; in July 2012, it was NIS 4,300. For the period from April 2015 to March 2016, it was set at NIS 4,650; from April 2016 to June 2016 or the higher of (i) NIS 4,650 (ii) 47.5 per cent of the Average Wage of the Israeli market (as determined by the Israeli National Insurance Institute) at such period (the "April-June 2016 Wage"); for the period of July 2016 to December 2016, the higher of (i) the April-June 2016 Wage or (ii) NIS 4,825; and, for the period from January 2017 onwards, the minimum monthly wage shall be set at NIS 5,000.

Social security, including national 'health tax' and other costs, has to be added to the average monthly wage costs to arrive at overall payroll costs. In general, the additional costs to industrial employers are between about 20 per cent and 35 per cent of gross wages. Non-industrial and non-tourist enterprises pay up to a further four per cent for employers' tax. Although overall working hours are being maintained, many enterprises have switched to a work week of five days from the previous five and a half days.

#### *Termination of Employment*

Both employer and employee should give due notice of termination. Disputes are within the jurisdiction of the Labor Courts. Severance pay is payable by law, upon dismissal, retirement at official retiring age, and in other specified circumstances, at the rate of one month's basic salary for every year of service, or at the rate of 12 days' basic pay for every year of service in the case of daily workers.

Most employers contribute tax-deductible payments to a regulated fund on account of the amounts required for severance pay.

#### **Sales Agreements**

Sales agreements are governed by the general contract laws and the Sales Law of 1968, which contains the following pertinent provisions:

- The seller is required to deliver the object and transfer ownership;
- If no time or place of delivery is specified, then delivery should take place within a reasonable time at the place of business of the seller;

- The seller is required to deliver the exact object as described in the agreement, both as to quantity and nature, and, where applicable, the object should comply with the sample or with accepted usage;
- The purchaser should inspect objects upon receipt and advise the seller immediately of any defect; and
- The contract of sale should be carried out according to customary usage and in good faith.

International sales are governed by the International Sale of Goods Law of 1999 (ISL), which adopted the Uniform Law on International Sale of Goods (the '1980 Vienna Convention'). The ISL is applied when the parties are located in different countries, while the Sales Law applies to sales wholly within Israel.

The ISL also deals with the sale of movable property only, while the Sales Law applies to both movable and immovable property. Furthermore, the ISL provides for its own complete remedies, while the Sales Law includes certain specific remedies and refers to the Contracts (Remedies for Breach of Contract) Law of 1970 for others.

## **Financing Joint Venture**

### **In General**

Credit facilities are generally provided against suitable collateral within an overall agreed credit framework that may include overdraft facilities, short-term loans, bank guarantees, and other credit obligations.

Several development banks specialize in providing medium and long-term financing to industry, tourist, and agricultural projects. An additional banking service is provided by way of medium-term foreign suppliers' credit for equipment and machinery, available in credit lines offered to encourage exports from various countries.

The increased liberalization of the banking system has been accompanied by the wide use of financial instruments such as forward transactions, financial futures, options, and interest rate swaps.

### **Leasing Companies**

Leasing companies are active in providing asset-backed finance to industry and commerce and to private individuals.

Approved leasing enterprises are entitled to the same taxation and other benefits accorded to approved enterprises under the ECI Law to whom the acquired assets have been leased, provided that the benefits from investment grants are passed on to the approved lessees.

**Export Financing**

Export financing is conducted by commercial banks that have access to such funding as is required to support exports from Israel. Exporters obtain authorization from the Bank of Israel to finance their export-related activities based on their levels of exports.

Foreign currency risk insurance covers the differences that can arise between internal inflation and the changes in the rate of exchange of the Israeli shekel in relation to a basket of foreign currencies. To protect the exporter against the risk of non-payment by customers abroad, certain political and commercial risks are covered by guarantees issued by the Israel Foreign Trade Risks Insurance Co. Ltd. established by the government.

**Financial Investment Institutions Other Than Banks**

Insurance companies also may be a source of financing for joint ventures. They are regulated and their investment activities using insurance funds are strictly controlled.

Commercial financing is generally only permissible from the institution's own equity funds. Pension and other funds such as severance pay funds, mutual funds, and unit trusts invest in securities designated by law and are not sources of commercial financing.

**Financial and Stock Markets**

The most significant group of bonds listed on the TASE are government and private company bonds linked to the Consumer Price Index (CPI), classified according to various groups of linking arrangements and interest rates. There also are bonds linked to foreign currencies, principally to the rate of exchange of the United States dollar. Very few unlinked bonds are traded on the TASE.

The reduction in government expenditure and a balanced budget have reduced the bond refinancing needs of the government since 1986. This has opened the way for more private company bond issues that are claiming a larger proportion of the overall market.

Facilities are available for factoring of receivables and participation in international commodity, options, and futures markets subject to currency control regulations.

**Special Financing Incentives**

The Encouragement of Capital Investments, 1959 (the "ECI Law") provides the market with various means of financing which may be applied to joint ventures. If a joint venture complies with the necessary requirements, it is entitled to grants and/or loans provided under the various alternatives that exist under the ECI Law provisions.

Joint ventures also may be financed through the Budgetary Fund for Business Partnership Capital, which offers risk-sharing and concentrating on novel high-

risk projects, and the Small Business Encouragement Fund, which supplies bank loans to qualified small enterprises.

Industrial research and development enjoys its own special financing options under the Encouragement of Industrial Research and Development Law of 1984.

A further source of financing is available through Venture Capital Funds (VCF). The VCF model allows the government, through a company called The Inbal Insurance Company, to fund certain venture capital companies. This is a major advantage since some of the funds raise part of their capital in the TASE, where they are traded, thus allowing investors easy access.

The VCF is monitored by the TASE. Investment in the VCF also offers certain tax advantages and has been freed from the bureaucratic red tape which characterized research and development investments in the past.

## **Incentives Available to Foreign Joint Venture Partners**

### **In General**

The Investment Authority has been created by the government to encourage investment, to coordinate between various government departments and agencies dealing with investments, and to assist foreign investors.

Several laws and enactments exist to encourage investments in Israel. The most important of these is the ECI Law, which is constantly undergoing changes. The ECI Law seeks to smooth the investor's path by minimizing bureaucratic red tape.

It also established the Israel Investment Center (IIC), which examines investment projects, grants Approved Enterprise status to qualified projects, and approves applications for available incentives in accordance with the geographical location of the enterprise<sup>5</sup> and certain criteria.

Generally, only limited companies incorporated in Israel or foreign companies registered in Israel are eligible to obtain Approved Enterprise status.

In the past, Approved Enterprise status was granted to investment projects judged to be economically sound, having a high value-added, good marketing potential, and capable of creating new jobs. At present, the IIC approves the establishment or expansion of enterprises on condition that it is an Industrial Enterprise as such term is defined in the ECI law, meets certain export requirements of its product, and is competitive and contributes to the Israeli Gross Domestic Product (GDP).

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<sup>5</sup> In the past, the CIE Law divided Israel into three zones: Development Zone A, Development Zone B, and Central Israel. In December 2010, following Amendment Number 68 to the CIE Law, there are only two Zones: Development Zone A and all other places.

To qualify, investment projects should meet certain criteria, including international competitiveness, high added-value to the independence of the Israeli economy and to its GDP, and the registration of the company in Israel, assuming the control over the business and management is in Israel.

### **Legislative Source**

The ECI Law envisages grants and low tax packages for an ‘Approved Enterprise’ — being a company that is granted an approval by the Investment Center upon the fulfillment of certain conditions; or a tax holiday package (tax exemption/low tax), for a ‘Preferred Enterprise’ — being a company that is eligible for such package without an approval from the Investment Center, provided it fulfills certain conditions.

### **Investment in an Approved Enterprise**

#### *In General*

Investment projects approved by the Investment Center will benefit from a grant provided on fixed assets included in the project, as approved by the Investment Center. Such grants vary between investment projects in respect to the Development Zone they belong to, and the field in which they are active (e.g.; industrial enterprises, hotels, or other tourist enterprises).

### **Investment in a Privileged Enterprise**

#### *Tax Exemption*

Following Amendment Number 68, instead of the various tax exemptions provided to a ‘Privileged Enterprise’, the ECI Law provides a fix set of tax rates applicable to the entire industrial activity in Israel of a Preferred Enterprise, depending on the Zone in which the Preferred Enterprise is located.

Subsequent to Amendment Number 68, there is no period limit for the tax exemption provided to the ‘Preferred Enterprise’, thus such enterprise shall be eligible to the reduced tax rates as long as it meets the criteria in each tax year.

#### *Dividends*

According to the ECI Law, dividends derived from profits of a ‘Preferred Enterprise’ will be subject to a reduced tax rate.

### **Research and Development Incentives**

The Research and Development Fund offers grants of between 20 per cent to 50 per cent to approved projects. If the project is commercially successful, the company is obliged to repay the grant through royalty payments.

The Encouragement of Research and Development in Industry Law of 1984 (the ‘ERD Law’) regulates endowment of grants, loans, exemptions, concessions, and relief to research and development programs that have received proper

authorization under the ERD Law. Authorization is generally granted to programs related to the development of know-how, processes, or methods of production of new products or processes, or for substantive improvements of existing products or processes.

Grants also may be received from Bilateral Foundations between Israel and other countries (such as Israel–United States Bi-national Industrial Research and Development or Singapore–Israel Industrial Research and Development Foundation) at a rate of up to 50 per cent for joint projects.

### **Tax Relief**

Foreign tax credits are given to resident companies in respect of foreign taxes borne on overseas-sourced income and capital gains. There is no system of ‘global’ foreign tax credits. Each foreign source is treated as separate for the consideration of credits.

Since 1 January 2003, Israeli companies are allowed to deduct the tax paid on foreign company profits and the withholding tax paid on dividends from taxes payable, provided they directly hold at least 25 per cent (or at least 50 per cent indirectly) of the shares in the foreign company.

### **Incentives outside Capital Investment Encouragement Law**

Entrepreneurs and investors in other sectors of the economy, or investors in small businesses whose investments or operations do not meet the requirements of the CIE Law, can benefit from a recently formed fund intended to enhance business activity. The said fund operates outside governmental scope and covers the whole spectrum of the business sector.

The Fund for Small Businesses is set up by the Ministry of Economy, and assists existing enterprises whose growth has been blocked by lack of collateral, so that they can expand their operations. Assistance is provided in the form of guarantees for a bank loan to be disbursed to the entrepreneur according to the following rules:

- The investor should furnish at least 20 per cent of the total project sum;
- The ceiling for such loans ranges from NIS 100,000 to NIS 6,500,000 per enterprise, due to each enterprise’s conditions; and
- Investors are required to sign a personal guarantee for the bank loans.

The State usually provides 60 –85 per cent guarantee for the loans. The Interest on such loans is similar to interest on similar loans and is subject to the bank’s discretion.

### **Reduction of Production Costs**

The government has reduced various production costs and eliminated the burden imposed by government taxation and supervision. The government’s contribution

toward reduction of costs and elimination of various obstacles has a direct bearing on the cost of labor, capital, and raw materials.

Reducing the cost of capital is part of the continuing reform in the capital and money market in connection with deregulation of foreign currency controls.

### **Trade Agreements**

Israel has free trade agreements (FTAs) with Canada, the European Free Trade Association (EFTA), the European Union (EU), Mexico, Turkey, the United States, MERCOSUR (Brazil, Argentina, Uruguay, and Paraguay), AFTA (Switzerland, Lichtenstein, Norway, and Iceland), and Panama. Multinational companies carrying on business transactions between the European Union (EU)<sup>6</sup> and the United States<sup>7</sup> can reap considerable benefits by interposing Israel in transactions between the two continents. Israeli exports to the EU benefit from preferred status over direct American exports to the EU, and vice versa.

Apart from the reductions and exemptions granted under FTAs, Israel enjoys considerable customs duty reductions for industrial exports to Australia, Austria, Finland, Japan, Norway, Sweden, Switzerland, and the EFTA under preferential customs agreements.

### **Taxation in Israel**

#### **In General**

The Income Tax Ordinance (New Version)–1968 forms the basis of Israeli taxation. The principal taxes are as follows:

- Taxes on income and gains, such as income tax, company tax, capital gains tax, and land appreciation tax;
- Taxes on transactions, such as value-added tax (VAT), customs and excise duties, sales tax and purchase tax;
- Taxes on property, such as *arnona* (general rates of municipal taxes); and
- Other taxes, such as National Insurance contributions, employers' tax, and health insurance contributions.

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6 The FTA between Israel and the EC provides for the establishment of an FTA for industrial products and reduced customs duty on certain agricultural products exported from Israel to the EC. Thus, Israel's industrial exports to the EC benefit from preferential status over those from other developed countries outside Europe, which are subject to full customs duties and other trade restrictions. Today, there are practically no restrictions on the quantity of goods that can be exported from Israel to the European Union.

7 To qualify, Israeli exports should be shipped directly to the United States, and the product should be entirely developed or manufactured in Israel, or should contain an imported component, the commercial character of which has been significantly altered through processing. These conditions are reciprocal.

As of 2003, residents<sup>8</sup> pay tax on all income, whether sourced in Israel or abroad. Foreign residents continue to be taxed on income accrued in or derived from Israel, according to specified source rules.

Legal entities incorporated or registered in Israel are deemed residents by the mere act of incorporation or registration. Foreign entities also are deemed residents if the control and management of their business is carried out from Israel.

Joint ventures are taxed according to the framework or vehicle through which the business is carried on. A joint venture which operates as an Israeli company will be taxed like any other resident Israeli company. All other non-corporate joint ventures are normally regarded as partnerships, and the parties will be taxed as individuals.

### **Taxes on Income and Gains**

#### *In General*

Individual tax rates are progressive and range from 10 per cent to 50 per cent of taxable income, while the corporate tax rate currently stands at 24 per cent and will be lowered to 23 per cent in 2018.

#### *Dividends*

Dividends distributed to resident or non-resident individual shareholders and non-resident corporate shareholders are subject to a withholding tax at the rate of 25 per cent. ‘Substantive Shareholders’ — those who hold at least 10 per cent of the means of control of the company — are taxed at 30 per cent. There is no withholding tax for dividends distributed to a resident corporate shareholder.

The rates of withholding tax applicable to non-residents, both individual and corporate, are normally reduced, where double tax treaties are applicable usually to rates which range from 15 per cent to five per cent.

#### *Capital Gains*

Capital gains resulting from the sale of assets in the course of a business or a trade are generally subject to the same rates as ordinary income. Nevertheless, only the real gain<sup>9</sup> is taxed at these rates.

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<sup>8</sup> Residency for individuals is established according to the person’s center of life, which can be gleaned from family and socio-economic ties, permanent dwelling, physical residence, normal business activity, and membership in organizations. However, an individual who stays in Israel for 183 days or more during the tax year, or for 30 days or more during the tax year and a total of 425 days or more during the two preceding tax years, is presumed to be a resident. However, this presumption can be refuted if it is shown by the individual or the tax authorities that the individual’s center of life is in Israel.

<sup>9</sup> This is the gain remaining after adjusting the original purchase price of the assets sold in accordance with the CPI.

Capital gains resulting from the sale of investment assets (i.e., not part of the seller's business or trade) are subject to a reduced rate, which is the same rate that applies to dividends: 25 per cent generally, and 30 per cent in case of a Substantive Shareholder. These rates apply both to traded and non-traded securities.

Capital gains in the hands of a resident are taxed regardless of the geographical source of such gains. Conversely, all capital gains sourced in Israel are taxable even if they are in the hands of a foreign resident, and include foreign assets that consist of a direct or indirect right to a moveable or immoveable asset in Israel.

Non-residents, however, are exempt from tax on capital gains of both traded and non-traded securities.

Moreover, double tax treaties also affect the taxation of capital gains accrued in Israel to residents of treaty-partner countries. Capital gains are normally taxed only in the country of residence of the taxpayer, but capital gains on movable property that forms part of a permanent establishment are taxable in the source country.

Capital gains on immovable property may be taxed in the country in which the property is situated and also in the country of residence, in which case a tax credit will be given in the country of residence for tax paid in the source country.

#### *Interest on Financial Vehicles*

Real interest from Israeli financial vehicles and foreign-traded securities is taxed at the rate of between 25 to 30 per cent. Interest on certain governmental debentures and deposits linked to the cost of living index or to foreign currency also is taxed at the rate of 15 per cent.

New immigrants continue to benefit from the 20-year tax exemption regarding interest on foreign currency deposits in Israeli banks, and foreign residents continue to be exempt from tax in respect of interest on bank deposits.

#### **Taxes on Transactions and Other Taxes**

The rate of VAT<sup>10</sup> currently stands at 17 per cent. The VAT collected is paid over to the Customs and Excise Authorities monthly after deducting any VAT paid to previous suppliers in the chain. Exports are generally zero-rated.

National Insurance taxes are collected on salaries and on self-employment income earned, and range from six per cent to 15 per cent.

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<sup>10</sup> This is an indirect tax based on the consumption of goods and services in Israel, and is normally borne by the ultimate consumer. The tax is levied on imports and at each stage in the production and distribution chain on the basis of the value added to the goods or services at that stage.

## **Other Matters**

### *Business Expenses and Depreciation*

Only expenses which were wholly incurred during the tax year for producing income may be deducted by the taxpayer. The type and nature of expenditure permitted to be deducted from business income conforms to generally accepted accounting principles.

Depreciation of fixed assets at the rates specified in law is deductible in computing taxable profits. These rates may differ from the rates used in the company's financial reports.

### *Anti-Avoidance Provisions*

Section 86 of the Income Tax Ordinance grants the assessing officer the power to disregard certain transactions if he thinks that the particular transactions which reduce the amount of tax payable are artificial or fictitious, or that one of the principal objectives of the transactions is the improper avoidance or reduction of tax.

There are several other provisions in the Income Tax Ordinance that empower the assessing officer to use discretion and to apply alternative methods of assessment in certain instances, including cases where related-party transactions are involved. There also are provisions for the prevention of treaty-shopping.

### *New Immigrants*

New immigrants to Israel and returning residents, having been non-residents for at least 10 years, are exempt from tax on all taxes of foreign-sourced income and capital gains for 10 years.

### *Income from Personal Vocation*

Since, as of 2003, residents are taxed on a worldwide basis, residents receiving income from a vocation or occupation abroad are subject to Israeli tax on such income, even if this is not their regular vocation or occupation in Israel.

### *Controlled Foreign Companies*

Resident shareholders holding 10 or more percent of the means of control of a foreign company (Controlled Foreign Company—CFC) are subject to dividend tax on the after-tax income of the company, even if not distributed (deemed dividend), if the following conditions exist:

- The income of the company is mostly passive; and
- At least 50 per cent of the voting rights, the right to dividends or assets upon liquidation, or the right to appoint a director are directly or indirectly held by Israeli residents; or

- More than 40 per cent of the said rights are held by Israeli residents with related foreign residents resulting in cumulative holdings of more than 50 per cent; or
- A resident has the right to veto substantial managerial decisions of the company, including distributions of dividends and liquidation; and
- The CFC's passive profits in its country of residence are taxed at 15 per cent or less.

Upon the actual payment of dividend by the CFC to its shareholders, credit is granted equal to the tax paid in the foreign country. A tax credit for taxes paid by the shareholder under the CFC rules is given against a taxable capital gain in the event of a subsequent sale of the shares in a CFC.

#### *Emigration Tax*

A person ceasing to be a resident is deemed to have sold his or its capital assets on the day he or it ceased to be a resident. Payment of the capital gains tax due as a result of such 'sale' may be postponed to the date of actual sale.

In such a case, the taxable gain will be the real gain at the date of actual sale proportionate to the period from the date the asset was purchased to the date the residency ceased.

### **Trusts**

#### *Liability to Tax*

The liability to tax on the accrued income of the trust is imposed on the trustee—resident or non-resident—who is the person assessed but whose accrued income is deemed the income of the settlor.<sup>11</sup>

The determination whether or not there exists a liability to tax on the accrued income, however, depends on the residence status of the settlor and/or the beneficiaries even though, in general, it is not the settlor and/or beneficiaries—whether resident or non-resident—who are personally assessed to tax, but rather the trustee.<sup>12</sup>

#### *Israeli Resident Trust*

There are three definitions of the Israeli resident trust (IRT), namely:

- A trust, revocable or irrevocable, in which, at the time it was created, at least one settlor/contributor and at least one beneficiary were Israeli residents and,

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11 The income may be deemed that of the beneficiary in an irrevocable trust if a full distribution is made within six months of the end of the tax year in which the trust accrued the income, and the settlor, trustee, and beneficiary opt accordingly.

12 Exceptions: settlor and beneficiaries are liable to tax if they opt accordingly or if tax cannot be collected from the trustee, but, in the case of a beneficiary, only up to the amount actually distributed to him.

during the tax year, at least one settlor or one beneficiary is resident (Primary Definition); or

- A trust in which all its settlors passed away and in the relevant tax year at least one beneficiary is an Israeli resident; or
- A trust which is neither a foreign resident trust nor a foreign beneficiary trust or relatives trust (see definitions below) (Default Definition).

Tax considerations include the following:

- Creation/contribution (transfer of assets to trust without consideration) — if the creation/contribution is by an individual, it is not taxable; if by an entity (e.g., company), it is deemed a sale and may be taxable.
- Accrued income — is fully taxable on its worldwide current income whether distributed or not since the IRT is deemed resident in Israel.
- Distributions — are taxable or non-taxable as would have been the case if transferred directly from settlor to beneficiary in accordance with the provisions in the Ordinance regarding capital gains tax; i.e., cash distributions are generally not taxable, but distributions of non-cash assets may be taxable if they would not have qualified as a *bona fide* gift, or if the assets consist of immoveable property situated in Israel, or the distribution is to a non-resident beneficiary.

#### *Foreign Residents Trust*

A foreign residents trust (FRT) is:

- A trust, revocable or irrevocable, in which during the relevant tax year all its settlors and all its beneficiaries are foreign residents or all its settlors are foreign residents and all its beneficiaries are public purpose beneficiaries or foreign residents and since its establishment it has had no Israel resident beneficiaries; or
- A trust, revocable or irrevocable, all the settlors of which have died and all its beneficiaries in the tax year are foreign residents, or all its settlors have died and all its beneficiaries in the tax year are public purpose beneficiaries or foreign residents and since its establishment it had no Israel resident beneficiaries.

Tax considerations include:

- Creation/contribution (transfer of assets to trust without consideration) — same as in the case of an IRT.
- Accrued income — not subject to Israeli tax, whether distributed or not, except in the case of Israeli-sourced income, the FRT being deemed a non-resident trust.
- Distributions — same rules apply as in the case of an IRT, keeping in mind that the settlor is non-resident and the tax liability or non-liability is governed accordingly.

*Foreign Beneficiary Trust*

A foreign beneficiary trust (FRBT) is defined as:

- An *inter vivos* irrevocable<sup>13</sup> trust in which, subject to certain other conditions, all the beneficiaries during the tax year are identifiable non-residents and at least one settlor is an Israeli resident and Israeli resident beneficiaries are excluded in the trust deed.

Tax considerations include:

- Creation/contribution (transfer of assets to trust without consideration) — is subject to tax as would have been the case if the asset had been transferred directly from the settlor/contributor to the beneficiary.
- Current income — is deemed the income of the non-resident beneficiaries and, therefore, not subject to Israeli tax, whether distributed or not, except in the case of Israeli-sourced income, the FRBT being deemed a non-resident trust.
- Distributions — not taxable except in the case of distributions of immovable property that may be taxable under the Land-Tax Law.

An Israeli resident beneficiary trust (IRBT) is defined as:

- A trust, revocable or irrevocable, all settlors of which from the date of its creation until the relevant tax year are foreign residents and in the relevant tax year it has at least one Israeli resident beneficiary which is not a public purpose beneficiary.

Tax considerations include:

- The same rules that apply to an IRT apply to an IRBT.

A Relatives Trust is defined as:

- An IRBT in which all settlors and all Israel resident beneficiaries are 'Relatives'. Relative for this purpose mainly means that the settlor is a parent, parent's parent, spouse, child, or grandchild of the beneficiary.

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13 For Israeli tax purposes, a trust is deemed revocable not only if it specifically provides for revocability, in whole or in part (in favor of the settlor and/or settlor's spouse), but also if any one of 10 listed conditions exists, notwithstanding that it is declared irrevocable, e.g.: one or more of the beneficiaries is the settlor or the settlor's spouse, or the settlor or the settlor's spouse may become a beneficiary; the settlor or his relative has the ability to direct the acts of the trustee or give instructions on the manner of administering the trust, its assets, change of beneficiaries, or distribution of the assets or income to the beneficiaries, or the settlor's approval is required for the acts of the trustee; or the settlor has the ability to direct that the trust be dissolved or the trustee changed for any reason not in law, the whole directly or indirectly; or the beneficiaries have been changed or new ones have been added without there being provisions permitting this in the trust documents.

Tax considerations include:

- The taxation of a Relatives Trust is imposed in one of two options at the irrevocable election of the trustee of the Relatives Trust. Under the default option, any distribution to the Israeli beneficiary of income sourced outside of Israel will be subject to 30 per cent tax.
- Under the second option, if the trustee so chooses irrevocably in a written notice to the Israeli Tax Authority, the Relatives Trust will be taxed at the rate of 25 per cent of the accrued income of the trust (sourced out of Israel) which is allocated for distribution to the Israeli beneficiary. Israeli sourced income of the Relatives Trust will always be fully taxed similarly to income of an IRT.

#### *Trust by Will*

A trust by will (WI) is a trust created in a will in which all settlors are testators who were Israeli residents on the date of death.

Tax considerations include:

- Creation/contribution (transfer of assets to trust by way of will) — not taxable.
- Current income — The trustee's income and assets are deemed to be that of the beneficiary, i.e., if there is at least one resident beneficiary, the trust will be deemed a resident trust, and taxed accordingly. If there are no Israeli beneficiaries, the trust will be deemed a non-resident trust and taxed in the same manner as an FRBT.
- Distributions — If the beneficiary is resident, it is taxable as in the case of an IRT. If the beneficiary is non-resident, it is taxable or non-taxable as in the case of a foreign beneficiary trust.

#### *Conversion of Status of Trust*

A trust may change its characterization, and hence its tax liability status, from one tax year to the next pursuant to any relocation of the settlor and/or beneficiaries. Thus:

- An IRT that ceases to be as such because it no longer meets the required conditions and becomes an FRT, will be subject to an exit tax in the same way as a resident who emigrates. If it becomes an FRBT, the trustee will be deemed to have sold the assets to a non-resident on the day the Israel resident trust ceased to be as such.
- An FRT ceases to be as such if one of the settlors becomes a new or returning resident, in which case new or returning resident tax exemptions will apply to the trustee's income, on condition that all the beneficiaries of the trust are new or returning residents as well.
- A Relatives Trust ceases to be as such and reclassified as an IRT if one of its settlors passes away, unless the spouse of such settlor is still alive and on condition that she was the settlor's spouse at the time of one of the contributions

to the Relatives Trust. Nevertheless, if one of the beneficiaries of the trust is a new resident or a returning resident, tax exemptions will continue to apply to the trustee's income.

### **Tax Treaties**

Israel is a party to numerous double taxation treaties,<sup>14</sup> and most of these treaties are patterned after the Organization for Economic Cooperation and Development (OECD) model treaty. Their underlying principle is that the investor is credited in his country of residence with the taxes paid in the other country in which income arises.

Where treaty relief is not available, Israel will grant unilateral relief by way of tax credits or, if the credit exceeds the Israeli tax payable, by way of a tax deduction.

The Minister of Finance is authorized to refund tax to a non-resident if the amount of tax payable in Israel exceeds the amount of tax credit available in the foreign country of permanent residence, in respect of tax payable there on the same income.

The treaties usually reduce the withholding tax rates on dividends, interest, and royalties paid from Israel to a foreign shareholder or lender, to a range of five to 15 per cent instead of the normal 25 to 30 per cent. In most cases, the reduction is reciprocal and applies to dividends and interest paid into Israel. Furthermore, most of the treaties reduce royalty payments from Israel to 10 per cent or five per cent.

The liability of tax in a certain country generally does not attach to the profits from a business carried on in that country by a resident of another country, where the two countries are parties to a treaty, unless the business is carried on through a permanent establishment<sup>15</sup> by the resident of the other country. Profits

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14 General double taxation treaties have been signed with Austria (a new treaty was initialed in July 2010), Belarus, Belgium (a new treaty was initialed in March 2010), Brazil, Bulgaria, Canada, China, Croatia, Czech Republic, Denmark, Estonia, Ethiopia, Finland, France, Germany, Georgia, Greece, Hungary, India, Ireland, Italy, Jamaica, Japan, Latvia, Lithuania, Luxembourg, Malta, Mexico, Moldova, The Netherlands, Norway, Panama, the Philippines, Poland, Portugal, Romania, Russia, Singapore, Slovakia, Slovenia, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, Thailand, Turkey, Ukraine, the United Kingdom (a new treaty was initialed in April 2009 but has not been ratified as yet), the United States, Uzbekistan, and Vietnam.

15 Generally, the definition of a permanent establishment includes places of management, branches, offices, factories, workshops, mines, quarries, places of natural resources extraction, plantations, vineyards, orchards, forests, building sites, construction projects, or assembly projects that continue for certain prescribed periods. An agency normally constitutes a permanent establishment where the agent has general authority to negotiate or conclude contracts, or holds a stock of merchandise from which orders are regularly filled on behalf of the principal. A permanent establishment usually does not include business done through a broker or an independent agent, nor does it include a fixed place of business maintained exclusively for the purchase of goods, or facilities for warehousing, stockholding, information, advertising, and ancillary scientific research.

derived from the operation of ships or aircraft in international traffic and income from real estate normally have special tax liability rules. Independent self-employed entrepreneurs providing services are only taxed in the country of residence, unless they have an established base in the source country. However, income from employment is usually taxed in the country where the person is employed, unless it is for a short term.

### **Restrictions on Activities of Foreign Joint Venture Partners**

From May 1998 to October 2000, the regime of currency restrictions was virtually abolished. Under the Currency Control Permit of 1998, all activities and transactions with foreign residents and in foreign currencies which were previously prohibited are now permitted.

The Bank of Israel has fixed extensive reporting obligations on all residents in respect of transactions in foreign currencies and foreign assets.

### **Protection of Foreign Investors**

Israel has entered into treaties with other countries for the protection of foreign investors.<sup>16</sup> It also has signed, but not yet ratified, treaties with Macedonia and South Africa.

The treaties protect foreign investors from expropriation without proper compensation. Expropriation of foreign assets runs contrary to the government's policy to encourage foreign investments, and is thus rarely utilized in practice. Where expropriation is inevitable, the affected investor is entitled to proper compensation not only according to the provisions of the applicable treaty, but also according to Israeli domestic law.

### **Impact of Changes in Law Subsequent to Formation**

Israel has no written constitution as such, but its parliament (*Knesset*) has enacted several Basic Laws which deal with issues that may be termed constitutional or quasi-constitutional:

Unlike ordinary legislation enacted by the *Knesset*, which may be amended or repealed by a simple majority, Basic Laws generally require a special majority to be amended or repealed. Nevertheless, these laws do not have any superior force and can be repealed by the *Knesset* as any other laws.

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<sup>16</sup> These include those with Albania, Argentina, Armenia, Azerbaijan, Belarus, Bulgaria, China, Croatia, Cyprus, Czech Republic, El Salvador, Estonia, Ethiopia, Georgia, Germany, Guatemala, Hungary (Treaty terminated on 26 June 2007; existing investments are protected for 10 years after termination), India, Kazakhstan, Latvia, Lithuania, Moldova, Mongolia, Poland, Romania, Serbia-Montenegro, Slovakia, Slovenia, South Korea, Thailand, Turkey, Turkmenistan, Ukraine, Uruguay, and Uzbekistan.

Thus, there is no legal obstacle to prevent the *Knesset* from enacting, amending, or repealing a law with retroactive effect. It is possible that a joint venture may be adversely and beneficially affected by changes in the law subsequent to its formation, within the limitations on retroactive legislation. In general, the retroactive effect of an enactment cannot be implied, but should be specifically stated in the relevant enactment.

However, when the courts are faced with retroactive legislation, they tend to apply the principle of certainty of law, and thus are reluctant in most cases to allow legislation to affect rights and duties retroactively.

In addition, the Public Investment in Financial Assets in Israel Protection Law 1984 ('PIL') prohibits the government from confiscating public investments as such term is defined in the PIL, made subsequent to the enactment of the PIL and the retroactive adverse change of the 'conditions' of such public investments. The term 'conditions' includes the redemption date and payment rate, the interest rate and payment date, and the tax rate of any such public investment.

## **Antitrust and Competition Law**

### **In General**

Owing to the small size of the consumer market, there are many cases of 'supply monopolies' and cartels in Israel. Nevertheless, these are subject to the Restrictive Trade Law of 1988 (RTL).

Under the RTL, every 'restrictive arrangement' or agreement<sup>17</sup> should be registered and should be approved by the Restrictive Trade Tribunal ('Tribunal'). A government-appointed commissioner oversees all restrictions of trade. He has the right to grant an exemption from the RTL, and represents the interests of the government before the Tribunal.

The RTL also defines monopolies and regulates their operation. Failure to comply with the provisions of the RTL constitutes an offense punishable by two years' imprisonment or heavy fines for each day that the offense continues. The Consumers Association and other consumer councils are active in checking trade practices which are monopolistic by nature.

### **Mergers**

Although the government generally supports mergers that will strengthen Israel's competitive capability, the RTL nevertheless provides for supervision of mergers by the commissioner, whose prior approval of the merger is required in the following cases:

- Where the merger would result in the effective control of more than 50 per cent (or lower, if the Minister of Trade and Industry so decrees) of the

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<sup>17</sup> This is defined as an arrangement or agreement containing restrictions on prices, profits, division of market, quantity, or quality of goods.

production, sale, distribution, or purchase of a single or group of product(s) or service(s);

- Where the combined turnover of the merging parties in the previous fiscal year exceeded NIS 150-million; or
- Where one of the merging parties operates a monopoly as defined by the RTL.

In the case of a merger with a company which simultaneously holds a business in Israel and abroad, only turnovers in Israel will be considered.

The commissioner may refuse the approval of the merger, or may grant it subject to certain conditions, if he believes that there is reasonable fear that the merger will substantially restrict competition or will adversely affect the public in respect of the price, quality, quantity, or frequency of supply of the product or service. The decision of the commissioner is appealable to the Restrictive Trade Tribunal.

A merger decision should be approved by the board of directors and by the shareholders at the general meetings in each one of the merging companies. While approving the merger, the directors should consider whether the company has the ability to fulfill its financial commitments after the merger occurs, and creditors of the company are entitled to object to the merger decisions.

### **Statutory Protection**

The Uniform Contracts Law of 1982 (UCL) seeks to protect customers from prejudicial provisions in uniform contracts. A 'uniform contract' pertains to any contract the provisions of which, in whole or in part, have been fixed in advance by one of the parties to be included in many contracts with unspecified persons.

Under the UCL, the courts and the special tribunal created under the UCL may annul or change provisions of a uniform contract which, having regard to the general context of the contract and the circumstances, are prejudicial to the customer or grant the supplier an unfair advantage which may result in prejudice to the customer.

### **Price Controls**

A system of price controls operates in Israel through the Ministry of Economy, particularly in those sectors of the economy where monopolistic conditions prevail and where government subsidies are provided for essential foods and services.

In principle, the rest of the economy is supposed to operate on the basis of a free market. Nevertheless, the government does use its powers to regulate prices in particular sectors that are not subject to monopolistic conditions so as to control inflationary pressures.

## **Dispute Resolution**

### **Courts**

The judicial system in Israel consists of the following courts:

- Magistrates' courts for civil and minor criminal offenses;
- District courts for all criminal and civil cases not within the competence of the magistrates' courts;
- The Supreme Court, which may reverse or alter the judgment of other courts, but cannot negate, reverse, or alter laws passed unless they contradict a Basic Law;
- Separate courts for traffic, family, labor, and juvenile offenses;
- Municipal courts with clearly defined jurisdiction;
- Administrative and constitutional tribunals;
- Court for Economic Matters (division of the District Court); and
- Religious courts for marriage, divorce, family matters, and domestic disputes.

### **Domestic Arbitration**

Dispute resolution involving litigation before the courts is not always recommended, given the large number of civil suits filed in Israel, and the resultant aggravation and considerable financial loss for the parties. Under these circumstances, resorting to arbitration may be more practical.

The parties are free to choose any individual or group of individuals as arbitrators. Arbitrators are normally lawyers or accountants, and the parties and the arbitrator have complete freedom to decide the schedule and pace of the arbitration hearings. Normally, the arbitrator is not bound by the rules of civil procedure, and may not follow substantive law if the parties so desire.

Arbitration in Israel is governed by the Arbitration Law of 1968. Parties who agree to submit to arbitration should do so in writing, and the submission is subject to the general laws of contract. The submission may refer to a dispute already existing, or to the resolution of disputes should they arise in the future between the parties. As such, it is wise to include an arbitration clause in the joint venture agreement.

The arbitration award may be enforced by leave of court in the same manner as a judgment or order of the court. An award may be set aside if it has been improperly procured, if the arbitrator has exceeded his jurisdiction, or if the award is flawed on its face.

### **Foreign Arbitration**

Israel is a party to international treaties dealing with the recognition and enforcement of foreign arbitration awards, and these have been adopted by the domestic law within the framework of the Arbitration Law. Recognition and enforceability of foreign awards are subject to several rules:

- The arbitration agreement which resulted in the foreign award should be valid under the law by which it is governed;
- The award should be made by a tribunal appointed in the agreement or constituted by the parties;
- The award should be made according to the law governing arbitration procedures;
- The award should be final in the country where it was made; and
- The award and its enforceability should not be against public order and policy in Israel.

Where at least one of the parties is a foreigner, as is the case in an international joint venture, it may be suitable to elect one of the various foreign arbitration systems as the means of resolving disputes between the parties.

Israel has recognized the International Center for the Settlement of Investment Disputes (ICSID) as an appropriate forum for dispute resolution. Thus, where the other contracting party also recognizes this forum, the treaty will normally refer disputes for resolution before the ICSID. If not, the treaties usually provide for alternative means for dispute resolution.

Although the United Nations Commission for International Trade Law (UNCITRAL) Rules and the UNCITRAL Model Law on International Commercial Arbitration have not yet been formally adopted by domestic law, they are widely recognized by the Israeli commercial community.

