# Doing Business in Israel


## 2014

BDO Ziv Haft

April 2014

Dear Friends,

Israel of 2013 has a technologically advanced market economy. Its major imports include crude oil, grains, raw materials, and military equipment. Cut diamonds, high-technology equipment, and pharmaceuticals are among the leading exports. Israel usually posts sizable trade deficits, which are covered by tourism and other service exports, as well as significant foreign investment inflows.

The global financial crisis of 2008-09 spurred a brief recession in Israel, but the country entered the crisis with solid fundamentals - following years of prudent fiscal policy and a resilient banking sector. The economy has recovered better than most advanced, comparably sized economies.

Natural gas fields discovered off Israel's coast during the past two years have brightened Israel's energy security outlook. The Leviathan field was one of the world's largest offshore natural gas finds this past decade, and production from the Tamar field is expected to meet all of Israel's natural gas demand beginning mid-2013.

While on the one hand, this year was characterized by a slowdown in economic growth, stemming primarily from a freeze on exports as a result of appreciation of the Shekel, a general moderate global demand environment and particularly Israel's major export targets, there were on the other hand signs that economic growth was pciking up, with the increase in public and private consumption, the drop in unemployment rates, collection of confined profits and a curb on government spending, the upshot of which was a low deficits in 2013.

This publication can serve as a valuable tool for investors that wish to gain update information that will allow them to grasp the general picture of various aspects relating to doing business in Israel. The information presented here relates to recent macro economical tendencies, general overview about Israel and its society, Israel's business environment, accounting framework, taxation and government tax incentives.

Israel's economy has shown consistent stability, with a solid economic performance reflected once again in macro data for 2013. Prospects for the upcoming years are optimistic, especially in light of aforementioned events. Israel remains an excellent place to do business.

Sincerely,

Dan Margalit
Chairman & CEO
BDO Israel

# PREFACE

This publication has been prepared by BDO Israel to provide our clients, associates and foreign investors with an overview of Israel's economy and business environment.

Our goal in this publication is to summarize useful information, so as to provide our readers with a "taste" of Israel. The publication aims at covering most, but not all, aspects of doing business in Israel and should therefore not be regarded as a manual or a textbook on the subject.

Prior to making any investing decision, it is recommended to seek the advice of Israeli economic consultants in the relevant sectors. Our partners and associates at BDO Israel provide reliable and professional service to all investors considering investing in Israel.

BDO Israel is one of the leading accounting firms in the banking and financing sectors, in addition to our proven leadership in other areas such as health care, real estate and high-tech. We also act as a principal financial service provider to government offices in Israel.

BDO is the fifth largest international network, with combined revenues of approximately €4.9 billion. The firm has 1,264 offices in 147 countries worldwide, with a total of approximately 48,369 partners and professional staff.

The information presented here was updated in January 2014, based on data available at the time of printing. The publication is intended for information purposes only and does not in any way replace or amend any of the laws and regulations mentioned.

We thank the lawfirm of Gideon Fisher & Co., for their assistance in reviewing some of the chapters included here.

Although we have conducted extensive research to prepare this publication, we are not responsible for any inaccuracies that may have arisen.

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## 1.1. FOREWORD

Israel of 2013 has a technologically advanced market economy. Its major imports include crude oil, grains, raw materials, and military equipment. Cut diamonds, high-technology equipment, and pharmaceuticals are among the leading exports. Israel usually posts sizable trade deficits, which are covered by tourism and other service exports, as well as significant foreign investment inflows. The global financial crisis of 2008-09 spurred a brief recession in Israel, but the country entered the crisis with solid fundamentals - following years of prudent fiscal policy and a resilient banking sector. The economy has recovered better than most advanced, comparably sized economies. In 2010, Israel formally acceded to the OECD. Israel's economy also has weathered the Arab Spring because strong trade ties outside the Middle East have insulated the economy from spillover effects. Natural gas fields discovered off Israel's coast during the past two years have brightened Israel's energy security outlook. The Leviathan field was one of the world's largest offshore natural gas finds this past decade, and production from the Tamar field is expected to meet all of Israel's natural gas demand beginning mid-2013. In mid-2011, public protests arose around income inequality and rising housing and commodity prices. The government formed committees to address some of the grievances but has maintained that it will not engage in deficit spending to satisfy populist demands.

In 2013, the GDP in Israel maintained a moderate pace of 3.3%, including the effect of gas production from the Tamar field, estimated at 1%. Thus, in neutralizing this effect on the GDP, economic growth in 2013 amounted to 2.3%, compared with 3.4% in the preceding year. This slowdown primarily stems from the freeze on exports, which was influenced by appreciation of the Israeli Shekel and moderate demands globally in general and in Israel in particular. Conversely, the growth in public and private consumption has supported economic growth. Against this background, the rate of unemployment in Israel dropped in 2013 from 6.7% to only 5.8% in consequence of recruitments in the public sector. Furthermore, given that tax revenue was significantly higher than expected, along with the collection of confined profits and the measures introduced to curb government spending, the deficit in 2013 was lower than anticipated, totalling 3.2% of GDP. With respect to the upcoming year, despite the predicted improvement in global ecomomic growth and trade, the pace in Israel is expected to remain the same, largely due to the decline in the effect of gas production and the strong Shekel which is likely to make it more difficult for exports. According to Bank of Israel forecasts, economic growth in 2014 is expected to stand at 3.1%.

Below is a summary of the main economic indicators in Israel. This chapter includes a forecast of major economic developments based on several sources including, inter alia, the Bank of Israel's Research Department, the Ministry of Finance and number of commercial banks.

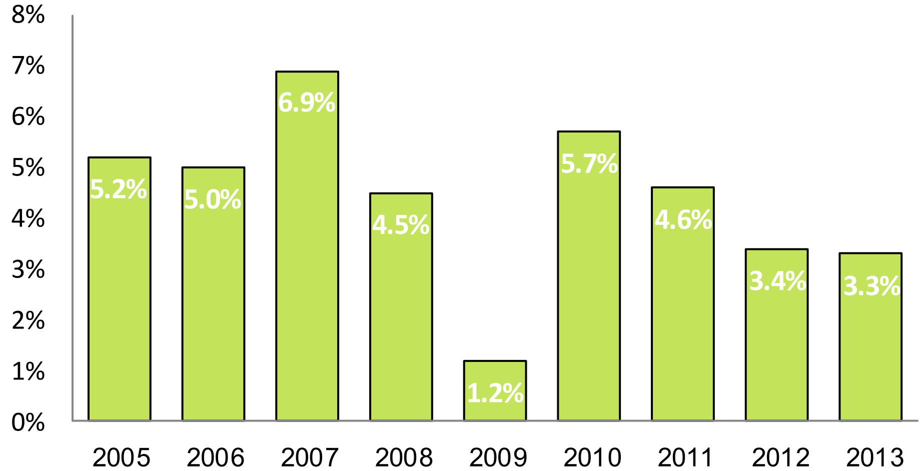
## 1.2. MACRO-ECONOMIC DEVELOPMENTS IN 2013

### 1.2.1. Gross Domestic Product (GDP)

In 2013, Israeli GDP increased by 3.3%, continuing the growth of 3.4% in 2012 and 4.6% in 2011.

Israel’s population grew by 1.9% in 2013, while GDP per capita increased by 1.4%, compared with a 1.5% increase in 2012. In 2013, GDP per capita totaled NIS 130.8 thousand ($32.6 thousand). By comparison, based on OECD data, GDP per capita in OECD countries increased by 0.7% in 2013.

**Annual Growth Rate in Gross Domestic Product**




*Source: Central Bureau of Statistics Israel, Monthly Bulletin of Statistics, January 2014.*

### 1.2.2. Investments

Investments in fixed assets rose by 0.3% in 2013, compared with a 3.5% increase in 2012 and 15.7% in 2011.

Investments in various fields of the economy (including the non-residential construction sector, machinery, equipment and vehicles, but excluding ships and aircraft) rose in 2013 by 0.5%, after a 2.7% increase in 2012 and 17.4% in 2011.

Investments in residential housing decreased by 0.3% in 2013, after a 5.4% increase in 2012 and a 11.6% increase in 2011.

### 1.2.3. Employment

The number of jobs in the overall economy as of December 2013 decreased by 10.4%, compared with the corresponding period in 2012, while the average gross salary increased by 1.7%. The monthly average wage per employee in October 2013 amounted to NIS 9,050 (2,607$).

According to data recorded by the Central Bureau of Statistics, unemployment in November 2013 reached a rate of 5.8% of the civilian labor force.

### 1.2.4. Fiscal Developments

In 2013, the current balance of payments account in the government sector showed a deficit of NIS 24.3 billion - compared with NIS 30.5 billion in 2012. In terms of GDP, this amounted to a 2.3% deficit in 2013, compared with 3.1% in 2012 - representing current income less current expenditure for all public sector bodies: the government, local authorities, national institutions and non-profit organizations, which obtain the majority of their funding from the government.

The increase in government budget deficit in 2013 reflects a 10.1% increase in tax collection, compared with 2012 in which a 3.3% rise in tax collection was reflected. The expenditures component remained unchanged at the 99% rate.

Government spending rose this year by 6.0%, compared with 7.0% in 2012. Public spending, accounting for 59.5% of overall government expenditure, increased by 5.8% in current prices (3.2% in fixed prices) in 2013. The interest expense on outstanding government debts rose by 7.1%.

Transfers from the government sector to private consumption marked a 6.3% rise in 2013, following a 6.6% rise in 2012. In 2013, NIH (National Institutes of Health) allocations accounted for 6.5% growth out of the transfer increase.

The overall balance of payments for the government sector, obtained from summing-up the net balance in the current account and the net balance in the capital account, reflects a GDP deficit of 3.2% in 2013, compared with 3.9% in 2012.

### 1.2.5. Balance of Payments

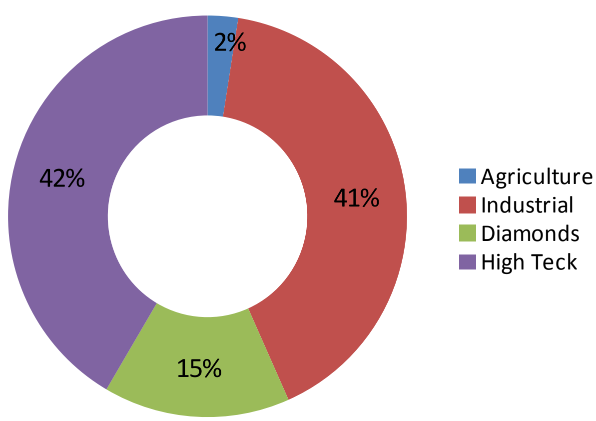
Export of goods and services in 2013 dropped by 0.1%, after a rise of 0.9% in 2012 and of 7.3% in 2011. Industrial exports, excluding diamonds, dropped this year by 3.5%, after a rise of 1.8% in the previous corresponding period. Revenue from the export of tourist services dropped by1.2%, following a drop of 1.4% in 2012.

Export of services excluding tourism and start-up companies, that primarily include software and research services, rose by 3.9%, after a 10.7% rise in 2012. Diamond exports dropped by 1.7% while agricultural exports rose by 2.7% in 2013.

Import of goods and services (at fixed prices), has remained steady this year, after a rise of 2.3% in 2012 and of 10.5% in 2011. Import of goods and services, excluding defence imports, ships, aircraft and diamonds, has dropped by 2.0% after a rise of 5.2% in 2012 and of 8.9% in 2011.

The year 2013 marked a current account surplus on trade in goods and services (excluding defense imports) totaling $5.7 billion, compared with $3.2 billion surplus in 2012. The final account, including goods and services (and defense equipment), income from work, capital and current transfers from abroad, showed this year a deficit of $3.9 billion, compared with a $0.85 billion surplus during the previous year. The current account surplus for the preceding year comprised 1.3% of GDP, compared with 0.3% in 2012.

**The following diagram illustrates the composition of Israel's international trade:**




*Source: The Israel Export & International Cooperation Institute, Summary of export data for 2013 and forecast for 2014, January 2014*

**Inflation Rates**


*Source: Bank of Israel, January 2014*

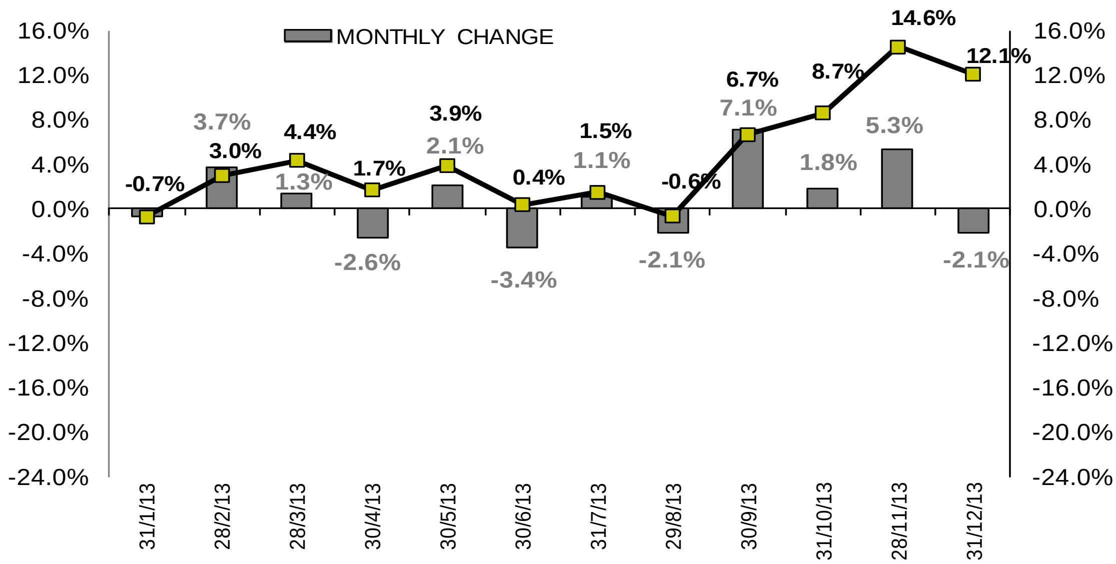
### 1.2.6. Monetary Development and Capital Markets

The Consumer Price Index (CPI) rose by 1.8% in 2013, compared with 1.6% in 2012 and 2.2% in 2011. In 2013, the government's annual inflation target of 1%-3% was accomplished. The main contributors to the CPI hike in 2013 were housing and consumption prices.

Inflation forecasts for the upcoming twelve months indicate a continuing rise in CPI within the target range, to which the housing index is also a major contributor. This index rose by 0.7% during 2013.

During 2013 interest rates dropped by 0.5% percent points in June and in another 0.25% in October. Altogether, the Bank of Israel reduced the interest rate by 0.75 percent, setting it at 1% in December 2013. The monetary policy change, reflected by a decrease in interest rates, is explained by the attempt to minimize the negative influence of the global economic activity deceleration on the Israeli market in order to encourage economic growth. Owing to a decline in the inflation environment over recent months alongside the continued moderation in private home prices, the Bank of Israel was able to pursue its expansionary monetary policy.

**TA 25 Index (Maof)**




*Source: Tel Aviv Stock Exchange, January 2014*

The year 2013 opened in continuing the trend that began in the last quarter of 2012. However, in consequence the Positive development in the geo-political level the trend was changed and during the last quarter of 2013 the capital market increases of 13%. In total, TA 25 increased at 12%, compared with 9% at 2012. In dollars terms, TA 25 increased at 21% during 2013, similar to the average of indexes' yields of stocks in leading stocks exchanges in Europe, but lower than the U.S. stocks exchange that rose by 30% in 2013. Positive factors influencing the capital market were: interest cutbacks by the Bank of Israel, the decline in unemployment rates and the drop in government spending; and on the international level, price increases in the American market, the deal between the U.S. and Russia on dismantling Syrian chemical weapons and the six-month interim nuclear agreement signed in Geneva between Iran and the six major powers. Among the negative factors were the geopolitical developments in the Middle East, weakening of the U.S. dollar against the NIS by about 7 % and the slump in economic growth towards the end of the year.

In the corporate bond sector, both the high-yield bonds as well as the general corporate bonds provided a positive return. The corporate bond yield increased by 8.9%, attaining a market value of NIS 271 billion.

The gross amount of capital raised by the government in 2013 decreased to a total of $19 billion, compared with the significant amount of $22 billion in 2012. The reduction in Finance Ministry gross IPOs was made possible inter alia due to budget deficit cuts - which dropped to 3.2% of GDP this year, compared with 3.1% in the previous year. This is attributed to the government's one-time revenue from taxes, on account of the sale of "Ishkar" and "WAZE" and the release of "confined" profits by companies. Additionally, the Finance Ministry made public offerings abroad, raising in the U.S. some $2.1 billion through the issue of dollar government bonds for 10 and 30 years, at a redemption yield of 3.2% and 4.6% respectively. The yields are higher by 1.35% of the interest on U.S. government bonds for the same time range - which is the lowest ever in the past years.

In parallel, there were vast redemptions of NIS bonds in an overall value of $9 billion and of index-linked bonds in an overall value of $4.4 b. Accordingly, the scope of Ministry IPOs stood this year at $5.8 billion - similar to the total capital raise in 2012.

Industry indices experienced price increases. The TA-Finance index marked a 18.8% increase over the year while the Blue Tech 50 marked a 8.6% increase.

In 2013, the public purchased ETFs totaling $8.1 billion. The public's holdings this year rose by $11.5 billion to a total of $32 billion in November 2013, when 60% of the increase stemmed, as aforesaid, from public purchases and 40% from asset base rises.

The public purchased net ETFs over domestic share indices in an amount of $1 billion - three times higher than total net purchases in 2012. The value of the public's holdings of ETFs over local share indices rose by $2.7 billion, the increase being largely due to the rise in asset base prices.

The public purchased in 2013, ETFs over foreign share indices in an amount of $2.6 billion, after making purchases in the scope of $0.6 billion in 2012, which caused the principal increase of $3.7 billion in the value of public holdings of these ETF.

The public purchased in 2013 net ETFs over bond indices and goods in an amount of $0.5 billion - after net purchases in the scope of $0.3 billion in 2012. The value of public holdings of these ETFs rose by $1.7 billion, when the increase stemmed largely from asset base rises.

The daily trading volume in ETFs over share indices (domestic and international) rose in 2013 (on the TASE and elsewhere) by $79 million, higher by 27% than in 2012. This volume comprised some 23% of the overall share trading volume, compared with 20% in the preceding year.

This year has marked a growth in IPOs and private placements in Israel, reaching $1.7 billion - compared with $0.9 billion in the preceding year. There were four IPOs in 2013, for a total of $92 million most of this amount - $59 million - was raised through the first sale of stock of IDI Insurance Ltd., the parent company of IDI Direct Insurance. The other three companies are: Mendelson Infrastructures, the biomed firm Kadimastem and technology company Somoto.

10 further companies jointed the TASE this year, through operations in "shell companies"; 7 of them were operations in the biomed and technology sectors.

Real estate companies raised $0.6 billion through share offerings. This amount comprises half of the amount raised this year through share offerings to the public.

By the end of the year, 508 companies were listed on the TASE, compared with 540 in 2012. At present, there are 44 dual companies listed in the USA and Europe and 8 additional companies listed on both the TASE and Europe.

## 1.3. FORECAST OF ECONOMIC DEVELOPMENT IN 2014

The main sources for the following table are publications of the Ministry of Finance, Bank of Israel and commercial banks.

| Annual Change in | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014* |
|---|---|---|---|---|---|---|---|---|---|
| Inflation | -0.1% | 3.4% | 3.8% | 3.9% | 2.7% | 2.2% | 1.6% | 1.8% | 1.9% |
| Revaluation vs. US$ | 8.2% | 9.0% | 1.1% | 0.7% | 6.0% | -7.7% | 2.3% | 2.9% | 3.6% |
| GDP | 5.0% | 5.3% | 4.2% | 0.8% | 4.8% | 4.6% | 3.4% | 3.3% | 3.1% |
| GDP per capita | 3.1% | 3.5% | 3.0% | -1.1% | 2.7% | 2.7% | 1.5% | 1.4% | 1.2% |
| Investment in fixed assets | 6.1% | 11.4% | 4.1% | -5.8% | 13.6% | 16.0% | 3.5% | 0.3% | 5.3% |
| Unemployment | 8.6% | 6.6% | 6.1% | 7.4% | 7.0% | 5.6% | 6.7% | 5.8% | 7.4% |
| Export | 9.5% | 8.6% | 5.9% | -12.6% | 13.4% | 5.5% | 1.0% | -1.6% | 4.5% |
| Import | 3.8% | 12.8% | 2.4% | -14.0% | 12.6% | 11.1% | 3.2% | 4.3% | 4.5% |
| Public Consumption | 2.2% | 3.0% | 3.2% | 2.5% | 3.7% | 2.9% | 3.2% | 3.2% | 1.1% |
| Private Consumption | 4.6% | 7.2% | 3.9% | 1.7% | 3.3% | 1.9% | 3.2% | 4.0% | 3.7% |
| Housing Starts | -3.7% | -1.3% | 6.1% | 6.0% | 9.9% | 9.0% | -15.1% | 5.5% | - |

** Forecast for 2014*

## 2. ISRAEL - GENERAL OVERVIEW

### 2.1. BACKGROUND

Since declaring its independence in 1948, Israel has been the home of Jewish immigrants from all over the world. The country's population - comprising approximately 75.2% Jews, and 20.6% Arabs, and others - increased from 870,000 inhabitants in 1948 to over 8.1 million in 2013.

Over the past decade alone, Israel's population has grown by 24.9%. However, since 1992, the immigration rate has gradually declined, reaching only about 18 thousand people in 2013, compared with 16.5 thousand in 2012.

An important economic landmark influencing the development of the modern Israeli economy was the intensified negotiations in the 1990's with the neighboring Arab countries, which attracted an increasing number of direct and indirect foreign investors to Israel. This was followed by the hi-tech bubble burst at the beginning of the last decade and the deterioration of the geopolitical situation.

In recent years - from 2005 till the eruption of the global financial crisis in 2008 - Israel enjoyed a high annual growth rate of 4.9%. This resulted from the boost in the worldwide economy, economic reforms undertaken by the Government and improvement in the geopolitical situation.

However, the global economic conditions continue to affect Israel as an open market exposed to economic trends. The effect of the recent events in the global environment, including the Euro zone financial crisis, are relatively moderate, but their impact is expected to be greater in future. Indications of an economic slowdown are evident, represented by amoderate GDP growth rate of 3.3% in 2013, and the Bank of Israel's 3.8% growth forecast for 2014.

### 2.2. GOVERNMENT

Israel is a secular democracy whose parliament (Knesset) is elected through general elections every four years, unless the Knesset or Prime Minister decide to hold them earlier. Under certain circumstances, the Knesset can also serve for more than four years.

Israel has an electoral system based on nation-wide proportional representation, and the number of seats which each party receives in the Knesset is proportional to the number of voters. The only limitation is the 2% qualifying threshold. According to this system, voters vote for a party list and not for a particular candidate on the list.

Since the establishment of a 'primaries' system in some of the parties, these parties directly elect their candidates for the Knesset. In other parties, candidates are elected through the party's institutions.

All Israeli citizens over 18 are entitled to vote, whilst those over 21 may be elected to parliament.

After the elections, the Israeli President consults with representatives of all parties and, subsequently, delegates the task of forming a government to the chairman of the party most likely to succeed. If he or she succeeds, he or she is nominated as Prime Minister and is responsible for forming a government and appointing ministers.

The last general elections in Israel were held in January, 2013. The President appointed Benjamin Netanyahu, head of the Likud party and incumbent prime minister, to form a government.

The function of the President of the State is primarily a representative one. He is elected by the Knesset every seven years, for a limited period of one term. The President holds the statutory power to accredit diplomatic senior staff, pardon criminals, sign on laws etc.

The judicial system is independent of the executive and legislative systems. The Supreme Court is the highest court of the State, serving both as the High Court of Appeal and the High Court of Justice.

Below the Supreme Court is the District Court (located in Jerusalem, Tel-Aviv, Haifa, Nazareth and Beer-Sheva). The District Court is the first court of submission for certain judicial matters - in addition to administrative courts, family courts, municipal courts, religious courts, etc. Each type of court has a clearly defined area of jurisdiction.

Israel's central bank, the Bank of Israel, serves as economic advisor to the government. It defines and implements monetary policy, controls local banks, supplies notes and coins, manages the State's foreign currency, etc. Another administrative institution is that of State Comptroller - responsible for auditing and checking all the activities of the ministries, municipalities and other institutions subject to inspection by law.

## 2.3. FACTS AND FIGURES

Israel is situated along the Mediterranean coast, extending on an area of 22,000 km. (8,500 sq.m.), including the Golan Heights. This is exclusive of the territory of the Gaza Strip and parts of the West Bank, which were given to the Palestinians in the context of the Peace Process and the Disengagement Plan.

Israel is about 430 km (265 miles) long and 110 km (70 miles) wide. It borders Lebanon in the north, Syria in the northeast, Jordan and the West Bank in the east, the Gaza Strip and Egypt on the southwest.

Modern Israel has numerous ancient sites with ongoing archeological digs. New archeological findings are constantly discovered.

Israel's terrain varies from hilly, mountainous landscape, with rich agricultural land in the north, to barren desert sites in the south. The lowest place on the globe, the Dead Sea, is situated in the south of Israel.

**Israel's major cities:**

**Jerusalem** - The capital of Israel and location of the Knesset and numerous historic and religious sites; population - approximately 987.4 thousand.

**Tel-Aviv** - Israel's major city - financial, commercial and industrial center, with a population of approximately 1.31 million.

**Haifa** - Principal port city in the north of Israel, with a population of approximately 549.4 thousand.

**Beer Sheva** - The largest city in the Negev desert (in the south), with a population of approximately 650.6 thousand.

Israel has a Mediterranean climate, characterized by long, hot, dry summers (June to September), with temperatures usually in the high 80's (27C), 90's (32C). Jerusalem is dryer and cooler, Eilat extremely hot but dry. Winters are short, mild and wet, 50-60's (10-15C) in most places, but in the 40's (5C) in Jerusalem.-, where it can be very cold at night.

Israel's average annual rainfall varies from over 800 mm (31 inches) in the north (Upper Galilee) to less than 40 mm (1.6 inches) in the south (Eilat).

The prevailing system for measurement is the metric system.

## 2.4. ISRAEL'S CURRENCY

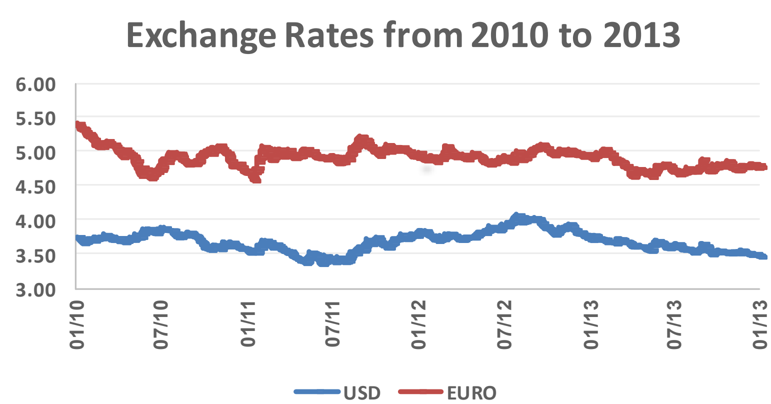
Israel's monetary unit is the New Israel Shekel (NIS). One NIS is comprised of 100 agorot.

The representative dollar rate is an indicator for its exchange rate on the foreign currency market. It is based on the average buying and selling rates published by the banks.

Other foreign currency rates, besides the dollar, are calculated at their rate on international currency markets, when the representative rate is being determined. Accordingly, the ratios for the representative rates of various currencies reflect their exchange rates abroad at the time they are determined.

The Bank of Israel calculates representative exchange rates once a day on foreign currency business days only.

The following graph presents the foreign exchange rates in Israel during the years 2010-2013:




The representative exchange rates of the Israeli Shekel in relation to some major currencies on December 31, 2013, were as follows:

| | NIS |
|---|---|
| US Dollar | 3.4710 |
| Euro | 4.7819 |
| UK Sterling Pound | 5.7419 |
| Swiss Franc | 3.8973 |
| Japanese Yen (100) | 3.3063 |

## 2.5. INFRASTRUCTURE

Israel offers a broad and solid infrastructure to entrepreneurs, investors and business people in all sectors. The Israeli banking system is modern, automated, highly computerized and a well-established component of the international banking system.

Diverse services required by businesses, such as insurance, legal, temporary manpower, communications; IT systems etc. are available in the most advanced formats.

There is an advanced domestic and international transportation system, with an extensive inter-urban highway network. New highways are constantly being built to enable fast and safe mobility throughout the country. Israel is linked to the rest of the world via air and sea.

### 2.6. WORKING IN ISRAEL

In order to work in Israel, a non-resident is required to obtain a work permit (usually B-1 visa) or hold a status other than "tourist". To obtain work permits, Israeli employers are required to apply to the Ministry of Labor and Social Affairs and, where applicable, to the Investments Center as well.

According to the "Law of Return", immigrants are entitled to a "permanent resident" status, or an A-1 visa, granting immigrant a "temporary resident" status.

### 2.7. BUSINESS HOURS

Full time work hours are generally 40-45 hours per week in a 5 - 5.5-day week, beginning on Sunday and ending on Thursday, or Friday at noon.

Work hours in administrative offices are generally from 8:00-9:00 am to 4:00-5:00 pm. Some banks are open from 8:30 am to 12:30 pm from Sunday through Thursday and from 4:30 to 6:30 pm on two afternoons, while others are close on Sundays, but open on Friday.

Stores are regularly open until 7:00 pm or later. On Saturday (the Jewish Sabbath) almost all businesses and offices are closed.

Legal holidays are determined in accordance with the Hebrew calendar. On the eve of Jewish holidays, business usually ends in the early afternoon.

Legal holidays in 2013 and 2014 are as follows:

| Holiday | 2013 | 2014 |
|---|---|---|
| Passover | March 26 | April 15 |
| Independence Day | April 16 | May 6 |
| Pentecost (Shavuot) | May 15 | June 4 |
| Jewish New Year | Sep. 5- 6 | Sep. 25-26 |
| Day of Atonement (Yom Kippur) | September 13 | October 3 |
| Feast of Tabernacles (Sukkot) | September 19 | October 9 |

# 3. *OVERVIEW OF ISRAEL'S HIGH-TECH INDUSTRY⁎

## 3.1. ISRAEL'S HIGH-TECH INDUSTRY - INTRODUCTION

The technology industry in Israel has been the driving force of the nation's economy, and has played a prominent role in Israel's economic development, particularly over the past decade. Only 25 years ago, most of the country's technology was concentrated in military/security-related industries. Although Israel was not a major factor in the global hi-tech industry at the time, Israeli companies now have a strong foundation in hi-tech industries worldwide and Israel ranks among the leading countries in the number of Nasdaq-listed hi-tech companies.

As the hi-tech sector - despite the recession in the early 2000s - became the primary engine for economic development, its recovery in 2005 was essential in bringing Israel's economy back to a sustainable growth path. This was reflected in the boost in investments, recruitment of capital, cutback in unemployment, hi-tech exports and corporate mergers - all of which have demonstrated precisely this. Various indicators show that, after a slight rise in 2005, growth was sustained in 2006 and 2007, marking an improvement in the hi-tech sector.

However, given the credit crunch in 2008, the financial resources available for the hi-tech industry have declined significantly, causing hi-tech and start-ups companies to lay off employees or shut down completely. This trend continued during the first half of 2009. But in mid-2009 it became evident that the effect of the global crisis on Israel was relatively mild. Consequently, the market began moving towards an upward trend, which persisted through 2010 and 2011.

2013 was characterized by diverse hi-tech fields, impressive exits and primarily the sale of Givon Imaging to the Irish Covidian Corporation, at a staggering price of $1 Billion. A further expression of the success of this sector comes from the direction of the TASE, with a 28% rise in the Biomed Index throughout 2013, positioning it at the top of the successful indices list for the preceding year. Apart from this, a number of Israeli biomed companies had an initial public offering, while Enzymotec (based in Migdal Ha'emek) outdid itself by selling shares in an IPO on the American NASDAQ, valued at $320 million.

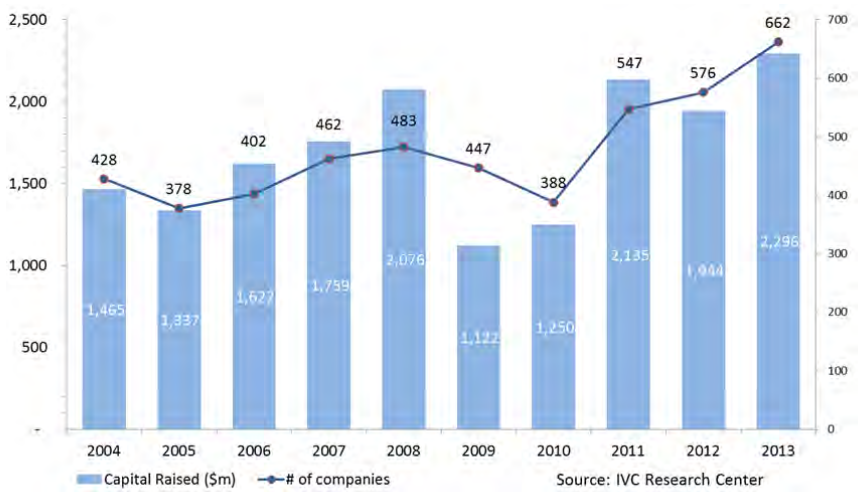
However, alongside the success, various hi-tech companies were faced with major challenges, including budget cutbacks, closedown of divisions and staff dismissals.

## 3.2. THE HIGH-TECH WORLD IN 2013

In 2013, approximately 662 Israeli hi-tech companies raised $2.29 billion from local and foreign investors. This figure is 18% higher than the $1.94 billion raised in 2012, and 7.5% higher than the $2.13 billion raised in 2011.

⁎ This chapter is based on data gathered by IVC Research Center, February 2014.

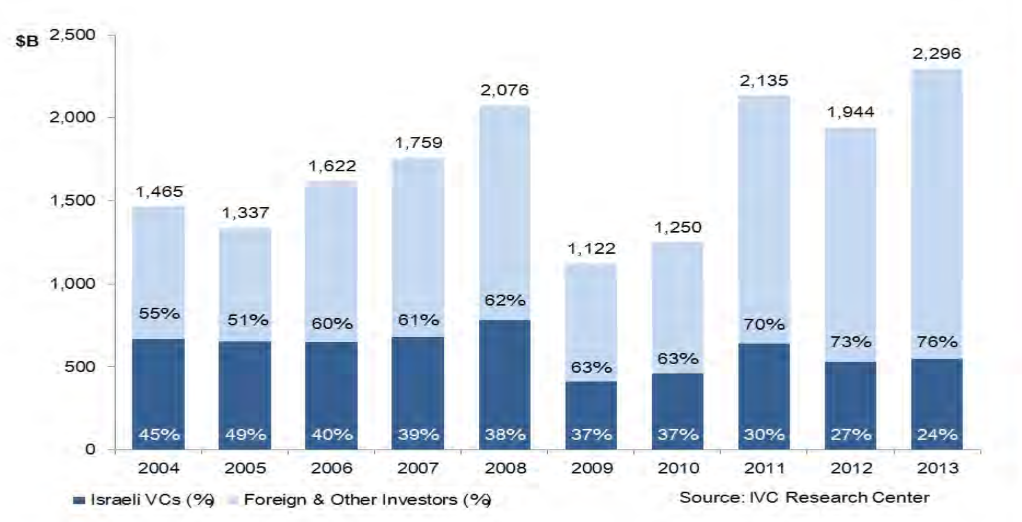
**Capital Raised by Israeli High-Tech companies ($M), 2004-2013**




Hi-tech exports totaled $21.2 billion in 2013 - reflecting a 1.5% increase compared with 2012.

In 2013, venture capital funds constituted 24% of the overall capital invested in Israeli hi-tech companies, compared with 27% in 2012 and 30% in 2011. As 2012, there are signs of an increase in the number of investments made by foreign and other.

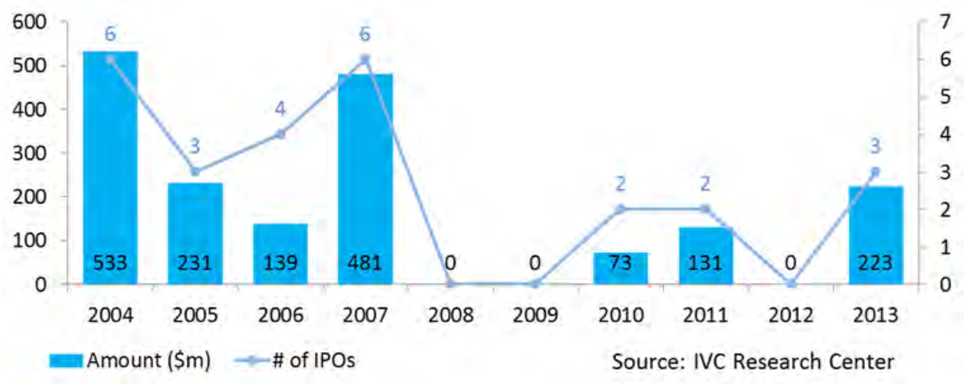
**Capital Invested in Israeli High-Tech Companies by Israeli VC Funds, Foreign and Other Investors (%) 2004-2013**



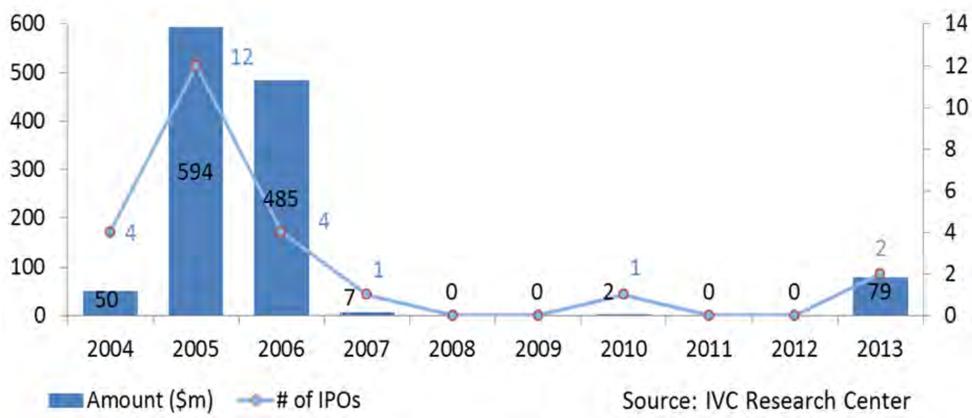

In 2013, three companies were listed on the NASDAQ, compared one company listed in 2012

The following graphs illustrate the amount of capital raised in the U.S. and European IPOs:

**Capital Raised in IPOs on the US Stock Exchange by Israeli High-Tech Companies in 2004-2013**




**Capital Raised in IPOs on the European Stock Exchange by Israeli High-Tech Companies in 2004-2013**




## 3.3. THE VENTURE CAPITAL INDUSTRY

Israel's venture capital (VC) industry has played a fundamental role in the dramatic development of the hi-tech industry over the past years. By providing and allocating funding, VC has served as a link between start-up companies and investors, and is regarded as essential infrastructure for any technological environment. It is also an effective tool for financing, supporting and guiding companies towards a successful course, in addition to being one of the leading VC industries worldwide, with dozens of funds operating from Israel ("Israeli VC Funds").

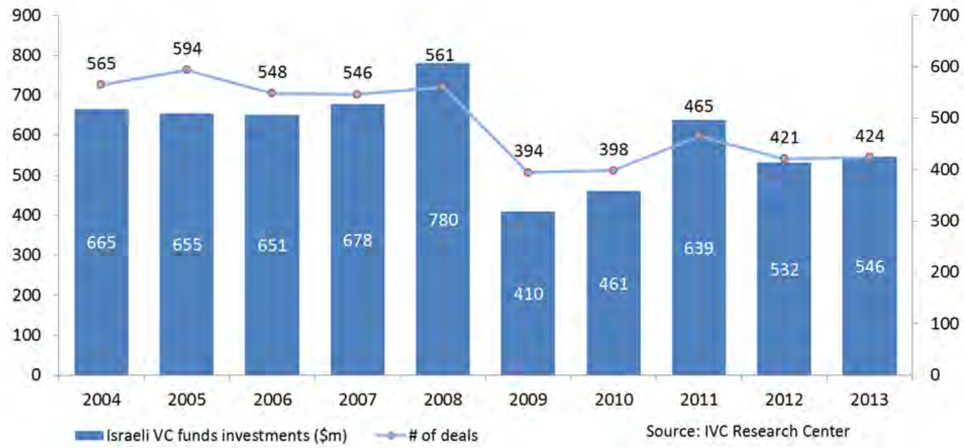
The funds are supplemented by other investors, including public companies, private investors and non-Israeli-based VC funds.

The VC industry has grown tremendously over the past decade. This is due to several factors, including: tax exemptions on Israeli VC investments, funds established in conjunction with large international banks and financial companies, and the involvement of major organizations wishing to capitalize on the numerous technology companies originating in Israel.

In 2013, Israeli VC funds invested $546 million in Israeli hi-tech companies, compared with $532 in 2012 and $639 million in 2011.

The following graph illustrates the capital raised for the hi-tech industry over the past ten years:

**Capital Invested in Israeli High Tech Companies by Israeli VC Funds (M$), 2004-2013**



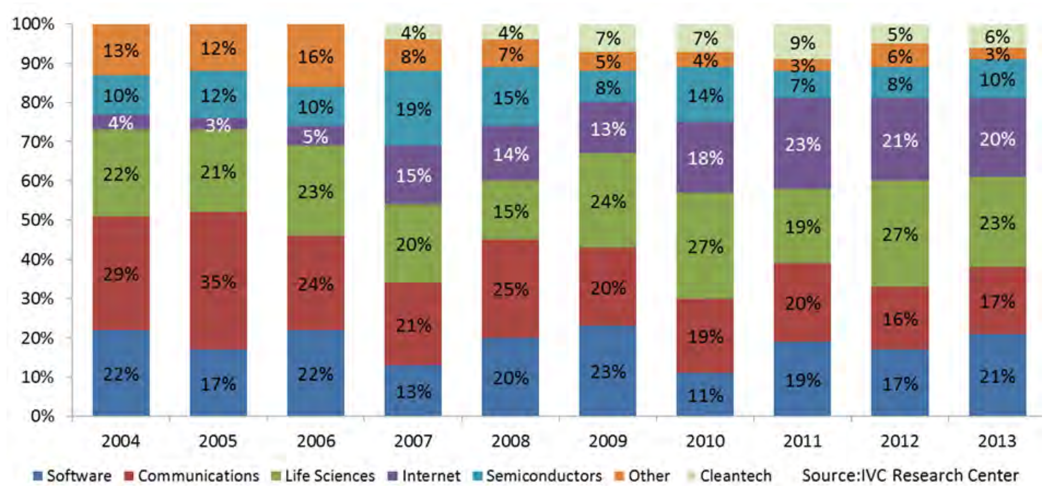

3.4. **ANALYSIS OF VENTURE CAPITAL RAISED BY INDUSTRY**

Israeli companies have a distinct presence among the various hi-tech industries. The capital ratio raised by the different sectors has varied over the past few years.

In 2013, the Life Science sector attracted the largest share of investments. One hundred and forty two Life Science companies raised $522 million, or 23 percent of the aggregate capital raised by high-tech companies, compared with $519 million or 27 percent in 2012. The internet companies followed with $454 million or 20 percent. The software sector attracted $227 million or 10 percent and the communication sector attracted approximately $386 million or 17 percent.

The following graph displays the relative part of the different sectors out of total capital raised over the past 10 years:

**Capital Raised by Israeli High-Tech Companies by Sector (%), 2004-2013**




Below is an analysis of the capital raised by Israeli companies in leading sectors of the economy. The data is based on IVC Research Center analyses.

### 3.4.1. Communications

Communications is considered a major field for raising capital. However, whilst in 2004-2006 communications-related venture capital reached an average 44% out of the aggregate amounts raised; recent years have been marked by a decline in this sector's share. The capital raised by the communications sector during 2011, 2012 and 2013 reached 20%, 16% and 17% respectively out of the aggregate amounts raised.

It should be noted that the local media and telecommunications field has undergone various changes over the past decade, turning it into an attractive and accessible market for investors generally. One example is the vigorous competition evident in the multi-channel broadcasting field.

### 3.4.2. Software

Software companies raised 21% of the overall amount of capital invested in 2013 - indicating an increase compared with 17% in 2012 and 19% in 2011.

### 3.4.3. Internet

The aggregate capital raised by Israeli hi-tech companies via the Internet sector amounted to 18%-21% over the past three years, compared with 13%-15% during 2007-2009. In 2013, capital raised by this sector amounted to 20%.

### 3.4.4. Life Sciences

The life sciences have, in recent years, evolved into a major field as far as capital recruitment is concerned. In 2013, Life science companies raised 23% of the overall capital invested.

## 3.5. CAPITAL RAISED BY ISRAELI HIGH-TECH COMPANIES BY STAGES

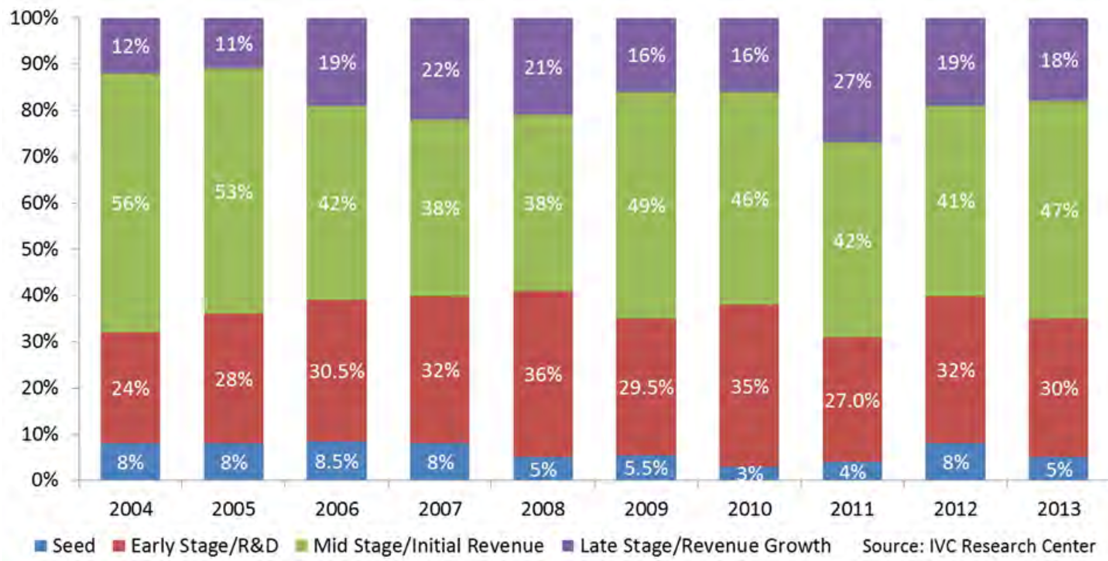
The life span of a company is defined by several stages - from the earliest, known as the “seed” stage, to the last - known as the “revenue growth” stage (when a company operates as a selling entity).

Over the last several years, the capital structure in a company's development stage has changed. In the 90s and at the beginning of the last decade, investments during the initial phase were common. Today, the majority of investments are made during the intermediate and later stages, in order to lower risk levels.

In 2013, mid stage companies led capital raising - as in the last decade - with $1.1 million or 47% of total funds raised. Seed companies attracted 5%, slightly under the 8% of 2012. Early stage companies accounted for 30%, marking a slight decrease from 32% in 2012 and an increase from 27% in 2011. Mid and late stage companies together raised $1.5 billion, an increase of 32.7% from 2012, when mid and late stage companies attracted $1.13 billion.

The following graph illustrates the distribution of capital raised over the past ten years by stages:

**Capital Raised by Israeli High-Tech Companies by Stage (%), 2004-2013**



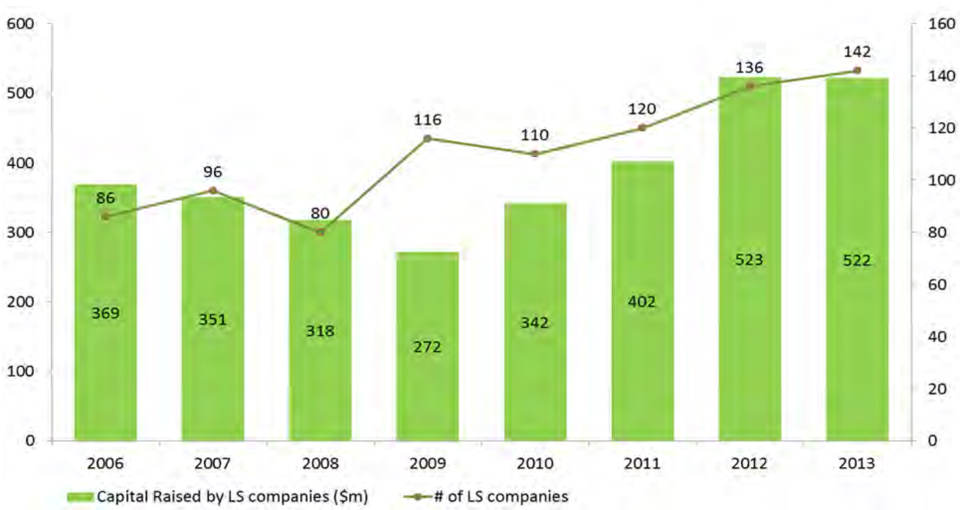

## 3.6. THE BIOTECHNOLOGY INDUSTRY IN ISRAEL

Modern science utilizes biological information accumulated over 150 years - mainly the genetic code and DNA structure decoded some 50 years ago. The biotechnology business environment has evolved as a result of the breakthrough in genome development over the past years. The information accumulated in a genome project, in which whole platforms of the human genome were discovered, has created new opportunities for many start-up companies. The assumption is that Israel’s fast and cost-effective development cycle is the key advantage relative to United States counterparts, attracting investment funds from various parts of the world.

Total investment in the life science companies during 2013 amounted to $522 million, similar to the $523 million in 2012.

The following graph illustrates the capital raised by the life science industry over the past seven years:

**Capital Raised by Israeli Life Science Companies ($M), 2006-2013**

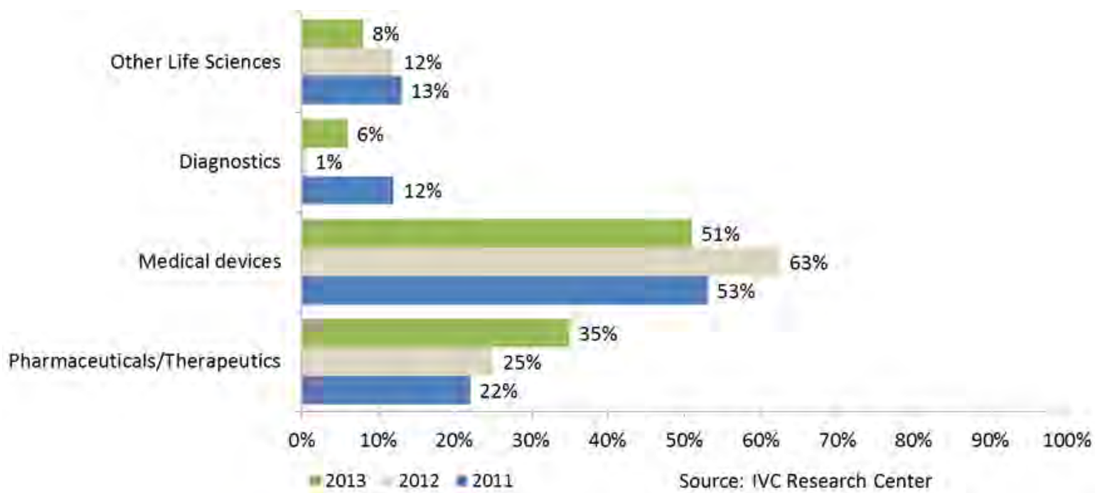


A major sub-branch of biotechnology is the field of medical devices. This sector drew, in 2013, 51% of the aggregate capital raised for the industry - marking a decrease of 20% of its share compared with the previous year.

The Israeli government has encouraged investments in this sector, by initiating plans to establish incubators dedicated to bio-technological development.

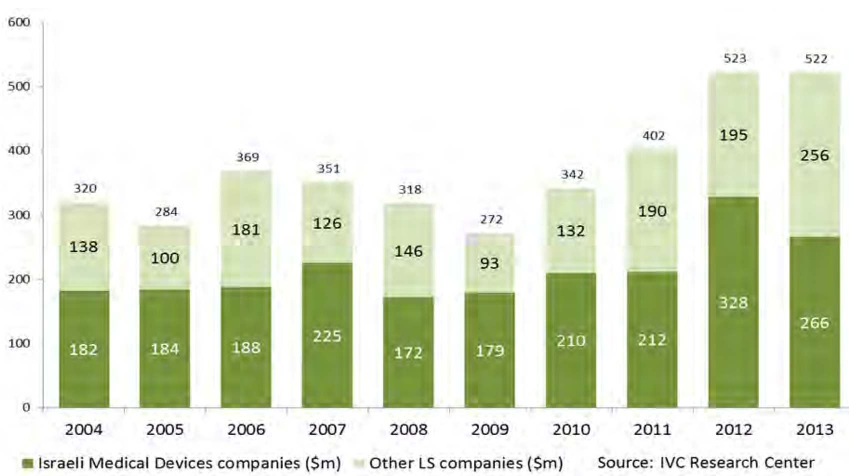
The following graph shows the capital raised by the Israeli life science industry and the dominance of medical device companies vis-a-vis other sectors over the past three years:

**Capital Raised by Israeli Life Science Companies (%), 2011-2013**




The following graph shows the capital raised by the Israeli life science industry divided into sub-sectors over the past ten years:

**Capital Raised by Israeli Life Science Companies ($M), 2004-2013**



# 4. BUSINESS STRUCTURE

## 4.1. BUSINESS ORGANIZATIONS

### 4.1.1. General

Most of the legal entities in the modern Israeli business world operate under Israeli law. These legal entities include companies, partnerships, cooperatives, and nonprofit organizations. Individuals may conduct business without establishing any separate legal entity.

### 4.1.2. Companies

The most common form of business entity in Israel is a limited liability company with capital stock (share capital). The Companies Law, 1999, which went into effect on February 1, 2000, oversees corporate activities. However, issues pertaining to liquidations, pledges and secured bonds are still settled by the Companies Ordinance, which preceded the Companies Law.

A company can either be limited by capital stock or unlimited - in which case its stockholders have no ceiling to their liability.

No requirements exist regarding the nationality or residency of stockholders and company directors.

In order to be incorporated, a company must register with the Registrar of Companies at the Ministry of Justice. An incorporated company is required, inter alia, to have Articles of Incorporation.

The Articles of Incorporation state, inter alia, the company's name, objectives, the composition of its capital stock (ordinary, preferred, etc.), the number of shares the founders undertook to purchase and the stockholders' liabilities.

The Articles of Incorporation define the rules for managing the company and the relationship between the company and its stockholders and directors. They also determine the procedures for amendment of the Articles.

The Companies Law comprises two groups of regulations. First, the mandatory (cogent) regulations applicable to all companies - whether the company chooses to include them in its Articles of Incorporation or not. The second group is the voluntary (dispositive) regulations, considered to be acceptable to every company, unless specifically amended.

Israeli companies are subject to the following principal rules and limitations:

- Companies may acquire their own stocks or financing, e.g. acquisition by others, subject to criteria and restrictions prescribed by law.
- Generally, amendment of a regulation in the Articles of Incorporation requires a standard majority of stockholders.
- Companies are required to prepare annual audited financial statements, usually for the year ended December 31.
- In 2000, regulations were published granting concessions to public companies with registered shares in foreign exchange markets.
- Among the regulations published in 2001, regulations concerning the creditors' approval of dividend distribution were specified.
- Regulations published in 2002 prescribe the procedure for settlements between a company and its shareholders and/or creditors and suspension of proceedings according to section 350 of the Companies Law.

- Amendment 16:

1. In 2011, Amendment 16 to the Companies Law was published, the purpose of which was to change the balance of forces in the corporate triangle - controlling stockholders, minority stockholders and board of directors - while at the same time attempting to establish equilibrium between these elements. The Amendment enhanced the status of the minority stockholders, intensifying their ability to make decisions in the Company. It was also determined that transactions with interested parties would require a vote by the majority rather than a third of the minority stockholders, while payment of remuneration and management fees to a controlling stockholder was subject to reapproval once every three years, instead of imposing no time limit prior to the Amendment.

2. In addition, the Amendment proposed that companies undertake a "corporate code", and adopt it as part of their Articles of Association. This a code establishes a further regulation concerning directors, such as: in a company with no controlling stockholder, increasing the number of independent directors to a majority, and in a company with a controlling stockholder - increasing to at least one third, creating a complete separation between managers and directors, etc.

   The corporate code was implemented according to the method of "adopt or explain" - implying that while there is no obligation to adopt the code, the company must state in its annual report whether or not it has been adopted while giving an explanation if not.

3. The Amendment has toughened the rules of action for a board of directors within an organization, by prohibiting the owner to serve as a "shadow director" (i.e. a person who does not serve as a director but in accordance with whose directions the directors of a company are accustomed to act). It also obligates directors to exercise independent judgment, prohibits the appointment of a person who is subordinate to the CEO as board chairman, and prescribes that only a special majority can allow a person to serve simultaneously as chairman and CEO (instead of one third of the majority stockholders).

4. Furthermore, Amendment 16 also enhances the independence of an audit committee by prescribing that its chairman could only be an outside director, the majority of its members would be independent directors, anyone dependent on a stockholder for his living could not sit on the committee, the participation of controlling stockholders in committee meetings would be limited, and that the elections committee would be the body to determine what action necessitates special approval.

5. The Amendment upgrades the functions of outside directors elected by a majority of stockholders who are not interested parties (instead of one third from among the minority stockholders). The maximum period in office has been extended from 6 to 9 years, while the incumbency of outside directors may be extended without the controlling stockholder's consent. The prohibited relationships of outside directors has also been extended to similar relationships with family, while an outside director who terminates his office at the company must undergo a cooling off period in all of the group's companies.

- Amendment 17:

  This amendment was aimed at dealing with what is known as the 'Agency Problem', this refers to a commonplace scenario where a separation between interests holders in the company and management of the company - leads to the corporation's management representing only a minory of shareholders and may be found sometimes at conflict of interest between acting in the best interests of the shareholders or managing the company in a way that is unbeneficial to the shareholders wealth, but is more beneficial to their own wealth.

  Amendment 17 identifies the Agency Problem in privately held corporations that issue debentures, where often family members or a small core of management may have incentives that are counter to the interest of the debenture owners, for this reason Amendment 17 amends the Companies Law so that several elements of public corporate governance will now apply to these corporations as well.

  Amednment 17 suggests two kinds of safeguards for the public who owns privately owned corporation's debentures: the first, proper regulation over the financial reports of the privately owned corporation that issue debentures; the second, that there a general meeting of debenture owners will have similar authorities to those of general meeting of shareholders.

  Ammendment 17 includes additional safeguards include, stripping away voting rights from family members of the management of debentures issuing private corporations to prevent conflict of interests, and requiring that the head of a company's directorate cannot also serve as the companies chief operating officer.

- Amendment 18:

  The main innovation is aimed at tackling the exceptional problems facing companies that issued bonds in situations where they were involved in economic difficulties and wished to reach a compromise or settlement with bondholders likely to bring about a significant change in the repayment terms of the bonds (hereinafter - "debt settlement").

  The purpose of the amendment is to assist the parties in the negotiations process and to enable bondholders to arrive at a viable decision regarding approval of the debt settlement, as well as granting the court tools for effective control of the process.

  As outlined below, the amendment requires that formulating a debt settlement be accompanied by a court expert. The expert would assist the parties in the negotiation stages, on completion of which he would draft an opinion on the feasibility of the debt settlement offered to the bondholders. Appointing an expert and obtaining his opinion will be a prerequisite for approval of the debt settlement, unless the court determines otherwise in light of specific circumstances.

- Amendment 20:

  The amendment is designed to settle the remuneration structure for office holders in public companies and in bond holding corporations, in a manner that will limit as much as possible the controlling shareholders' influence on such remuneration. Based on the amendment, the said companies will be obligated to adopt a policy regarding the terms of office and employment of office holders (hereinafter - "remuneration policy"). The board of directors will determine the policy based, inter alia, on the recommendations of a specific committee (hereinafter - "remuneration committee"), to be submitted for review and approval by the general assembly. The purpose of the remuneration policy is to assist in attaining the company's goals, work plans and policy for the long term, while giving due consideration to its risk management. The process of approving this policy in the above format is intended to ensure that decision making on the terms of office and employment of office holders will be for the benefit of the company only, independently of other's interests, such as those of a controlling shareholder.

  The amendment establishes, inter alia, approval procedures for the remuneration policy as outlined above, as well as specific approvals for the office and employment terms of a company CEO, other office holders who are not directors, and for directors.

- Amendment 22:

  Amendment 22 is part of a broader reform in the Israeli financial market, and was part of the Law to Promote Competition and Decrease Centralization Act of 2013.

  First, the amendment restricts investment of pension funds by institutional investors in centralized corporations.

  Second, the amendment also restricts complex pyramid holdings by corporations, where a single corporation has a controlling interest in other corporations, through which they control a third or fourth layer of corporations. The amendment now restricts the holdings to a two tier structure at most, unless specifically allowed in the Companies Law. Also, to protect the public interests, two tier corporations will have to reserve at least a third of their directorial seats to external directors.

  Finally the amendment restricts corporations from owning equity holdings in both financial and non-financial holdings.

#### 4.1.2.1. Public Company

- A public company is a company whose stock is listed on a stock exchange or offered to the public in a prospectus, and held by the public.
- The Articles of Incorporation should not consist of any restrictions on the transfer of a public company's stocks.
- If a public company's stock is traded on the Tel Aviv Stock Exchange (TASE), the company is required to:
- Publish annual audited financial statements and quarterly non-audited (but reviewed by a CPA) financial statements.

- Appoint at least two directors, known as “Independent Directors” who have no economic affiliation to the company or substantial relationship with its business management. Regulations published in 2000 concern compensation and expense payments to an “Independent Director”. These regulations classify companies according to different levels, based on their capital, and they also determine the amount of compensation and expense payments to which the “Independent Director” is entitled.
- If all the directors are of the same gender, directors of the opposite gender should be appointed as "Independent Directors".
- Appoint a certified public accountant (CPA), responsible, *inter alia*, for auditing the company’s annual financial statements.
- Appoint an audit committee comprised of at least three directors. All "Independent Directors" must be members of the audit committee.
- Appoint an internal auditor.
- File annual and quarterly financial statements with the Registrar of Companies, the TASE, and the Securities Authority.
- Publish a prospectus in respect of any public offering.
- Report immediately on any major event.
- Report on any potential conflict of interests between the company and its controlling stockholders.
- New regulations were published during 2000 concerning proof of stock ownership for voting at the general meeting. Furthermore, there are regulations for convening reporting general meetings and meetings of stockholders in public companies, negotiating mergers, acquisition offers, and concessions in transactions with interested parties.
- New regulations were published in 2000, which were updated over the years to include the GAAP rules adopted by the Israeli legislation and regulations, to simplify the rigorous approval requirements prescribed by the Companies Law concerning transactions between a company and an interested party. Various concessions were granted to public companies with respect to the approval of specific transitions that are more common and dynamic.
- In view of the global trend to establish the concept of corporate social responsibility (CSR), since 2001 publicly traded corporations are required to report on their social contribution policy in the directorate statement.
- In light of the increasing importance attributed in the last years to risks management, new regulations were published in 2002 compelling companies to disclose information regarding exposure to market risks, including quantitative information. In addition, the Israeli Knesset (Parliament) amended, at the end of 2006, the Regulations in accordance with the "Second GALAI Committee" resolutions. The Amendment obligates companies to file annual and periodic reports integrating accounting regulations and Board reporting disclosure requirements. This implies that corporate reports will reflect the exposure of companies to market risks and risk management. The said Amendment includes 2006 reports as well.

- In 2003, the Israel Securities Authority published new guidelines requiring companies to publish information with respect to the number of directors who possess accounting and financial skills. Each company should assign a minimum number of such directors, bearing in mind its size, operations, etc., and disclose this number in its annual reports and whether the current board of directors complies with it.
- other new guidelines published in 2003 by the Israel Securities Authority concern significant valuations. Companies are required to attach to their financial reports each valuation applied to determine the value of an asset, liability, engagement, capital or activity considered to be of significance to the company's business. Furthermore, there is a requirement for disclosure regarding the work contracted to the appraiser and the method and information forming the basis of the valuation.
- In 2004 the Israel Securities Authority published new amendments to the Securities Law, in accordance with the Barneah Committee. Those new amendments are based mainly on the American SEC. The Barneah Committee's recommendations include: simplification of the structure and size of IPO’s, comparison of reporting and liability levels in annual reports to those common in IPO's, creation of a clear and written structure for the section describing the company’s business, its ability to provide information vis-à-vis data already published and as well as projected data. Adoption of the new adjustments will create a revolution in the reporting procedures applied by public companies in Israel. It will also facilitate recurrent public offerings and simplify the integration of Israeli public companies in international markets.
- New regulations were published in 2005, to simplify the procedure of issuing new shares to the public, for the benefit of public companies whose shares are already listed on the stock exchange. Subject to certain conditions, essentially concerned with the listed company’s adherence to obligations under the Securities Law and Regulations, the company is entitled to issue new shares by publishing an off-the-shelf prospectus.
- In 2007, the Israeli Securities Authority ratified the recommendations submitted by the "Goshen Committee"- a Corporate Governance Inspection Committee defining the level of disclosure public companies are obligated to provide pursuant to the Securities Law.
- Based on the said Committee's resolutions, the Securities Authority approved the outline of disclosure requirements to be included within the Securities Law. This applies to corporate articles of association and decisions made by companies' relevant agents, all in regard to corporate governance and as provided by the Companies Law.

  Appropriate corporate governance provisions will be compiled in an Addendum to the Companies Law, entitled: "Public Companies' Recommended Corporate Governance Provisions". Once these are published, companies will be obligated to address them as well.

  Furthermore, the Securities Authority and Justice Ministry have granted their consent to the Committee's recommendations, to be adopted as obligatory legislation. This includes drafting rules for implementation by corporate Audit/Balance Committees when approving financial reports and directors declarations.

  The Committee's resolutions deal with the following issues: independence of board of directors; structure and operations of corporate audit committees; approval of transactions with a controlling party; designating a court specializing in corporate and securities laws.

#### 4.1.2.2. Amendment No. 3 to the Companies Act

In view of the experience and precedents gained from the legal and business community in Israel after enacting the Companies Act for six years (since February 1, 2000), the third Amendment to the Act was legislated in March, 2005 and subsequently became effective, amending a number of important issues, *inter alia:*

- The conditions that must be proved in court to justify a claim for lifting the veil of a company, were revised and withdrawn. The original section of the Companies Act was general and enabled the court to persue a rather broad interpretation of its wording, to lift the company's veil easily and expose shareholders to personal damage. Consequently, this part was revised through legislation, with the general section being cancelled and the conditions stipulated there narrowed down.
- The Section making it possible to lift the veil of a company against directors, officers and other key personnel cancelled and consequently the Company Act enables veil lifting only against shareholders.
- The terms approving the appointment of a CEO in a public company, and enabling him to act simultaneously as Board Chairman, as an exception to its prohibition in the Companies Act, were relieved.
- The Company Act granted inactive private companies exemptions from the requirement to appoint a certified public accountant and compile annual audited financial statements. The above exemptions were extended to also include companies with minor activity, whose annual turnover does not exceed NIS 500,000.

#### 4.1.2.3. Private Companies

- A private company is a non-public company.
- A private company may have one or more stockholders.
- A private company is required to file an annual report with the Registrar of Companies including information regarding stockholders and directors but not financial statements.
- Concurrently with the enactment of the Companies Act in 1999, regulations were published regarding reports, registration details and forms that define the registration and reporting processes and specify the different forms for reporting.
- Annual audited financial statements, prepared according to generally accepted accounting principles, should be presented at the stockholders' annual meeting.
- Stocks and other securities should not be offered for sale to the public.

#### 4.1.2.4. Foreign Companies

- Foreign companies wishing to conduct business in Israel are required to register with the Registrar of Companies and to submit their Articles of Incorporation (original and an authorized Hebrew translation), list of directors and other required information.
- Foreign companies wishing to issue securities on the TASE are required to operate according to the TASE and Securities Authority requirements.

#### 4.1.2.5. Capital Structure

- Securities - Several types of securities are commonly used by Israeli companies, some of which are described below:
- Common Stock - entitles voting rights and participation in earnings and excess assets in the event of liquidation. The shares may be of different par values and rights. However, TASE regulations require a company to hold only one type of shares for issuing stocks.
- Preferred Stock - provides preferred rights for both dividends and/or liquidation.
- Management Shares - usually issued to the founders, entitling them to special rights, especially in respect of appointing directors and voting rights.
- Redeemable Shares - the Companies Act permits companies to issue redeemable shares. Such shares may entitle their holders to exercise various rights, as determined by the company, including voting rights and profit sharing.
- Warrants - entitle conversion to common stock at a pre-determined price.
- Convertible Bonds - entitle conversion of bonds to shares at a pre-determined conversion ratio.
- Dividends - An Israeli company may distribute its retained after-tax earnings by way of dividends. The dividends can be distributed from real earnings alone (after elimination of inflationary gains). Distribution of dividends is subject to fulfillment of two criteria: profitability test and the ability to meet all existing and future contingent liabilities, based on audited or reviewed financial statements, not earlier than six months prior to the actual distribution of dividends.

### 4.1.3. Partnerships

The Partnership Ordinance (New Version) 1975 governs the activities of partnerships. If a partnership is established for the purpose of conducting business in Israel, it is required to be registered with the Registrar of Partnerships at the Ministry of Justice. Registration requires, inter alia, furnishing the Registrar of Partnerships with the partnership's name, activities, address, partners' names and identifying details, etc.

- A partnership may not have more than 20 partners. However, a partnership of lawyers or auditors for engaging in their profession may include over 20 members. The Justice Minister is entitled to apply this provision to other partnerships of certain professionals for engaging in their profession.
- A partnership may be general or limited.
- A partnership is not required to file annual reports of any kind. Profit or loss should be added to the financial reports and income statements of the individual partners.

#### 4.1.3.1. General Partnership

In a general partnership, each partner is responsible for the partnership's liabilities without limitation. Each partner is entitled to act on behalf of the partnership and is held to be its agent. Each partner's activities and actions are binding on the other partners.

#### 4.1.3.2. Limited Partnership

A limited partnership is required to have at least one general partner whose liabilities are unlimited. The limited partners' liabilities are limited to the extent of their capital contribution, as specified in a written agreement among all partners.

The limited partners are prohibited from taking part in management of the partnership.

A limited partnership may not conduct business prior to its registration.

### 4.1.4. Cooperatives

The Cooperatives Ordinance governs the activities of cooperatives. Cooperatives are required to register with the Registrar of Cooperative Societies at the Ministry of Labor and Social Affairs.

Members of a cooperative may be individuals or other cooperative societies.

Restrictions exist regarding membership in a cooperative society and the contents of the cooperative Articles of Incorporation.

This type of entity is not very common and serves businesses mainly in the transportation and agriculture sectors.

### 4.1.5. Non-Profit Organizations

Non-profit entities may be established and operated within one of three frameworks:

- Non-profit societies or associations, in accordance with the “Amutot” Law, 1980, as amended on 31/12/2009 to include provisions enabling the merger of "Amutot";
- Corporations with public objectives, under the Companies Law;
- Public trusts.

The vast majority of these entities function as “Amutot” (non-profit associations). The Registrar of Non-Profit Associations oversees the registration and activities of these organizations, defined by the following characteristics:

- Prohibiting profit distribution to association members.
- Limiting of the association’s activities to those stated and authorized.
- Prohibiting any sale or transfer of members’ rights.

The association may be registered under standard by-laws or by-laws adopted by the founders. In either case, the by-laws must include provisions as to the following institutions:

- The Managing Committee (similar a corporation's Board of Directors).
- An Audit Committee.
- A Certified Accountant (for associations with revenue exceeding NIS 1 million per annum).

All associations must file with the Registrar a protocol of its annual members’ meeting as well as and annual detailed, audited financial statements.

Many non-profit associations, upon complying with the stringent standards prescribed by the Registrar and the Israeli Treasury, are entitled to generous Government grants.

In addition, non-profit associations may be entitled to obtain the status of a "public institution" from the Israeli tax authorities, enabling donors to deduct a portion of the funds donated from their taxable income.

## 4.2. TEL AVIV STOCK EXCHANGE

### 4.2.1. General

Securities issued by public companies and government bonds are traded on the Tel Aviv Stock Exchange (TASE). Approximately 638 companies are listed on the TASE.

Trading in securities and raising capital through public offerings are regulated by the Securities Act of 1968 under which the Securities Authority was established, in order to protect investors' interests.

The Securities Authority's principal tasks are:

- Authorizing the issuance of a prospectus.
- Checking financial reports and special transactions.
- Supervising the TASE.
- Investigating matters concerning the Securities Act.

As a rule, in order to issue securities to the public, the issuer is required to issue a prospectus according to specific requirements.

Among other requirements, a public company is required under the Companies Law to report on certain significant matters as follows:

- Changes in the Memorandum and Articles of Incorporation (only Articles of Incorporation for companies incorporated after February 1, 2000).
- Details of holders of 5 percent or more of the voting rights or shares of the company, including any changes in such holdings.
- Any material agreement the company has entered into.
- Salaries of the company's 5 highest paid officers and directors.
- Any benefits and transactions with holders of 5% or more of the issued capital stock.
- Change of auditors.
- Changes in the capital stock.
- Composition of the board of directors.
- Conflict of interests between the company and the controlling stockholders.
- Private placements.

### 4.2.2. Prerequisites

Listing stock on the Tel Aviv Stock Exchange is subject to the TASE Board approval and compliance with the following prerequisites:

- The issued capital stock is fully paid.
- The Memorandum and Articles of Incorporation (only articles after February 1, 2000) do not limit transferability of listed securities.
- Listed securities are spread adequately, both in value and distribution (for more information - please refer to paragraph 4.2.3 below).
- Terms and prices of offerings and issuances should be equal for all. However, some distinctions regarding certain investors or issuances, as determined in the TASE guidelines, may be permitted.

- The Articles of Incorporation determine that voting at the general meeting will be by vote count.
- The company agrees to comply with the rules of the TASE and its Board.
- The TASE Board may add conditions to the registration of securities and prevent their listing in certain cases.
- A controlling shareholder in a company which is insolvent or has announced it is unable to pay off its obligations under the Certificates of Obligation, who holds such Certificates, is not entitled to repayment of debts owed to him by the company, except after the company has fully paid off all of its obligations to other holders of Certificates of Obligation, including payment of interest and linkage differentials as specified in the Deed of Trust.

  In this section - “**holder -** who holds control, directly or indirectly, or through a corporation or indirect control thereof”.

  **“Certificates of Obligations -** as defined in Clause 35.a.”.

### 4.2.3. Principal Listing Criteria

As a rule, compliance with certain criteria is a condition for listing shares on the Tel Aviv Stock Exchange.

Regarding an IPO, the following table summarizes the principal financial criteria required *(US$ 1 = NIS 3.471):*

| **Criteria** | **Alternative** | | | |
|---|---|---|---|---|
| | **A** | **B** | **C ("Large Company")** | **R & D Company (*)** |
| Period of activity in the field defined in the articles of incorporation that has complete financial reports. | 12 Months | 12 Months | - | - |
| Stockholders' equity before registration (US$ million) | 0.62 | 0.62 | - | - |
| Stockholders' equity after registration (US$ million) | 7.20 | 10.08 | - | 2.30 |
| Added value in the 12 months preceding registration. | 1.15 | - | - | - |
| Public equity (US$ million) | 5.76 | 8.64 | 23.05 | - |
| Value of the public's share of stocks issued (US$ million) | 5.76 | 5.76 | 23.05 | 4.61 |
| Market Capitalization (US$ million) | - | - | 57.62 | - |

*(*) The following terms have to be complied with:*
*The company invested at least NIS 3M ≈ US$ 864,000 in the last three years in R&D activities from other sources, including investments from the Chief Scientist.*
*The investment was approved as an R&D investment.*
*(i) Investment in R&D can be invested by a subsidiary or subsidiaries of the company requesting to be traded, subject to several conditions.*
*(ii) The company (requesting to register on the trade market) will either pursue its R&D activities or continue manufacturing and marketing the outcome of its previous R&D.*

*(**) Added value is defined as:*

| | |
|---|---|
| Income before tax | XX |
| Salaries and related expenses | +XX |
| Depreciation | +XX |
| Finance expenses | +XX |
| | XX |

As mentioned earlier, requirements exist for adequate spread of the issued securities. The following tables summarize these requirements.

Minimum Public Equity *(US$ 1 = NIS 3.471)*:

| When Public equity is: (US$ million) | Share of public equity out of total equity should exceed | |
|---|---|---|
| | Non R&D company | R&D company |
| From 4.61 | - | 10.0% |
| From 5.76 | 25.0% | 10.0% |
| From 8.64 | 20.0% | 10.0% |
| From 11.52 | 15.0% | 10.0% |
| From 14.41 | 10.0% | 7.5% |
| From 57.62 | 7.5% | 7.5% |

Minimum Number of Holders *(US$ 1 = NIS 3.471)*:

| Type of Security | Minimal # of Holders | Minimal Holding per Holder |
|---|---|---|
| Stocks | 100 | US$ 4,610 |
| Convertible Bonds | 100 | US$ 4,610 |
| Bonds | 35 | US$ 57,620 |

An individual is designated as a stockholder if the holding's worth exceeds the minimum specified in the above table, or if the individual holds, together with others, a total higher than the required minimum per holder, as specified in the above table.

In the event that requirements for the minimum number of holders are not fully met, the TASE Board may alter these to a certain extent. If the altered requirements are not fully met, the securities will not be listed on the TASE.

### 4.2.4. Dual listings

The Securities Law was amended in 2000, known as Amendment 21, in order to enable Israeli companies traded on foreign exchanges to dual-list, but it empowers the Israel Securities Authority to allow foreign companies traded in U.S. markets to dual-list under the law as well. The Securities Law enables companies to list easily and at almost no cost, and offers many benefits for U.S.-traded companies, their founders and investors, as well as for the Israeli securities industry as a whole.

Companies trading on the NASDAQ, New York Stock Exchange, American Stock Exchange or London Stock Exchange major markets for at least a year since their IPO's, or for less than a year if they maintain a market value exceeding $150 million, are eligible to dual-list under the Securities Law. Companies trading on the NASDAQ Capital Market for at least a year required in addition to the minimum market value of $30 million. Another provision is that all of a company's outstanding shares must be of one class.

### 4.2.5. Miscellaneous

Separate criteria exist for issuing shares of real estate companies, motion picture productions, and limited partnerships for oil exploration.

In addition, separate criteria exist for issuing bonds, warrants, and securities of investment holding companies and securities of listed companies.

## 4.3. INSURANCE, CREDIT AND CAPITAL MARKET REFORM

In April 2004, the Finance Minister appointed an Inter-Ministerial Committee to study recommendations on steps to be taken for establishing an efficient and competitive capital market in Israel.

The Committee published its report on September 2004. The report was approved by the Government in November (with minor changes), and enacted into law by the Israeli Parliament in The Law to Increase Competition and Reduction of Centralization and Conflicts of Interests in the Israeli Financial Market Act of 2005.

The creation of a competitive capital market is based on three main processes:

- Enhancing competition in managing the public's financial assets, by developing alternative investment channels to those offered by the banks, and decentralizing management of existing ones.
- Enhancing competition in granting credit - by developing non-banking credit instruments.
- Enhancing competition vis-a-vis the household sector - by exposing households to alternative systems of credit suppliers and exploring measures to facilitate switching from one bank to another.

# 5. BUSINESS ENVIRONMENT

## 5.1. HUMAN RESOURCES

### 5.1.1. Education

Israel's labor force is relatively well educated. The following table provides data regarding the years of schooling of Israelis aged 15 and over:

| | |
|---|---|
| 0 | 2.6% |
| 1-4 | 0.8% |
| 5-8 | 6.2% |
| 9-10 | 9.9% |
| 11-12 | 33.9% |
| 13-15 | 22.3% |
| 16+ | 24.3% |

*Source: Central Bureau of Statistics, Israel, Statistical Abstract of Israel, 2013*

### 5.1.2. Distribution of Employees

The work force at 2012 totaled approximately 3,139,500 employees. The following table summarizes the distribution of employed persons according to economic sectors in average for the year 2012:

| | |
|---|---|
| Agriculture | 1.8% |
| Manufacturing | 14.2% |
| Electricity and water supply | 0.9% |
| Construction | 4.9% |
| Trade (Retail and Wholesale) | 15.7% |
| Accommodation services and restaurants | 7.1% |
| Transportation, storage and communication | 4.4% |
| Banking, insurance and finance | 4.0% |
| Education | 13.1% |
| Health, welfare and social work | 7.9% |
| Administrative and support service activities | 10.8% |
| Information and communications | 6.6% |
| Professional, scientific and technical activities | 6.8% |
| Art, entertainment and recreation | 1.8% |

*Source: Central Bureau of Statistics, Israel, Statistical Abstract of Israel, 2013*

Salaries and wages paid to Israeli employees are highly diversified. The following table presents the average wages per employee post. The figures are rounded and presented in US Dollars, per month:

| Industry | US$ per month |
|---|---|
| Agriculture | 1,824 |
| Manufacturing | 3,704 |
| Electricity and water supply | 5,530 |
| Construction | 2,663 |
| Trade (Retail and Wholesale) | 2,365 |
| Accommodation services and restaurants | 1,211 |
| Transportation, storage and communication | 3,129 |
| Banking, insurance and finance | 4,715 |
| Education | 2,079 |
| Health, welfare and social work | 2,870 |
| Administrative and support service activities | 1,328 |
| Information and communications | 4,490 |
| Professional, scientific and technical activities | 3,801 |
| Art, entertainment and recreation | 1,221 |

*Source: Central Bureau of Statistics, Israel, Statistical Abstract of Israel, 2013: US$1 = NIS 3.471*

As of February 2013, the minimum monthly salary is set at NIS 4,300. In addition to his salary, the employee is entitled to compensation for travel expenses to and from his regular place of work (public transportation tariffs).

For most employees, overtime is paid at the rate of 125% for the first two hours and 150% for subsequent hours each day. Employees are entitled to special compensation for work on Saturdays and holidays.

In addition to salary, the employer is required to pay/contribute various social benefits, as follows:

**Compulsory contributions:**

- **National Insurance (Social Security)** - 6.80% of gross salary (in addition to the employee's contribution). The National Insurance Institute pays compensation in respect of unemployment, disability, retirement, military reserve duty, child allowances, maternity leave, etc.
- **Severance pay** - 8.33% of gross salary. An employee dismissed from her place of work is entitled to severance pay based on her latest salary amount for each year of employment.
- **Sick leave** - accumulation of 1.5 days per month. In many cases, the sick leave allowance may amount to 30 days per annum. Employees may accumulate up to 90 sick days.
- **Vacation** - Israeli law prescribes a minimum vacation period of two weeks annually. The number of days increases according to seniority, reaching four weeks for those employed more than fourteen years by the same employer. The vacation allowance is payable in addition to legal and religious holidays.

- **Annual reserve military service** - The employer usually pays the employee’s regular salary, including all social benefits, for the entire reserve duty period. The National Insurance reimburses the employer for the amount gross salary during his reserve duty.
- **Recuperation pay** - Employees are entitled to recuperation pay according to seniority at work and based on the Collective Work Agreement. The minimum amount for full time employees in the business sector is US$ 458 per annum and it may reach approximately US$ 916 per annum.
- **Pension Insurance** - All employees are entitled to pension insurance after 6 months of employment. An employee with a pension fund from the previous workplace is entitled to contribtution from the first day of work, and this is payable 3 months after the start of employment at the new workplace. Contribution by the employer is set at 6% and contribution by the employee is set at a minimum rate of 5.5%. The employer's compensation contribution is 6%, and altogether a minimum of 17.5%.

**Optional contribution:**

- **Fund for postgraduate and professional studies** – The employer’s contribution is 7.5% - 8.4% of gross salary. The employee also contributes to the Fund a fixed percentage of gross salary.

**Miscellaneous:**

- Some employers pay annual bonuses equivalent to 1-2 additional monthly salaries.

In addition to the above social benefits, other legislation and regulations exist to regulate working conditions, but they cannot be directly “converted” into money.

**Among these laws and regulations are the following:**

- Employment of Women Law - the law protects female employees and specifies the terms and restrictions imposed on employers regarding their female employees in connection with night work, pregnant women’s rights, maternity leave, etc.
- Equal Opportunity in Employment Law - prohibits discrimination against employees in all matters and for any reason.
- Equal Pay Law - legislates female employees’ rights to equal pay for equal work with the same employer.
- Youth Labor Law - regulates the work conditions of individuals under 18.

## 5.2. ANTITRUST LAW

Business activity is subject to various laws and regulations, depending on the nature, scale, sector, etc. of the business, and requires licenses from ministries, municipalities, authorities, and other statutory authorities. In general, common business and trade practices are restricted by rules and regulations similar to those prevailing in other western countries. However, particular attention ought to be paid to the Antitrust Law, 1988, enforced by the Israeli Antitrust Authority.

### 5.2.1. Restrictive Practice Agreements

A restrictive arrangement is an agreement made between individuals conducting business, pursuant to which at least one of the parties restricts itself in a way that could obviate or reduce the business competition between that party and part or all of the other parties to the agreement, or between that party and an entity that is not a party to the agreement.

An agreement that determines prices, market share, profit margins, or quotas will be deemed to be a restrictive agreement. However, the law excludes some agreements from its general definition so that they are not considered restrictive agreements (e.g. entitlement to use proprietary rights, international transport, etc.).

Participation in any restrictive agreement is prohibited unless the agreement has been approved by court, received a temporary permit, by the Director-General of the Antitrust Authority or was granted an exemption.

In recent years, enforcement of this law has become more evident, in view of the expansion of the Antitrust Authority and the growing awareness of the advantages of competitive markets in Israel.

Block exemption: In 2000, the Director-General of the Antitrust Authority defined block exemptions that exempt specific agreements from the need for a permit.

These block exemptions include R&D agreements, joint ventures, franchises, etc.

### 5.2.2. Mergers and Acquisitions

According to the Restrictive Business Practices Law, the following mergers and acquisitions require the approval of the Antitrust Authority prior to becoming effective:

- Subsequent to the merger or acquisition, the share of the merged parties in the production, sale, marketing, or purchase of a single product or a group of products or services will exceed 50%.
- The combined turnover of the merged companies (domestic turnover only) in the fiscal year prior to the merger exceeded NIS 150 million (approximately US$ 42 million), and at least two of the merged companies have a turnover of more than NIS 10 million (approximately US$ 2.84 million) each.
- One of the parties is already a monopoly.
- The last amendment for 2012 prescribes the composition of the mergers exemptions committee such that it will comprise 5 women and 3 jurists.

## 5.3. INTERNATIONAL TRADE

Israel has extensive business relationships worldwide. The table below summarizes Israel's international trade in 2013 (excluding Diamonds).

| | Import | | Export | |
|---|---|---|---|---|
| | US$ mill | % | US$ mill | % |
| Grand Total | 62,884 | 100.0% | 47,570 | 100.0% |
| Europe | 27,530 | 43.8% | 19,701 | 41.4% |
| European Union | 21,607 | 34.4% | 15,164 | 31.9% |
| Italy | 2,682 | 4.3% | 1,133 | 2.4% |
| Belgium and Luxembourg | 1,697 | 2.7% | 756 | 1.5% |
| Germany | 4,663 | 7.4% | 1,737 | 3.7% |
| Netherlands | 2,718 | 4.3% | 2,092 | 4.4% |
| United Kingdom | 2,035 | 3.2% | 3,425 | 7.2% |
| Spain | 1,377 | 2.2% | 1,251 | 2.6% |
| France | 1,536 | 2.4% | 1,337 | 2.8% |
| Other European Union Countries | | 7.9% | | 7.3% |
| Association (E.F.T.A.) | 3,175 | 5.0% | 287 | 0.6% |
| Switzerland | 3,040 | 4.8% | 216 | 0.5% |
| Other E.F.T.A Countries | 135 | 0.2% | 71 | 0.1% |
| Other European Countries | 2,749 | 4.4% | 4,251 | 8.9% |
| Turkey | 2,354 | 3.7% | 2,496 | 5.2% |
| Russian Federation | 172 | 0.3% | 1,009 | 2.1% |
| Other Countries in Europe | 223 | 0.4% | 746 | 1.6% |
| Asia | 12,774 | 20.3% | 9,990 | 21.0% |
| India | 828 | 1.3% | 1,085 | 2.3% |
| Hong Kong | 957 | 1.5% | 546 | 1.1% |
| Taiwan | 800 | 1.3% | 713 | 1.5% |
| Japan | 1,083 | 1.7% | 670 | 1.4% |
| China | 5,598 | 8.9% | 2,558 | 5.4% |
| Singapore | 734 | 1.2% | 735 | 1.5% |
| South Korea | 1,461 | 2.3% | 616 | 1.3% |
| Thailand | 426 | 0.7% | 276 | 0.6% |
| Other Asian Countries | | 1.4% | | 5.9% |
| Africa | 292 | 0.4% | 1,360 | 2.8% |
| America | 8,724 | 13.9% | 13,591 | 28.6% |
| North America | 7,810 | 12.4% | 11,213 | 23.6% |
| USA | 7,302 | 11.6% | 10,274 | 21. 6% |
| Mexico | 141 | 0.2% | 373 | 0.8% |
| Canada | 367 | 0.6% | 567 | 1.2% |
| Central America | 145 | 0. 2% | 605 | 1.3% |
| South America | 769 | 1.2% | 1,773 | 3.7% |
| Oceania | 111 | 0.2% | 597 | 1.3% |
| Unclassified Countries | 13,453 | 21.40% | 2,330 | 4.9% |

*Source: Central Bureau of Statistics, Israel, Israel's Foreign Trade by Countries, January 2014.*

The import of goods totaled $63.0 billion in 2013, compared to $47.5 billion in exports. Total trade deficit (excluding diamonds) totaled $15.3 billion, in comparison to $19.7 billion in 2012. 31.9% of goods exported (excluding diamonds) was directed to the EU countries, 21.6% to the U.S. and 21.0% to Asia. Development of trade in goods in 2013, compared with 2012, was influenced mainly by the increase in demand throughout 2013, as well as by changes in the value of the dollar against other currencies in which import and export transactions are conducted.

The anticipated incoming tourism for 2013 has increased by 3% in comparison to the previous year.

The table below illustrates tourist traffic to Israel in recent years:

| INCOMING TOURISTS | |
|---|---|
| **Year** | **Thousands** |
| 2003 | 1,063 |
| 2004 | 1,506 |
| 2005 | 1,916 |
| 2006 | 1,834 |
| 2007 | 2,294 |
| 2008 | 3,034 |
| 2009 | 2,740 |
| 2010 | 3,450 |
| 2011 | 3,362 |
| 2012 | 3,520 |
| 2013 | 3,540 |

*Source: Central Bureau of Statistics Israel, Arrivals and Departures of Israelis and visitors from abroad, 2013.*

## 5.4. TRADE AGREEMENTS

Israel has entered into several trade agreements in order to strengthen its position in international markets. The most significant agreements are the Free Trade Area Agreement with the European Union, Free Trade Area Agreement (FTA) with the United States, Free Trade Area Agreement with the European Free Trade Association States (EFTA) and the Free Trade Agreement with MERCOSUR the South-American Common Market. The agreements with the European Union, the United States and South-American countries place Israel in the unique position of being a Free Trade Area partner with the principal economic regions worldwide. Thus, Israel is able to act as an intermediary for countries that do not have mutual agreements, provided that products comply with the provisions of each agreement. In addition, Israel has signed FTA Agreements with Canada and Turkey, a General Agreement on Tariffs and Trade (GATT) with the World Trade Organization, and has been granted preferences under the GSP (General System of Preferences) by Australia, Austria, Canada, Finland, Japan, New Zealand, Norway, Sweden, Switzerland, and the United States. As part of the peace process, Israel signed an Agreement for Economic Development with the Palestinian Authority.

### 5.4.1. Israel-European Union Free Trade Agreement

In 1995 Israel entered into an Agreement for the establishment of a free trade zone with the European Union for industrial products and some agricultural products.

Under this Agreement, most Israeli-made products are exempt from import duties. On its part, Israel gradually reduced import duties on European-made products.

In general, to be eligible for exemption from import duties, products are required to comply with certain “rules of origin”. These rules require a minimum local-added-value depending on the origin of materials, manufacturing process, etc.

Tariff and non-tariff barriers still exist concerning agricultural products and processed foods in respect of international trade with the European Union.

### 5.4.2. Israel-USA Free Trade Area Agreement

In 1985, Israel and the United States entered into the Free Trade Area Agreement. This Agreement was fully implemented on January 1, 1995.

The Agreement eliminates all import duties and non-tariff barriers between Israel and the United States. The Agreement allows non-tariff restrictions on agricultural products.

“Rules of origin” exist, which are different from those of the European Agreement, to determine products’ eligibility to benefits from this Agreement.

### 5.4.3. Israel-EFTA Free Trade Area Agreement

The Agreement between Israel and EFTA countries became effective on January 1, 1993. The Agreement is intended to eliminate or reduce duties, mainly on industrial goods, and also to reduce non-tariff barriers.

This Agreement has its own “rules of origin” as well, different from those of the above mentioned agreements.

### 5.4.4. Israel-MERCOSUR Free Trade Agreement

A free Trade Area Agreement between Israel and the Common Market of South America between Argentine Republic, the Federative Republic of Brazil, the Republic of Paraguay and the Oriental Republic of Uruguay (MERCOSUR).

The Agreement was signed on December 8, 2005 and went into effect on June 1st, 2010, Israel is the Only non-South American country that has an FTA agreement with MERCOSUR, giving Israel a relative advantage in trade compared to other non-South American countries.

The "Rules of origin" of MERCOSUR apply to this agreement; these are uniform rules for all South-American countries that are part of MERCOSUR.

### 5.4.5. Israel-Canada Free Trade Agreement

A Free Trade Area Agreement between Israel and Canada was signed in July 1996 and became effective on January 1, 1997. The Agreement expresses the parties' intention to gradually eliminate duties on industrial goods and some agricultural products.

The Agreement with Canada offers special advantages, since both parties have entered into FTA Agreements with the United States, enabling Israel to include United States origin components in its exports to Canada, and Canadian components in its exports to the United States, without breaching any "rules of origin".

## 5.5. PROPRIETARY RIGHTS

Israel is a member of international agreements regarding intellectual proprietary rights. The following section summarizes legislation regarding patents, trademarks, copyrights, etc.

### 5.5.1. Patents

The Patent Act, 1967, regulates the protection of patents in Israel. Regular patents are protected for 20 years from date of application, while “patents of addition” are protected for the unexpired terms of the main patent.

Patents may be granted on the invention of a product or process which is innovative, and which was never previously used or published.

### 5.5.2. Trademarks

The Trademarks Ordinance, 1972, and its provisions regulate the protection of trademarks in Israel. This protection is granted for an initial period of ten years, and may subsequently be renewed for further periods of fourteen years each, indefinitely. However, a third party may challenge trademarks that have not been used for three years or more, and may request their revocation.

### 5.5.3. Copyrights

The Israel Copyrights Law regulates the protection of original literary, musical, artistic, and dramatic works. The protection is granted for the lifetime of the creator plus 50 years for musical and artistic works, and 70 years for literary and dramatic works. Computer programs are protected under this law as well.

### 5.5.4. Commercial Torts

The Commercial Torts Law 1999 is relatively new in the proprietary rights field, and still in its first years of exercise in Israel’s business and legislative environment. The Commercial Torts Law incorporates several commercial torts, mainly exercised as common law by the Israeli courts up until their reversal into legislation, such as unfair interference to a business, passing-off, false description and etc. The innovativeness of the Commercial Torts Law applies especially in regards to the remedies enacted by it, for example the Anton Pillar court order.

# 6. INVESTMENT INCENTIVES AND TRADE ADVANTAGES

## 6.1. GENERAL

The State of Israel encourages investments from both Israeli and foreign residents, by offering a wide range of incentives and benefits. The principal goals include: efforts to attract foreign investments to Israel, boost economic growth, develop human resources, etc.

To attain these goals, Israel offers substantial benefits and concessions through a number of laws and regulations, as summarized below.

Special emphasis is laid on high-tech companies and R&D activities, as considerable importance is attached to these fields. Furthermore, numerous programs have been formed, starting from the seed stage, to support the high-tech industry.

Israeli companies may also be eligible for benefits from international funds created as a result of cooperation agreements established between the Israeli and foreign governments, including the United States, Canada, the United Kingdom, the European Union, Singapore, Korea etc.

Additionally, to promote weak economic regions within Israel, benefits are granted in a two differential manner (A and rest of Israel) - being substantially greater in the priority region (A) than in the rest of the country. As a rule, Zone A includes the following regions: the Galilee, Jordan Valley, the Negev and Jerusalem for hi tech enterprises. However, enterprises are eligible for benefits anywhere they are erected, provided they comply with the relevant criteria (see hereinafter).

## 6.2. LAW FOR ENCOURAGMENT OF CAPITAL INVESTMENT

### 6.2.1. Overview

The government's principal tool in this respect is the Law for the Encouragement of Capital Investment-1959 (hereinafter: "the Law"). As part of the Supplement to Economics Arrangement Law (enacted in conjunction with the 2011 - 2012 budget) (hereinafter: "the 2011 Amendment") recently ratified, significant changes were introduced in the application of the Law. The new tax benefits track will apply to income generated from January 1, 2011 onward. (For details of the previous law's provisions - see "Doing Business In Israel 2010"). It should be mentioned that in 2013 the law was amended again (hereinafter: "2013 Amendment") and the tax rates were changed.

The Law offers business enterprise promoters two types of tax breaks, under the tax benefits tracks or grants track (applicable in Zone A only). It should be noted that the 2011 Amendment prescribes that enterprises may enjoy both tracks simultaneously (in contrast to the previous law, whereby a company could not benefit from both courses at the same time).

Under the tax benefits track, an enterprise which qualified for this was granted a "beneficiary plant" status under the previous "preferable plant" law, while under the new law and grants track, such enterprise is given the status of "approved plant".

The Law applies to industrial enterprises (in diverse branches such as: textiles, food, electronics, chemicals, pharmaceuticals, computer software, biotechnology, nanotechnology, renewal energies, R&D etc.), hotels and other tourism ventures[1], industrial and residential construction, etc. (hereinafter

[1] Hotel and other tourism ventures remains under the previous law orders.

collectively referred to as "Enterprises").

Based on a broad view of the Israeli labor force, R&D potential and the desire to maintain professional and advanced workers within its borders, the Law also applies to industrial development centers located in the country. These R&D centers can enjoy the full benefits granted by the Law, although they may not necessarily comply with the generally accepted definition of "industry". Industrial R&D services rendered to a foreign resident will be recognized as industrial activity if approved by the Head of Industrial R&D Administration.

It should be noted that a key condition for enjoying the benefits is compliance with an export rate of at least 25% of the industrial enterprise's turnover as outlined below.

### 6.2.2. Tax Benefits Track

In the framework of the 2011 Amendment, all the existing tax benefits were canceled and a unified tax rate introduced on the aggregate revenue generated from manufacturing activity, for industrial enterprises complying with the minimum export conditions established.

The tax rates to be applied, pursuant to the 2013 Amendment, are 9% in Priority Region A and 16% in all other areas (for the 2014 fiscal year; 10% and 15% respectively for the 2011-2012 fiscal years; and 7% and 12.5% respectively for the 2013 fiscal year). The rate for individual recipients of dividends under the tax benefits track will be 15%, both for Israeli as well as foreign residents, while intra-corporate dividend distributions (between Israeli companies) will be exempt from tax even if derived from the subsidiary's "preferable income".

#### 6.2.2.1. Conditions for Enjoying the Tax Benefits Program

An enterprise wishing to enjoy these benefits is not required to apply to the tax authorities, but may independently implement them in its income tax returns.

The terms stipulated by law for obtaining tax concessions are as follows:

1. The enterprise must be owned by a company registered in Israel and the business of which is controlled and managed in Israel, apart from a "family company", a "transparent company" or a Kibbutz. The law will also apply to registered partnerships, provided the partners have all been incorporated in Israel. Factories and quarries for producing natural resources (minerals, gas and oil) are excluded from the definition of "industrial enterprises" in regard to this particular activity. Companies fully owned by the government will not be entitled to the benefits granted under the law.

   The company must maintain admissible books and records and file any reports required under Israeli law. The company and its officers must be free of previous convictions on tax-fraud charges during the 10 years proceeding the benefits periods.

2. The enterprise must have an industrial plant.

3. The enterprise is competitive and contributes to the Gross local Production. An enterprise will be deemed to have fulfilled this condition if it is engaged in biotechnology, nano-technology or renewal energies R&D and has obtained the approval of the Head of Industrial R&D Administration.

   Alternatively, an enterprise will be deemed to have fulfilled this condition if exports amount to 25% at least of its turnover in case of a new plant or expansion of an existing one, unlike the previous law, whereby the minimum requirement for expanding a plant was a measurement of the increase turnover as compared to the basic revenue. An enterprise with "indirect exports" may, under certain conditions, also be deemed to have fulfilled this condition.

Only income from operations in Israel will be considered as "preferable" income".

As mentioned earlier, the tax benefit track does not require prior approval from the authorities. Notwithstanding the aforesaid, in order to provide greater certainty, an enterprise choosing the tax benefits program may apply to the tax authority for an advanced (or pre) ruling whereby the company complies with the terms stipulated by law, and also for regulating other issues involved in the application of the law.

Under the new law, a particular tax benefits track exists for "special industrial enterprises" (applicable to large companies and/or investments), setting the applicable tax rates at 5% in Priority Area A and 8% in all other areas, for a period not exceeding 10 years.

Transitional Orders:

- The previous law is applicable to enterprises whose investments started before 31/12/2010 and they notified the authorities that the "election" year for the benefit period would be no later than 2012.
- The previous law will also apply to old programs, based on the benefits prescribed by law in the “election” year or on the date of granting approval, as the case may be.
- Notwithstanding the foregoing, enterprises wishing to apply the new law may do so while at the same time relinquishing the remaining benefits available under the previous one. Accordingly, a company eligible for tax breaks under the alternative track offered by the previous law, may apply the new law by notifying the authorities no later than the date specified for filing the annual report, and this shall apply to the fiscal year following the one for which the report had been filed. From the above, it emerges that an enterprise may pursue the new tax track from 2011, provided the authorities are notified accordingly in the context of the 2010 fiscal report.

Grants Program

### 6.2.2.2. General

- Pursuant to the 2011 Amendment, the stipulation prohibiting multiple benefits (tax track and grants track) has been withdrawn. As such, industrial enterprises complying with the required export conditions may benefit simultaneously from both the grants as well as the tax benefits track, as discussed earlier. Notwithstanding the above, should export conditions apply to revenue deemed as an "expansion" of previous activity, the enterprise may still benefit from the grants track even though the tax benefits will not apply. Eligibility for investment grants will be limited only to industrial enterprises located in Priority Area A. The grants program is limited to the budget framework approved annually for this track under the budget law.
- Approved Enterprises are entitled to grants of up to 20% of tangible fixed assets. Nevertheless, the 2011 Amendment framework prescribes that approval of the grants will not be limited solely to investments in fixed assets but will also include investments in human resources and other ventures, provided these are in line with the defined targets. Furthermore, the Investment Center Management will be authorized to grant State-guaranteed loans.

### 6.2.2.3. The Main Conditions

The government provides grants as participation in financing the purchase of tangible fixed assets. The grants vary - depending on the type of enterprise and the National Priority Region.

The amount of the grant is calculated as a percentage of the original cost of land development and investment in buildings, machinery, and equipment. Machinery and equipment must be new, or used imported machinery and equipment not previously applied in Israel, provided the Investment Center Board had approved them.

Their cost includes installation and related expenses. For self-constructed or self-created assets, a determined reasonable profit, at a rate fixed by law, may be added to the costs incurred.

The investment program should be completed within 5 years from date of approval.

The grants are not deemed to be income but are deducted from the cost of the fixed assets.

The terms stipulated by law for obtaining a grant are as follows:

1. The enterprise must be an industrial plant or a hotel.
2. The enterprise contributes to the independence of the State's economy.
3. The enterprise is competitive and contributes to the gross local production. An enterprise will be deemed to have fulfilled this condition if it is engaged in the fields of biotechnology or nano-technology and has obtained the approval of the Head of Industrial R&D Administration to this effect.

   Alternatively, an enterprise will be deemed to have fulfilled this condition if exports amount to 25% of its turnover at least. Where a plant has been expanded, an enterprise will be deemed to have fulfilled this condition if its exports amount to at least 25% of the increased turnover as compared to the basic revenue. Nevertheless, an enterprise wishing to enjoy the tax track at the same time required to export 25% of its turnover.

   An enterprise with "indirect exports" may, under certain terms, also be deemed to have fulfilled this condition.

We must note, that under the grants program, is required to fund 24% of the scope of approved investment in equity.

### 6.2.2.4. Approval Procedure

As aforementioned, the law includes two principal schemes for obtaining tax concessions: one is the grants program, and the other - the benefits program. To obtain the status of “Approved Enterprise” under the grants program, a company is required to submit a plan to the Investments Center.

The Investment Center Management is authorized to approve applications received during the relevant budget year in the context of the current or the previous year's budget.

Lately, pursuant to the comprehensive amendment of the Law, the terms for obtaining concessions were stipulated both in respect of grants as well as tax benefits. Consequently, the procedures for granting the status of "approved enterprise" differ. Whereas an enterprise applying for grants will be required to submit a plan to the Investments Center, this will not be required of an enterprise wishing to benefit from tax concessions under the status of "preferable enterprise". If the enterprise complies with the threshold conditions stipulated by law, it could enjoy these tax benefits and claim them under the income tax returns it files.

The determination by either the Investment Center or the tax authorities as to whether an enterprise is an "industrial enterprise" is binding upon both bodies for a 5-year period, unless substantial changes are introduced or erroneous reporting has been discovered in the enterprise.

#### 6.2.2.5. Determining Priority Regions A and other areas

In accordance with the provisions of the Law for the Encouragement of Capital Investments, development regions will be determined according to a number of criteria. These comprise a combination of the following factors: geographic location (priority given to Jerusalem, the South and North, Sderoth and the Gaza Envelope), socio-economic level, unemployment rate, location within Israel's industrial sectors or in the minorities settlements (settlements where 80% of the residents are non-Jews).

For a detailed review of the above - see Ministry of Commerce, Industry and Labor website: http://www.tamas.gov.il/CmsTamat/Ishuvim.aspx?sValue

## 6.3. DEPRECIATION

The regular Depreciation rate determined in the income tax (Depreciation) regulation-1941 ("Depreciation Regulation"). Under the Depreciation Regulation, the main depreciation rates are as follows:

| Asset | Depreciation rate |
|---|---|
| Equipment and machinery (general) | 7% |
| Electricity plant (equipment) | 7% |
| Buildings | 2%-4% |
| Computers | 25%-33% |
| Electronic and Computing equipment | 15% |
| Vehicles | 15% |

### 6.3.1. Accelerated Depreciation

Approved beneficiary and preferable enterprises are eligible for accelerated depreciation on tangible assets, reaching 400% of standard depreciation rates on buildings (not exceeding 20% per annum and exclusive of land), and 200% on equipment. The tax authorities may allow increased rates of up to 250%, if there is evidence of a high depreciation rate of equipment. This benefit is available for a 5-year period from date of commencement of operation rather than from purchase date of asset, and implementation thereof depends on the type of each particular asset as well as various rules.

Furthermore, special provisions were enacted in the Law for the Encouragement of Industry (Taxes), 1969 to grant favored enterprises accelerated depreciation. The Income Tax (Inflationary Adjustments) (Depreciation Rates) Regulations-1986, provides special depreciation rates to industrial plants and hotels with regard to specific fixed assets. The regulations are valid despite of the annulment of the Income Tax (Inflationary Adjustments) Law. The terms "industrial plant" and "industrial company" are defined in the Law for the Encouragement of Industry (Taxes). An "industrial company" is defined as "a company resident in Israel deriving at least 90% of its income in a tax year from an "industrial plant" owned by it". An "industrial plant" is a term which applies to companies engaged primarily in production. The regulation offers 5% depreciation for buildings owned by industrial companies, which function as industrial plant.

Moreover regarding equipment, section 2 of the Regulations provides depreciation rates as follows:

| | |
|---|---|
| If the equipment is used in one shift | 20% (or - 15%) |
| If the equipment is used in two shifts | 30% (or - 18%) |
| If the equipment is used in three shifts | 40% (or - 22%) |

Alternately, a company may choose the devalued balance method, in which the depreciation calculated as part of the devalued balance of the asset as for the beginning of the year:

| | |
|---|---|
| If the equipment is used in one shift | 30% for four years and the rest at the fifth year. |
| If the equipment is used in two shifts | 40% for three years and the rest at the forth year. |
| If the equipment is used in three shifts | 50% for two years and the rest at the third year. |

A taxpayer electing to use the declining balance method for a specific depreciable asset is bound by the election for the entire period during which the asset is in use.

It should be noted that the accelerated depreciation mentioned above depends on classifying the plant as an "Industrial Plant" and the company as an "Industrial Company".

### 6.3.2. Allowing Investments in R&D Company's Shares

Pursuant to the 2011 and 2012 Economic Arrangements Law, a temporary order has been issued, allowing deduction of investments in a R&D company's shares vis-a-vis investments made both by individuals as well as corporations. It should be emphasized that in both cases, the allowable amount will be deducted from the original share price.

#### 6.3.2.1. Individuals

An amount paid out by an individual or his relative for investing in a “special purpose company”, in consideration of which company shares of up to NIS 5 m. Were allotted to him, will be deductible against the individual's overall income in three equal annual installments (or even less), as from the fiscal year in which the capital had been invested. Amongst others, the requirement is that the capital invested ought to have been paid between 1.1.2011 and 31.12.2015, and that most of it is applied by the special purpose company to cover R&D expenses incurred in Israel. The individual is required to hold shares of a special purpose company throughout the reduction period. The Chief Scientists' approval is required for the scope of R&D expenses. The law stipulates further conditions for allowing the said deduction.

#### 6.3.2.2. Companies

A “preferred company” or “beneficiary company” as defined in the Law for the Encouragement of Capital Investments, will be entitled to deduct the cost of shares acquired during the period between 1.1.2011 and 31.12.2015 in an “entitling company” not related to it, to the extent of 20% per annum from the year after such acquisition. It should be noted that the entitling company's equity capital will be deducted from the acquisition cost.

The law specifies a number of conditions for applying the deduction, inter alia that the investment involve the acquisition of at least 80% of the means of control (other than by way of allotment) in the entitling company; that in the year of acquisition and in each of the bonus years, the acquiring company and entitling company be a beneficiary or preferred company; a minimum number of academic employees is required in the field of engineering, computers, natural or exact sciences and a minimum amount of R&D expenses must be incurred during the acquisition year and in each of the acquisition years both by the acquiring as well as the entitling company. For purposes of the deduction, approval must be obtained from the tax authorities that the purpose of the investment is neither the avoidance of tax nor reduction of the tax liability. The law stipulates further conditions for the tax reduction.

## 6.4. ENCOURAGEMENT OF CAPITAL INVESTMENTS IN THE TOURIST INDUSTRY

It should be noted that the previous law benefits (both in the tax benefit track as well as the grants track) are relevant for hotels, accommodation facilities and other tourist attractions.

It should be noted that since Amendment 60 to the Law (from 2005), only accommodation facilities meeting the "foreign residents accommodation" conditions are eligible for benefits under the Law. As a rule and in order to comply with the above, at least 25% of overnight stays in an accommodation facility must be overnight stays by foreign residents. This condition does not apply to tourist attractions.

According to law, benefits may be claimed on the construction or expansion of a "tourist facility for overnight stay". The legislator gave a distinction for the meaning of the term "tourist facility for overnight stay", stipulating that such a facility must be:

"A structure comprising 11 or more rooms, providing overnight services to guests passing by and for fixed periods of time, together with accompanying services including catering, entertainment and leisure services".

From the above, it emerges that a wide range of overnight accommodation services and other facilities are eligible for the benefits provided under the Law. Thus, one may easily determine that hotels, motels, guest houses and even hostels are eligible for such benefits, provided they fulfill the condition of the number of rooms stipulated by law.

We should also mention that the map for priority regions applicable to tourist facilities differs from the map for priority regions applicable to the industrial sector. Thus, and in regard to hotels, it was determined that Development Region A includes, inter alia, the Western and Upper Galilee, around Lake Kinnereth, Nazareth, Haifa, along the Carmel Shore, Nethanya, Ramle, Jerusalem and Jerusalem Corridor, and the Southern Region excluding Eilath and the Dead Sea.

### 6.4.1. Investment Grants

An entrepreneur wishing to establish an ‘overnight tourist facility’ is entitled to an investment grant and a capital grant, which vary according to the facility’s location. Investment grants vary from 10% - 24% of the entrepreneur’s investment expenses, less land costs.

The investment grant is not automatically offered; the entrepreneur must submit a detailed preliminary application to the Investment Center Management at the Ministry of Tourism. Based on established criteria, the application should address the various aspects to be considered by the Ministry (planning, minimum accommodation standards, etc.). In order to obtain the grant, the Ministry must issue a “letter of approval” for the plan. It should also be noted that the entrepreneur must submit the plan prior to proceeding with the actual investment, as grants are not approved “retroactively” on capital already invested.

In addition to the said grants, the regulations prescribe a number of tax benefits for approved tourist facilities, the principal one of which, in our opinion, is accelerated depreciation on an investment in a tourist facility structure.

#### 6.4.1.1. Tax Benefits Track for Overnight Tourist Facilities

As mentioned earlier, the tax track applies only to “overnight tourist facilities” and not to tourist attractions. Furthermore, this track does not require the authorities’ prior approval as it applies automatically, on compliance with the conditions prescribed by law. Legislation prescribes a number of conditions, beyond “foreign residents accommodation” which, on fulfillment thereof, entitle the owner of the facility to claim tax benefits.

The principal conditions for this are:

a. The facility must be under the ownership of an Israeli company not fiscally "transparent" for tax purposes.

b. To erect or widen the hotel, capital had been invested there in a minimum amount prescribed by law.

Under the tax benefits track, the owner of the facility is entitled to the following: a tax exemption on increase in turnover (deferring the tax until profit distribution) - currently 10 years exemption in priority Region A, 6 years in priority zone B and two years exemption in the rest of the country; accelerated depreciation and reduced tax rates (Tax at shareholders level due to receipt of dividends is generally 15%). Alternative track available In Priority region A, with a final 11.5% tax on undistributed profits at Company level on increase in turnover and (with no further taxation at the company level with profit distribution) tax at shareholders level due to receipt of dividends 15% to shareholder resident in Israel and 4% to shareholder resident abroad.

## 6.5. INCENTIVES FOR BUILDING RENTAL HOUSING

Building residential rental apartments is an essential social and economic goal, and it is for good reason that assessees who build and rent out apartments are eligible for diverse benefits and incentives offered through the tax system. Beyond the exemptions and benefits granted to individual property owners who rent out apartments, there are two parallel laws to encourage large-scale construction of rental housing.

The first and oldest law code is contained in Chapter Seven-1 of the Law for the Encouragement of Capital Investments. The second and relatively new law is the Law for the Encouragement of Rental Housing, enacted in 2007. In effect, after enacting the latter, two parallel systems of law were created to encourage the building of rental apartments, and an assessee may operate to apply one of them.

Pursuant to Chapter Seven-1, tax incentives are granted in regard to a building complying with the terms of the "Rental Building" designation, or the "New Rental Building" designation, which is usually one whole or several buildings located in one complex, and approved as such by the Investment Center Administration. It should be noted that there are entitlement conditions for actual tax benefits, including inter alia: the size of a minimum rented area, minimum rental periods, compliance with monthly rent limits, restrictions on the sale of part of a building for a specific period, etc.

The Law for the Encouragement of Rental Housing - 2007 is designed to increase the inventory of apartments available for rent. The Law grants benefits only to companies, by way of enabling accelerated depreciation and giving them a full exemption from Appreciation Tax. Unlike Chapter Seven-1, this concerns a track requiring no prior government approval. It is noteworthy that this Law, too, sets entitlement conditions for obtaining actual tax benefits, including inter alia: minimum number of apartments in a building, minimum rental fee, minimum rental period, restrictions on the sale of a building etc.

Below is a review of the scope of tax benefits available between these two legislative systems. (The review will address, with respect to Chapter Seven-1, the provisions applying to a "New Rental Building" only).

<u>Rental Income</u> - Reduced tax on income derived from the lease of a "new rental building" - at the rate of 11% for companies and 20% for individuals. Companies are liable to a lower effective tax rate of 10% on foreign investments, where the foreign investment exceeds 90%.

Dividend - 15% tax is chargeable on dividends distributed from the earnings of an approved enterprise which is a rental apartment building.

**Total "direct to house" tax under Chapter Seven-1 is 24.35%.**

Income from the Sale of a Building (Appreciation Tax) - This is liable to tax at the rates mentioned above. We must emphasize that these tax rates apply to betterment accumulated for the entire period and not merely from the effective date (November 7, 2001). It is also noteworthy that Section 72A of the Property Taxation Law denies such exemption for residential apartments, relevant only to individuals, in the sale of apartments in a rental building eligible for benefits under the Law.

Purchase Tax - There is a reduced purchase tax of 0.5%, where the Investments Center demands the transfer of title to a property which is a building or plot constituting a business inventory or fixed asset for a company held by the same owners, for purposes of a "rental building", with certain restrictions.

Accelerated Depreciation - at the rate of 20%.

V.A.T. Benefit on the Sale of a Building - Section 31(a) of the V.A.T. Law stipulates a tax exemption on the sale of such part of a building used for rent and having enjoyed the said tax benefits. The Section stipulates that if that part approved as a rental building had been rented for five years at least, the sale thereof would be exempt from V.A.T.

V.A.T. on Apartment Rental - The exemption specified in Section 31(1) of the V.A.T. Law shall apply in regard to rental housing for a period not exceeding 25 years.

### 6.5.1. Law for the Encouragement of Rental Housing

Rental Income - at the corporate tax rate which is currently 25%.

Dividend - Tax rate as stipulated in Section 125b of the Ordinance or 126(b) of the Ordinance.

Income from the Sale of a Building (Appreciation Tax) - Tax exemption on a sale will apply only if the rental building has been fully sold. No exemption will apply on the sale of individual apartments or on parts of a building, or on the sale to a relative. The full exemption will apply only after 25 years' rental. If the building is sold earlier (provided this is not before the end of 10 years rental), it must be sold only to a company that undertakes to continue renting it for a further period, such that the total rental periods will reach 25 consecutive years.

Accelerated Depreciation - at the rate of 20%. The said depreciation refers to the structure component without the land. In regions where the land component is high, the benefit pertaining to depreciation will amount to only the cost of the structure - a fact likely to impact the feasibility of a project. To take the fullest advantage of accelerated depreciation, the company must show positive income in the amount of losses from the rental of structures throughout the first five years rental at least.

V.A.T. Benefit on the Sale of a Building - Non-existent.

V.A.T. on Apartment Rental - The exemption specified in Section 31(1) of the V.A.T. Law will apply in regard to the rental of residential apartments for a period not exceeding 25 years.

## 6.6. OTHER INCENTIVE PROGRAMS

### 6.6.1. Small Business Loan Fund

The Small Business Authority of Israel was established in 1993, to fill the need for a policy-making organization to encourage small businesses, entrepreneurs, etc. The Authority's major roles include initiation and application of government policies for encouraging small businesses, setting up local, regional, and professional centers to assist them, and initiating the establishment of capital funds and other financial resources for small businesses, etc.

Among its other roles, the fund helps to establish or expand small businesses, while the government provides bank guarantees to serve as collateral for commercial loans.

The loan extended to a single business is for approximately NIS 500,000, for a five-year period, to fund the purchase of equipment or one year's working capital. The borrower is required to furnish the bank with a lien on the equipment financed by the loan, as well as personal guarantees. To be eligible for the loan, the business must meet certain criteria, as follows:

- The annual turnover must not exceed NIS 100,000,000.
- The loan should be used solely for new activities: establishing a new business or expanding an existing one. The funds should not be used for the purchase real estate, construction activities, or the acquisition of an existing business.
- Paid-in capital should not be 10-25% of the loan.

The fund is currently managed by three commercial banks. The State guarantees up to 70% of each loan amount and up to 30% of the entire loan portfolio.

### 6.6.2. State-Guaranteed Loans Offered to Medium-Sized Businesses

The Fund for Establishing and Supporting the Operation of Medium-Sized Businesses operated by the Ministry of Economy, offers State-guaranteed loans of up to 8% of an entity's annual turnover. The program is intended for medium-sized businesses with an annual sales turnover of NIS 22-100 m. The scope of collateral security required is 25%, while the Government extends a guarantee of up to 70% of the loan amount. Furthermore, the owners' personal guarantee is required.

The loan is for a term of up to five years, with a one-year extended grace period for repayment of the principal. Interest is at the customary rate prevailing in the banking system on such loans. The Fund is operated by commercial banks.

### 6.6.3. Assistance to industrial plants in financial difficulties

Pursuant to a government resolution, a committee of Ministry director-generals was formed to review industrial plants and submit recommendations to a ministerial team.

Government assistance is conditional on an independent investment in the plant, or a recovery plan including additional funding from the owners.

An external examiner appointed by the committee reviews applicant plants and their compliance with specific criteria, including:

- A recovery plan, its economic feasibility, the financial justification of the plant’s existence for the long term, and the ability to introduce recovery measures within a specific period of time.
- The lateral implications.

- The number of employees and minimum employment period.
- The scope of assistance required.
- The participation of other entities, including the owners.
- The ability to reduce the number of employees according to the recovery plan.
- Funding must not exceed NIS 10 million, and will deprive the plant's eligibility for further government assistance. However, should the plant apply for other financial assistance from a government entity, the plant must repay the loan.
- The salaries of managers and employees must not exceed NIS 50,000.

If the applicant plant meets the above criteria, it will be eligible for a government loan. The amount is determined by the committee, while its terms are specified by the Accountant General at the Ministry of Finance, in the event of additional funding from banks. Repayment terms are equivalent to those stipulated by these banks.

The owners are required to guarantee the loan.

### 6.6.4. Business Tutorage

The Minister of Economy focuses on assisting small and medium sized businesses by appointing “tutors” to cater to the specific requirements of each business (e.g. general management, financial management, production management, marketing, information systems, human resources, etc.).

Eligible businesses are tutored by independent consultants, whose fees are paid by the Ministry (75%) and the business (25%) within an agreed time frame, based on the latter’s needs and the Ministry's policy and budget.

Medium sized businesses (11 - 100 employees) are entitled to up to 150 hours of tutorship; small businesses (5 - 10 employees) are entitled to up to 100 hours; very small businesses (up to 4 employees) are entitled to 20 hours only.

In addition, very small business managers may participate in special courses, in the framework of Small Business Development Centers, designed to develop their managerial skills.

The Ministry of Agriculture allocates funds for “tutorage” of agricultural businesses.

### 6.6.5. Employment Grant Program

In order complement to the revised Law for the Encouragement of Capital Investments, the government has decided to establish an additional program to increase employment in remote areas of Israel, as well as specific centers with high unemployment.

Support will be provided for the establishment or expansion of industrial plants, telephone call centers, computer service support centers or logistic centers. In order to qualify for such program, these enterprises will be required to employ a minimum number of workers at a minimum wage, as detailed below.

In order to be granted support from this program, companies are required to compete, and will be invited to submit proposals twice a year. The maximum amount of support offered is as follows:

All areas: 15% of the cost of average monthly wage for additional employees, but no more than NIS 120,000 per employee for the entire period.

Minority and Ultra-Orthodox towns - as above. Enterprises paying wages below NIS 6,750 will be entitled to more than NIS 60,000.

Despite the above, the total average support granted to each enterprise will not exceed NIS 100,000 per employee.

The eligible areas are: Priority Development Areas "A" and "B"; and designated towns for the minority population (Arab, Druze, Circassian) or the Ultra-Orthodox Jewish population.

The enterprise must pay its employees the following minimum wages at least:

- Minority and Ultra-Orthodox towns - the minimum wages.
- In all other eligible areas - NIS 6,750 NIS monthly wage.

Enterprises should hire a minimum number of employees, depending on the region and the track (new plant or expansion).

### 6.6.6. Intra-Plant Training

The Ministry of Labor and Social Affairs assists companies (mainly manufacturers) in providing in-house training for unemployed people and undertaking to employ them. Training is provided either "on the job" for unskilled workers or those who have completed vocational courses but lack experience.

### 6.6.7. Quality Management Project

The project caters to industrial enterprises employing 50 to 500 people, for the introduction of modern management techniques. The grant covers 50% of consulting fees, up to 400 hours. The fee must be used within a period of 6 to 12 months.

### 6.6.8. “Preparation for Exposure” Fund

The fund is designed to help industrial enterprises gear up for competition due to exposure, and assists them in increasing imports and reducing customs and import duties. Grants may reach the equivalent of US$ 500,000 and government guarantees are available as well.

### 6.6.9. Approved Foreign Expert

A foreign resident approved by the Investment Center as a foreign expert, is liable to Israeli income tax at a rate of up to 25% during the first three years of employment. This period may be extended by an additional year. The reduced tax rate is applicable to a salary of up to US$ 75,000 per annum, plus social benefits.

### 6.6.10. Capital Intensive Companies

Under the Law for Encouragement of Capital Investments, Israeli and foreign entities wholly-owned by foreign investors, whose paid-in capital exceeds US$ 30 million, of which 75% at least is applied for "qualifying activities", are entitled to the special status of a “capital- intensive” company. The Income Tax Commissioner is authorized to amend the rules for attaining this status. Capital-intensive companies are entitled to a series of tax benefits over a 30- year period, including:

- 25% corporate tax.
- 15% withholding tax on dividends.

- Corporate tax refunds in the event of distribution of dividends. In this case, the withholding tax on dividends will be 25%.
- Tax exemption from sale of shares.

Finance Ministry approval is required for this status. An approved capital-intensive company may also be an Approved Enterprise.

## 6.7. SPECIAL FREE ZONES

### 6.7.1. Eilat Free Trade Zone

Eilat and its surrounding area were declared to be a free trade zone. The major benefits are as follows:

- Companies providing services and/or resident in Eilat are exempt from value-added-tax.
- Employers are reimbursed for part of labor costs paid in Eilat.
- Providers of advisory services to hotels in Eilat are exempt from value-added-tax.

### 6.7.2. Free Port Zones

The ports of Haifa, Ashdod, and Eilat contain areas declared as free port zones. Companies (only) located in the free port zones are eligible for benefits, granted in addition to any other benefit to which these companies are entitled under other encouragement laws. These additional benefits include:

- Lower corporate tax rates (in Eilat).
- Lower withholding tax on dividends (in Eilat).
- Exemption from property tax.
- Unrestricted use of foreign currency.

At present, the legislation in respect of free ports zones has not been enacted.

### 6.7.3. Free Processing Zones

In June 1994, the Free Processing Zone Law was enacted but its amendment in the near future is almost certain.

The first zone under this law is currently in the planning stages and will be located near Beer Sheva, in the Negev. Free processing zones may be developed by private concessionaires only, in compliance with a number of financial and organizational restrictions.

Some of the benefits to the concessionaires and enterprises operating in such zones are as follows:

- Companies are fully exempt from any direct tax for up to 20 years. Other entities are subject to direct tax of 15%.
- Withholding tax on dividends will not exceed 15%.
- Full exemption from municipal taxes (including betterment tax) and any indirect taxes (except for passenger vehicles).
- Capital gains on sale of shares are taxable at a rate of up to 15% unless reinvested within six months - in which case, they are fully exempt from capital gains tax.

- There are no custom duties or import restrictions (except in respect of health and environmental regulations, etc.)
- No foreign currency control will be imposed.

## 6.8. RESEARCH AND DEVELOPMENT

Numerous research and development programs provide a wide range of incentives to companies engaged in R&D activities.

### 6.8.1. Chief Scientist's Office

The Government of Israel provides cash grants, usually up to 50% of approved R&D expenses. Approval of R&D programs and actual expenses are under the responsibility of the Chief Scientist's Office at the Ministry of Economy.

The research committee is entitled to approve a participation grant of 20, 30, 40, or 50% of total R&D expenses and if located in National Priority Regions they are entitled to 10% grant. Start-ups may receive certain alleviations.

There are several incentive plans under the sponsorship of the Chief Scientist's Office. Among these one may find:

- Regular grant programs, offering up to 50% of R&D expenses. The eligible program should be for know-how, processing and/or manufacturing procedures, the manufacture of new products or a significant improvement on an existing process or product.
- **Magnet** - This program, intended for generic R&D technologies, encourages the formation of a consortia of industry and academic institutions to develop key technological infrastructures. Magnet also supports the integration of advanced technologies into industry through user associations. Grants of 66% of total approved R&D costs for industrial entities, and up to 80% of approved costs for academic institutions are available, with no royalty requirements.
- **Magneton** - This program is similar to the Magnet; however, it encourages cooperation between a single academic institution and an industrial plant. The available grant is up to 66% of the approved research budget.
- **Nofar** - This program is designed to support applied academic research in biotechnology, and to promote the transfer of technology to industry. Grants are available up to 90% of the approved research budget.
- **Kamin** - This program is design to support applied academic research which is not yet ready for business involvement. The activity is done in the academic research institute's labs, and the rest of the budget is financed by the institute. The grant is limited to up to 85%-90% of the approved budget.

Expenses are approved on an itemized basis, while salaries and wages are limited, particularly those of interested parties. A set of rules determines the nature and amount of each approved expense. Unapproved expenses are not entitled to grants.

If the R&D program is successful, royalties are payable to the Chief Scientist's Office. These usually range between 3% and 5% of the sale of products developed using government aid, and are paid till full repayment of the grant, linked to the Libor + 1%.

If production is relocated overseas, the Chief Scientist's prior consent is required, while 120%-300% of the grant must be repaid respectively, according to the production percentage being relocated. Additionally, the amount of royalties will increase.

In case of selling technology or know-how outside Israel for projects sponsored by the Chief Scientist, or any other right derived from such technology for enterprises outside Israel, payment will amount to a portion of the remuneration for such know-how, set at a ratio of the total grant out of the overall investments in the project. However, the payment will not be less than the amount of grants provided to the company, and up to 300% of the total grant received if, R&D activity stays in Israel but no less than 75% of salaries paid through 3 months prior the sale of the supported technology or know-how, and up to 600% of the grant received if R&D discontinue is Israel.

Aid to Individual Technology Entrepreneurs

- TNUFA- The Israel Idea Promotion Center is a non-profit Israeli, government-supported organization, dedicated to helping individual entrepreneurs successfully commercialize their new product ideas by providing seed money grants of 85% or up to NIS200,000 in addition to free legal, marketing and business-management consultations. Most of TNUFA's budget is based on royalties from successful projects.
- The Ministry of Absorption also provides financial aid to immigrant entrepreneurs.

## 6.8.2. Technological Incubators

### 6.8.2.1. Technological Incubators

Technological incubators provide a supportive framework enabling entrepreneurs with innovations - veteran Israelis and immigrants alike - to develop their ideas into a commercial product, and reach the point at which they can attract capital investments from the private business sector. R&D activities conducted in technological incubators are entitled to grants of up to 85% of the approved program or 100% in peripheral incubators. The grant is limited to NIS 2.1 million for a two-year period.

### 6.8.2.2. Biotechnological Incubators

Biotechnological incubators are aimed at supporting this type of research, given the specific nature and needs of this sector. In line with the current tendency for privatization, the private sector, in the form of franchisees, plays a key role in the project.

The government's participation in such projects is through a convertible bond, while the incubators are actually managed by the franchisees.

The franchisee obtains, for each project, a government loan of up to 85% of the approved budget in the 1st year, up to 80% in the 2nd year and up to 75% in the 3rd year. The approved budget for up to 3 years shall not exceed NIS 8,100,000. The franchisee is responsible for raising supplementary funding to cover the rest of the approved budget.

For each incubator project, the franchisee negotiates with the entrepreneur the percentage of control in the company running the project.

The franchisee provides a physical plant with adequate infrastructure for biotechnological R&D, administrative staff and accessibility to consulting services. In return for covering the operating costs of the biotechnological incubator, the franchisee receives up to 5% of the shares of each company accepted by the incubator.

## 6.9. INTERNATIONAL COOPERATION

The Israeli government has entered into a number of R&D cooperation agreements with foreign governments and the European Union, to foster ties between Israeli and overseas companies designed to facilitate joint ventures in the R&D, manufacturing and marketing fields. Such agreements exist with the United States, Canada, the European Union countries, and Asia.

### 6.9.1. The Seventh Framework Program of the European Union's Commission on Science and Technology

The European Union's Seventh Framework Program for Research and Technological Development (FP7) is for 7 years and is active from 2007 to 2013.

The FP7 budget is 50 billion ERUO.

Priorities covered by FP7 include life sciences, genomics and biotechnology for health, information society technologies, nanotechnologies and nanosciences, "intelligent" materials, new production processes and devices, aeronautics and space, food quality and safety, sustainable development, global change and ecosystems, citizens and governance, and other promising research areas.

Research institutes and companies in associated EU countries are eligible for the funding of joint projects, in partnership with EU countries. The projects have to be trans-national, i.e., only consortia of partners from different member and associated countries can apply. The coordinating office is ISERD.

### 6.9.2. Eureka

Eureka is a Europe-wide network for industrial R&D, uniting 40 countries by promoting 'market-driven' collaborative R&D projects in most fields of advanced civilian technology. An agreement signed in 1993 with the European Eureka Secretariat allows Israeli companies to join this prestigious program.

### 6.9.3. Bi-National Funds

6.9.3.1. **BIRD-F** - The Israel-U.S. Bi-national Industrial Research and Development Foundation (BIRD-F) assists R&D programs involving non-defense products and processes jointly implemented by Israeli and United States companies.

BIRD-F finances 50% of R&D projects.

As in the case of government programs, the grants, if successful, are repayable as royalties up to 150% maximum of the amount of the grant.

6.9.3.2. **CIIRDF -** The Canada - Israel Industry and Research Development Foundation was founded at the end of 1994 and is similar to BIRD-F. CIIRDF funds 50% of joint Canadian- Israeli projects encompassing several Canadian provinces.

6.9.3.3. **SIIRD** - The joint Israel-Singapore Fund began operating in 1997. At the initial stage, each country deposited into the fund annually US$2 million for grants, with the aim of increasing the capital over time. SIIRD finances bi-national R&D projects up to 50% of R&D expenses or US$ 750 thousand, and is similar in composition and activities to BIRD-F and CIIRDF.

6.9.3.4. **KORIL - RDF** - The Israel-Korea Fund was jointly initiated by the Chief Scientist and MOCIE (Korean Ministry of Industry and Commerce). The fund is a Korean non-profit organization run by representatives from both countries. Each country deposited US$ 1 million annually into the fund for the first three years of activity, to finance bi-national R&D projects. The fund finances R&D 3-year projects for a total of up to 50% of R&D expenses, or up to US$ 500 thousand, and is designated as a “conditional grant”. If the project produces sales, the grant is repaid through royalty payments.

### 6.9.4. Other International Programs

6.9.4.1. **U.S.-Israel Science and Technology Commission** - The Commission was a joint initiative of the late Prime Minister Itzhak Rabin and United States President Bill Clinton, for further cooperation between Israel and the United States, and to add a new dimension to scientific and technological cooperation between Israeli and U.S. hi-tech companies. The Commission has two objectives: funding long-term projects with substantial technological impact and removing any impediments - such as FDA regulations.

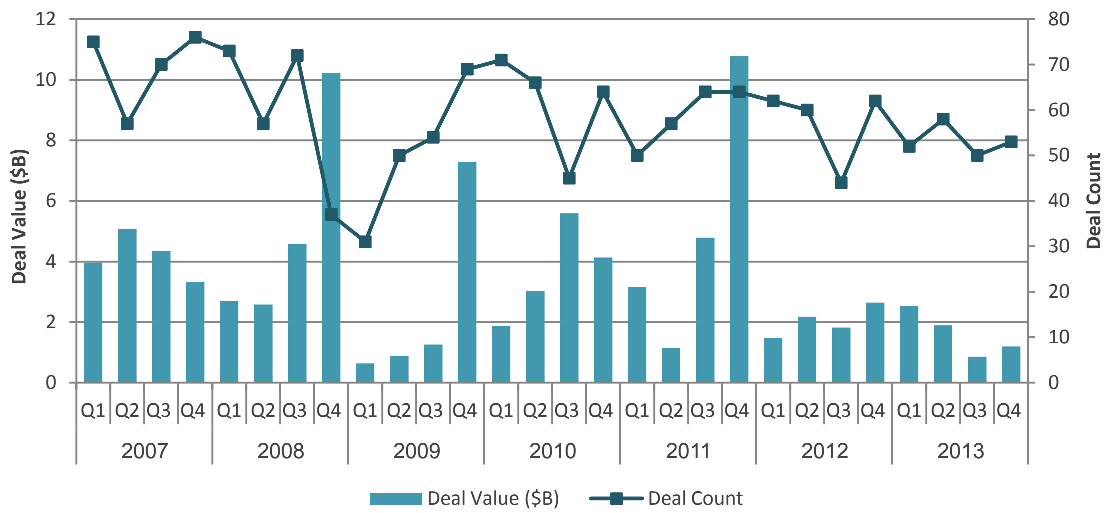
6.9.4.2. **BSF** - Israel-U.S. Bi-national Science Foundation provides assistance to scientists and start-up programs. The grants are intended to support 18 months of a two-year research program, with the objective of providing seed money to young independent scientists.

6.9.4.3. **Bi-National R&D Agreements** - Promotes R&D cooperation between Israeli and foreign companies, while each company is assisted by its home country. These agreements were signed with 28 countries.

# 7. M&A Activity in Israel

## 7.1. GENERAL

M&A activity of Israeli companies is quite significant. 213 transactions were concluded during 2013 for an overall value of $6.5 billion, compared with 228 in 2012 for $8.1 billion. 2012 and 2013 were marked by a certain reduction in the number and scope of transactions, which is explained by an uncertain economic environment, similar to 2009.




*Source: Bloomberg*

Even though both 2012 and 2013 seemd to reflect a certain slowdown in M&A activity in the country, the Israeli business environment is expected to generate significant M&A opportunities in the upcoming years due to new regulations/legislation, liquidity issues and other reasons discussed below.

## 7.2. NEW REGULATION AND LEGISLATION

The Israeli corporate sector is generally dominated by large conglomerate groups. There are roughly 20 families controlling 25 percent of the listed Israeli companies and 50 percent of the total market share in the Tel Aviv Stock Exchange (TA-25), one of the highest concentrations among developed economies. Concerns that the growth of market power and control might have an adverse effect on competition have led to the recent creation of the Committee on Increasing Competitiveness in the Economy (CICE).

CICE's recommendations were published at the beginning of 2012 and were followed by adequate legislation during 2013, and are intended to take effect within the next four years:

- Pyramid holding structure - Holding companies will have to limit their pyramid structure to no more than three public layers.
- Cross-Holdings - Holding companies must reduce cross-holdings in financial and industrial businesses.

The outcome of the new regulation and legislation will lower the risk of highly-leveraged companies and reduce their relative strength in the economy, while increasing the influence of minority shareholders. Furthermore, the new regulation and legislation would compel holding companies to divest some of their holdings, while bringing dynamism and change of ownership, thereby increasing competition among businesses and reducing consumer prices in the market.

## 7.3. LIQUIDITY

During the 2000's and until the economic crunch in late 2008, the business environment in Israel supported increased M&A activity both domestically and globally, due to comfortable credit conditions, awakening capital markets and smooth regulations. Such conditions enabled various Leveraged Buyouts (LBO's) by investment firms, holding companies and others.

In 2012, some of these organs encountered liquidity problems, while regulations became more stringent (as mentioned earlier), banks and financial institutions tightened up their credit policies and the Israeli capital market became more cautious, with the result that refinancing has become an extremely difficult process. Such conditions cause "good companies" to be in the market while the controlling shareholders seek to liquidate their holdings. Companies such as Ham-let, Clal Industries and Maxima were sold by IDB in 2012; Kaman holdings entered into receivership; Delek Real-estate and Africa-Israel went through significant debt restructuring accompanied by asset liquidations are merely examples.

During 2013, the liquidity in the market has improved significantly towards the end of year, even though the total public debt issuance has been down 8.5% from 38.8 billion NIS in 2012 to 35.5 billion NIS in 2013. The comosition of the debt has changed significantly between the years, while in 2012 45% of the debt was issued to banks and utilities, in 2013 roughly 48% was issued to real-estate companies.

During 2013, the public equity market in TASE has significantly improved and became an alternative to the debt market, to some extent. In 2013 roughly 4 billion NIS were raised in equity, as compared to 2 billion NIS during 2012.

## 7.4. AGING FOUNDERS

The Israeli business environment and culture has always supported entrepreneurship and start-ups, and during the 70's a significant number of businesses were established, encouraged by government regulations and economic reforms. Consequently, many business owners have now reached the retirement age, in some cases without the emergence of the next generation to succeed them, thereby creating an inevitable need to sell the business.

## 7.5. PRIVATE EQUITY ACTIVITY

Israel is enjoying a growing interest in both local and foreign Private Equity Funds (PE's).

The local PE industry has significantly grown through the 2000's, while funds such as Markstone, FIMI, Shamrock and others have initiated successful transactions and exits with significant returns, with an average of 20%-30% IRR. The funds appetite for Israeli-related acquisitions is constantly growing: the local FIMI PE raised a record $900 million for its fifth fund, Fortissimo PE raised $265 million for its third fund, Tene PE raised $150 million for its third fund and so on - all in 2012. Even though in 2013 only one Israeli PE has raised $200 million, the significant capital that seeks investments in local companies is quite significant and is expected to generate M&A activity in the next year or two.

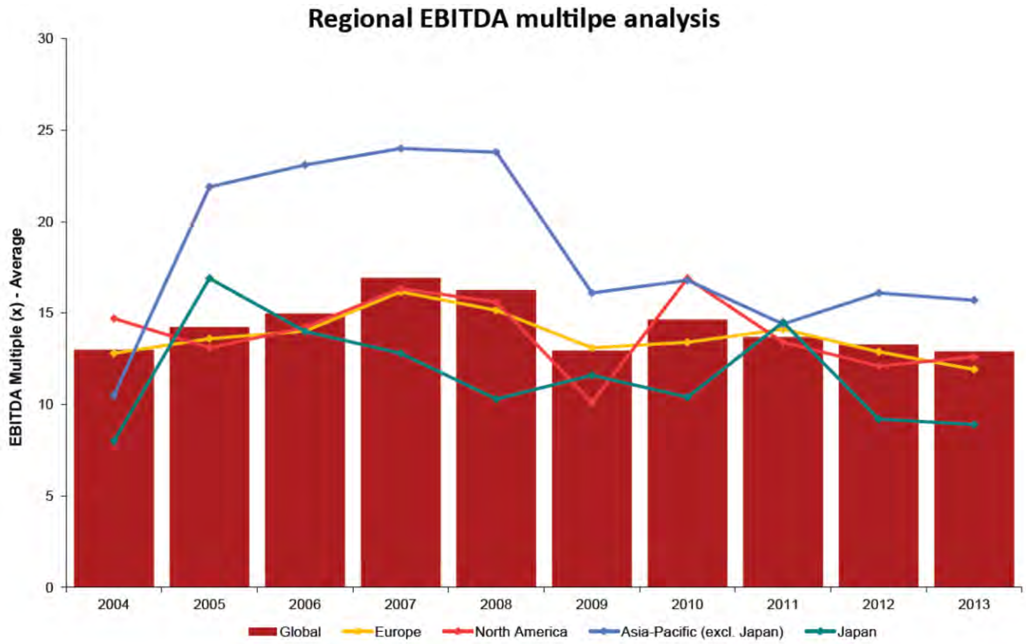
The successful local PE activity has in recent years also attracted the large global PE funds and investment companies - such as Berkshire Hathaway (Iscar), Apax partners (Bezeq, Psagot, Tnuva), Permira (Netafim); others, notably Blackstone, Blackrock, KKR, are expected to introduce their operations in Israel in the near future.

PE activity is also expected to generate significant "sell side" opportunities. Most funds are obliged to exit their investments within 7 to 10 years since their acquisition. As the major activity of most funds had occurred during 2005-2008, various opportunities are expected to be out in the market in the upcoming years.

## 7.6. ISRAELI MARKET MULTIPLES

The global historic EBITDA multiples vary between 12 and 16, while the fast growing economies provide significantly higher multiples, reaching even a range of 20's during 2005-2008.

The developed countries tend to have lower multiples, supported by lower market expectations, even though the perceived risk is considered to be relatively low.




*Source: Mergermarket*

Although there are no formal sources tracking the Israeli market multiples over time, the domestic market is traditionally "enjoying" lower EBITDA multiples most commonly in the range of 5-10 (allways can be found exclusions, such as Given Imaging acquisition for roughly $1 billion with an EBITDA multiple of 35) - significantly lower than the global average. The main reasons are:

- Size Premium - Israeli companies are usually smaller than the average company in the global market, and thus getting a negative size premium.
- Geopolitical Perceived Risk - Foreign investors perceive a higher geopolitical risk in Israel than in their homeland.
- Limited Competition - Even though the Israeli market attracts various foreign investors, the local Israeli market has a relatively limited amount of potential bidders, which drives lower prices in M&A deals.
- Capital Market - The Israeli capital market provides a pricing reference for M&A deals. Since the market volume and attraction is globally limited, so is its pricing.

In 2010, Israel joined the OECD and was added to the MCSI index, reflecting its change of status to a "developed country". Accordingly, the Israeli market's relatively low multiples are expected to increase in the future, yielding a potential extra capital gain as a higher return on investment, compared with other developed countries and the global average in general.

# 8. FOREIGN EXCHANGE CONTROL AND PREVENTION OF MONEY LAUNDERING

## 8.1. FOREIGN EXCHANGE CONTROL

In May 1998 the currency control policy was changed and, for all intents and purposes, restrictions on activities and transactions of Israelis abroad and transactions in foreign currency, both in Israel and abroad, were abolished.

As part of the liberalization program, the Controller of Foreign Currency at the Bank of Israel issued a general permit whereby an Israeli resident is free to engage in foreign currency transactions and in transactions with foreign residents, which otherwise required a permit.

The last restriction remaining under the Foreign Exchange Control Law until recently, forbade Israeli institutional investors from holding foreign currency and investing abroad amounts exceeding 20% of their total assets. This restriction was removed in January 2003.

In 2010 following, on the one hand the acknowledgement that more updated financial regulations are necessary in light of the global financial crisis of 2008, and on the other hand the desire to continue the liberalization of the Israeli financial market, the Israeli Legislator passed the Bank of Israel Act of 2010. As part of the act, the general permit of 1998 was repealed, and the reporting restrictions were now set forth in Article 39 of the Act.

Under Article 39 of the Act, the information requirements relating to foreign exchange control were expanded through Executive Order by the governor of the Bank of Israel, the executive order establishes some reporting restrictions that are imposed on banks, financial brokers, and institutional investors.

An Israeli resident is obligated to report to the Bank of Israel - with specific forms- in each of following cases:

1. Form 1 - Reporting on the founding or purchasing of a foreign corporation or a loan given to a foreign corporation.
2. Form 2 - Report on an investment or realization of an investment in a foreign corporation.
3. Form 3 - Report on an investment or realization of an investment of a foreign corporation or foreign resident in an Israeli corporation.
4. Form 4 - Report on direct outstanding investments of a foreign resident or a foreign corporation in an Israeli corporations.
5. Form 5 - Report on direct outstanding investments of an Israeli corporation in foreign corporations.
6. Form 6 - Report on an initial public offering (IPO) of an Israeli Corporation outside of Israel
7. Form 7 - Report of an Israeli corporation on its stocks and interests holders.
8. Form 8 - Quarterly report by an Israeli corporation concerning its assets and obligations in Israeli and foreign currency (applies to Israeli corporations that have foreign holdings exceeding 20 million U.S. dollars, or a yearly revenue in excess of 50 million U.S. dollars.
9. Form 9 - report by an Israeli Non-Profit on the donations it has received, financial holdings and foreign accounts (applies to Israeli Non for Profit organizations that have received donations exceeding 20 millions U.S. dollars or have financial assets outside of Israel that are equivalent to 20 million dollars.)
10. Form 10 - report by an Israeli resident on investments and financial holdings and foreign accounts (applies to Israeli residents that hold financial assets abroad that are worth 20 million U.S. dollars or more).

A banking institute according to Article 2 of the Executive Order, must report to the Bank of Israel about any of the following transactions, including nature of the transaction as well as identity of the parties to the tansaction:

1. A transaction between an Israeli resident and a foreign resident that was facilitated by the banking institute.
2. A transaction required by an Israeli resident to be done with foreign currency that was facilitated by the banking institute.
3. A transaction required by a foreign resident to be done with Israeli currency that was facilitated by the banking institute.

A financial broker according to Article 2 of the Executive Order must report to the Bank of Israel:

1. About any Israeli securities or stocks held by him for a foreign resident and on foreign securities or stocks held by him for an Israeli resident;
2. If the value of said securities of stocks is over 100,000$ or their equivalent in Israeli currency, or in the case the Israeli resident for whom the financial broker is holdin the securities a financial broker himself, or an insurer or a trust fund or a pension fund, the financial broker will report additional information to the Bank of Israel including information concerning the identity of the Israeli resident and the additional details about the specific securities in question.

An Israeli resident according to Article 3 of the Executive Order will bear additional reporting responsibility requirements. These requirements include the furnishing of information to the financial broker executing the transaction and reporting directly to the Controller of Foreign Currency, as outlined below.

An Israeli resident engaging with a foreign resident using a financial broker is required to report to the financial broker on the nature of the engagement.

In the event that Israeli currency is transferred to the account of a foreign resident, it is the foreign resident's responsibility to inform the financial broker regarding the residency of the other party and, if this concerns an Israeli resident, the nature of the transaction should be reported as well.

### 8.2. THE PREVENTION OF MONEY LAUNDERING

Alongside the globalization of nations and information networks, there have been cases of “money laundering”. The international effort against money laundering has taken a more aggressive course in the past decade.

In 1989, an international force called FTAF - Force Task Action Financial - was established in Paris under the patronage of the G-7 industrial nations.

Israel officially joined this fight in 2000, with the enactment of the Prohibition of Money Laundering Law in the Knesset. This Law enables Israel to take an active role in the international fight against money laundering.

The law was expanded through an Executive Order in 2002 issued by the Minister of the Treasury, that deals specifically with identification, reporting and registering obligations on providers of currecncy services.

The Executive Order of 2002 imposes certain identification and reporting obligations on financial institutions, including banks, stock exchange members and money changers. These institutions are required to identify anyone, either a person or a corporation, requesting services such as opening of an account, change of ownership of an account, or execution of certain transactions. The aforementioned institutions are also required to report certain transactions to the authority for the prevention of money laundering. These transactions fall into two categories as specified in Article 6 of the Executive Order of 2002:

- Transactions whose size exceeds defined amounts.
- Unusual transactions - transactions which appear to be unusual in light of the information the institution possess - for example, a transaction whose aim seems to be avoidance of the size reporting requirements; an account whose holder seems to be operating on behalf of someone else, etc.

Additionaly an entire chapter was added to the Banking Law (Registration) Act of 1981 in 2011, dealing with clearing of transactions (payment to the supplier for assets acquired by the same supplier’s client through a debit card, against receipt of payment for the assets from the debit card issuer, and if payment to the supplier was made by the issuer - against receipt of payment for the assets directly from the client) including “cross clearing”.

Furthermore, pursuant to Article 36(13)(3), the Minister of the Treasury is authorized (if he deems it necessary to promote competition in the clearing of transactions in debit cards or to protect the interest of clients or suppliers) after consultation with the Supervisor of the Banks and chairman of the Antitrust Authority of Israel, to order that a clearing house with an extensive volume of activity enter into an engagement with an issuer to clear transactions in debit cards issued by the same issuer, if the Controller considers that the clearing house as aforesaid refused to enter into an engagement with the issuer on unreasonable grounds, under the terms stipulated in this section.

Pursuant to Article 36(13)(2), an issuer with an extensive volume of activity shall not refuse to enter into an engagement with a clearing house for performing a cross-transaction of transactions in debit cards issued by it, on unreasonable grounds.

In this respect, we should mention that Article 36(13)(4) also obligates, inter alia, the Supervisor of the Banks to publish on the Bank of Israel’s Internet site, once a year, a list of issuers with extensive activity, and to notify, accordingly, issuers with extensive activity not included in the list in the year preceding the publication.

# 9. ISRAEL LANDS ADMINISTRATION

## 9.1. RESPONSIBILITIES

The Israel Land Authority (ILA) is responsible for managing land owned by the State of Israel, Keren Kayemet Le'Israel (Jewish National Fund, KKL), and Rashut Pituach (Development Authority) - comprising 93% of the land in Israel. Land managed by the ILA is considered to be State-owned.

Management policy is based on the following laws and regulations:

- **Basic Law: Israel Land** - stipulates that State-owned land may not be sold or leased.
- **The Land of Israel Law (1960)** - regulates change of ownership of State land.

  After Amendment No. 3 of the law, passed in 2011, a revision was made to the provisions of the Law, with respect to a limitation on transfer/acquisition of title to land to foreigners.

According to the amendment:

"**Land Titles"** - Title to land or a leasing right for cumulative terms exceeding five years, or an option to extend such term by an overall period exceeding five years, including a based on an undertaking to grant or to assign ownership or a lease for the said term.

"**Foreign" -** each of the following:

(1) An individual who is not any of these:
   (a) An Israeli citizen or resident.
   (b) Anyone entitled to immigrate to Israel under the Law of Return, 1950.

(2) A corporation under the control of one or more individuals, other than those mentioned in paragraph (1) above.

(3) Anyone acting on behalf of an individual or corporation as set forth in paragraphs (1) or (2) above.

- **The Israel Lands Administration Law (1960)** - grants the Israel Lands Administration responsibility for managing State land.
- **The Treaty Between the State of Israel and KKL (1961)** - provides that the ILA will manage State-owned land, as defined above.

## 9.2. MAIN ACTIVITIES

- **Marketing and development** - land is planned and developed in conformity with goals set by the Government of Israel and the Israel Lands Administration Council, in coordination with the relevant ministries and authorities (Housing and Construction, Tourism, Industry and Trade, municipalities, etc.). Planning and development goals include, inter alia, the creation of housing and employment, and provision of recreation facilities. Land is generally sold or leased on the basis of issuing tenders and occasionally by drawing lots.
- **Acquiring land** - on behalf of the State of Israel, particularly when the State is interested in developing areas for communal purposes, such as roads, schools, cultural centers, etc.

  The acquisition process is usually by way of direct purchase or by offering the landowner or holder of land rights an alternative property, or monetary compensation.
- **Control over use of land** - since the land is allocated for specific purposes, controls are exercised, inter alia, in order to prevent breach of contract.

### 9.3. ISRAEL LAND ADMINISTRATION OFFICES

**Headquarters**
15 Hatzvi Street, bezeq building
Jerusalem 9438622
Fax: (073) 202-1500

**Haifa District**
15 Pal Yam Street
Haifa 3100401
Fax: (04) 864-5537

**Tel Aviv District**
125 Menahem Begin Road
Kiryat Hamemshala
Tel Aviv 6107201
Fax: (03) 763-2010

**Southern District**
4 Tikva Street
Kiryat Hamemshala
Beer Sheba 8410102
Fax: (08) 626-4303

**Judea and Samaria District**
Civil administration building
POB 43, Beit El 9063101
Fax: (02) 997-7770

**Northern District**
Plaza Hotel, Carmel Street
Upper Nazareth 1710502
Fax: (04) 655-8213

**Jerusalem District**
216 Jaffa Street
Jerusalem 36259
Fax: (02) 531-8706

**Central District**
125 Menahem Begin Road
Kiryat Hamemshala
Tel Aviv 6107201
Fax: (03) 763-2132

**The Golan Heights**
Masada
POB 244, Masada 1243500
Fax: (04) 698-5208

**Eilat Branch**
Red Sea Shopping Center
Eilat 8811001
Fax: (08) 646-6981

# 10. BDO INTERNATIONAL

## 10.1. ABOUT BDO

BDO International is a worldwide network of professional accounting and consulting firms, serving global and national organizations. Since its establishment in 1963, BDO has grown to become the fifth largest firm in this sector worldwide. From its European roots, BDO has developed a global network of 1,264 offices in 147 countries. More than 48,369 partners and professional staff provide auditing, accounting, tax, financial and management advisory services in BDO's locations worldwide.

BDO's special skills lie in combining its local knowledge, experience, and understanding of the international context to provide integrated global services. At BDO, common practice and quality control procedures do not constitute a constraint on innovation and independence of thought, but represent the starting point. It is a full-service organization focusing on the needs of growing businesses.

BDO's reputation derives from timely provision of creative and objective service. The organization takes pride in its clients' success and development, based on a personal relationship combining the benefits of professional knowledge, integrity and an entrepreneurial approach with an understanding of the client's immediate and long term requirements. This ensures provision of an objective professional service of the highest quality, tailored to meet the individual needs of each client, whether governments, multinational companies, national businesses or private individuals.

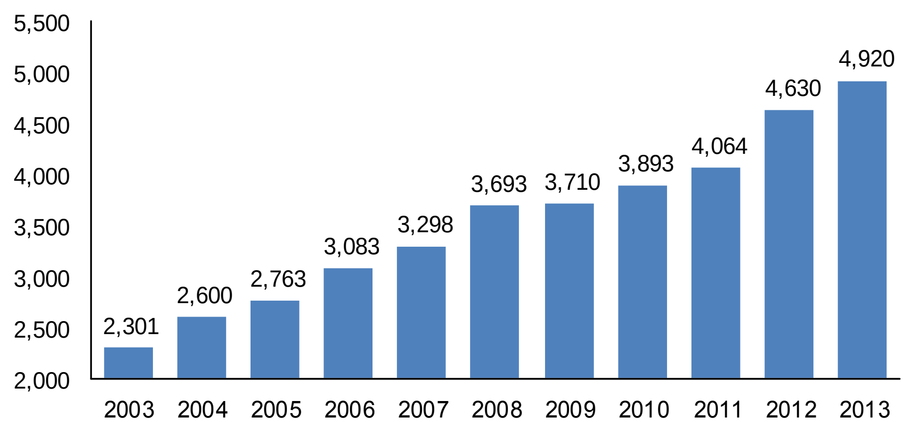
## 10.2. KEY FIGURES FOR DECEMBER 31, 2013

### 10.2.1. Global Income

BDO is a multinational organization founded in Europe in 1963 and has since been committed to service excellence and client satisfaction.
The organization has member firms throughout Europe, North and South America, Asia and the South Pacific, Middle East and Africa, and continues to expand.

The following diagram illustrates BDO's income development in the years 2003-2013:

**Fee Income (Euro millions)**

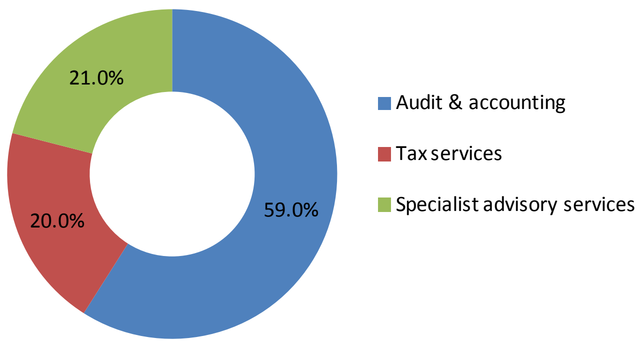



Global fee income shows an increase of 6.3% compared with the previous year.

### 10.2.2. Income by Discipline

BDO is a full-service organization that offers a range of professional auditing, accounting, tax, financial and management advisory services.

The following diagram illustrates BDO's fee split by discipline in 2013:



## Appendix 1 - USEFUL ADDRESSES IN ISRAEL

Please note that when dialing from abroad, first dial the access code for international calls, then **972**, after which the area code (omitting the '**0**'), and then the telephone number.

### A. MINISTRIES AND GOVERNMENT OFFICES:

**Prime Minister's Office**
Kiryat Ben Gurion,
Jerusalem 91008
Telephone: (072) 275-4231
Facsimile: (02) 560-5000
E-mail: policyplanning@it.pmo.gov.il

**Ministry of Agriculture**
Hamacabim Roud,
Beit Dagan 50250
P.O Box 30
Telephone: (02) 629-0111
Facsimile: (02) 629-0156
E-mail: pniot@moag.gov.il

**Ministry of Communication**
23 Yaffo Street
Jerusalem 91999
Telephone: (02) 670-6301
Facsimile: (02) 624-0029
E-mail: dovrut@moc.gov.il

**Ministry of Construction and Housing**
Kiryat Hamemshala
Jerusalem 91180
Telephone: (02) 584-7211
Facsimile: (02) 582-2114
E-mail: doar@moch.gov.il

**Ministry of Environment**
5 Kanfey Nesharim Street
P.O.Box 3403370
Jerusalem 95464
Telephone: (02) 649-5803
Facsimile: (02) 649-5892
E-mail: pniot@sviva.gov.il

**Ministry of Finance**
1 Kaplan Street
Kiryat Hamemshala
Jerusalem 91950
Telephone: (02) 531-7111
Facsimile: (02) 569-5347
E-mail: pniot@mof.gov.il

**Ministry of Health**
2 Ben Tabai Street
P.O.Box 1176
Jerusalem 91010
Telephone: (02) 670-5811
Facsimile: (02) 672-5836
E-mail: pniot@moh.health.gov.il

**Ministry of Industry, Trade And Labor**
Kiryat Hamemshala
5 Bank Israel Street
Jerusalem 91036
Telephone: (02) 666-2000
Facsimile: (02) 666-2923
E-mail: pniot@moit.gov.il

**Ministry of Justice**
29 Tsalch Adin Street
Jerusalem 91490
Telephone: (02) 646-6666
Facsimile: (02) 646-7085
E-mail: Pniyot.Tzibur@justice.gov.il

**Ministry of Social Affairs**
2 Kaplan Street
Kiryat Ben Gurion
P.O.Box 915
Jerusalem 91008
Telephone: (02) 675-2523
Facsimile: (02) 566-6385
E-mail: sar@molsa.gov.il

**Ministry of National Infrastructure**
216 Jaffa Road
Jerusalem 91360
Telephone: (02) 500-6777
Facsimile: (02) 500-6720
E-mail: pniot@mni.gov.il

**Ministry of Science,Technology and Space**
Government Offices, Building C
Hakirya Hamizrachit
P.O.Box 49100
Jerusalem 91490
Telephone: (02) 541-1100
Facsimile: (02) 532-3497
E-mail: libio@most.gov.il

**Ministry of Culture and Sports**
14 Hamasger,
Tel Aviv 67776
Telephone: (03) 636-7223
Facsimile: (03) 688-3430
E-mail: ministerts@most.gov.il

**Ministry of Tourism**
5 Bank Israel Street
P.O.Box 1018
Jerusalem 91009
Telephone: (02) 666-4200
Facsimile: (02) 666-4400
E-mail: giordanar@tourism.gov.il

**Bank of Israel**
2 Kaplan Street
Kiryat Hamemshala
P.O.Box 780
Jerusalem 91007
Telephone: (02) 655-2211
Facsimile: (02) 652-8805
E-mail: pniyotz@boi.gov.il

**The Custom and VAT Authority**
5 Bank Israel Street
P.O.Box 320
Jerusalem 91002
Telephone: (02) 666-4000
Facsimile: (02) 666-4011
E-mail: pniotmaam@mof.gov.il

**Foreign Trade Administration**
Kiryat Hamemshala
5 Bank Israel Street
Jerusalem 91036
Telephone: (02) 666-2622
Facsimile: (02) 666-2958

**Investment center**
Kiryat Hamemshala
5 Bank Israel Street
Jerusalem 9103101
Telephone: (02) 666-0373
Facsimile: (02) 625-0442

**The Office of the Chief Scientist**
5 Bank Israel Street
P.O.Box 3166
Jerusalem 9103101
Telephone: (02) 666-2485
Facsimile: (02) 666-2928

**Patent Registry**
1 Hapoel Sports Association Street
Technology Park
Jerusalem 96951
Telephone: (02) 565-1666
Facsimile: (02) 646-7774
E-mail: Patent@justice.gov.il

**Securities Authority**
22 Kanfei Nasharim Street
Jerusalem 95464
Telephone: (02) 655-6555
Facsimile:(02) 651-3646
E-mail: webmaster@isa.gov.il

## B. OTHER USEFUL ADDRESSES:

**Bank Hapoalim Ltd.**
50 Shderot Rotchild Street
Tel Aviv 61000
Telephone: (03) 653-2407
Facsimile: (03) 567-6688

**Bank Leumi Le-Israel B.M.**
19 Herzel Street
Tel Aviv 66884
Telephone: (03) 514-8111
Facsimile: (03) 514-7272

**Israel Discount Bank Ltd.**
27 Yehuda Halevi Street
Tel Aviv
Telephone: (03) 514-6355
Facsimile: (03) 514-6287

**United Mizrahi -Tefahot Bank Ltd.**
7 Jabotinsky Street
P.O.Box 3450
Ramat Gan 52136
Telephone: (076) 804-0770
Facsimile: (03) 755-2199

**First International Bank of Israel Ltd.**
9 Ahad Ha'am Street
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Facsimile: (03) 513-4067

**Industrial Development Bank of Israel Ltd. - Information**
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Tel Aviv 67138
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**Federation of Israel Chamber of Commerce (Tel Aviv-Jaffa)**
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Tel Aviv 6713203
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Facsimile: (03) 561-9025

**The Institute of Certified Public Accountants (Israel)**
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**The Israel Export & International Cooperation Institute**
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Facsimile: (03) 514-2902

**Israel Hotel Association**
Industry House
29 Hamered Street
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Facsimile: (03) 510-0197

**Israel - US Binational Industrial Research and Development Foundation**
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**MATIMOP**
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**Tel-Aviv Stock Exchange**
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**Kibbutz Industries Association**
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**Israel Government Tourist Corporation**
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### ARGENTINA

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### AUSTRALIA

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6 Turrana Street
Yarralumla
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**Consulate General of Israel**
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Facsimile: 61-2-9262-5242
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### AUSTRIA

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Wien 1180
Vienna
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### AZERBAIJAN

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### BELARUS

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### CANADA

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## EL SLAVADOR

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18 th Fl.Cheonggye 11 Building 149
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## NETHERLANDS

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## UKRAINE

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