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Israel

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5.1 Introduction

Israel is a parliamentary democracy. Its parliament, the *Knesset*, passes laws, elects the Prime Minister and the President, and approves the Cabinet. It has an independent judiciary, a well-developed body of commercial law, and experienced communities of lawyers, judges and financial service practitioners. It is also a member of the Organization for Economic Co-operation and Development.

Israel is known for its high-tech sector and has been nicknamed the ‘start-up nation’.² It is a world leader in expenditures on research and development as percentage of gross domestic product, the number of innovative companies per capita, and venture capital investment per capita.³ It is also one of the global leaders in investment in Cybersecurity, Fintech, the Internet of Things, and Agritech.⁴

Israeli start-ups received over USD 6.3 billion in investment in 2018, over USD 8.3 billion in 2019, and over USD 5.2 billion in the first half of 2020,⁵

¹ We are grateful to Jacob Laband, Ori Margalit, and Daniel Pessar for excellent research assistance.

² Dan Senor and Saul Singer, *Start-Up Nation: The Story of Israel's Economic Miracle* (Hachette Book Group 2009).

³ Klaus Schwab, World Economic Forum, The Global Competitiveness Report 2019 (2019) 17 http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf accessed 30 August 2020.

⁴ Start-Up Nation Central, The State of The Israeli Ecosystem in 2018 <https://lp.startupnationcentral.org/annualreport/> accessed 30 August 2020.

⁵ IVC Research Center & ZAG-S&W, Israel Tech Funding Report: Capital Raising Analysis, Trends and Insights – Q2 2020 (July 2020) <https://www.ivc-online.com/Portals/0/RC/Survey/IVC-ZAG>

achievements attributable in part to the Israeli government's Innovation Authority. The Innovation Authority aims to strengthen competitiveness and productivity by supporting technological innovation through research and development grants, incubators and accelerators.⁶

The state's legal framework is friendly to foreign investment. Foreign investors can freely repatriate funds from Israel to their home countries; foreign investors are generally exempt from Israeli capital gains tax;⁷ and there are no limitations on foreign ownership of shares in Israeli companies or on a non-resident acting as a director or officer of an Israeli company.

Israel also boasts a modern business culture, characterized by a high level of English proficiency (allowing transaction documents to be drafted in English) and an advanced banking system.

More than 350 multinational companies – including Amazon, Apple, Facebook, Intel, and Microsoft – have established research and development centres in Israel, drawn by its combination of scientific excellence, entrepreneurial culture, and hospitable legal environment.⁸

5.1.1 History of the legal system

The State of Israel was founded in 1948 upon the end of the British Mandate. British common law principles, which the British Mandate had adopted as ordinances, became part of Israeli law. Many of these ordinances are still part of the law, including the Torts Ordinance, the Partnership Ordinance, and the Evidence Ordinance.

Over the years, Israel has significantly amended or replaced these ordinances with new laws. One such new law is the Companies Law of 1999

%20FUNDING_REPORT%20Q2_2020_Final.pdf?_atscid=7_134353_41893417_1416487_0 accessed 30 August 2020.

⁶ Israel Innovation Authority, *Innovation in Israel Overview 2018–19* https://innovationisrael.org.il/en/sites/default/files/2018-19_Innovation_Report.pdf accessed 30 August 2020.

⁷ See Section 5.7.10.

⁸ IVC Research Center, GKH Law Firm and Israel Advanced Technology Industries, *Multinational Companies (MNC) – Contribution to the Israeli Tech Ecosystem* (December 2019) <http://www.iati.co.il/files/files/IATI%20MNCs%20Report%202019.pdf> accessed 30 August 2020.

(‘the Companies Law’), which is amended regularly.⁹ Although the Companies Law draws on Anglo-American law, it also contains features unique to Israel. For example, minority shareholders of a public company have veto power over extraordinary transactions in which a controlling shareholder has a personal interest.¹⁰

5.1.2 The court system

Israel’s judiciary is comprised of the Supreme Court, six District Courts, and 28 Magistrate Courts.¹¹ It also includes several specialized tribunals such as the Labor Courts,¹² Military Courts,¹³ Family Courts,¹⁴ Rabbinical Courts,¹⁵ a Competition Court,¹⁶ and a Standard Form Contract Court.¹⁷

This three-tiered court system is without juries.¹⁸ The courts hear both civil and criminal cases. Magistrate Courts hear civil claims valued up to NIS 2.5 million (about EUR 625,000)¹⁹ and criminal charges punishable by up to seven years of imprisonment.²⁰ The District Courts hear all other civil and criminal claims, as well as appeals from the Magistrate Courts. The Supreme Court hears appeals from the District Courts in addition to petitions on constitutional matters and certain administrative matters, which it hears as the High Court of Justice.²¹

⁹ Companies Law, 5759–1999, SH No. 1711 p. 189 (Isr.) (‘Companies Law’).

¹⁰ Section 1 of the Companies Law defines an extraordinary transaction as a transaction not in a company’s ordinary course of business, a transaction that is not undertaken in market conditions, or a transaction that is likely substantially to influence the profitability of a company, its property, or liabilities. For empirical analysis of the effect of the minority shareholders’ veto power, see Jesse M Fried, Ehud Kamar and Yishay Yafeh, ‘The Effect of Minority Veto Rights on Controller Pay Tunneling’ (forthcoming 2020) *Journal of Financial Economics*.

¹¹ Basic Law: The Judiciary, § 1(a), SH No. 1110 p. 78 (Isr.) (‘Basic Law: The Judiciary’).

¹² Labor Court Law, 5769–1969, § 1, SH No. 553 p. 70 (Isr.).

¹³ Military Justice Law, 5715–1955, § 183, SH No. 189 p. 171 (Isr.).

¹⁴ Family Court Law, 5755–1995, SH No. 1537 p. 393 (Isr.).

¹⁵ Rabbinical Courts Jurisdiction (Marriage and Divorce) Law, 5713–1953, § 1, SH No. 134 p. 165 (Isr.).

¹⁶ Economic Competition Law, 5748–1988, § 32, SH No. 2781 p. 246 (Isr.).

¹⁷ Standard Contracts Law, 5742–1982, § 6, SH No. 1068 p. 8 (Isr.).

¹⁸ Ministry of Foreign Affairs of Israel, The Judiciary: The Court System, <https://mfa.gov.il/MFA/AboutIsrael/State/Democracy/Pages/The%20Judiciary-%20The%20Court%20System.aspx> accessed 30 August 2020.

¹⁹ Courts Law (Consolidated Version), 5744–1984, § 51(a)(2), SH No. 1123 p. 198 (Isr.) (‘Courts Law’).

²⁰ *ibid* § 51(a)(1)(a).

²¹ *ibid* § 52; Basic Law: The Judiciary (n 11) § 15.

Certain matters are within the exclusive jurisdiction of the District Courts regardless of their monetary value. These include real estate disputes (other than over the possession, the use, or the distribution of real estate, or the distribution of rights to use real estate), criminal matters involving finance, antitrust, or organized crime,²² and tax disputes.²³ The Economic Divisions of the District Courts in Tel Aviv and Haifa hear all matters brought in those courts relating to companies and their shareholders.²⁴

A judgment of the District Court on appeal from the Magistrate Court can be appealed to the Supreme Court only with the approval of the District Court or the Supreme Court.²⁵ The approval is granted in cases of particular importance, primarily constitutional questions or areas in which the lower courts have issued conflicting rulings.²⁶ Interlocutory appeals require the approval of the appellate court.

The District Courts also sit as administrative courts, except for matters within the sole jurisdiction of the Supreme Court sitting as High Court of Justice.²⁷ Decisions of the District Court sitting as an administrative court can be appealed to the Supreme Court.

5.2 Establishing a company

The most common entity in Israel is a limited liability company. Most companies are private, though several hundred companies are publicly traded on the Tel Aviv Stock Exchange or abroad. Other common entity forms under Israeli law are general partnerships and limited partnerships.

Israel allows individuals to operate a sole proprietorship without incorporating an entity. Sole proprietors must register with the tax authorities and open files for income tax, value-added tax, and social security under

²² *ibid* § 51(a)(1).

²³ Income Tax Ordinance (New Version), 5721–1961, § 153, DMI No. 6 p. 120 (Isr.) ('Income Tax Ordinance').

²⁴ Courts Law (n 19) § 42B(a).

²⁵ *ibid* § 41(b).

²⁶ Leave for Civil Appeal 103/82 *Haifa Parking Ltd. v Hadar Haifa Ltd.*, 36(3) PD 123 (1982) (Isr.).

²⁷ Administrative Courts Law, 5760–2000, § 3, SH No. 1739 p. 190 (Isr.).

their personal identification number. They must pay income tax, and social security tax.

Sole proprietors with an annual revenue below NIS 100,491 (about EUR 25,000) are exempt from value-added tax. Those exceeding this threshold must issue tax invoices and report to the tax authorities on a bimonthly or monthly basis, depending on revenue.²⁸

Non-profit activities can be conducted through non-profit associations²⁹ or through public benefit companies.³⁰ Cooperative societies were also previously common, and many settlements (including agricultural collectives known as *Kibbutzim*) as well as some healthcare providers and other organizations still operate in this form. However, following the enactment of the Companies Law, cooperative societies have become less popular and many converted into companies.³¹

The main laws governing companies in Israel are the Companies Law and the Securities Law of 1968 ('the Securities Law').³² The Ministry of Justice, the Ministry of Finance, and the Securities Authority oversee and enforce these laws. Certain industries, including financial services, utilities, telecommunications and defence, are subject to additional regulation.

5.2.1 Companies

A single shareholder, either an individual or an entity, can form a company. The founders are the company's initial shareholders. Foreign residents and nationals can be shareholders and directors.

The company's organs are the general meeting of shareholders, the board of directors, the general manager, and any person whose acts are deemed by law or by the company's articles of association to be acts of the company.³³

²⁸ Value-added Tax Law, 5736–1975, SH No. 791 p. 52 (Isr.) ('Value-Added Tax Law').

²⁹ Associations Law, 5740–1980, SH No. 983 p. 210 (Isr.).

³⁰ Companies Law (n 9) § 345A.

³¹ For example, Egged, Israel's largest public transit company, was restructured from a cooperative society to a company in 2019. See Egged, *Egged Profile* <https://www.egged.co.il/Article-830-Egged-Cooperative.aspx> accessed 30 August 2020.

³² Securities Law, 5728–1968, SH No. 541 p. 234 (Isr.) ('Securities Law').

³³ Companies Law (n 9) § 46.

The Companies Law affords private companies greater flexibility than public companies. It defines a private company as one whose shares are not traded on an exchange in Israel or abroad, or offered to the public using a prospectus under the Securities Law.³⁴

5.2.2 Public companies

A public company is a company whose shares are listed on an exchange or have been publicly offered using a prospectus under the Securities Law and are held by the public.³⁵

Israeli companies traded domestically or abroad are subject to several requirements. They must obtain minority shareholder approval for the appointment of two independent directors who are unrelated to the company or its controlling shareholder or, if there is no controlling shareholder, to the general manager, the chief financial officer, the chair of the board of directors, or any 5 per cent shareholder.³⁶ Public companies must appoint an independent audit committee comprised of at least three members, including the two outside directors.³⁷ They must appoint an internal auditor,³⁸ and they must file annual and quarterly reports. Small companies can file semi-annual reports instead of quarterly reports.³⁹

Other rules apply only to public companies, such as special procedures for approving compensation of officers. This chapter focuses mostly on private companies.

³⁴ *ibid* § 1.

³⁵ Section 15(a) of the Securities Law (n 32), provides that no person shall offer securities to the public other than according to a prospectus authorized by the Israel Securities Authority or a draft prospectus authorized and signed under the Securities Law and submitted to the Israel Securities Authority. Section 16 of the Securities Law provides that a prospectus shall contain every detail of importance to a reasonable investor considering the purchase of the securities.

³⁶ Companies Law (n 9) § 239.

³⁷ *ibid* § 115.

³⁸ *ibid* § 146.

³⁹ Securities Regulations (Periodic and Immediate Reports), 5730–1970, § 5D(5), KT No. 2591 p. 2037 (Isr.) ('Securities Regulations (Periodic and Immediate Reports)').

5.2.3 Partnerships

The Partnership Ordinance⁴⁰ governs general partnerships and limited partnerships. In a general partnership, each partner is personally liable for the partnership's liabilities. In a limited partnership, only the general partners are personally liable. A company can be the general partner of a limited partnership.

A limited partner cannot participate in the management of the partnership. Should a limited partner choose to take a more active role in management, her partnership liability will be the same as a general partner's for as long as she participates in management activities.⁴¹

A partnership for the purpose of running a business must register within a month of establishment.⁴² However, the law also recognizes unregistered partnerships.⁴³ For example, many law firms are unregistered partnerships.

Partnership registration requires, among other things, providing the partnership's name, activities and address, the partners' names, and a partnership agreement to the Registrar of Partnerships.

5.2.4 Choice of entity

It is difficult to convert a business from a company into a partnership, or vice versa. Conversion requires new organizational documents and asset transfers. It also potentially constitutes a tax event, requiring a ruling from the Tax Authority to defer the tax. Therefore, the initial choice of organizational form is important.

Typically, new businesses incorporate as a company to benefit from limited liability and from the business community's familiarity with this

⁴⁰ Partnership Ordinance (New Version), 5735–1975, DMI No. 28 p. 549 (Isr.) ('Partnership Ordinance').

⁴¹ *ibid* § 63(c).

⁴² *ibid* § 4. A partnership among farmers for cultivation of land is exempt.

⁴³ Section 1 of the Partnership Ordinance (n 40) defines a partnership as 'a number of people engaged together in partnership relations' – regardless of whether the partnership is registered.

form. However, a company is subject to two levels of tax – a corporate tax and a shareholder tax on dividends.⁴⁴

A partnership, unlike a company, is a pass-through entity for tax purposes: all its income or losses pass through the partnership to the individual partners according to their share. Accordingly, a partnership is tax efficient for activities expected to result in high capital gains: while a company's capital gains, distributed as dividends, will be taxed at a rate between 43 per cent and 50 per cent, a partnership's capital gains will only be taxed at a rate between 25 per cent and 33 per cent. Venture capital funds and other investment vehicles therefore typically choose to incorporate as partnerships to take advantage of this beneficial tax treatment.

5.2.5 Division of power in companies

The organs of the company are the general meeting of shareholders, the board of directors, and the general manager. Acts of these organs are acts of the company.⁴⁵ This does not derogate from the liability of each organ for its actions.⁴⁶

The Companies Law sets forth key principles of corporate governance. As in many countries, this includes the establishment of corporate organs, fiduciary duties of office holders and controlling shareholders, shareholder rights, director independence requirements, separation of the position of chair of the board of directors from that of general manager in public companies, remedies for shareholder oppression, approval mechanisms for related-party transactions, and remedies for violations of law.⁴⁷

5.2.6 Shareholders

The company is a separate legal entity entitled to rights and subject to obligations.⁴⁸ Accordingly, the shareholders of a company with limited liability are not liable to company creditors. However, under certain

⁴⁴ *ibid* § 6.

⁴⁵ Companies Law (n 9) §§ 46, 47.

⁴⁶ *ibid* § 54.

⁴⁷ Israel Securities Authority, *Corporate Governance in Israel: Compatibility with the OECD Code on Corporate Governance* (November 2006) http://www.isa.gov.il/Download/IsaFile_1124.pdf accessed 30 August 2020.

⁴⁸ Companies Law (n 9) § 4.

circumstances a court may pierce the corporate veil and impute the rights and obligations of a company to its shareholders, and vice versa.⁴⁹

A court will pierce the corporate veil only under exceptional circumstances. These include instances in which the shareholders use the corporate form to deceive or deprive a creditor of her rights,⁵⁰ or in a manner that undermines the company's purpose while taking an unreasonable risk that undermines its ability to repay its debts.⁵¹

Unless the articles of association provide otherwise, a private company must hold an annual general meeting every calendar year, and no later than 15 months after the most recent annual general meeting.⁵² General meetings must be convened in accordance with the notice requirements of the articles of association.⁵³

Most shareholder resolutions require approval by a majority of the votes cast at a general meeting that meets quorum requirements. The articles of association may require a special majority.⁵⁴ Resolutions may also be adopted by a written consent of all shareholders entitled to vote without a general meeting.⁵⁵ Adopting a resolution by written consent obviates the need to convene a shareholder meeting with advance notice (of typically seven to 14 days). It is common for start-up companies with a small number of shareholders to adopt all resolutions in connection with a financing round (such as the amendment of articles of association and the appointment of new directors) by written consent when time is of the essence.

Small shareholders often give an irrevocable proxy to large shareholders or to the chair of the board of directors, facilitating the adoption of shareholder resolutions either by written consent or at a general meeting.

⁴⁹ *ibid* § 6.

⁵⁰ *ibid* § 6(a)(1)(a).

⁵¹ *ibid* § 6(a)(1)(b).

⁵² *ibid* § 60(a).

⁵³ *ibid* §§ 67, 68.

⁵⁴ *ibid* § 85.

⁵⁵ *ibid* § 76.

The Companies Law specifies the powers of the general meeting, and the company cannot limit or reassign them.⁵⁶ The general meeting has the power to amend the articles of association; to appoint or terminate the internal auditor and to set the terms of her employment; to appoint external auditors; to approve related-party transactions not in the ordinary course of business; to increase or reduce the number of authorized shares; and to approve a merger.⁵⁷ The general meeting also approves the liquidation of the company.⁵⁸

The articles of association may authorize the general meeting to assume the powers of another organ, and can provide for transfer of the powers of the general manager to the board of directors *ad hoc* or for a period of time.⁵⁹ If the board of directors is unable to exercise an essential power for the proper conduct of the company, the general meeting may exercise this power even if there is no provision for this in the articles of association.⁶⁰

5.2.7 The board of directors

The board of directors of a private company may have one or more directors.⁶¹ The board of directors charts the company's business plan and oversees its implementation by the general manager; determines the company's organizational structure, capital structure, and executive pay policy and pay contracts; monitors the company's finances; approves related-party transactions and submits certain extraordinary related-party transactions for approval by the shareholders; approves the issuance and the repurchase of shares; approves dividends; and appoints and removes the general manager.⁶² The board of directors cannot delegate these powers to the general manager.⁶³

The Companies Law requires the board of directors to meet at least once per calendar year in person or by any means of telecommunication. The

⁵⁶ *ibid* § 58.

⁵⁷ *ibid* § 57.

⁵⁸ *ibid* § 57(8).

⁵⁹ *ibid* § 50(a).

⁶⁰ *ibid* § 52.

⁶¹ *ibid* § 93(a).

⁶² *ibid* § 92(a). For a definition of an extraordinary transaction, see Companies Law (n 9) § 1.

⁶³ *ibid* § 92(b).

board can adopt resolutions by unanimous written consent.⁶⁴ Directors must receive in advance a notice of the meeting of the board of directors and its agenda. However, the board of directors can unanimously adopt resolutions not on the agenda, if the articles of association do not provide otherwise.

The board of directors can form committees. However, it must make certain decisions by itself that cannot be delegated to a committee. These include general policies, board appointments, and the approval of financial reports, related-party transactions, and distribution of dividends.⁶⁵

A private company is not required to appoint a general manager. If it declines to do so, the board of directors is tasked with managing the company.⁶⁶ The general manager is responsible for the daily administration of the company within the scope of the duties and responsibilities established by the board of directors.⁶⁷

5.2.8 Protection of minority shareholders

The Companies Law imposes a duty of loyalty on the company's office holders,⁶⁸ controlling shareholders, shareholders holding a swing vote, and shareholders who have under the articles of association the power to appoint or block the appointment of an office holder or other power vis-à-vis the company.⁶⁹ In addition, shareholders who have been treated unfairly or fear being treated unfairly in the future can petition a court to issue instructions for running the company.⁷⁰ The court can instruct other shareholders or the company to purchase the petitioners' shares, among other powers.⁷¹

In some cases, the articles of association provide further protection to minority shareholders. For example, the articles of association can provide that certain resolutions require a supermajority (for example,

⁶⁴ *ibid* § 103.

⁶⁵ Companies Law (n 9) § 112(a).

⁶⁶ *ibid* § 119.

⁶⁷ *ibid* § 120.

⁶⁸ *ibid* § 254.

⁶⁹ *ibid* § 193(a).

⁷⁰ *ibid* § 191.

⁷¹ *ibid*.

75 per cent) or that certain shareholders have the right to veto specific transactions. It is customary to provide venture capital funds veto rights to protect their interest as minority shareholders when the founders hold the majority of shares.

5.2.9 Distributions

Companies can distribute profits to shareholders through dividends or share repurchases from the greater of either cumulative profits or profits in the last two years (the 'profit test'), as long as sufficient funds remain to meet company's existing and anticipated obligations as they become due (the 'solvency test').⁷²

Unlike the profit test, the solvency test involves exercising judgment. It requires the board of directors to consider the net value of assets on the company's balance sheet and review anticipated cash flows in coming years, including the financing needed to replace fixed assets, the maturity date of debt obligations, and the financial covenants in bank loans or other financial instruments.

The board of directors determines whether the distribution meets these tests. A company can petition an Israeli court to approve a distribution that does not meet the profit test after giving creditors, the Tax Authority, and the Official Receiver an opportunity to object. Repurchased shares are held in treasury with no rights until reissued.

5.2.10 Accounting and audit

Private companies must maintain records of their income and expenses, and prepare financial reports.⁷³ The board of directors approves and signs these reports, and presents them for shareholder approval at the annual general meeting.⁷⁴ Private companies that do not hold an annual general meeting must send a copy of their annual financial reports to each of their registered shareholders.⁷⁵ The records must be kept throughout the statute-of-limitations period (seven years).

⁷² *ibid* § 302(a).

⁷³ *ibid* § 171(b).

⁷⁴ *ibid* § 173(a).

⁷⁵ *ibid* § 61(b).

The annual general meeting appoints an auditor to serve until the end of the following annual general meeting, unless the articles of association provide for a longer period.⁷⁶

5.2.11 Repurchase of founders' shares

A standard arrangement in Israeli start-ups subjects the shares of founders to a right of repurchase by the company or a third party as nominee for the company for par value if the founder leaves the company. Usually, the repurchase rights are exercisable only if the company terminates the founder for cause (like fraud or a material and intentional breach of contract by the founder) or if the founder resigns other than for good reason (like a material adverse change in the founder's position or terms of employment in the company). While the shares are subject to repurchase, they are non-transferable.

A percentage of the shares cease to be subject to repurchase each month, until no shares are subject to repurchase, typically in three to four years. All of the shares cease to be subject to repurchase rights upon an initial public offering or another exit event. While the shares are subject to repurchase, the founder retains their voting rights. This regime is often referred to as 'reverse vesting'.

5.3 Procedural aspects of starting a company

5.3.1 Opening a bank account

Israeli banking laws and anti-money-laundering regulations require an identification process and a personal interview to open a bank account in Israel. Banks must record the details of the beneficiary of the new account.

⁷⁶ *ibid* § 154(b).

If the beneficiary is a company, the company and its controlling person⁷⁷ are considered beneficiaries.⁷⁸

Opening a bank account requires several documents. In general, a company must provide identification documents for individuals authorized to manage the account on behalf of the company. It must also provide its articles of association and certificate of incorporation, minutes certified by an attorney of a meeting of the board of directors resolving to open the account, and a designation of who may act in the account. Banks can also require additional documents.⁷⁹

5.3.2 Founders' agreement

It is common for founders to enter into an agreement to govern their relationship before the company is formed. This agreement typically states the company's intended purpose, place of registration, share capital and transfer restrictions, and lays out details concerning its management, board of directors, shareholders, veto rights, financing and signature rights. Additionally, it sets forth the assignment of intellectual property rights by the founders to the company, non-competition by founders and confidentiality. The founders' agreement is often terminated upon the formation of the company and the raising of funds, since the articles of association and founders' employment agreements take its place in governing the company.

5.3.3 Registering a company

The Registrar of Companies uses a standardized registration form requiring the following information:⁸⁰

⁷⁷ Section 1 of the Prohibition on Money Laundering Law, 5760–2000, SH No. 1753 p. 293 (Isr.) defines a controlling person as (a) an individual with the ability to direct the company's business alone or with others, other than ability arising solely from being an office holder; (b) an individual holding 25 per cent or more of any means of control, when no one else holds more of those means of control; or (c) in the absence of a controlling person under (a) or (b), the chair of the board of directors and the general manager or, if there are none, the office holder able to direct the company's business.

⁷⁸ Prohibition on Money Laundering Law, 5760–2000, § 7(a), SH No. 1753 p. 293 (Isr.).

⁷⁹ Banking Supervision Department, *Proper Bank Management Provision No. 422*, Opening and Managing Account with a Credit Balance, 3 (Bank of Israel, 28 November 2018).

⁸⁰ Companies Regulations (Reporting, Registration Details and Forms), 5760–1999, § 1, KT No. 6011 p. 166 (Isr.) ('Companies Regulations').

Three proposed names

The company must provide three alternative names. The Registrar of Companies may refuse to register a company if the proposed names are misleadingly similar to the name of another registered company or trade mark, or otherwise misleading⁸¹ or against public policy.⁸²

*Signed articles of association*⁸³

The articles of association must contain the company's proposed name and purpose, the number of authorized shares of each class (and their par value in the case of par-value shares), the allocation of shares issued to each shareholder, an indication of whether the shareholders' liability is limited, and the shareholders' identities and addresses. The articles of association are filed in Hebrew, signed by the founding shareholders, and certified by a lawyer.

*Declaration by the company's initial directors*⁸⁴

The directors must declare that they are willing and qualified to serve and are not prohibited from doing so under the Execution Law of 1967 ('the Execution Law'),⁸⁵ the Insolvency and Rehabilitation Law of 2018 ('the Insolvency and Rehabilitation Law'),⁸⁶ or a court order.⁸⁷

*The company's purpose*⁸⁸

Most companies define their purpose as broadly as possible (for example, to engage in any lawful business). Some companies are formed for a specific purpose and indicate this purpose in their articles of association.⁸⁹

⁸¹ Companies Law (n 9) § 27.

⁸² *ibid* § 28.

⁸³ Companies Regulations (n 80) § 1. A proposed amendment to the Companies Law would allow online certification of the founding shareholders' signatures on the articles of association.

⁸⁴ *ibid*.

⁸⁵ Execution Law, 5727–1967, Chapter G1, SH No. 1479 p. 284 (Isr.).

⁸⁶ Insolvency and Rehabilitation Law, 5778–2018, SH No. 2708 p. 310 (Isr.) ('Insolvency and Rehabilitation Law').

⁸⁷ Companies Law (n 9) § 7.

⁸⁸ Companies Regulations (n 80) § 1.

⁸⁹ Companies Law (n 9) § 32(3).

*Determination of exemption from filing balance sheets*⁹⁰

A private company must submit its financial statements with its required annual report to the Registrar of Companies, unless its articles of association restrict share transfers, prohibit public offerings, or limit the number of non-employee shareholders to 50. The registration form should indicate whether the company meets these conditions. Most private companies choose to include these restrictions in their articles of association, and accordingly do not publicly file their financial statements.

*Registered and issued share capital*⁹¹

The registration form must list the par value and the number of shares in each class. It must also list the name, the identification number, the registered address and the shares held (class, par-value and number) by each shareholder. Private companies can issue multiple classes of shares and designate different voting rights for each class in the articles of association. Public companies cannot issue multiple classes of shares with different voting rights. However, starting a year after becoming public, they can issue non-voting shares with dividend preference in addition to a single class of voting shares.⁹²

*Indication of limited liability*⁹³

The registration form must indicate whether the shareholders' liability is limited. In practice, all companies are formed with limited liability, except for those required by law to have unlimited liability (such as companies providing legal services).⁹⁴

*General manager's details*⁹⁵

The registration form must contain the general manager's name, identification number, email address and telephone number.

⁹⁰ Companies Regulations (n 80) § 1.

⁹¹ *ibid.*

⁹² Securities Law (n 32) § 46B.

⁹³ Companies Regulations (n 80) § 1.

⁹⁴ Bar Association Law, 5721–1961, § 59A(a)(1), SH No. 2203 p. 165 (Isr.).

⁹⁵ Companies Regulations (n 80) § 1.

*Authorized signatory*⁹⁶

The company must also provide the details of an office holder authorized to submit reports to the Registrar of Companies on behalf of the company.

*Declaration of initial shareholders*⁹⁷

The initial shareholders must declare that they qualify to organize the company and hold its shares, and that they are not restricted from doing so under the Execution Law, the Insolvency and Rehabilitation Law, or court order. Companies should also declare that they are duly incorporated and are under no legal restrictions.

Documents submitted to the Registrar of Companies (for example, copies of directors' and shareholders' passports) must be certified. If prepared abroad, they must be notarized and apostilled in the director's or the shareholder's country of citizenship, or by an Israeli consul in that country. Once the Registrar of Companies is satisfied that all documents are in order, it issues articles of association providing the company's name, date of incorporation, and registration number.

The Companies Law does not require a minimum capital or professional qualifications to incorporate a private company.

The Companies Law and its related regulations impose certain reporting obligations on companies, including the submission of an annual report within 14 days of the annual general meeting, and the notification of the Registrar of Companies whenever the company:

- changes its registered office address;
- issues new shares;⁹⁸
- transfers shares;⁹⁹
- changes the composition of its board of directors;¹⁰⁰
- increases its registered capital;¹⁰¹

⁹⁶ *ibid.*

⁹⁷ *ibid.*

⁹⁸ Companies Regulations (n 80) § 2.

⁹⁹ *ibid* § 2.

¹⁰⁰ *ibid* § 5.

¹⁰¹ *ibid* § 6.

- converts from a private company to a public company, or vice versa;¹⁰²
or
- registers a lien.¹⁰³

5.4 Running a business

The directors and officers of a company, sometimes referred to as its office holders, owe fiduciary duties to the company and to its shareholders.

5.4.1 The duty of care

The duty of care requires office holders to make informed decisions.¹⁰⁴ For directors, this means being familiar with the business and the financial condition of the company, attending meetings of the board of directors and, under certain circumstances, convening board meetings.

The director's primary function is oversight. The law allows directors to review the company's documents and inspect the company's assets.¹⁰⁵ Some of the company's activities may be beyond the director's expertise. In these cases, the director can rely on experts. The director should supply the expert with the pertinent information and exercise judgment in deciding whether to follow the expert's advice.¹⁰⁶

A breach of the duty of care can arise from an office holder's actions or from her failure to act as a reasonable office holder would act under similar circumstances. Office holders who breach their duty of care are personally liable.

Israeli case law has adopted the business judgment rule, which protects an office holder from liability so long as the decision is informed, does not involve a conflict of interest, and was made in good faith for the benefit

¹⁰² *ibid* § 10.

¹⁰³ *ibid* § 12.

¹⁰⁴ Companies Law (n 9) §§ 252(a), 253.

¹⁰⁵ *ibid* § 265(a).

¹⁰⁶ *ibid* § 253.

of the company.¹⁰⁷ In addition, the law allows the company to exculpate office holders, to provide them with liability insurance, or to indemnify them for breaches of the duty of care that are not intentional or reckless.¹⁰⁸ These three forms of protection resemble the ones available in the United States.

5.4.2 The duty of loyalty

The duty of loyalty requires an office holder to act in good faith for the benefit of the company. In particular, an office holder must avoid any conflict of interest between her position in the company and her other positions or personal affairs. In addition, she must not compete with the company or usurp business opportunities that belong to the company. This restriction typically prevents a venture capital fund from investing in competing companies or, in rare cases, drives the fund to appoint different partners to each of the respective boards of directors.

An office holder must also disclose to the company any information that may be of interest to the company received because of her position in the company. The law does not prohibit office holders from owing loyalty to third parties, including specific shareholders.¹⁰⁹ A director appointed by a venture capital fund would thus owe loyalty both to the company and to the fund she represents. When the two duties conflict, the director must recuse herself from any related discussions or decisions.

The company may revoke an act performed by an office holder in the company's name towards a third party or demand restitution from the third party if the third party knew that the office holder breached her duty of loyalty to the company.¹¹⁰ The law allows the company to insure or indemnify (but not to exculpate) an office holder in connection with a breach of the duty of loyalty, if the office holder acted in good faith and had reasonable grounds to believe her actions would not harm the company.¹¹¹

¹⁰⁷ Civil Appeal 7735/14 *Verdnikov v. Elovitch* (28 December 2016), Nevo Legal Database (by subscription, in Hebrew) (Isr.).

¹⁰⁸ Companies Law (n 9) §§ 258(b), 259(a), 260, 261(1), 263(2).

¹⁰⁹ *ibid* § 254(b).

¹¹⁰ *ibid* § 256(c).

¹¹¹ *ibid* §§ 258(a), 260, 261(2), 263(1).

An extraordinary transaction in which an office holder has a personal interest requires approval by the board of directors and, if the office holder is a director, also approval of the shareholders.¹¹² A director with a personal interest in a transaction cannot vote as a director on the transaction.¹¹³ When a controlling shareholder has a personal interest in a transaction involving a public company, the transaction requires approval by the audit committee of the board of directors, the board of directors, and a majority of the minority votes cast in the general meeting of the shareholders.¹¹⁴

If the company does not exercise its right of action against an office holder for breaches of the duty of care or of loyalty,¹¹⁵ any shareholder can bring a derivative action on behalf of the company against the office holder.¹¹⁶

5.4.3 Labour law

Two laws of a constitutional nature, Basic Law: Human Dignity and Freedom¹¹⁷ and Basic Law: Freedom of Occupation,¹¹⁸ set forth principles of employee protection. Israel has also enacted many laws and regulations governing particular employment issues. These laws include the Hours of Work and Rest Law of 1951,¹¹⁹ the Wage Protection Law of 1958,¹²⁰ the Notice to Employee Law (Terms of Employment) of 2002,¹²¹ the Severance Pay Law of 1963,¹²² and the Annual Leave Law of 1951.¹²³

These laws guarantee fundamental employee rights, including minimum wages, paid leave, sick leave, maximum working hours, overtime working hours, rest days, holiday pay, and advance notice of dismissal, severance pay, maternity leave, social security, and wage protection. Employees may

¹¹² *ibid* § 272(b). For a definition of an extraordinary transaction, see Companies Law (n 9) § 1.

¹¹³ *ibid* § 278(a).

¹¹⁴ *ibid* § 275(a).

¹¹⁵ *ibid* § 194(a).

¹¹⁶ *ibid* § 197.

¹¹⁷ Basic Law: Human Dignity and Freedom, 5752–1992, SH No. 1391 p. 150 (Isr.).

¹¹⁸ Basic Law: Freedom of Occupation, 5754–1994, SH No. 1454 p. 90 (Isr.).

¹¹⁹ Hours of Work and Rest Law, 5711–1951, SH No. 76 p. 204 (Isr.).

¹²⁰ Wage Protection Law, 5718–1958, SH No. 247 p. 86 (Isr.).

¹²¹ Notice to Employee Law (Terms of Employment) 5762–2002, SH No. 1837 p. 210 (Isr.).

¹²² Severance Pay Law, 5723–1963, SH No. 404 p. 136 (Isr.).

¹²³ Annual Leave Law, 5711–1951, SH No. 81 p. 234 (Isr.).

not waive these rights or agree to a lower standard than that provided by law.

In addition, collective labour agreements grant unionized employees other rights, like fringe benefits, tenure, and extended leave of absence. The Israeli government has extended certain collective agreements to all employees in Israel. These extension orders impose duties on all employers and provide benefits to all employees. Notable extension orders require employers to provide employees with travel expenses, minimum pensions, and recreational payments. Individual employment agreements often provide better terms for employees than their mandatory rights.

The law also requires employers to inform employees in writing of the employment terms. This means that the employee must receive a copy of the employment agreement or a statutory form specifying the terms of employment.¹²⁴ An employment agreement will typically include confidentiality provisions, assignment of intellectual property and non-competition clauses.

The law does not clearly define the terms ‘employer’ or ‘employee’. According to the case law, an employer–employee relationship exists when the parties’ conduct fits this status. Labour courts utilize a series of factual tests to determine that an employer–employee relationship exists. The main test examines whether the individual is integrated into the workplace or provides services as a contractor. Additional tests include the presence of subordination and supervision, an agreement between the parties, the continuity of the relationship, and the form of payment.

Under labour court rulings, the existence of an employer–employee relationship is determined not by the consent of the parties, but rather by the actual nature of the engagement between a company and the individual. Where the court concludes that a contractor is an employee of a company, the employee is entitled to all mandatory employment payments.

However, in exceptional cases, the court can accept a company’s counterclaim for restitution or offset if all of the following conditions are met. First, the payment to the contractor is 150 per cent or more of the salary

¹²⁴ Notice to Employee Law (Terms of Employment) Regulations (Form and Content), 5762–2002, § 1(a), KT No. 6180 p. 927 (Isr.).

that the employer paid or was prepared to pay to a comparable employee. Second, the agreement with the contractor provides that if a competent authority (such as the tax authorities or a court) determines that the contractor was or is the company's employee, the contractor's pay will be reduced and she will return any excess pay already received; the company will be entitled to offset this excess pay against pay due to the contractor. Furthermore, the contractor must have requested to be retained as a contractor.¹²⁵

5.4.4 Equity pay

Private companies in the Israeli high-tech sector often use equity-based pay (including employee share ownership plans, or ESOP) to ensure that employees have a long-term interest in the company's success. Under an ESOP, employees receive options to acquire shares of the company at a pre-set exercise price. The options typically vest over four years. If the share price exceeds the exercise price, the employee will exercise the vested options and realize a profit. Unexercised options typically expire within 90 days of the termination of employment.

The Income Tax Ordinance of 1961 ('the Income Tax Ordinance') governs the taxation of equity-based compensation. It sets forth a capital gains-tax track with a trustee, an earned-income-tax track with a trustee, and a track without a trustee.¹²⁶ The capital gains track allows the employee to receive options and subsequently sell shares while paying tax at a capital gains rate of up to 28 per cent (including a 3 per cent excise tax). In the two other tracks, the employee pays income tax at an ordinary rate of up to 50 per cent (including a 3 per cent excise tax).

An Israeli employer¹²⁷ can deduct equity-based pay with no limits under the earned-income-tax track. It cannot deduct equity-based pay under the capital gains-tax track.

¹²⁵ Labor Appeal 3–128 *Gidron v State of Israel* (15 June 1987), Nevo Legal Database (by subscription, in Hebrew) (Isr.).

¹²⁶ Income Tax Ordinance (n 23) § 102.

¹²⁷ *ibid* § 102. It defines an employer company as (a) an Israeli company or a foreign company with a permanent establishment or a research and development centre in Israel, if this status was approved by the tax authority in the case of a foreign company; (b) a company controlling the employer or controlled by the employer; or (c) a company controlled by a person who controls the employer. Section 32(9) of the Income Tax Ordinance defines control as directly or indirectly holding, alone or with

Virtually all Israeli start-ups elect the capital gains-tax track, allowing Israeli employees to pay the lower tax, because they often do not have profits from which to deduct equity-based pay (so there is no benefit in choosing the earned-income track) and they compete for employees in the country's booming high-tech sector.

5.4.5 Service inventions

The Patents Law of 1967 ('the Patents Law')¹²⁸ provides that an invention conceived by an employee during and as a result of her employment belongs to the employer (a 'service invention'), unless the employer and the employee entered into an agreement specifically stating otherwise.¹²⁹ The Copyright Law of 2007 ('the Copyright Law')¹³⁰ sets forth a similar rebuttable presumption with respect to copyrightable material. Employment agreements usually specify the scope of intellectual property rights that the employee assigns to the employer. Similar agreements can cover consultants.

The case law provides that, in the case of a dispute, the employer carries the burden of proving that an invention is a service invention. Courts consider the following non-exhaustive list of factors to establish a causal connection between the employment and the invention.

One factor is whether the invention was conceived as a result of a task assigned to the employee or the consultant. A second factor is whether the development of the invention by the employee or the consultant was part of her work. A third factor is whether the invention relates to the employer's business or its actual or anticipated research and development activities. A fourth factor is whether the employee developed the invention at least in part during her working hours or using the employer's equipment, supplies, facilities or confidential information. A fifth factor is whether the employer gave the employee or the consultant instructions

a relative (a spouse, brother, sister, parent, parent's parent, descendant and spouse's descendent, and the spouse of any of the aforementioned) (a) at least 10 per cent of the issued share capital or 10 per cent of the voting rights; (b) the right to hold at least 10 per cent of the issued share capital or 10 per cent of the voting rights; (c) the right to receive at least 10 per cent of the profits; or (d) the right to appoint a director.

¹²⁸ Patents Law, 5727–1967, SH No. 510 p. 148 (Isr.) ('Patents Law').

¹²⁹ *ibid* § 132.

¹³⁰ Copyright Law, 5768–2007 § 34, SH No. 2119 p. 38 (Isr.) ('Copyright Law').

relating to the development of the invention. A sixth factor is whether the employer supervised or controlled the process during which the employee conceived the invention. A seventh factor is whether the employee or the consultant received from the employer special pay for the development of the invention.¹³¹

5.4.6 Compensation under the Patents Law

The Patents Law grants employees the right to receive pay for service inventions. It also provides that, unless the employer and the employee agree otherwise, a government committee will determine the employee's entitlement and its amount.

In 2015, the Supreme Court affirmed a decision of the Compensation and Royalties Committee holding that a waiver of the right to receive compensation for service invention can be written, spoken or implied.¹³² In this case, the employee signed an explicit release of all claims against the employer at the termination of his employment in return for payment. This was sufficient evidence of the employee's intent. A 2019 District Court decision held that a waiver in a standard form contract is fair and enforceable.¹³³

5.4.7 Non-competition agreements

Israeli law permits individuals to compete with former employers. This right is based on *Basic Law: Freedom of Occupation* and public policy.¹³⁴ Many employment agreements still prohibit employees from competing with the employer during employment, as well as for a specified period

¹³¹ Yoel Tzur, 'Legal Aspects of Service Invention' [1982] 34 *HaPraklit* 185 (by subscription, in Hebrew) (Isr.); Opening Motion 729/80 (TA) *Dolev v Amgar*, PM 43(1), 99 (1982) (by subscription, in Hebrew) (Isr.); Opening Motion (TA) 994/83 *Rosentzvaig v Israel Aerospace Industries Ltd.* (22 January 1998), Nevo Legal Database (by subscription, in Hebrew) (Isr.); Administrative Appeal 37979–06–18 (TA) *Israel Aerospace Industries Ltd. v Fried* (2 January 2019), Nevo Legal Database (by subscription, in Hebrew) (Isr.).

¹³² High Court of Justice 4353/14 Barazani v Iscar Ltd. (8 July 2015), Nevo Legal Database (by subscription, in Hebrew) (Isr.).

¹³³ Declarative Judgment (Tel Aviv) 53043–06–14 Berliner v Adama Machteshim Ltd. (15 May 2019), Nevo Legal Database (by subscription, in Hebrew) (Isr.).

¹³⁴ Labor Appeal 164/99 *Dan Frumer and Check Point Software Technologies Ltd. v RADGuard Ltd.*, 34 PDA 294 (4 June 1999) (in Hebrew) (Isr.) ('Frumer').

following employment, though there are limitations on the enforceability of these undertakings.

In the leading cases on the matter, *Check Point*,¹³⁵ *Sa'ar*,¹³⁶ and *Girit*,¹³⁷ the courts ruled that, absent special circumstances, a non-competition undertaking is void. In *Check Point*, for example, the court determined that a non-competition undertaking is valid only if it protects the 'legitimate interests' of the employer. The court provided a non-exhaustive list of factors that may justify its enforcement:

- A substantial risk exists of revealing trade secret as defined in the Commercial Torts Law of 1999 ('the Commercial Torts Law').¹³⁸
- The employer invested substantial resources in training the employee to reach the required professional capabilities.
- The employee received adequate pay for the limitation on her freedom of occupation (some employment agreements explicitly state that a certain percentage of the employee's salary is for the non-competition agreement).
- The employee acted in bad faith prior to termination of employment. For example, the employee solicited customers of the employer to join her in her new competing business before resigning.
- Failure to enforce the agreement would damage the employer.¹³⁹

In practice, labour courts enforce non-competition clauses only when the employee acted in bad faith. Examples include an employee who started a competing business during her employment,¹⁴⁰ a general manager who started a new business while in office and tried to unjustly take intellec-

¹³⁵ *ibid* at 296.

¹³⁶ Civil Appeal 6601/96 *AES System Inc. v Sa'ar*, 54(3) PD 850, 866 (28 August, 2000) (by subscription, in Hebrew) (Isr.).

¹³⁷ Labor Appeal 189/03 *Girit Ltd. v Aviv*, 39 PDA 728 (18 December 2003) (by subscription, in Hebrew) (Isr.) ('*Girit*').

¹³⁸ Commercial Torts Law, 5759–1999, SH No. 1709 p. 146 (Isr.) ('Commercial Torts Law').

¹³⁹ For additional rulings following these principles, see Labor Appeal 292/99 *Amichai v Yossi Goldhamer Ltd.*, 35 PDA 204 (17 July 2000) (by subscription, in Hebrew) (Isr.); Labor Appeal 1055/01 *Corry v Erroca International Ltd.* (6 March 2001), Nevo Legal Database (by subscription, in Hebrew) (Isr.); Expedited Procedure 5254/06 (Jerusalem) *Ben-Lulu v Magnolia Silver Jewelry Ltd.* (25 January 2007), Nevo Legal Database (by subscription, in Hebrew) (Isr.); Union Action (Tel Aviv) 3560–07 *LDI Licensing Dynamics International Ltd. v Hachmon* (18 March 2013), Nevo Legal Database (by subscription, in Hebrew) (Isr.).

¹⁴⁰ *Girit* (n 137) 730.

tual property from the company and register patents relating to it,¹⁴¹ and employees who provided client lists to competitors.¹⁴²

Moreover, the enforcement period is only several months to a year, regardless of the period specified in the agreement. Courts seldom award damages for breach of these clauses and, when they do, it is usually because they find that the employee acted in bad faith. These damages are generally small.¹⁴³

Despite these enforcement difficulties, non-competition and non-solicitation covenants are common in employment contracts. Foreign and domestic investors frequently request execution of these covenants by key employees.

To prevent transfer of know-how to competitors by former employees, companies require employees to sign non-disclosure agreements and proprietary information and invention assignment agreements. These agreements restrict employees from sharing confidential information or knowledge with third parties. They can also include an acknowledgement, an assignment, or a waiver of rights in the company's inventions and other proprietary information.

5.5 Divorce or death of a security holder

5.5.1 Prenuptial agreements

The Property Relations between Spouses Law of 1973 establishes rules for the division of assets between spouses or common law spouses, although spouses and common law spouses can agree in a prenuptial agreement or otherwise to divide their assets differently.

¹⁴¹ Labor Case (Tel Aviv) 3706/07 *CHECKM8 Ltd. v Vaknin* (25 November 2007) Nevo Legal Database (by subscription, in Hebrew) (Isr.).

¹⁴² Labor Appeal 86/08 *Shachal Telerefua Ltd. v Tuval* (23 September 2008) Nevo Legal Database (by subscription, in Hebrew) (Isr.) (*'Shachal'*); Labor Case (Tel Aviv) 7883/01 *Tzach Orani Service, Sales and Manufacturing of Scales Ltd. v Wilkiski* (30 April 2009), Nevo Legal Database (by subscription, in Hebrew) (Isr.).

¹⁴³ *Shachal* (n 142).

In the event of a divorce, an individual may receive shares in a company which their spouse founded and in which he or she holds securities, even if the spouse incorporated the company before the marriage. Therefore, a prenuptial agreement must be drafted to protect the founder's and the company's interests and to ensure that the shares will be allocated to the founder and not to the founder's spouse. If the company was formed during the marriage, the shares are typically registered in the name of the founder's spouse. Upon a divorce, there are two ways to allocate the shares. One way is to allocate all shares to the founder (and provide other assets of equal value to the founder's spouse). The second way is to divide the shares between the two spouses, while providing the founder with voting control.

5.5.2 Wills

Under the Succession Law of 1965, inheritance is by will or by law. The law recognizes a handwritten will, a will before witnesses, a will before an authority and a verbal will. If the deceased did not leave a valid will, the heirs will be, depending on the circumstances, her spouse, children, parents, grandparents and, in the absence of any heirs, the state.

To secure the business in the event of a shareholder's death, the company's articles of association should include a provision ensuring that upon producing evidence of the grant of probate, a declaration of succession, or other evidence that the board of directors deems sufficient, the deceased's shares will transfer to the heir and the heir will be registered as a shareholder.

5.6 Growing the business

Israeli law allows for a variety of investment structures in equity or debt. In the high-tech industry, the practice is similar to that of venture capital funds in the United States and relies mostly on issuing preferred stock or convertible debt.

Companies and capital providers are free to specify their desired terms of investment, including the amount invested, the valuation, the type of shares, and investor rights. Companies can obtain funding in many ways, including equity, debt, and convertible debt. Entrepreneurs can also apply

for grants and other government funding. Below are the most common types of financing techniques.

5.6.1 Bootstrapping

At an early stage of a start-up's life, founders rely on personal savings for funding. Besides reducing the cost of financing, this so-called bootstrapping allows an early-stage business to focus on its operations rather than on investor demands. However, start-ups hoping to grow quickly often raise equity capital from third parties.

5.6.2 Equity

Equity funding refers to financing in exchange for shares or securities convertible into shares. Normally, this includes an investment agreement (or a share purchase agreement) under which the company issues shares, along with a shareholders' agreement or an investors' rights agreement governing the relationship between the shareholders and the company. Upon obtaining investment from new investors, the company usually amends its articles of association to reflect the new shares, changes to the composition of the board of directors, veto rights and other updates.

Many Israeli companies utilize a form of investment known as SAFE (Simple Agreement for Future Equity) developed by Y-Combinator, a leading start-up incubator in the United States.¹⁴⁴ Under a SAFE investment, investors advance funds to the company. The valuation of this investment is determined only later, when a larger funding round takes place. At that point, the SAFE investment converts into equity, typically at a discount and subject to a cap.¹⁴⁵

Although SAFE agreements are meant to be standardized, some investors require the addition of protective provisions. For example, some agreements contain a most-favoured-nation clause, entitling present investors to any more favourable terms offered to future investors. Other SAFE investors seek control over the decision to convert the SAFE investment

¹⁴⁴ Carolyn Levy, Y-Combinator, *Safe Financing Documents* (September 2018) <https://www.ycombinator.com/documents> accessed 30 August 2020 ('Y-Combinator').

¹⁴⁵ *ibid.*

into shares, participation preferences upon liquidation, a seat on the board or veto rights.

5.6.3 Debt

Companies that wish to limit shareholder dilution secure a credit line or obtain a loan from a bank or another financial institution, like a venture lender. Procuring a loan includes applying to several institutions and negotiating with one a loan suited to the company's circumstances. Some lenders require collateral for repayment of the loan. A typical collateral includes a charge over certain assets, like intellectual property.

Lenders often demand a warrant granting them the right to buy shares at the company's valuation at the time of the loan grant to enjoy an upside potential in addition to interest payments. The warrant typically covers 10 to 20 per cent of the loan amount.

The terms and practices of venture lending in Israel are similar to those in the United States, as many US venture lending firms lend to Israeli start-ups.

5.6.4 Government funding

The Israeli government is active in financing start-ups and technology companies – mostly through the Innovation Authority, formerly known as the Office of the Chief Scientist at the Ministry of Economy and Industry. The Innovation Authority is responsible for implementing government policies that promote industrial research and development in Israel. It offers financing based on research and development plans, which are subject to approval under the Law for the Promotion of Research, Development, and Technological Innovation in Industry of 1984.

The Innovation Authority does not offer technological support. Intellectual property and know-how funded by the Innovation Authority are subject to reporting obligations and must pay royalties on product sales, as well as exit fees if the intellectual property or know-how is transferred outside of Israel.

Israeli companies are eligible for funding under intergovernmental programmes such as the European Union's Horizon 2020 and the US-Israel's BIRD (Binational Industrial Research and Development) initiative.¹⁴⁶

5.6.5 Crowdfunding

The Securities Law provides that securities offered to the public (more than 35 non-accredited investors) require the filing of a prospectus approved by the Israel Securities Authority.¹⁴⁷ Offers to accredited investors do not require a prospectus and can be combined with an offer to up to 34 non-accredited investors.¹⁴⁸ Accredited investors include institutional investors – entities like insurance companies, banks, provident funds, and venture capital funds – as well as qualified individuals.¹⁴⁹

An individual is qualified if she meets one of the following three criteria.

- She owns liquid assets of more than NIS 8,095,444 (about EUR 2 million).
- She earns more than NIS 1,214,317 (about EUR 300,000) or belongs to a household with a total income that exceeded NIS 1,821,475 (about EUR 455,000) in each of the last two years.
- She owns liquid assets worth more than NIS 5 million (about EUR 1.25 million) and either earns more than NIS 607,158 (about EUR 150,000) or belongs to a household in which total income exceeded NIS 910,737 (about EUR 227,000) in each of the last two years.¹⁵⁰

Several online platforms allow fundraising from qualified individuals.¹⁵¹ The online platform verifies individuals as qualified and registers them as members. Companies seeking funding list and provide information on these platforms to members. A member who decides to invest in a company can do so directly or, more typically, through a limited

¹⁴⁶ For the various programmes, see Israel Innovation Authority, *Bilateral Programs for Parallel Support* <https://innovationisrael.org.il/en/program/bilateral-programs-parallel-support> accessed 30 August 2020.

¹⁴⁷ Securities Law (n 32) § 15; See also Securities Regulations (Details with Regard to Sections 15A to 15C of the Law) 5760–2000, § 2, KT No. 6037 p. 616 (Isr.).

¹⁴⁸ Securities Law (n 32) § 15A(a)(1).

¹⁴⁹ *ibid* Schedule One.

¹⁵⁰ *ibid*.

¹⁵¹ One such platform is OurCrowd <https://www.ourcrowd.com> accessed 30 August 2020. Another platform is iAngels <https://www.iangels.com> accessed 30 August 2020.

partnership set up by the platform. The platform charges the company a finder's fee or charges members a management fee (1 to 2 per cent of the investment a year) and a success fee, which typically ranges from 10 to 20 per cent of the profits on the investment.

In 2015, the Securities Law was amended to encourage high-tech firms to remain in Israel by facilitating local fundraising.¹⁵² This amendment enabled small- and mid-size companies to raise funds from non-qualified individuals through regulated crowdfunding websites without a prospectus.

As a result of this law and its related regulations, Israeli companies can now raise between NIS 4 million (about EUR 1) and NIS 6 million (about EUR 1.5 million) every twelve months through crowdfunding, either through a single offer or a series of related offers.¹⁵³ The basic amount is capped at NIS 4 million. However, companies can increase the amount to NIS 5 million with the approval of the Innovation Authority or the Small and Medium Businesses Authority, and to NIS 6 million if there is a lead investor – typically, a venture capital fund or other sophisticated investor – investing on the same terms.¹⁵⁴

To approve this increase in crowdfunding caps, the Innovation Authority examines whether the company conducts research and development, has a reasonable business plan and the necessary technological capabilities, and employs a dedicated research and development team. It also checks whether the company has exclusive ownership of the relevant know-how and any rights derived from this know-how, including intellectual property.¹⁵⁵ The Small and Medium Businesses Authority examines whether the company's business plan is reasonable and aligns with the Authority's priorities. It ensures that the company's management and professional teams possess the necessary skills for the company to meet its goals and that the company will be able to repay its debts.¹⁵⁶

¹⁵² Law for the Promotion of Investment in Companies Operating in the Areas of High Technology (Legislation Amendments), 5755–2015, SH No. 2519 p. 316 (Isr.).

¹⁵³ Securities Regulations (Offering Securities through an Offering Coordinator), 5777–2017, § 14(a), KT No. 8317 p. 364 (Isr.).

¹⁵⁴ *ibid* § 14(c).

¹⁵⁵ *ibid* § 1(a).

¹⁵⁶ *ibid* § 14(b).

An investor may not invest more than NIS 10,150 (about EUR 2,500) per investment round. Moreover, in each 12 month period, the amount of investment by an investor in all crowdfunding investments cannot exceed NIS 20,300 (about EUR 5,000). The crowdfunding regulations allow a higher amount for certain high-net-worth individuals. For example, for an individual with annual income between NIS 761,280 (about EUR 190,000) and NIS 1,218,040 (about EUR 300,000), the cap is the lower of either 5 per cent of annual income or NIS 101,500 (about EUR 25,000).¹⁵⁷

Crowdfunding is still limited in Israel, and most start-ups are funded by venture capital funds or by high-net-worth individuals known as ‘angel investors’.

5.6.6 Mergers and acquisitions

In most cases, the acquisition of an Israeli start-up is through a share purchase agreement in which the buyer acquires all or a large majority of the shares of the start-up. Some acquisitions are in the form of an asset purchase agreement in which the buyer acquires the assets and assumes the liabilities of the start-up. Sellers prefer a share purchase agreement because it reduces their tax burden. Share purchase agreements entail only a shareholder tax, whereas an asset purchase entails two levels of tax – a corporate tax and in addition either a dividend or a liquidation tax upon distribution of the proceeds from the sale.

The Companies Law permits mergers between two Israeli companies. To effect the merger, each of the constituent companies needs to obtain the approval of its board of directors and shareholders. The standard requirement is approval by a majority of votes cast at a shareholder meeting of each constituent company. The merger requires approval by a majority of votes of disinterested shareholders cast in the event of cross-ownership or joint ownership of the constituent companies.¹⁵⁸

Under the Companies Law, a party to a merger must inform its creditors of the proposed merger. At the request of a creditor of either party to the proposed merger, a court may postpone or enjoin the merger if there is a reasonable concern that as a result of the merger the resulting company

¹⁵⁷ *ibid* § 15(b)(2).

¹⁵⁸ Companies Law (n 9) § 320.

will be unable to repay its debts. A merger may not be completed until 50 days after the parties file the merger agreement with the Registrar of Companies, and 30 days after the shareholders of each party approve the merger.

Mergers and acquisitions can also utilize provisions of the Companies Law governing arrangements between companies and their shareholders. These provisions require approval by a majority of the shareholders participating in the meeting and 75 per cent of the votes cast. Court approval of the transaction is also required and may entail further delay.¹⁵⁹

5.7 Taxation

5.7.1 Income tax

The Income Tax Ordinance defines taxable income as income after expenses, deductions, set-offs, and exemptions.¹⁶⁰

Individuals are subject to tax at progressive marginal rates up to 50 per cent (including a 3 per cent excise tax).¹⁶¹ The corporate tax rate is a flat rate of 23 per cent,¹⁶² though various government incentive programmes set lower rates.¹⁶³

Net business losses may be carried forward, but not backward, infinitely. They may be offset against any income in the year they were incurred, and against business income or capital gains from the disposition of a business asset in subsequent years.

The law classifies certain income from the disposition of assets as capital gain, which is subject to a reduced tax rate. In addition, there are reduced tax rates for income from dividends, interest, rental income from residential property and certain other sources.¹⁶⁴

¹⁵⁹ *ibid* § 350.

¹⁶⁰ Income Tax Ordinance (n 23) § 1.

¹⁶¹ *ibid* § 121(a).

¹⁶² *ibid* § 126(a).

¹⁶³ See Section 5.6.4.

¹⁶⁴ Income Tax Ordinance (n 23) § 88.

5.7.2 Capital gains tax

Residents are subject to capital gains tax upon the disposition of tangible or intangible capital assets in Israel or abroad. Non-residents are generally exempt from capital gains tax, but may be subject to capital gains tax in certain circumstances, such as following the sale of a right in Israeli real estate.

The standard capital gains tax rate for individuals is 25 per cent. An individual directly or indirectly holding at least 10 per cent of the interest in a company at the time of sale or any time during the 12 months preceding the sale is subject to a 30 per cent tax. Capital gains from an ongoing business activity (for example, capital gains from a business of securities trading) are taxed as ordinary income based on the applicable marginal tax rates. A company's capital gains are taxed at the corporate tax rate of 23 per cent.

Capital losses can be offset in the current year against capital gains. In addition, capital losses from the sale of securities can also be offset against dividends and interest income paid with respect to these securities or dividends, as well as interest income paid with respect to other securities (if the dividends or interest were taxed at a rate of no more than 25 per cent). In subsequent years, capital losses can be offset only against capital gains. Capital losses can be carried forward, though not backward, indefinitely.

5.7.3 Dividends

Dividends paid between Israeli companies are exempt from tax. Dividends paid by an Israeli company to an individual who is a resident are subject to a 25 per cent tax.¹⁶⁵

The tax rate on dividends to an Israeli individual is 30 per cent, if the dividend is paid to a holder of at least 12 per cent of the shares at the time of distribution or anytime in the preceding 12 months.¹⁶⁶ The tax rate is 20 per cent regardless of holdings, if the distribution is from profits attributable to an 'approved enterprise', a 'beneficial enterprise', a 'preferred

¹⁶⁵ *ibid* § 126A(a).

¹⁶⁶ *ibid* § 125B(2).

enterprise', a 'preferred technology enterprise', or a 'special preferred technology enterprise' of the distributing company.¹⁶⁷

Dividends received by non-residents are subject to a withholding tax of 25 per cent. However, in many cases non-residents may benefit from a lower withholding tax under a treaty between Israel and the non-resident's country of residence.

5.7.4 Interest

Companies are subject to tax on interest income at the corporate tax rate. Individuals pay a 25 per cent tax on interest income from financial instruments linked to the consumer price index or to a foreign currency, and are exempt from tax on the indexation income.¹⁶⁸ An individual's interest income from financial instruments not linked to the consumer price index or to a foreign currency is taxed at 15 per cent.

The reduced rate of 15 per cent is not available to an individual who either claims a deduction of interest expenses, holds 10 per cent or more of the shares of the company paying the interest, has a special relationship with the company paying the interest, or receives the interest as business income. In these cases, the interest income will be taxed at the individual's marginal rate.

5.7.5 Excise tax

Individual investors subject to tax in Israel must pay a 3 per cent excise tax on income exceeding NIS 651,600 (about EUR 162,500).¹⁶⁹ This amount is linked to the consumer price index and is updated annually. Covered income includes, among other things, business income, dividends, capital gain, interest, and royalties.

¹⁶⁷ Encouragement of Capital Investments Law, 5719–1959, § 22, SH No. 293 p. 234 (Isr.) ('Encouragement of Capital Investments Law').

¹⁶⁸ For example, an individual who earns 100 NIS in interest plus 20 NIS in indexation of the financial instrument to the consumer price index or to a foreign currency must pay a tax of NIS 25 (25 per cent of NIS 100).

¹⁶⁹ Income Tax Ordinance (n 23) § 121B(1)(a); the rate is adjusted annually based on the rate of inflation.

5.7.6 Companies tax

The taxable income of Israeli companies is subject to a company tax at a flat rate of 23 per cent.

5.7.7 Value-added tax

The Value-added Tax Law of 1975 requires a business to collect a value-added tax of 17 per cent from customers upon the sale of a product or the provision of services. The business then pays the tax on a monthly basis to the state after deducting the value-added tax that the business paid to its suppliers (known as input value-added tax). The business receives a refund if the input value-added tax exceeds the value-added tax it collected from its customers.¹⁷⁰

Some transactions – notably, services provided by a resident to a non-resident in which no Israeli asset is involved – are zero rated.¹⁷¹ Businesses engaged in these transactions do not collect a value-added tax from customers, but are nevertheless entitled to recover their input value-added tax.

5.7.8 The Encouragement of Capital Investment Law

The Encouragement of Capital Investment Law offers grants and tax benefits to promote investment in priority areas of the national economy. It is revised occasionally to reflect evolving priorities and is administered by the Authority for Investments and Development of the Industry and Economy.

The Authority can provide grants of up to 20 per cent of investments in fixed assets, production equipment, or other priority facilities in Israel. Grants for investment in the Negev region in the South of Israel are of particularly high priority, and can reach 30 per cent of the investment.¹⁷²

Companies qualifying for ‘priority enterprise’ status or ‘special priority enterprise’ status pay a reduced corporate tax, which can be as low as 9

¹⁷⁰ Value-added Tax Law (n 28) § 39(a).

¹⁷¹ *ibid* § 30.

¹⁷² Encouragement of Capital Investments Law (n 167) § 40C.

per cent. A company with either status can also benefit from accelerated depreciation, and its shareholders pay dividend tax at a reduced rate. Eligibility for these benefits requires exporting over 25 per cent of annual sales to certain qualifying markets.¹⁷³

5.7.9 Taxation of non-residents

Non-resident individuals and non-resident corporations are generally subject to income tax on income accrued, derived, or realized in Israel or from sources in Israel, as well as capital gains attributable to disposition of assets situated in Israel, or the rights connected to these assets.

Non-residents who do not have a permanent establishment in Israel (a fixed place through which the business is wholly or partly carried on) to which the income is attributable are subject to a withholding tax on passive income (such as royalties, dividends and interest) and income from services in Israel.

Dividends paid by a resident company to an individual who is a non-resident are subject to withholding tax at a rate of 25 per cent (or 30 per cent, if the individual is a 10 per cent shareholder).¹⁷⁴ Dividends paid by a resident company to a non-resident company are subject to withholding tax at a rate of 23 per cent (the current Israeli corporate tax rate). The rates may be reduced under certain exemptions, tax rulings or a tax treaty. For example, the US-Israel Tax Treaty provides that the withholding tax rate for dividends is 25 per cent, although the rate may be reduced to 12.5 per cent or 15 per cent under certain circumstances.¹⁷⁵

Interest paid by a resident company to a non-resident company is subject to a withholding tax at the rate of 25 per cent or at the corporate tax rate of 23 per cent. These rates may also be reduced under a tax treaty. For example, interest paid by residents to US residents is subject to a 17.5 per cent withholding tax, or 10 per cent if the payment is to a US bank.¹⁷⁶

¹⁷³ Ministry of Economy and Industry Website, *The Authority for Investments and Development of the Industry and Economy* (8 December 2019) https://www.gov.il/en/departments/Units/israel_investment_center accessed 30 August 2020.

¹⁷⁴ Income Tax Ordinance (n 23) § 125B.

¹⁷⁵ Convention between the government of the State of Israel and the government of the United States of America with respect to Taxes on Income, 37 KA No. 1189 p. 1 (1975) (Isr.).

¹⁷⁶ *ibid* 22–3.

5.7.10 Exemptions from capital gains tax for non-residents

In most circumstances, a non-resident is exempt from paying a capital gains tax on the sale of securities of Israeli companies or on the sale of rights in entities with most of their direct or indirect assets in Israel. The exemption applies if the securities or rights were purchased on or after 1 January 2009. The exemption does not apply if the gain is attributable to a permanent establishment of the non-resident in Israel.

In addition, capital gains from the sale of securities listed on an Israeli stock exchange are tax-exempt if they are not attributable to the non-resident's permanent establishment in Israel. This exemption does not cover the part of the gain allocatable to the period before the shares were listed.

Some limitations apply to these exemptions. For example, a non-resident company will not be entitled to these exemptions if a resident directly or indirectly holds more than 25 per cent of certain rights in it or is directly or indirectly entitled to 25 per cent of its income.¹⁷⁷

5.7.11 Income tax treaties

Israel is party to 69 treaties for the avoidance of double taxation.¹⁷⁸ The tax liability of non-residents is subject to relief under these treaties. Furthermore, most tax treaties provide reduced tax rates on Israeli-sourced dividends and interest to non-residents.

Most tax treaties provide that a non-resident, as defined in the treaty, is not subject to Israeli taxes on capital gains arising from the disposition of shares in a resident company unless, among other things, the gain is attributable to the seller's permanent establishment in Israel.

Israeli tax authorities have stated that investors in Israeli venture capital funds or private equity funds may be deemed to have a permanent establishment in Israel by virtue of the activities of the local fund manager.

¹⁷⁷ Income Tax Ordinance (n 23) § 68A (a).

¹⁷⁸ Ministry of Finance Website, Chief Economist Department, *International Affairs, International Taxation, Avoidance of Double Taxation Treaties* <https://mof.gov.il/en/InternationalAffairs/InternationalTaxation/Pages/AvoidanceDoubleTaxationTreaties.aspx> accessed 30 August 2020.

However, these funds typically obtain a tax ruling exempting their investors from Israeli tax.¹⁷⁹

5.8 Protecting an idea or a product

Israeli intellectual property law is an evolving field. The laws that apply to intellectual property are the Copyright Law, the Trademarks Ordinance of 1972, the Patents Law, the Performers and Broadcasters Rights Law of 1984, the Performers and Broadcasters Order (TRIPS Agreement) of 1999, the Law for the Protection of Integrated Circuits of 1999, the Designs Law of 2017 ('Designs Law') and, for trade secrets, the Commercial Torts Law. In addition, the Unjust Enrichment Law of 1979 is often invoked when bad faith or unfair competition accompanies an unlawful use of intellectual property. Some other laws can indirectly affect intellectual property rights, including the Promotion of Research, Development, and Technological Innovation in Industry of 1984 and Amendment No. 40 of the Communication Law (Telecommunications and Broadcasting) of 1982, enacted in 2008.¹⁸⁰

5.8.1 Trade secrets

The Commercial Torts Law defines a trade secret as 'commercial information of every kind, which is not public knowledge or which cannot readily and legally be discovered by the public, the secrecy of which gives its owner an advantage over competitors, provided that its owner takes reasonable steps to protect its secrecy'.

Trade secrets are a common form of intellectual property, and in some cases are the company's most valuable asset. They include client lists, databases, formulas, methods, processes, know-how, business plans or ideas, technical information, and source codes. Handling them requires caution because, unlike registered intellectual property, failure to maintain confidentiality can result in a complete loss of rights.

¹⁷⁹ Income Tax Ordinance (n 23) § 16A; Circular 9/2018, *Venture Capital Taxation* (14 November 2018) <https://www.gov.il/he/departments/policies/income-tax-professional-inst-09-2018> accessed 30 August 2020.

¹⁸⁰ Communication Law (Telecommunications and Broadcasting) (Amend. No. 40), 5768–2008, SH No. 2153 p. 518 (Isr.).

The law defines misappropriation of trade secrets broadly. The definition covers taking a trade secret (not necessarily from its owner) by improper means without the owner's consent; using a trade secret without its owner's consent in breach of a contractual or fiduciary obligation; or receiving or using a trade secret when it is known or apparent that it was transferred in a manner prohibited by the previous two restrictions.¹⁸¹

5.8.2 Copyright

Copyrighted work in Israel falls into one of the following categories: literary, dramatic, musical, artistic works, sound recordings and computer software.¹⁸² The term 'artistic work' includes drawings, paintings, works of sculpture, engravings, lithography, maps, charts, architectural works, photographic works, and works of applied art. The law provides copyright protection for 70 years after the death of the creator,¹⁸³ except for musical recordings, which are only protected for 50 years after their creation.¹⁸⁴

Israel is a signatory to the Berne Convention for the Protection of Literary and Artistic Works, the TRIPS (Trade-related Aspects of Intellectual Property Rights) Agreement, and the WIPO (World Intellectual Property Organization) Agreement. Israel enforces copyright protection of material created in another member state as if it was created in Israel.¹⁸⁵

Israel has adopted a flexible fair-use defence against copyright violation claims related to private study, research, critique, review, journalistic reporting, quotation, or instruction and examination by an educational institution. In addition, subject to some restrictions, the law permits the copying of computer software for backup, maintenance, or creation of derivative work.¹⁸⁶

¹⁸¹ Commercial Torts Law (n 138) § 6.

¹⁸² Copyright Law (n 130) § 1.

¹⁸³ *ibid* § 38.

¹⁸⁴ *ibid* § 41(b).

¹⁸⁵ Berne Convention for the Protection of Literary and Artistic Works 21 KA No. 737 p. 581 (1886) (Isr.); Copyright Order (TRIPS Agreement), 5759–1999, KT No. 6013 p. 223 (Isr.); Convention Establishing the World Intellectual Property Organization 21 KA No. 736 p. 539 (1967) (Isr.).

¹⁸⁶ Copyright Law (n 130) §§ 19, 24.

5.8.3 Trade marks

Israeli law protects registered and unregistered trade marks that are well known to the public. The Trademarks Ordinance of 1972 covers registered trade marks, and the Civil Torts Law of 1999 covers unregistered trade marks.

Trade marks can include letters, numbers, words, images, or other signs used to describe or distinguish goods. Service marks, collective marks and certification marks may also be registered.

Registration at the Trademarks Office protects a trade mark for 10 years and is renewable without limitation.¹⁸⁷ A trade mark that is well known in Israel and owned by a citizen of a World Trade Organization member country, or an owner of a permanent establishment in Israel, is protected even if it is not registered or used in Israel. Registration of a trade mark in several categories of products and services requires the filing of an application and payment of a fee in each category.¹⁸⁸

As a signatory to the Paris Convention for the Protection of Industrial Property, Israel regards the preliminary trade mark application date as the priority date, as long as a trade mark was registered in another signatory country no more than six months before its registration in Israel. As nationals of a signatory to the Madrid Protocol, Israeli nationals can file international applications for trade mark registration.¹⁸⁹

5.8.4 Patents

To receive a patent, an invention must be novel, useful and non-obvious.¹⁹⁰ The Registrar of Patents first examines and approves a patent, after which the patent can be registered at the Patent Office. Patents are generally granted for 20 years from the application filing date.¹⁹¹

Israel is a signatory to the Paris Convention for the Protection of Industrial Property. A patent applicant who files in any country party to the Convention is entitled to use the patent's first filing date as the

¹⁸⁷ Trademarks Ordinance (New Version), 5732–1972, § 32, DMI No. 26 p. 511 (Isr.).

¹⁸⁸ *ibid* § 70.

¹⁸⁹ *ibid* § 54(a).

¹⁹⁰ Patents Law (n 128) § 3.

¹⁹¹ *ibid* § 52.

effective filing date for a patent application in any other party to the Convention within 12 months of the first filing date.¹⁹²

The Patents Law allows pharmaceutical companies to develop and market a generic version of a patented product following a patent's expiration. To balance this right, the Law enables the original patent-holder to receive a five-year patent extension.¹⁹³

5.8.5 Designs

The Designs Law of 2017 defines a design as the appearance of a product or a part of a product, including its outline, colour, shape, decoration, texture, or material. A product can include a set of objects, packaging, a graphic symbol, or an on-screen display, but excludes typefaces and computer software.¹⁹⁴

An unregistered design is eligible for protection if it is novel and unique and the product has been offered for sale or distributed in Israel commercially by or on behalf of the owner of the design, including on the Internet.¹⁹⁵

Registered designs are protected for 25 years from the date of application.¹⁹⁶ Unregistered designs are protected for three years from the day its owner or a person acting on her behalf first publishes the design, or the product bearing it, in Israel or abroad.¹⁹⁷ This protection rarely affects start-ups because their business is usually not based on designs.

5.8.6 Licensing agreements

Commercial parties in Israel often enter into licensing agreements, including agreements for in-licensing, cross-licensing, and technology disposition.

Licensing agreements typically specify the covered intellectual property, territories and fields of use, the degree of exclusivity, commercial terms (such as fees, milestone payments, royalty payments, or

¹⁹² Paris Convention for the Protection of Industrial Property, 10 KA No. 312 p. 405 (1883) (Isr.).

¹⁹³ Patents Law (n 128) § 64(a).

¹⁹⁴ Designs Law, 5777–2017, § 1, SH No. 2662 p. 1176 (Isr.).

¹⁹⁵ *ibid* § 4.

¹⁹⁶ *ibid* § 39.

¹⁹⁷ *ibid* § 65.

performance-based compensation), patent management and prosecution, reports and audits, warranties and indemnities, the licensing term and method of renewal, and terms regarding breach, termination, and the jurisdiction for litigating disputes.

5.9 Operational liabilities and insurance

5.9.1 Risk assessment

The responsibility for risk assessment in the company falls on the general manager, the other officers, the internal and external auditors and – most importantly – the board of directors. The board of directors of a company with significant financial operations must adopt a risk assessment policy for implementation by management, and must review and update the policy on an ongoing basis.¹⁹⁸

Large companies often appoint a risk assessment manager to develop mechanisms for identification, assessment, monitoring, control and reduction of risks. The risk assessment manager is also tasked with issuing a quarterly report to the board of directors, which the internal auditor and board of directors' audit committee (both mandatory in public Israeli companies) draws upon for its annual audit plan.

5.9.2 Legal compliance

The board of directors' audit committee is charged with addressing deficiencies in the management of the company's business, including governance practices. Similarly, one of the roles of the internal auditor is to ensure compliance with the law.¹⁹⁹

5.9.3 Exculpation, indemnification and insurance

If the articles of association so provide, a company can exculpate office holders from a breach of their duty of care so long as the breach is not intentional, reckless, or for personal benefit. The company cannot exculpate directors from a breach of the duty of care in the distribution of dividends, or from a breach of their duty of loyalty.²⁰⁰

¹⁹⁸ Securities Regulations (Periodic and Immediate Reports) (n 39) § 10(b)(7).

¹⁹⁹ Companies Law (n 9) § 151.

²⁰⁰ *ibid* § 258.

In addition, if the articles of association so provide, a company can indemnify an office holder for liability and expenses in defending her actions against a civil suit by the company or on its behalf, against a civil suit by a third party, and against public investigation or enforcement proceedings that ended with no conviction or sanction other than for negligence. Indemnification cannot cover fines or monetary sanctions. The provision in the articles of association can authorize the company to indemnify the office holder after the fact or commit the company in advance to indemnify her.²⁰¹ If the articles of association so provide, a company can also buy for an office holder insurance against liability to the company or to a third party.²⁰²

As in the case of exculpation, indemnification and insurance cannot cover actions taken for personal benefit or the intentional or reckless breach of the duty of care.²⁰³ Breaches of the duty of loyalty to the company are covered only if the office holder acted in good faith and had reasonable grounds for presuming that her action would not harm the company.²⁰⁴

Companies typically purchase employers' liability insurance and comprehensive general liability insurance, including contract liability coverage, property damage liability insurance, and professional liability insurance. Investment advisers, portfolio managers, mutual fund managers, trustees and credit rating agencies expect companies to have such insurance policies in place.

Companies that possess employees' or clients' personal information typically purchase insurance against data breaches, such as cybersecurity and privacy insurance. Relevant companies may also purchase product liability insurance.

5.10 Dissolving a company

The Israeli insolvency regime contemplates various scenarios for distressed companies: voluntary liquidation by the shareholders (if the company is solvent) or by the company's creditors; court-ordered liquidation; court-supervised liquidation initiated by the shareholders or the

²⁰¹ *ibid* § 260.

²⁰² *ibid* § 261.

²⁰³ *ibid* § 263(2).

²⁰⁴ *ibid* §§ 261(2), 263(1).

creditors; and reorganization in which the company may seek a stay of proceedings while it pursues a recovery plan.

Various parties can petition the court to open liquidation proceedings. If the company is solvent (that is, according to a directors' affidavit, the company can repay all of its outstanding liabilities within 12 months from the commencement of liquidation),²⁰⁵ its shareholders may commence voluntary liquidation proceedings and appoint a liquidator.²⁰⁶ The creditors, including future or contingent creditors, may also initiate voluntary or involuntary proceedings. In certain circumstances, employees, guarantors (such as banks and other financial institutions), the Attorney General of Israel, and the Official Receiver of Israel may also petition the court to open liquidation proceedings.²⁰⁷

5.10.1 Length and procedure

The length of the insolvency proceedings depends on the complexity of the case – for example, the number of creditors, the number of creditor classes, whether the debtor is a going concern, the ratio of debt to assets, the shelf life of the assets, and market conditions. The length of a case may also be affected by the court overseeing the liquidation.

A voluntary liquidation begins by filing with the Registrar of Companies a declaration signed by all of the directors or a majority of the directors that the company can pay all its debt within twelve months ('solvency declaration'). The solvency declaration takes the form of an affidavit signed in Israel before an Israeli attorney or, if signed overseas, before an Israeli consul. A solvency declaration in a foreign language must be accompanied by a notarized Hebrew translation.²⁰⁸

After filing the solvency declaration, the shareholders must approve a resolution to dissolve the company and appoint a liquidator. The company must post the resolution in the Official Government Gazette (*Reshumot*) within seven days of its adoption and notify the Registrar of Companies within 15 days of its adoption.

²⁰⁵ *ibid* § 342(25).

²⁰⁶ *ibid* § 342(27).

²⁰⁷ Insolvency and Rehabilitation Law (n 86) § 6.

²⁰⁸ Companies Law (n 9) § 342(25).

Within 21 days of the adoption of a shareholder resolution to appoint a liquidator, the liquidator must notify the Registrar of Companies.²⁰⁹ The liquidator acts on behalf of the company and her actions bind the company. Among other things, she has the authority to sell assets and pay debts. Unless the liquidator or the shareholders resolve otherwise, the appointment of the liquidator revokes the authority of the board of directors to act on behalf of the company.

Once the shareholders adopt the liquidation resolution, the company must cease to manage its business except as necessary for liquidation. All share transfers following that day are void except for transfers to the liquidator, or those made with her approval. The liquidator or any creditor may petition the court to give instructions or make determinations in matters concerning the liquidation.²¹⁰ The company continues to exist as a legal entity until the liquidation process is complete.

The liquidator must prepare a report showing how she carried out the liquidation and distributed the assets. The liquidator must also convene a final general meeting to approve the report, and publish notice at least one month in advance of the meeting in the Official Government Gazette.²¹¹ Shareholders cannot act by written consent in lieu of this meeting.²¹² Within a week after the meeting, the liquidator must submit to the Registrar of Companies a copy of the final report and a notice certifying that the final meeting was convened and approved the final report. Three months after the submission of the final report, the company will be liquidated. However, the liquidation can be revoked in the following two years.²¹³ During this period the company remains on the Registrar of Companies' roster without paying annual fees.

5.10.2 Fees

The state fees associated with insolvency proceedings vary according to insolvency type, company size and scope of activity. The legal fees and the liquidator fees depend on the amount of work required to distribute the assets.

²⁰⁹ *ibid* § 342(29).

²¹⁰ *ibid* § 342(35).

²¹¹ *ibid* § 342(38).

²¹² *ibid* § 342(24).

²¹³ *ibid* § 342(52)(b).

There are also small fees payable to the Registrar of Companies. The Registrar will waive these fees if the company's tax file was classified as inactive or closed in the year preceding the commencement of the insolvency proceedings. The Registrar will initiate the insolvency proceedings only after the company pays any overdue fees, such as annual registration fees.

5.10.3 Tax considerations

The Income Tax Ordinance regards liquidation as a sale of assets by the company; the subsequent distribution of any remaining proceeds after paying all debt is regarded as a dividend. The company can generally offset the deemed profits from the sale of assets against carry forward losses and ongoing losses.

A variety of tax considerations bear on the insolvency proceedings, including the treatment of losses and the treatment of asset sales. Under certain circumstances, mostly in voluntary liquidations, the shareholders will use the company's losses as an asset for tax purposes. For example, an acquirer of a company in liquidation may want to use the company's losses to offset future gains. Other important tax considerations include the method for calculating the consideration that shareholders receive in the liquidation and the method for calculating the value of sold assets.

5.11 The start-up ecosystem in Israel

Over the past three decades, Israel has transformed into a leading jurisdiction for start-ups, with a robust ecosystem of supportive mechanisms. Below we describe the building blocks of this ecosystem.

5.11.1 Funding

Israeli entrepreneurs can access many sources of funding, including angel investors, early-stage venture capital funds, and late-stage venture capital funds. Many leading international investors have offices in Israel or regularly visit the country.

5.11.2 Acceleration programmes

There are many accelerators in Israel offering start-ups training programmes, office space, mentorship and access to investors.

5.11.3 Academic research

Israel is home to world-class academic institutions, including Bar Ilan University, Ben Gurion University, Haifa University, the Hebrew University, the Technion, Tel Aviv University, and the Weizmann Institute. These institutions sponsor research by faculty members and grant them a portion of the proceeds from the commercialization of their inventions. Many academic institutions have in-house companies that commercialize inventions by granting licences to companies in the private sector. In some cases, the academic institutions obtain shares in these companies. Similarly, leading Israeli hospitals and state-owned enterprises maintain in-house acceleration programmes and grant employees a portion of any proceeds resulting from commercialized inventions.

5.11.4 Government support

The Innovation Authority provides support for start-up research and development costs through grants. It also works with the private sector to provide funding and investment to start-ups through over 20 start-up incubators. The Israeli Defence Force also invests heavily in research and development, with considerable spill-over into the private sector.

The Innovation Authority represents the government in signing and implementing agreements with other countries to foster joint research and development. For example, Israel has entered into bilateral funding agreements with Canada, India, Korea, Singapore, and the United States. These agreements allow Israeli companies and a counterparty from the other country to receive grants from both countries for the development of intellectual property. Israel is also a party to EU programmes funding research and development, such as Horizon 2020 and EUREKA. Israeli start-ups often win grants under these programmes.

Finally, the government encourages innovation through reduced tax rates for companies, founders and employees.

5.11.5 Presence of multinationals

Many of the largest companies in the world have research and development centres in Israel. Israeli start-ups have access to these leading companies for cooperation and for testing new ideas.

5.11.6 Support services

Israeli start-ups have access to superb advisers. These include the Big Four accounting firms, large law firms (both Israeli and international) and a pool of highly qualified financial officers, human resource managers, and other experienced professionals. This supporting cast helps entrepreneurs to build their business.

5.11.7 Cultural aspects

Of equal importance to the start-up ecosystem is the Israeli culture, which encourages risk taking and gives entrepreneurs a second chance if they fail. The investor community in Israel understands the risks involved in high-tech and expects most investments to fail and only a few to succeed, with successful investments more than making up for unsuccessful ones.

5.12 Conclusion

Israel is a world-renowned leader in innovation and entrepreneurship. The country's legal environment is an important basis for this success. It allows foreign investors to invest freely and repatriate funds without currency controls. It offers tax exemptions and a legal system based on common law. Its independent judiciary protects investors.

The law permits a variety of investment structures, including equity investments, debt financing, and combinations of the two. Entrepreneurs can also apply for public funding. In addition, the law provides strong protections for trade secrets, patents, copyright, trade marks, trade dresses and designs. Commercial entities in Israel commonly enter into licensing agreements, including in-licensing agreements, cross-licensing agreements and technology dispositions.

The law charges a company's board of directors with supervision of management. Companies reduce the exposure of their directors and officers to liability using exculpation, indemnification and insurance.

Finally, the law contemplates various scenarios for distressed companies, including voluntary liquidation, court-ordered liquidation, court-supervised voluntary liquidation, and reorganization.