Doing Business in Israel 2008

MINISTRY OF THE INTERIOR

March 23, 2008

Dear Friends,

Israel has been a frontrunner in economic development among western countries. The past years have been marked by a constant boost in the Israeli economy, along with improvement in all financial parameters. The fiscal deficit has declined, inflation is low, exchange rates have left the Shekel stronger than in the past, unemployment has dropped, Israel's foreign debt has substantially diminished and there is a continued flow of investments into Israel.

This data formed the basis for raising Israel's rating to A by analysts.

This is a vote of confidence for the Israeli economy, which has shown consistent stability and growth. In fact, it is the writing on the wall for anyone observing the picture with economic objectivity: a writing that says Israel is a good place in which to invest capital, and that there are good prospects for financial investments in this country.

If we add to this the tremendous success in the hi-tech industry, in sophisticated industries, the life sciences, biotechnology, nanotechnology, the defense industries and the medical sciences - then we have a sea of business opportunities with a vast potential.

Our silicon valley contains numerous, beautiful flowers of industry - investors are invited to come and enjoy them.

Sincerely,

Meir Shitrit
Minister of the Interior

PREFACE

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

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

Prior to making any decision regarding investment in Israel it is advisable to consult with Israeli economic consultants in the relevant sector. Our partners and associates at BDO Ziv Haft provide reliable and professional service to all investors that are considering investments in Israel.

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

BDO is the fifth largest international network with combined revenues of approximately €3.3 billion. BDO has 626 offices in 110 countries worldwide and a total of approximately 30,000 employees.

The information presented in this publication was updated in January 2008 based on data available at time of print. The publication is intended for information purposes only and does not in any way replace or amend any of the laws and regulations presented here.

We thank Gideon Fisher & Co. Law Offices for their assistance in reviewing some of the chapters in this publication.

Although we have conducted extensive research in order to prepare this publication, we are not responsible for any inaccuracies herein.

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1. THE ISRAELI ECONOMY IN 2007

1.1. FOREWORD

After the fast paced growth in world economy during 2006, the world economy continued to expand during the first half of 2007, with a growth rate of over 5%, but has entered an uncertain and potentially difficult period in the second half of the year. The financial turmoil of August and September threatens to derail a half-decade of global growth. The problems in credit markets have been severe, and while the first phase is now over, it is still not clear how the consequences will play out.

World gross product rose in 2007 by 3.6%, compared to 3.8% in 2006 and 3.4% in 2005. The U.S. economy grew by 2.2%, 1.2% less than in 2006. The Chinese economy sustained rapid growth at a rate of 11.5%, also characteristic of 2006.

The Israeli economy, however, showed good performance. 2007 indicated a similar development as in 2006, with a 5.3% and 5% growth rate, respectively. This was due to several reasons: (a) ongoing global growth in general and in the hi-tech sector in particular; (b) more mature conduct on behalf of the fiscal system, including budgetary restraint, leading to a decline in the external public debt, (c) a monetary policy that curbed interest rates and encouraged local demand and investment.

Following a summary of the main economic indicators in Israel, this chapter ends with a forecast of major economic developments, based on several sources including, *inter alia*, the Bank of Israel's Research Department, the Ministry of Finance and a number of commercial banks.

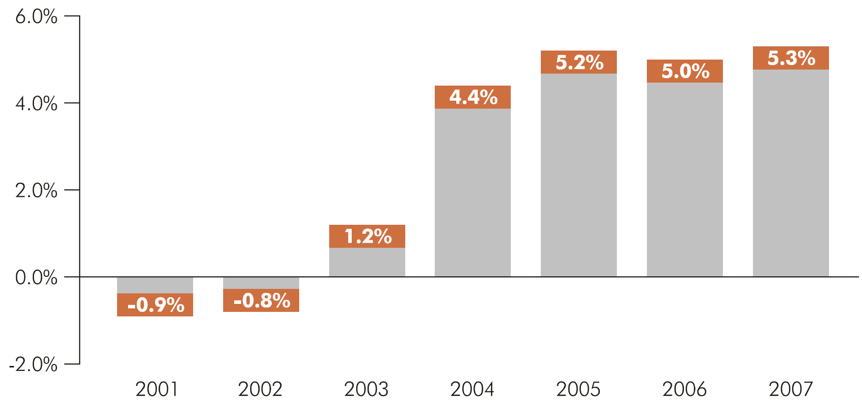
1.2. MACRO-ECONOMIC DEVELOPMENTS IN 2007

1.2.1. Gross Domestic Product

The first half of 2007 marked an accelerated growth of the Israeli economy, along with a substantial increase in all GDP components. If no drastic and unexpected change for the worse occurs in the second half of 2007, this will be the fourth consecutive year in which the Gross Domestic Product (GDP) has grown at a pace exceeding 5% per annum. Growth was accompanied by an improvement in the current account of the balance of payments, an increase in employment, a drop in unemployment and a high level of foreign investments. The GDP rose at an annual rate of 5.1% in the first half of 2007 (compared to the first half of 2006, according to original data). The growth in the business component was higher and totaled 5.6%, compared to the first half of 2006.

Compared to the second half of 2006, the GDP rose by 6.6% (the annual rate according to deducted seasonal data). The growth per capita in the first half of 2007 totaled 3.3%, compared to the first half of 2006 – similar to previous years. Thus, the trend in accelerated growth that began in the second half of 2003 continued, after the recession in Israel at the end of 2000. Economic growth during these years was accompanied by a considerable change in the composition of Israel GDP, reflected in the increased weight of the business product and the decreased weight of government services (the development of the business sector was more rapid than that of the entire economy).

The Annual Growth Rate in Gross Domestic Product



Source: Central Bureau of Statistics Israel, Monthly Bulletin of Statistics, January 2007.

1.2.2. Investments

Similarly, a rise of 9.3% occurred in the GDP, and a rise of 11.4% in investments in fixed assets, along with a rise of 27.5% in investments in overland transportation from imports, and a rise of 29.5 % in intangible assets.

Investments in residential housing grew by -2.9%, such that investments in fixed assets without housing construction grew by 14.2%. The increasing investments in fixed assets testifies to the stabilized growth pace and the transition to expanding the economy's production ability. This trend already began in 2006. On the other hand, output in 2004 and 2005 increased mainly by enhancing the efficiency of existing production factors. The growth in investments reflects, inter alia, the success of the policy to reduce the government's part in economic activity, and its decreasing need to raise capital on the domestic capital market – thereby making resources accessible to increasing the business sector's share of the investment.

1.2.3. Employment

The number of employee posts rose by 4.1% over the past year (August – October 2007), compared to the corresponding period in 2006. The gross real wage for a salaried post increased by one percent during the same period. This is explained by the fact that a large number of new jobs are part-time and are partly manned by new lower-paid workers, sometime in sectors that employ less skilled workers, and is also due to the continued reductions in tax rates on wages.

According to preliminary trend data of the Central Bureau of Statistics, the unemployment rate reached 6.6 of the civilian labor force in November; in other words, – i.e. there are signs of a continuing decline in the unemployment rate in Israel.

1.2.4. Fiscal Developments

In 2007, the current account of the balance of payments in the government sector showed (for the first time since 1986) a surplus reserve of NIS 5.6 billion – compared to a NIS 2.3 billion deficit in 2006. In terms of GDP, this totaled 0.8% of GDP in 2007, compared to 0.4% deficit in 2006. The surplus in the current account is equal to current income less current expenses of all the bodies in the sector: the government, local authorities, national institutions and non-profit organizations who obtain most of their funding from the government.

The increase in current government surplus reserves in 2007 reflects a 6% rise in current income, following an 8.6% rise of this component in 2006. The increase in revenue in 2007 reflects a direct tax collection rise (mainly income tax) and a decline in current transfers from overseas. Total income from taxes rose this year by 6.4%, following an 8.5% rise in direct tax collection in 2006.

Total current expenses in the government sector rose this year by 3.0%, after a 5.8% rise in 2006. Public spending, which accounts for 61.6% of total current government expenses, increased by 3.3% in current prices (2.6% in fixed prices) in 2007. Interest expenses on the government debt were also up (10.0%).

The transfers from the government sector to private consumption marked a 2.4% rise in 2007, following a 5.8% rise in 2006. Out of this, the National Institute allocations increased by 2.4%. On the other hand, 2007 marked a 26.1% decrease in financial support to local producers.

The overall balance of payments of the government sector, obtained as a summing-up of the balance of payments in the current account and the balance of payment in the capital account, showed a relatively small deficit of 0.3% in GDP in 2007

1.2.5. Balance of Payments

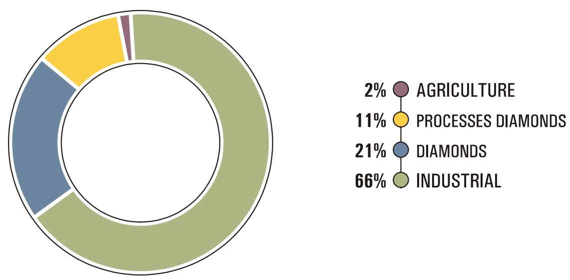
2007 marked a boost of 8.6% in the export of goods and services, after an increase of 5.9% in 2006 and of 4.3%% in 2005. Industrial exports (excluding diamonds) were up this year by 8.6%, after rising by 12.5% last year. Income from tourist service exports rose by 15.5%, after a drop of 6.6% in 2006.

The export of services, excluding tourism and including mainly software and research services, rose by 7.4%, following a rise of 8.3% in 2006. Additionally, this year marked a relatively prominent boost of 21.1% in agricultural exports, and a boost of 7.9% in diamond exports. Goods and services imported at fixed prices, increased this year by 12.8%, after a 3.3% increase in 2006 and a 3.5% increase in 2005. The import of goods and services, excluding defense imports, ships, airplanes and diamonds, increased by 14.1%, after rising by 3.3% in 2006 and 3.5% in 2005.

In 2007, there was a minor deficit in the account of goods and services (excluding defense imports), totaling $134 M, after a $3.6 M surplus in 2006. The final account, including goods and services (and defense imports), income from work, capital and current transfers from abroad, showed this year a surplus reserve totaling $6.2 billion, after a $8.9 billion surplus last year. The surplus in the current account for 2007 constituted 3.2% of the GDP, compared to 5.6% in 2006.

The following diagrams illustrate the composition of Israel's international trade:

Export by Product

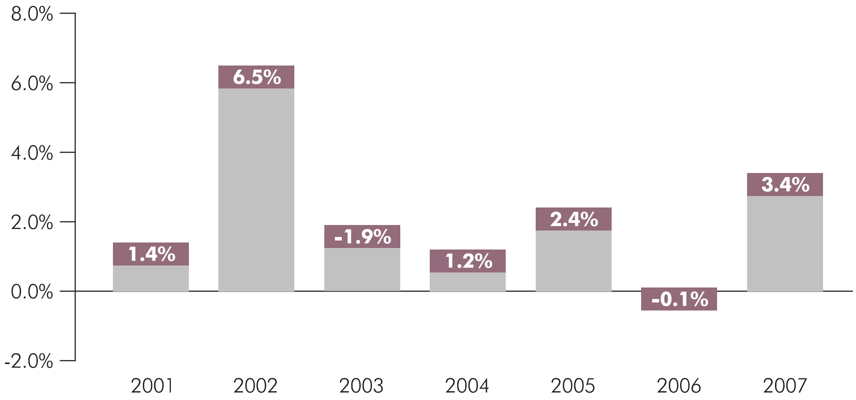


Source: Central Bureau of Statistics Israel, Monthly Bulletin of Statistics, January 2007.

1.2.6. Monetary Developments and Capital Markets

The prices of goods and services in the economy dropped in 2007 by 1.0%, after a 2.5% increase in 2006 and 2.6% in 2005. The prices of overall goods and services include prices of products and services manufactured locally and imports for all types of use – private and public spending, investments in construction, equipment, transportation, inventory and exports. GDP prices dropped this year by 0.2% while those of imported goods and services dropped by 2.9% in 2007. The prices of private and public spending and investments rose by 0.7% in 2007, while the prices of export goods and services dropped by 4.6%.

Inflation Rates



Source: Bank of Israel, January 2007.

1.2.7. Inflation

The Consumer Price Index (CPI) rose by 0.6% in December, a rate higher than forecasters' projections prior to its publication. The increase in energy and food prices made a prominent contribution to the rise in the index. This is the second consecutive month of a high rise in the index in relation both to the seasonal path consistent with the inflation target and also to prior assessments. In the course of 2007, the Consumer Price Index rose by 3.4 percent – above the inflation target. The CPI, excluding the energy and food components – constituting 76% of the overall index - rose in 2007 by 1.6%.

Expectations and forecasts of inflation and of the Bank of Israel interest rate rose - breakeven inflation. Inflation expectations for one year forward derived from the capital market rose in January to an average of about 2.5 percent, compared to an average level of 2 percent in December.

Israeli forecasters' projections about projected inflation one year forward remained steady in the last month, at an average of 2.5%. Domestic forecasters expect, on average, that the cumulative change in the Consumer Price Index in January-March 2008 will be a drop of 0.2%. The Bank of Israel and the domestic forecasters expect that inflation, observed over the past twelve months, will come within the target range in the second half of 2008. It should be noted that even when the monthly indices in 2008 become consistent with inflation of 2%, when reckoned over the twelve past months, inflation will return to the target range only in the second half of the year. According to the Bank of Israel's assessments, at the end of 2008 inflation over the previous 12 months will be close to the middle of the target range.

Israeli forecasters expect that, on average, the Bank of Israel's interest rate for February and March 2008 will remain unchanged, and will reach 4.6% by the end of 2008.

In the decision on the interest rate for February, the *Makam* curve reflects expectations in the financial markets that the Bank of Israel interest rate will slightly rise in the next twelve months.

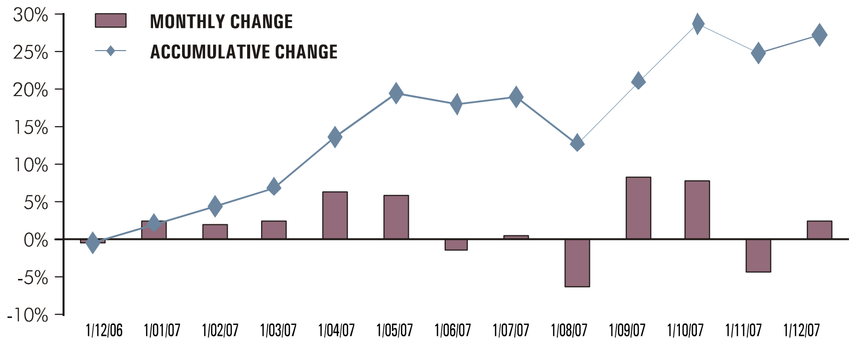
The interest on 5-year CPI-linked bonds remained steady in January, at an average rate of 3.2 percent, similar to its level in December. The nominal yield on 5-year non-linked government bonds dropped over the past month by about 0.1%, averaging approximately 5.6% in January. The yield on one-year *Makam* rose by 0.2 percentage points in January, compared to an average of 4.8 percent.

As of December 2007, the Bank of Israel interest rate was 0.75 percentage points higher than the US federal funds rate, and 0.25 percentage points higher than the ECB rate.

The gap between the yields on unlinked Shekel bonds and US 10-year bonds rose during the last month from 203 base points on 24 December to 233 base points on 23 January.

The Bank of Israel interest rate, less inflation expectations for one year forward was about 1.8 percent in December - a drop of 0.2 percentage points compared to December, due to the rise in expectations for inflation which was higher than the rise in interest rates.

TA-25 Index (Maof)



Source: Tel Aviv Stock Exchange, January 2007.

The soaring prices on the stock exchange were accompanied by a considerable growth in corporate earnings, indicating this was not merely a price bubble, as was the case in the hi-tech industry during 1999-2000.

650 companies were traded in 2007 in a broad spectrum of industries – an increase compared to the end of 2006, when 606 companies were traded. Evidence of the positive atmosphere in the capital market is the volume of average daily trading which in 2007 rose by 80% - compared with 2006 - to NIS 2 billion. ($520 million).

Over 130 Israeli companies, mostly in the hi-tech sector, are currently listed on various stock exchanges globally, including the NASDAQ and the New York Stock Exchange.

1.3. FORECAST OF ECONOMIC DEVELOPMENT IN 2008

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

Annual Change in	2001	2002	2003	2004	2005	2006	2007	2008*
Inflation	1.4%	6.5%	-1.9%	1.2%	2.4%	-0.1%	3.4%	2.8%
Devaluation vs. US$	9.3%	7.3%	-7.6%	-1.6%	6.8%	-8.2%	22.7%	5.1%
GDP	-0.9%	-0.8%	1.2%	4.4%	5.2%	5.0%	5.3%	4.3%
GDP per capita	-3.2%	-2.7%	-0.5%	2.6%	3.4%	3.1%	3.5%	2.5%
Investment in fixed assets	-8.9%	-1.6%	-1.5%	-0.2%	2.9%	6.1%	11.4%	8.6%
Unemployment	9.0%	10.4%	10.7%	10.4%	9.0%	8.6%	6.6%	7.4%
Export	-13.1%	0.2%	8.1%	17.4%	7.5%	9.5%	8.6%	6.9%
Import	-6.4%	-0.4%	3.5%	11.8%	1.6%	3.8%	12.8%	6.8%
Public Consumption	3.6%	5.7%	1.0%	-2.4%	2.7%	2.2%	3.0%	1.0%
Private Consumption	2.5%	-0.6%	2.0%	5.0%	3.4%	4.6%	7.2%	4.0%
Housing Starts	-30.0%	3.9%	-4.2%	-7.5%	3.8%	-3.1%	-3.8%	2.0%

** Forecast for 2008.*

2. ISRAEL – GENERAL OVERVIEW

2.1. BACKGROUND

Since declaring its independence in 1948, Israel has been the home of Jewish immigrants from all over the world. The country's population - composed of approximately 75% Jews, and 25% Muslims, Druze, Christians and others - grew from 870,000 inhabitants in 1948 to over 7.2 million in 2007.

In the past decade alone, Israel's population grew by 31%. This growth derived, partly, from the massive wave of immigration from the former USSR – following its break-up at the beginning of the last decade – and from Ethiopia. Immigration in the years 1995 – 2000 stabilized at approximately 70,000 new immigrants annually, but this figure has since dropped to, 21,000 in 2005 and 19,000 in 2006.

During the 1990s, Israel, along with its Arab neighbors, attempted to resolve the ongoing Middle East conflict by peaceful means and through talks and accords. The hope for peace and rapid economic growth attracted, at the time, an increasing number of direct and indirect foreign investors to Israel. In the early 2000's, the new geopolitical situation, including the rise in terrorist activities in Israel and globally, caused a recession in Israel. However, over the past few years, Israel has enjoyed substantial economic stability.

At present, the Israeli economy is mainly affected by two factors: government policy and the political situation.

2.2. GOVERNMENT

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

Israel has an electoral system based on nation-wide proportional representation, and the number of seats that every list receives in the Knesset is proportional to the number of voters. The only limitation is the 2% qualifying threshold. According to this system, the voters elect a party list rather than a particular individual on the list.

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

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

After the elections, the chairman of the largest party in the Knesset (Israeli Parliament) is entrusted with the task of forming a coalition. If he succeeds, he is elected as Prime Minister and responsible for forming a government and appointing ministers.

The last general general elections were held in Israel in March 2006 and the newly formed party, Kadima, won, headed by Ehud Olmert, who was nominated as prime minister and has since been serving in this office.

The function of the President of the State is primarily a representative one. He is elected by the Knesset every five years, for a limited period of two terms. The President holds the statutory power to appoint judges and the governor of the Bank of Israel; to accredit diplomatic senior staff, pardon criminals, etc.

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

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

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

2.3. FACTS AND FIGURES

Israel is situated along the Mediterranean coast, on an area with the size of 22,000 km. (8,500 sq.m.), including the Golan Heights, without the Gaza Strip and parts of the West Bank, which were given to the Palestinians in the context of the Peace Process and the Disengagement Plan.

Israel is 430 km (265 miles) long and between 110 km (70 miles) to 10 km (6 miles) wide. It has borders with Lebanon in the north, Syria and Jordan in the east, Egypt in the south and with areas under the Palestinian Authority.

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

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

Israel's major cities:

Jerusalem – The capital of Israel and location of the Knesset and numerous historic and religious sites; population - approximately 733,000.

Tel-Aviv – Israel's major city - financial, commercial and industrial center, with a population of approximately 384,000.

Greater metropolitan area – approximately 1.2 million.

Haifa – Principal port city in the north of Israel, with a population of approximately 268,000.

Beer Sheva – The largest city in the Negev desert (in the south), with a population of approximately 186,000.

Israel's climate is characterized by a hot and humid coastal climate, with a dry desert climate in the summer (July to September). The temperatures at this time of year vary from 28ºC (82.4ºF) in the north to 40ºC (104ºF) in the south. Winter begins around November and lasts until March, with relatively mild but rainy weather. A typical winter day in Jerusalem is about 5ºC (41ºF).

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

The prevailing system for measurement is the metric system.

2.4. ISRAEL'S CURRENCY

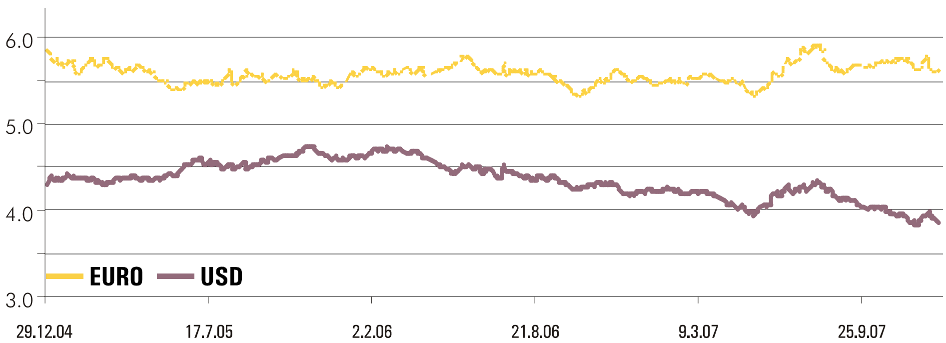
Israel's monetary unit is the New Israel Shekel (NIS). One NIS is comprised of 100 agorot.

The representative exchange rate of each foreign currency vis-a-vis the NIS is determined by the Bank of Israel as a function of the actual exchange rate of the "currency basket", which is the relative strength of each currency on international markets. The "currency basket" in 2006 was comprised of the following:

US$ 65.65%, €22.94%, £ 5.68% and ¥ 5.73%

The following graph presents the foreign exchange rates in Israel during the years 2005-2007:

Exchange Rates from 2005 to 2007



The representative exchange rates of the Israeli currency in relation to some major currencies on December 28, 2007, were as follows:

	NIS
US Dollar	3.8570
Euro	5. 6499
UK Sterling Pound	7.7015
Swiss Franc	3.3993
Japanese Yen (100)	3.4063

2.5. INFRASTRUCTURE

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

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

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

2.6. WORKING IN ISRAEL

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

According to the “Law of Return”, immigrants are entitled to a “permanent resident” status, or an A-1 visa, which grants the immigrant a “temporary resident” status.

2.7. BUSINESS HOURS

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

Work hours in administrative offices are generally from 8:00-9:00 am to 4:00-5:00 pm. Banks are open from 8:30 am to 12:30 pm from Sunday through Thursday and from 4:30 to 6:30 pm on two afternoons.

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

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

Legal holidays in 2007 and 2008 are as follows:

Holiday	2007	2008
Passover	April 3-9	April 20
Independence Day	April 24	May 8
Pentecost (Shavuot)	May 23	June 9
Jewish New Year	September 13-14	Sep. 30 – Oct. 1
Day of Atonement (Yom Kippur)	September 22	October 9
Feast of Tabernacles (Sukkot)	Sep. 27 - Oct.4	October 14

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

3.1. ISRAEL'S HIGH-TECH INDUSTRY – INTRODUCTION

The technology industry in Israel has been the driving force of the nation's economy, and has played a prominent role in Israel's economic development , particularly over the last decade. Only 20 years ago, most of the country's technology was concentrated in military/security-related industries. Although Israel was not a major factor in the global hi-tech industry at the time, Israeli companies at present have a significant foundation in hi-tech industries worldwide and Israel ranks among the leading countries globally in the number of Nasdaq-listed hi-tech companies.

Because the hi-tech sector became the primary engine for economic growth, - despite the recession, its recovery in 2005 was vital in bringing Israel's economy back onto a sustainable growth path - reflected in a boost in investments, recruitment of capital, cutback in unemployment, hi-tech exports and corporate mergers – all of which have demonstrated precisely this. Various indicators show that, after a slight rise in 2005, growth was sustained in 2006 and 2007, marking an improvement in hi-tech. This suggests that capital markets, as well as investors, are more optimistic than in the past; however, given the hi-tech bubble in 2000, they have developed a more cautious approach towards the industry.

3.2. THE HIGH-TECH WORLD IN 2007

The hi-tech sector in 2007 continued to expand, following the end of the recession and resumption of growth characterizing 2004, along with the stabilization felt in 2005. The capital raised by Israeli hi-tech companies totaled $US 1.76 billion, representing an 8.5% increase compared to 2006 and a 31.5% increase compared to 2005.

Hi-tech exports totaled $14.2 million in 2006 – representing approximately 48% of Israel's aggregate exports, reflecting a 9% growth compared to 2005.

In 2007, the ratio of capital deployed by Israeli VC's reached 39% of the aggregate amount, compared to 40% in 2006 and 49% in 2005. These figures

* This chapter is based on data gathered by IVC Research Center, February 2008

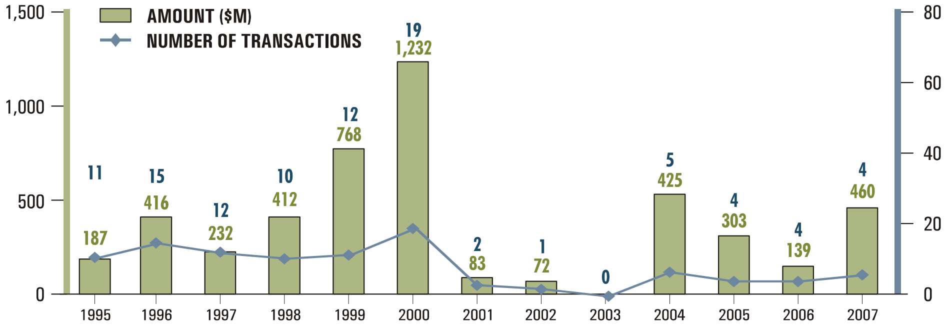
indicate the international interest expressed in the Israeli hi-tech industry and the larger investments of foreign funds.

In 2007, $467 million were raised by seven companies through initial public offerings (IPOs) , compared to $624 million by 8 companies in the preceding year. The essential difference between the two years is the source of capital. While in 2006 the amount of capital raised in the U.S. was substantially less than in Europe, over 98% of the money in 2007 was raised on U.S stock exchanges.

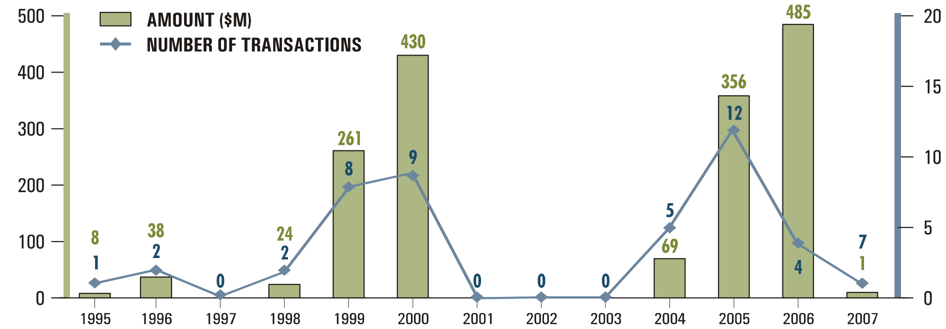
The capital raised in IPOs not only demonstrates economic growth in 2007, but also foresees continued development in the upcoming years.

The following graphs illustrate the capital raised in US and in European public offerings by Israeli high tech companies:

Capital Raised in US Initial Public Offerings of Israeli High-Tech Companies



Capital Raised in European Initial Public Offerings of Israeli High-Tech Companies



3.3. THE VENTURE CAPITAL INDUSTRY

Israel's venture capital (VC) industry has played a fundamental role in the dramatic development of the hi-tech industry in recent years. VC has served as a link between start-up companies and investors, by providing the latterwith the necessary funding, and is regarded as an infrastructure industry essential to every technological environment. Furthermore, VC is an effective tool in financing, supporting and guiding companies towards a successful course.

Israel's venture capital industry is one of the leading capital markets worldwide, with dozens of funds operating from Israel ("Israeli VC Funds"). The funds are supplemented by other investors, including public companies, private investors and non-Israeli-based VC funds.

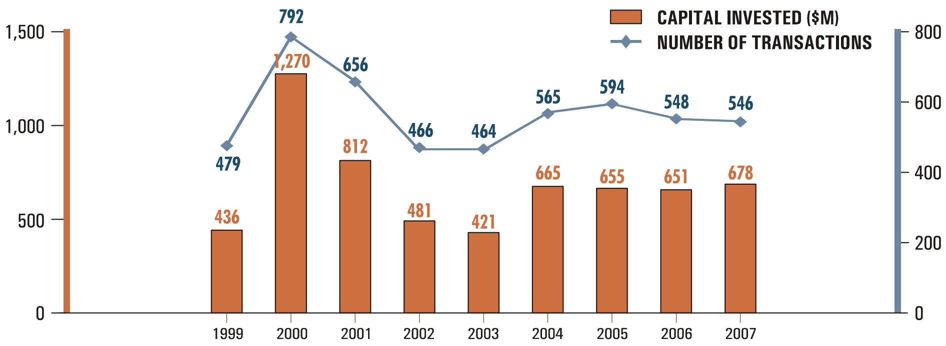
The venture capital industry has tremendously grown over the past decade. This is due to several factors, including: tax exemptions on Israeli VC fund investments, funds established in conjunction with large international banks and finance companies, and the involvement of major organizations wishing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

This type of involvement has generated an increase in funding sources, leading to larger investments by VCl funds per round.

In 2007, Israeli VCs invested approximately $678 million - similar to the amount invested in the two preceding years and higher by 61% compared to investments in 2003.

The following graph illustrates the capital raised for the high-tech industry over the past nine years:

Capital Invested by Israeli Vcs in Israeli High-Tech Companies ($M)

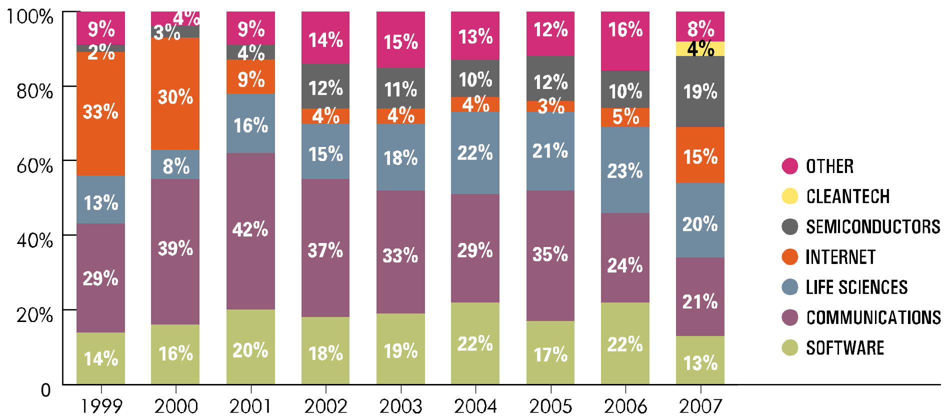


3.4. ANALYSIS OF VENTURE CAPITAL RAISED BY INDUSTRY

Israeli companies have a distinct presence in the various hi-tech industries. The ratio of capital raised by the different sectors has varied over the years, with a strong emphasis on communication companies and a more diversified distribution during 2007.

The following graph displays the relative part of the different sectors out of total capital raised over the past 9 years:

Capital Raised by Israeli High-Tech Companies by Sectors (%)



Following is an analysis of capital raised by Israeli companies in leading sectors. The following information is based on analyses from IVC Research Center.

3.4.1. Communications

Communications is considered to be a major field for raising capital. However, since 2002, when the amount of capital raised reached 50% of aggregate fund-raising, 2003 and 2004 marked a decline to 44% and 38% respectivly. In 2005 there was an increase to 46%, followed by a decline to 33% in 2006. In 2007 the amount of capital raised reached only 21% of aggregate fund-raising.

It should be noted that the media and telecommunications market in Israel has undergone several changes over the past decade, making it both attractive and accessible to investors generally. One example is the vigorous competition evident in the multi-channel broadcasting field. The Israeli Satellite Company – "Yes" – which began operating in 2000, is a serious challenge to cable companies. Another change is the addition of a new commercial channel in 2002 - “Channel 10” - currently ranked second in rating percentage.

3.4.2. Software

Software companies raised 13% of the aggregate capital invested in 2007 – marking a drop compared to 22% in 2006.

3.4.3. Internet

Although the hi-tech sector most affected by the recession was the Internet, investments in Internet companies as part of the aggregate capital raised have tripled from 5% in 2006 to 15% in 2007. This is a significant boost, compared to their share in 2005 and 2004.

3.4.4. Life Sciences

The life sciences have, in recent years, become a major field as far as capital recruitment is concerned. After having accounted for merely 8% of the capital raised in 2000, this branch of industry subsequently developed, stabilizing over the past three years by about 15% - 23% of overall capital recruitment.

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

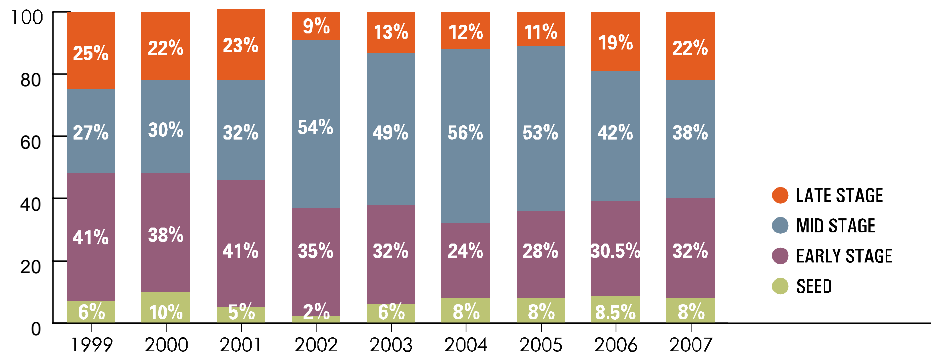
The life span of a company is defined by several stages - beginning with the earliest, known as the “seed” stage, and terminating with the last – known as the “revenue growth” stage (when a company operates as a selling entity).

Considering the changes occurring over the past years in capital structure, based on the various phases of a company’s life, the slack down in hi-tech has undoubtedly “taught investors a lesson" by causing them to become more cautious and solid. Whereas investments during a company’s start-up and very risky stage gradually declined from 41% in 1999 to 28% in 2005, investments in the intermediate and safer stage grew from 27% to 53% in 2005. These trends illustrate investors’ preference to minimizing risks by investing in active companies, where the uncertainty factor is not as high as in seed companies.

This trend changed in 2006, and investments at the later stage increased, in parallel with a continuous incline as the early stage also increased - on account of the intermediate stage. This might indicate that the ongoing recovery in hi-tech has enhanced investors' confidence in the industry, encouraging them to take more risks. During 2007, this trend continued with a further decrease in investments at the intermediate stage, from 42% in 2006 to 38% in 2007.

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

Capital Raised by Israeli Companies by Stage (%)



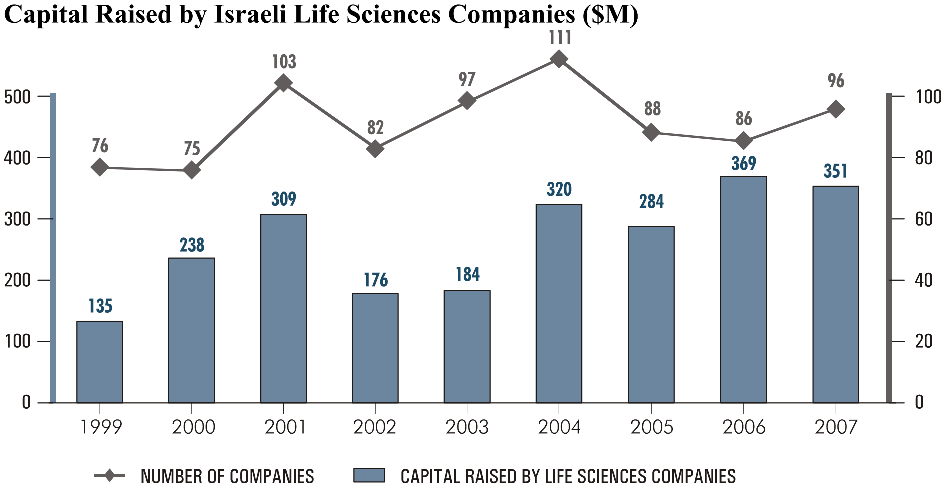
3.6. THE BIOTECHNOLOGY INDUSTRY IN ISRAEL

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

Total investment in life science companies in 2007 amounted to $351 million - lower by 5% compared to 2006.

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

Capital Raised by Israeli Life Sciences Companies ($M)

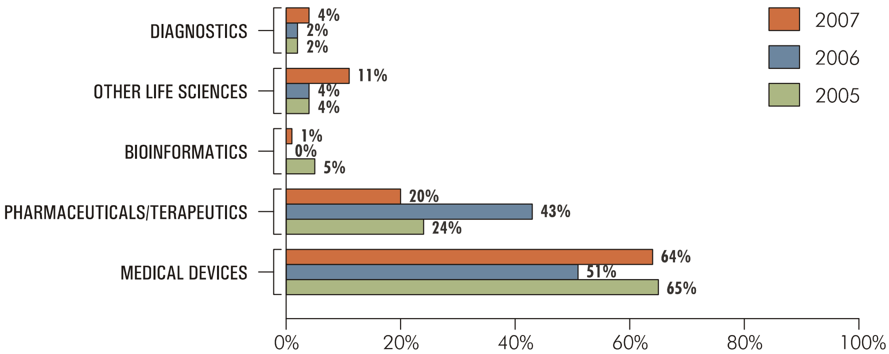


A major sub-branch of biotechnology is the medical devices field. This sub-branch drew, in 2007, 64% of the aggregate capital raised for the industry – approximately $255 million - marking an increase of over 19% compared to the previous year. Another prominent sub-sector is the pharmaceuticals industry, responsible for about 20% of total capital raised for the sector.

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

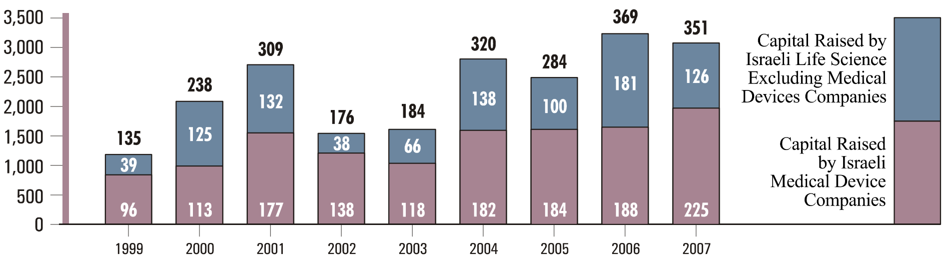
The following graphs show the capital raised by the Israeli life science industry and the dominance of medical device companies vis-a-vis other sectors over the past couple of years:

Capital Raised by Israeli Life Sciences Companies (%)



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

Capital Raised by Israeli Life Science Companies ($M)



4. BUSINESS STRUCTURE

4.1. BUSINESS ORGANIZATIONS

4.1.1. General

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

4.1.2. Companies

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

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

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

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

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

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

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

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

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

4.1.2.1. **Public Company**

A public company is a company whose stock is listed on a stock exchange or offered to the public in a prospectus, and held by the public.

The Articles of Incorporation should not consist of any restrictions on the transfer of a public company's stocks.

If a public company's stock is traded on the Tel Aviv Stock Exchange (TASE), the company is required to:

Publish annual audited financial statements and quarterly non-audited (but reviewed by a CPA) financial statements.

Appoint at least two directors, known as “Independent Directors” who have no economic affiliation to the company or substantial relationship with its business management. Regulations published in 2000 concern compensation and expense payments to an “Independent Director”. These regulations classify companies according to different levels, based on their capital, and they also determine the amount of compensation and expense payments to which the “Independent Director” is entitled.

If all the directors are of the same gender, directors of the opposite gender should be appointed as "Independent Directors".

Appoint a certified public accountant (CPA), responsible, *inter alia*, for auditing the company’s annual financial statements

Appoint an audit committee comprised of at least three directors. All "Independent Directors" must be members of the audit committee.

Appoint an internal auditor.

File annual and quarterly financial statements with the Registrar of Companies, the TASE, and the Securities Authority.

Publish a prospectus in respect of any public offering.

Report immediately on any major event.

Report on any potential conflict of interests between the company and its controlling stockholders.

New regulations were published during 2000 concerning proof of stock ownership for voting at the general meeting. Furthermore, there are regulations for convening reporting general meetings and meetings of stockholders in public companies, negotiating mergers, acquisition offers, and concessions in transactions with interested parties.

New regulations were published in 2000, to simplify the rigorous approval requirements prescribed by the Companies Law concerning transactions between a company and an interested party. Various concessions were granted to public companies with respect to the approval of specific transitions that are more common and dynamic.

In view of the global trend to establish the concept of corporate social responsibility (CSR), regulations were published in Israel during 2001 obligating the corporation to report on its social contribution policy in the directorate statement.

In light of the increasing importance attributed in the last years to risks management, new regulations were published in 2002 compelling companies to disclose information regarding exposure to market risks, including quantitative information.

In 2003, the Israel Securities Authority published new guidelines requiring companies to publish information with respect to the number of directors who possess accounting and financial skills. Each company should assign a minimum number of such directors, bearing in mind its size, operations, etc., and disclose this number in its annual reports and whether the current board of directors complies with it.

Other new guidelines published in 2003 by the Israel Securities Authority concern significant valuations. Companies are required to attach to their financial reports each valuation applied to determine the value of an asset, liability, engagement, capital or activity considered to be of significance to the company's business. Furthermore, there is a requirement for disclosure regarding the work contracted to the appraiser and the method and information forming the basis of the valuation.

In 2004 the Israel Securities Authority published new amendments to the Securities Law, in accordance with the Barneah Committee. Those new amendments are based mainly on the American SEC. The Barneah Committee's recommendations include: simplification of the structure and size of IPO’s, comparison of reporting and liability levels in annual reports to those common in IPO's, creation of a clear and written structure for the section describing the company’s business, its ability to provide information vis-à-vis data already published and as well as projected data. Adoption of the new adjustments will create a revolution in the reporting procedures applied by public companies in Israel. It will also facilitate recurrent public offerings and simplify the integration of Israeli public companies in international markets.

New regulations were published in 2005, to simplify the procedure of issuing new shares to the public, for the benefit of public companies whose shares are already listed on the stock exchange. Subject to certain conditions, essentially concerned with the listed company's adherence to obligations under the Securities Law and Regulations, the company is entitled to issue new shares by publishing an off-the-shelf prospectus.

Amendment No. 3 to the Companies Act

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

The conditions that must be proved in court to justify a claim for lifting the veil of a company, were revised and withdrawn. The original section of the Companies Act was general and enabled the court to persue a rather broad interpretation of its wording, to lift the company's veil easily and expose shareholders to personal damage. Consequently, this part was revised through legislation, with the general section being cancelled and the conditions stipulated there narrowed down.

The Section making it possible to lift the veil of a company against directors, officers and other key personnel cancelled and consequently the Company Act enables veil lifting only against shareholders.

The terms approving the appointment of a CEO in a public company, and enabling him to act simultaneously as Board Chairman, as an exception to its prohibition in the Companies Act, were relieved.

The Company Act granted inactive private companies exemptions from the requirement to appoint a certified public accountant and compile annual audited financial statements. The above exemptions were extended to also include companies with minor activity, whose annual turnover does not exceed NIS 500,000.

4.1.2.2. Private Companies

A private company is a non-public company

A private company may have one or more stockholders.

A private company is required to file an annual report with the Registrar of Companies including information regarding stockholders and directors but not financial statements.

Concurrently with the enactment of the Companies Act in 1999, regulations were published regarding reports, registration details and forms that define the registration and reporting processes and specify the different forms for reporting.

Annual audited financial statements, prepared according to generally accepted accounting principles, should be presented at the stockholders' annual meeting.

Stocks and other securities should not be offered for sale to the public.

4.1.2.3. Foreign Companies

Foreign companies wishing to conduct business in Israel are required to register with the Registrar of Companies and to submit their Articles of Incorporation (original and an authorized Hebrew translation), list of directors and other required information.

Foreign companies wishing to issue securities on the TASE are required to operate according to the TASE and Securities Authority requirements.

4.1.2.4. Capital Structure

Securities - Several types of securities are commonly used by Israeli companies, some of which are described below:

Common Stock - entitles voting rights and participation in earnings and excess assets in the event of liquidation. The shares may be of different par values and rights. However, TASE regulations require a company to hold only one type of shares for issuing stocks.

Preferred Stock - provides preferred rights for both dividends and/or liquidation.

Management Shares - usually issued to the founders, entitling them to special rights, especially in respect of appointing directors and voting rights.

Redeemable Shares – the Companies Act permits companies to issue redeemable shares. Such shares may entitle their holders to exercise various rights, as determined by the company, including voting rights and profit sharing.

Warrants - entitle conversion to common stock at a pre-determined price.

Convertible Bonds - entitle conversion of bonds to shares at a pre-determined conversion ratio.

Dividends - An Israeli company may distribute its retained after-tax earnings by way of dividends. The dividends can be distributed from real earnings alone (after elimination of inflationary gains). Distribution of dividends is subject to fulfillment of two criteria: profitability test and the ability to meet all existing and future contingent liabilities, based on audited or reviewed financial statements, not earlier than six months prior to the actual distribution of dividends.

4.1.3. Partnerships

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

A partnership may not have more than 20 partners.

A partnership may be general or limited.

A partnership is not required to file annual reports of any kind. Profit or loss should be added to the financial reports and income statements of the individual partners.

4.1.3.1. General Partnership

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

4.1.3.2. Limited Partnership

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

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

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

4.1.4. Cooperatives

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

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

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

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

4.1.5. Non-Profit Organizations

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

Non-profit societies or associations, under the “Amutot” Law, 1980;

Corporations with public objectives, under the Companies Law;

Public trusts.

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

Prohibiting profit distribution to association members.

Limiting of the association’s activities to those stated and authorized.

Prohibiting any sale or transfer of members’ rights.

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

The Managing Committee (similar a corporation's Board of Directors).

An Audit Committee.

A Certified Accountant (for associations with revenue exceeding NIS 1 million per annum).

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

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

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

4.2. TEL AVIV STOCK EXCHANGE

4.2.1. General

Securities issued by public companies and government bonds are traded on the Tel Aviv Stock Exchange (TASE). Approximately 600 companies are listed on the TASE.

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

The Securities Authority's principal tasks are:

Authorizing the issuance of a prospectus.

Checking financial reports and special transactions.

Supervising the TASE.

Investigating matters concerning the Securities Act.

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

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

Changes in the Memorandum and Articles of Incorporation (only Articles of Incorporation for companies incorporated after February 1, 2000).

Details of holders of 5 percent or more of the voting rights or shares of the company, including any changes in such holdings.

Any material agreement the company has entered into.

Salaries of the company’s 5 highest paid officers and directors.

Any benefits and transactions with holders of 5% or more of the issued capital stock.

Change of auditors.

Changes in the capital stock.

Composition of the board of directors.

Conflict of interests between the company and the controlling stockholders.

Private placements.

4.2.2. Prerequisites

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

The issued capital stock is fully paid.

The Memorandum and Articles of Incorporation (only articles after February 1, 2000) do not limit transferability of listed securities.

Listed securities are spread adequately, both in value and distribution (for more information - please refer to paragraph 4.2.3 below).

Terms and prices of offerings and issuances should be equal for all. However, some distinctions regarding certain investors or issuances, as determined in the TASE guidelines, may be permitted.

The Articles of Incorporation determine that voting at the general meeting will be by vote count.

The company agrees to comply with the rules of the TASE and its Board.

The TASE Board may add conditions to the registration of securities and prevent their listing in certain cases.

4.2.3. Principal Listing Criteria

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

Regarding an IPO, the following table summarizes the principal financial criteria required (*US$ 1 = NIS 3.846)*:

Criteria	Alternative			
	A	B	C ("Large Company")	R&D Company (*)
Period of activity in the field defined in the articles of incorporation that has complete financial reports.	12 Months	12 Months	-	-
Stockholders' equity before registration (US$ million)	1.04	1.04	-	-
Stockholders' equity after registration (US$ million)	6.5	9.1	No minimum	2.08
Added value in the 12 months preceding registration.	1.04	-	-	-
Public equity (US$ million)	5.2	7.8	20.8	-
Amount raised from the public on date of listing (US$ million)	-	-	20.8	-
Market Capitalization (US$ million)	-	-	52	-

(*) The following terms have to be complied with:

The company invested at least NIS 3M ≈ US$ 780,000 in the last three years in R&D activities from other sources, including investments from the Chief Scientist.

The investment was approved as an R&D investment.

(i) Investment in R&D can be invested by a subsidiary or subsidiaries of the company requesting to be traded, subject to several conditions.

(ii) The company (requesting to register on the trade market) will either pursue its R&D activities or continue manufacturing and marketing the outcome of its previous R&D.

(**) Added value is defined as:

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

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

Minimum Public Equity (*US$ 1 = NIS 3. 846)*:

When Public equity is: (US$ million)	Share of public equity out of total equity should exceed	
	Non R&D company	R&D company
From 4.16	-	10.0%
From 5.2	25.0%	10.0%
From 7.8	20.0%	10.0%
From 10.4	15.0%	10.0%
From 13	10.0%	7.5%
From 52	7.5%	7.5%

Minimum Number of Holders (*US$ 1 = NIS 3. 846)*:

Type of Security	Minimal # of Holders	Minimal Holding per Holder
Stocks	100	US$ 4160
Convertible Bonds	100	US$ 4160
Bonds	35	US$ 52,002

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

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

4.2.4. Dual listings

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

Companies that have traded on the NASDAQ, the New York Stock Exchange or the American Stock Exchange for at least a year since their IPO's, or less than a year but they maintain market value exceeding $150 million, are eligible to dual list under the Dual-Listing Law. Another condition is that all of the company's outstanding shares must be of one class.

4.2.5. Miscellaneous

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

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

4.3. INSURANCE, CREDIT AND CAPITAL MARKET REFORM

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

The Committee published its report on September 2004. The report was approved by the Government in November (with minor changes), and enacted as legislation by the Israeli Parliament on July 25, 2005.

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

Enhancing competition in managing the public's financial assets, by developing alternative investment vehicles to those offered by the banks, and decentralizing management of existing ones.

Enhancing competition in granting credit — by developing non-banking credit instruments.

Enhancing competition vis-a-vis the household sector — by exposing households to alternative systems of credit suppliers and exploring measures to facilitate switching from one bank to another.

5. BUSINESS ENVIRONMENT

5.1. HUMAN RESOURCES

5.1.1. Education

Israel's labor force is relatively well educated. The following table provides data regarding the types of schools last attended by Israelis aged 15 and over:

Academic	19.8%
Post High School	22.0%
High School, General	34.9%
Elementary School & Junior High School	20.6%
Did not attend school	2.8%

Source: Central Bureau of Statistics, Israel, Statistical Abstract of Israel, 2007

5.1.2. Distribution of Employees

The work force at the third quarter of 2007 totaled approximately 2,702,500 employees. The following table summarizes the distribution of employed persons according to economic branches in average to the year of 2007:

Agriculture	1.6%
Manufacturing	15.8%
Electricity and water supply	0.6%
Construction	5.6%
Trade and repair	13.4%
Accommodation services and restaurants	4.5%
Transportation, storage and communication	6.4%
Banking, insurance and finance	3.5%
Business services	14.0%
Public administration	4.5%
Education	13.0%
Health, welfare and social work	9.8%
Community, social and personal services	4.6%
Household services	1.8%

Source: Central Bureau of Statistics, Israel, Statistical Abstract of Israel, 2007 Salaries and Wages

Salaries and wages paid to Israeli employees are highly diversified.

The following table presents the average gross salaries and wages per employee post, according to industry, based on the year of 2007. The figures are rounded and presented in US Dollars, per annum:

Industry	**US$ per Annum**
Agriculture	15,374
Manufacturing	32,378
Electricity and water supply	57,243
Construction	20,195
Trade and repair	20,646
Accommodation services and restaurants	11,155
Transportation, storage and communication	27,742
Banking, insurance and finance	46,696
Business services	24,013
Public administration	36,942
Education	18,307
Health, welfare and social work	19,749
Community, social and personal services	15,839

Source: Central Bureau of Statistics, Israel, Statistical Abstract of Israel, 2007: US$1 = NIS 3.846.

As of November 2007, the minimum monthly salary is set at NIS 3,850. In addition to his/her salary, the employee is entitled to compensation for travel expenses to and from his/her regular place of work (public transportation tariffs).

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

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

Compulsory contributions:

- ♦ **National Insurance (Social Security)** - 5.68% of gross salary (in addition to the employee's contribution). The National Insurance Institute pays compensation in respect of unemployment, disability, retirement, military reserve duty, child allowances, maternity leave, etc.
- ♦ **Severance pay** - 8.33% of gross salary. An employee dismissed from his/her place of work, is entitled to severance pay calculated according to the amount of his/her latest monthly salary for each year of employment.
- ♦ **Sick leave** - accumulation of 1.5 days per month. In many cases, the sick leave allowance may amount to 30 days per annum. Employees may accumulate up to 90 sick days.
- ♦ **Vacation** - Israeli law prescribes a minimum vacation period of two weeks annually. The number of days increases according to seniority, reaching four weeks for those employed more than fourteen years by the same employer. The vacation allowance is payable in addition to legal and religious holidays.
- ♦ **Annual military service** - the employer usually pays the employee's regular salary, including all social benefits, for the period of his/her military reserve duty. National Insurance reimburses the employer with the amount of the employee's gross salary during his reserve duty.
- ♦ **Recuperation pay** – employees are entitled to recuperation pay according to seniority at work and based on the Collective Work Agreement. The minimum amount for full time employees in the business sector is US$ 440 per annum, and this may reach approximately US$ 740 per annum.

Optional contributions:

- **Fund for postgraduate and professional studies** – employer's contribution is 7.5% - 8.4% of gross salary. The employee also contributes a fixed percentage of his/her gross salary to the Fund.
- **Pension Fund** - several pension schemes exist, varying in details. The employer's contribution towards pension is in the range of 5%-6% of the employee's gross salary. The employee also contributes a fixed percentage of his/her gross salary to the Pension Fund.

Miscellaneous:

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

In addition to the above-mentioned social benefits, other legislation and regulations exist to regulate working conditions, but they cannot be directly "converted" into monetary cost.

Among these laws and regulations are the following:

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

5.2. RESTRICTIVE BUSINESS PRACTICES LAW

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

5.2.1. Restrictive Practice Agreements

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

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

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

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

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

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

5.2.2. Mergers and Acquisitions

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

- Subsequent to the merger or acquisition, the share of the merged parties in the production, sale, marketing, or purchase of a single product or a group of products or services will exceed 50%.
- The combined turnover of the merged companies (domestic turnover only) in the fiscal year prior to the merger exceeded NIS 150 million (approximately US$ 35 million), and at least two of the merged companies have a turnover of more than NIS 10 million (approximately US$ 2.35 million) each.
- One of the parties is already a monopoly.

5.3. INTERNATIONAL TRADE

Israel has extensive, business relationships worldwide. The table below summarizes Israel's international trade for the year 2007.

	Import		Export	
	US$	%	US$	%
Grand Total	**56,621**	**100.0%**	**54,065**	**100.0%**
Europe	**26,832**	**47.4%**	**19,244**	**35.6%**
European Union	**20,686**	**36.5%**	**16,024**	**29.6%**
Belgium	4,455	7.8%	4,070	7.5%
France	1,480	2.6%	1,328	2.5%
Germany	3,484	6.1%	1,920	3.6%
Italy	2,302	4.0%	1,316	2.4%
Netherlands	2,090	3.7%	1,617	3.0%
Spain	812	1.6%	1,081	2.0%
Sweden	556	0.1%	171	0.3%
United Kingdom	2,681	4.7%	1,954	3.6%
Other European Union Countries	1,801	3.2%	1,687	3.1%
Association (E.F.T.A.)	**2,960**	**5.2%**	**1,104**	**2.0%**
Switzerland	2,882	5.1%	1,036	1.9%
Other E.F.T.A Countries	81	0.0%	58	0.1%
Other European Countries	**2,444**	**4.3%**	**2,115**	**3.9%**
Turkey	1,607	2.8%	1,222	2.3%
Russian Federation	1,399	2.5%	609	1.1%
Other Countries in Europe	0	0.0%	17	0.0%
Asia	**11,907**	**21.0%**	**9,738**	**18.0%**
China (1)	3,477	6.1%	1,024	1.9%
Hong Kong	1,747	3.1%	3,115	5.8%
India	1,689	3.0%	1,606	3.0%
Japan	1,881	3.3%	775	1.4%
Singapore	558	0.1%	414	0.8%
Taiwan	708	1.2%	564	1.0%
Thailand	464	0.8%	452	0.8%
Other Asian Countries	18	0.0%	71	0.1%
Africa	**336**	**0.6%**	**1,185**	**2.2%**
America	**9,503**	**16.8%**	**21,239**	**39.3%**
USA	7,848	13.8%	18,893	34.9%
Canada	434	0.7%	715	1.3%
South America	**1,129**	**2.0%**	**1,163**	**2.2%**
Other American Countries	16	0.0%	27	0.0%
Oceania	**150**	**0.2%**	**564**	**1.0%**
Other Countries	**7,891**	**13.9%**	**2,093**	**3.9%**

Source: Central Bureau of Statistics, Israel, Monthly Bulletin of Foreign Commerce Statistics, December 2007.

The import of goods totaled $56.6 billion in 2007, compared to f $54.0 billion in exports. Total trade deficit totaled $2.6 billion, which is a 1.6 billion higher than the trade deficit in 2006. 29.6% of goods exported (excluding diamonds) was directed to the EU countries, 34.9% to the U.S. and 18% to Asia. In 2007, a 0.3% increase was recorded in trade surplus (excluding diamonds) with the U.S.

Incoming tourism in 2007 has inclined 25% during 2007 from previous year.

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

INCOMING TOURISTS	
Year	**Thousands**
2000	2,422
2001	1,196
2002	862
2003	1,063
2004	1,498
2005	1,916
2006	1,816
2007	2,270

Source: Central Bureau of Statistics Israel, press release, January 16th, 2008.

5.4. TRADE AGREEMENTS

Israel has entered into several trade agreements in order to strengthen its position in international markets. The most significant agreements are the Free Trade Area Agreement with the European Union, Free Trade Area Agreement (FTA) with the United States, and Free Trade Area Agreement with the European Free Trade Association States (EFTA). The agreements with the European Union, the United States and EFTA countries place Israel in the unique position of being a Free Trade Area partner with the principal economic regions worldwide. Thus, Israel is able to act as an intermediary for countries that do not have mutual agreements, provided that products comply with the provisions of each agreement. In addition, Israel has signed FTA Agreements with Canada and Turkey, a General Agreement on Tariffs and Trade (GATT) with the World Trade Organization, and has been granted preferences under the

GSP (General System of Preferences) by Australia, Austria, Canada, Finland, Japan, New Zealand, Norway, Sweden, Switzerland, and the United States. As part of the peace process, Israel signed an Agreement for Economic Development with the Palestinian Authority.

5.4.1. Israel-European Union Free Trade Agreement

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

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

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

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

5.4.2. Israel-USA Free Trade Area Agreement

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

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

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

5.4.3. Israel-EFTA Free Trade Area Agreement

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

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

5.4.4. Israel-Canada Free Trade Agreement

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

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

5.5. PROPRIETARY RIGHTS

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

5.5.1. Patents

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

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

5.5.2. Trademarks

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

5.5.3. Copyrights

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

5.5.4. Commercial Torts

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

6. ACCOUNTING AND AUDITING PERSPECTIVES

6.1. BACKGROUND

Generally Accepted Accounting Principles in Israel (Israeli GAAP) and Generally Accepted Auditing Standards in Israel (Israeli GAAS) are, basically, similar to the corresponding principles and standards of the International GAAP and GAAS. This chapter reviews Israeli GAAP and GAAS, to enable the reader to take these principles and standards into consideration when reading and evaluating audited financial statements prepared in accordance with Israeli GAAP.

In November 2005, the Israel Accounting Standards Board published a resolution on the adoption of International Financial Reporting Standards (IFRS) in Israel, pursuant to which the financial statements of public companies for the period commencing on or after January 1, 2008, will be prepared and presented in conformity with IFRS. Until all the International Financial Reporting Standards have been adopted by January 1, 2008, as aforesaid, the Israel Accounting Standards Board will attempt to adopt as many International Financial Reporting Standards as possible.

In light of the above resolution, the Israel Accounting Standards Board published, in July 2006, Accounting Standard No. 29 with respect to the adoption of IFRS. Standard No. 29 prescribes that entities which are subject to the Securities Act (1968) and report in accordance therewith, must prepare and present their financial statements in conformity with IFRS for periods commencing on or after January 1, 2008. Standard No. 29 also allows entities to prepare and present their financial statements according to IFRS for earlier periods, while enabling privately held companies to act as described above.

In light of the foregoing, the Israel Securities Authority (ISA) has initiated amendments to the Securities Regulations, to facilitate the application of the Accounting Standard No. 29. Pursuant to the prescribed guidelines, a reporting corporation is required to adopt a two-stage discloser. The principal recommendations are as follows:

- An Israeli entity is required, in its last financial statements under Israeli GAAP for the period ended December 31, 2007, to present reconciliations from Israeli GAAP to IFRS, along with an explanatory note regarding the effect of the transition.

- The said entity, in its report to the Board of Directors (MD&A) for the interim period ended June 30, 2007, must present existing information or valuations pertaining to the quantitative influence of the transition to International Reporting Financial Standards. Where the quantitative information available on the aforesaid date is incomplete or unreliable, the corporation is obligated to state this fact including the reasons for its occurrence. Thereafter, the information must be updated in the report to the Board of Directors for the following quarter.

6.2. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN ISRAEL

Until March 1997, the Institute of Certified Pubic Accountants in Israel ("the Institute") issued statements on accounting principles which bind its members and are recognized as Israeli GAAP. As of April 1997 the Institute, along with the Israel Securities Authority, transferred the authority for determining accounting standards to an independent body formed specifically for this purpose - the Israeli Accounting Standards Board (IASB).

Israeli GAAP prescribes diverse standards and regulations on a broad range of subjects - such as presentation, accounting policy and disclosure - primarily including:

- Framework for preparation and presentation of financial statements.
- Principles regarding consolidation or proportionate consolidation of financial statements, and presentation of investments on an equity basis.
- Required accounting policy for interim financial statements.
- Accounting policy and reporting rules in respect of severance, retirement, pension, and vacation pay.
- Disclosure requirements on balances and transactions with related parties.
- Special accounting treatment of transactions between a public company and its controlling stockholders.
- Presentation of marketable securities in the financial statements.
- Tax implications regarding the financial statements.
- Presentation statement of cash flows.

- Calculation of earning per share - Basic EPS and Diluted EPS.
- Accounting treatment of government grants in the financial statements.
- Format of financial statement presentation for industrial, commercial, publicly traded and other companies.
- Accounting treatment of share-based payments.
- Accounting treatment of income.
- Financial Instruments: Disclosure and presentation in the financial statements.
- Accounting treatment of inventory.
- Accounting treatment of property, plant and equipment.
- Accounting treatment of investment property.
- Accounting treatment of intangible assets.

It should be emphasized that in cases where no Israeli publications exist, the common practice in Israel is applied for determining the required policy on a certain issue. If no such common practice exists, International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) are applied.

Furthermore, if no common practice or IAS opinion exists, it is customary to study other international opinions, for instance those of the United States FASB.

The application of specific provisions in certain sectors (such as banks, insurance companies, municipalities, etc.) and in companies listed on the Tel Aviv Stock Exchange (such as the Israeli Securities Regulations) is paramount. These provisions determine, *inter alia*, accounting policy, presentation and disclosure in the financial statements.

The Israel Accounting Standards Board (IASB) has published the following accounting standards:

- Framework for the Preparation and Presentation of Financial Statements.
- Accounting Standard No. 1 concerning Holdings of Venture Capital Funds.
- Accounting Standard No. 2 concerning Construction of Buildings for Sale.
- Accounting Standard No. 3 concerning Borrowing Costs.
- Accounting Standard No. 4 concerning Construction Contracts.

- Accounting Standard No. 5 concerning Non-Profit Organizations (an amendment and update of Opinion No. 69 of the Institute of Certified Public Accountants in Israel).
- Accounting Standard No. 6 concerning Required Disclosure on the Effect of New Accounting Standards prior to their Implementation.
- Accounting Standard No. 7 concerning Events after Balance Sheet Date.
- Accounting Standard No. 8 concerning Discontinued Operations.
- Accounting Standard No. 11 concerning Segment Reporting.
- Accounting Standard No. 12 concerning the Termination of Inflation-adjusted Reporting. Effective date: December 31, 2002 for corporations whose reporting dates are December 31. For the prognosis of postponing the effective date of Accounting Standard No. 12 - see Accounting Standard No. 17 hereinafter.
- Accounting Standard No. 13 concerning the Effect of Changes in Foreign Exchange Rates. Effective date: December 31, 2002. For the prognosis of postponing the effective date of Accounting Standard No. 13 - see Accounting Standard No. 17 hereinafter.
- Accounting Standard No. 13 (revised), concerning the Effects of Changes in Foreign Exchange Rates. The Standard is based on International Accounting Standard 21 - the Effects of Changes in Foreign Exchange Rates. Accounting Standard No. 13 (revised) is effective for financial statements issued for periods beginning on or after January 1, 2008.
- Accounting Standard No. 14 concerning Interim Financial Reporting.
- Accounting Standard No. 15 concerning Impairment of Assets.
- Accounting Standard No. 17 concerning the one year deferral of the effective date of both Accounting Standard No. 12 - Termination of Inflation-adjusted Reporting, and Accounting Standard No. 13 - Effects of Changes in Foreign Exchange Rates.
- Accounting Standard No. 16 concerning Investment Property. The standard is based on International Accounting Standard 40 Investment Property.
- Accounting Standard No. 18 concerning Accounting for Health Maintenance Organizations.
- Accounting Standard No. 19 concerning Income Tax.

- Interpretation concerning the accounting treatment of income tax on investments in certain enterprises, pursuant to Amendment No. 132 of the Income Tax Ordinance.
- Accounting Standard No. 20 (revised) concerning the Accounting Treatment of Goodwill and Intangible Assets on Acquiring a Subsidiary.
- Accounting Standard No. 21 concerning Earnings per Share.
- Accounting Standard No. 22 concerning Financial Instruments: Disclosure and Presentation.
- Accounting Standard No. 23 concerning the Accounting Treatment of Transactions between an Entity and its Controlling Shareholder.
- Accounting Standard No. 24 concerning Share-based Payments.
- Accounting Standard No. 25 concerning Income.
- Accounting Standard No. 26 concerning Inventory.
- Accounting Standard No. 27 concerning Property, Plant and Equipment.
- Accounting Standard No. 28 concerning the Amendment of Transition Requirements in Accounting Standard No. 27 - Property, Plant and Equipment.
- Accounting Standard No. 29 concerning Adoption of International Financial Reporting Standards (IFRS).
- Accounting Standard No. 30 concerning Intangible Assets. The standard is based on International Accounting Standard 38 Intangible Assets.
- Accounting Standard No. 31 concerning the Amendment of Accounting Standard No. 22 - Financial Instruments: Disclosure and Presentation. The Standard is effective for financial statements issued for periods beginning on or after January 1, 2008.

- Interpretation No. 1 concerning the accounting treatment of impairment of investment in of an investee company, which is not a subsidiary.
- Interpretation No. 3 concerning the accounting treatment of impairment of investment in a non-subsidiary foreign entity.
- Interpretation No. 4 concerning the translation of financial statements into Shekels from the non-Shekel reporting currency.
- Interpretation No. 5 concerning an investor’s accounting for an investee when the investor has a majority of the voting interest but the minority shareholder or shareholders have certain approval or veto rights.

- Interpretation No. 6 concerning the accounting treatment of impairment of assets of a non-subsidiary investee company.
- Interpretation No. 7 concerning the accounting treatment of tax benefits for non-deductible equity instruments granted to employees.
- Interpretation No. 8 concerning reporting of gross income as a principal versus net income as an agent.
- Interpretation No. 9 concerning income from software transactions.

The agenda for the Israel Accounting Standards Board includes the following publications:

- Proposed Israel Accounting Standard No. 9 concerning the application of non-profit accounting for government-budgeted institutes of higher education (universities and colleges).
- Discussion memorandum concerning the recognition and de-recognition of financial instruments.
- Proposed Statements of Position concerning private sector constructing and operating arrangements of public property.

6.3. GENERALLY ACCEPTED AUDITING STANDARDS IN ISRAEL

An auditor in Israel performs an audit in order to express an opinion as to whether the financial statements present fairly, in all material respects, the financial position of the company, the results of its operations, changes in its stockholders' equity and cash flows, in conformity with generally accepted accounting principles (GAAP).

In performing the audit, the auditor is required to comply with the Auditor's Regulations (Auditor's Mode of Performance), professionally and prudently. Furthermore, the auditor is required to perform the audit independently and objectively.

The Institute of Certified Public Accountants in Israel regularly publishes guidelines for recommended auditing procedures to be applied by auditors including, *inter alia*, examining factors of corporate risk and focus on them. The Committee for Auditing Standards in Israel initiates adjustments and assimilates IFAC's standards according to the business environment and judicial developments in Israel.

Israeli GAAS contain diverse principles and procedures, comprising mainly the following:

- Auditor’s opinion: a uniform format and departure therefrom in cases where accounting policy and/or reporting is inappropriate, or if the scope of the audit is restricted.
- Special accountants' reports.
- Audit of events subsequent to balance sheet date.
- Management representation letter.
- Auditing procedures for transactions with related party.
- Review procedures for interim financial statements.
- Evaluation [of enterprise] as a going concern.
- Quality control in accounting firm.
- Reliance on experts.
- Audit in a computerized environment.
- Objectives and general principles governing an audit of financial statements.
- Planning.
- Other information in documents containing audited financial statements.
- Initial engagement - opening balances.
- Comparative financial statements.
- Analytical procedures.
- Risk assessment and internal control.
- External confirmations.
- Communicating audit matters to those charged with governance.
- Audit of accounting estimates.
- Audit evidence.
- Audit evidence - additional consideration of specific items.
- Audit sampling and other selective testing procedures.
- Audit materiality.
- Documentation.
- Consideration of internal auditing work.
- E-commerce.
- Terms of audit engagements.

- An auditor's responsibility to take into consideration fraud when auditing financial statements.
- Understanding the entity and its environment and assessing the risk of material misstatement.
- Audit considerations relating to entities using service organizations.
- ▪ E-commerce - effect on the audit of financial statements.

In addition to the above, specific regulations exist with respect to audits, such as the requirements of the State Controller, municipalities and local authority auditors, and the auditor's regulations, published in accordance with the Certified Public Accountants Law.

Various opinions regulate the conduct of an auditor and his mode of operation during the audit of financial statements in Israel.

At present, Israel is in the process of a general adoption of International Auditing Standards, following their adjustment to regulations and common practice in Israel.

It should be noted that the Auditing Standards Committee of the Institute of Certified Pubic Accountants in Israel is considering, *inter alia*, the following:

- Audit of small enterprises.
- Audit of projected information.
- Letter to the underwriter (when the examiner is the company's comptroller).
- Amendment to the review of interim financial statements (such as other information, communicating audit matters to those charged with governance, going concern).
- Legal documents.
- Laws and regulations applicable to the audit of financial statements.
- Comfort letter.
- Auditor's practices in response to assessed risks.
- Using the work of an expert.
- ▪ Auditing fair value measurement and disclosures.

6.4. PRINCIPAL DIFFERENCES BETWEEN ISRAELI GAAP AND U.S. GAAP

A study of financial statements in Israel, presented in conformity with Israeli GAAP, outlines the differences between Israeli accounting policy and/or presentation of data and/or disclosures in notes to the financial statements as compared with other countries, such as the United States, United Kingdom, etc.

The principle differences between Israeli and U.S. GAAP are:

- ***Transactions with controlling stockholders*** - The Israeli Securities Regulations concerning transactions between a company and its controlling stockholders, determine, inter alia, that such activities must be reflected in the capital reserve rather than the income statement. U.S. requirements concerning such issues are usually less restrictive.
- ***Inflationary adjustments*** - Up to December 31, 2003, for corporations whose reporting dates are December 31, financial statements in Israel were prepared on the basis of cost, adjusted to changes in the general purchasing power of the New Israeli Shekel (NIS).

  Up to December 31, 2003, for corporations whose reporting dates are December 31, for purposes of consolidating financial statements in the United States pursuant to FAS 52, the statements were prepared in NIS historic cost and not in adjusted NIS. Financial statements in the United States are not adjusted to inflation.
- ***Consolidated financial statements*** - The requirement to consolidate financial statements in Israel is similar to that of other countries, except for one major difference. In Israel, unlike the United States, no consolidation is made when minority shareholders maintain over 75 percent of shares with rights to profit, even though the parent company holds controlling shares in excess of 50%. Furthermore, there is no consolidation of variable interest entities under Israeli GAAP - unlike under U.S. GAAP, FIN46(R): Consolidation of Variable Interest Entities - An Interpretation of ARB No. 51.
- ***Proportionate consolidation of legal entities*** – This is not an accepted practice in the United States, although it is customary in Israel. Additionally, in case of an investment with the original intention of being realized in the short term - Israeli GAAP does not permit application of the equity method, while this is acceptable in the United States.

- ***Statement of cash flows*** **-** Cash and cash equivalents are defined differently in Israel and the United States. Furthermore, financing leases are included in Israel in financing and investment activities, while under U.S. GAAP they are included in non-cash activities. Additional presentation requirements exist in the United States beyond what is required in Israel in respect of taxes on income and interest on loans. Differences also exist in treating "currency translation" of foreign subsidiaries.
- ***Pension liabilities*** - In the United States, valuation of pension liabilities is based on the present value of actuarial estimates. In Israel, a provision for severance pay is generally made instead of, or in addition to any provision for pension, calculated on the assumption of retirement of all employees as of the date of the financial statements.
- ***Segment reporting*** - Israeli GAAP focuses primarily on the use of a primary and secondary format for reporting financial information pertaining to business and geographical segments. U.S. GAAP, on the other hand, uses a management approach for segment reporting, such that the enterprise component frameworks are evaluated by the chief operating decision-maker.
- ***Marketable securities*** **-** In Israel, investments in securities are classified into two categories (current and permanent investments). In the United States, on the other hand, investments are classified into three categories (held to maturity and trading, and available for sale investments). The categories prescribed in the United States have been adopted by the Israel Commissioner of Banks for financial statements compiled by banks. Differences also exist in regard to the application of statements of cash flows, and balance sheet presentation.
- ***Capitalized financing costs*** - The accounting treatment is prescribed in Israeli Accounting Standard No. 3, pursuant to which financial costs – which might have been avoided had the asset not been built/established - are capitalized to qualifying assets as defined in this Standard. According to Accounting Standard No. 3, all other financial costs are charged to the statement of operations for the appropriate accounting period. The Standard adopts the principles prescribed by the American Standard (FAS 34), whereby it is obligatory to capitalize financing costs. Differences exist in the definition of financing costs and capitalization methods.

- ***Impairment of assets*** **-** The Israel Accounting Standard Board published, in February 2003, Accounting Standard No. 15, based on the international practice of impairment of assets. The American practice concerning impairment is stated in FAS 144. Differences exist between FAS 144 and Accounting Standard No. 15, as to when and how to consider the need for impairment, and also in determining the useful life of an asset. In addition, Israeli GAAP, goodwill and indefinite-lived intangible assets are reviewed, at least annually, in order to establish impairment to the cash-generating units (CGU) or groups of CGUs, as applicable. US GAAP is similar to Israeli GAAP, although the level and the impairment test itself are different.
- ***Derivative instruments*** **-** Derivative instruments are recognized and measured in Israel in accordance with FAS 52 and FAS 80. (FAS 52 and FAS 80 were U.S. GAAP before the effective date of FAS 133). However, the Israel Banks Commissioner requested Israeli banks to adopt FAS 133 from the first quarter of 2003.
- ***Compound financial instruments*** **-** Under Israeli GAAP, convertible debt (a fixed number of shares for a fixed amount of cash) is accounted for on a split basis, while proceeds allocated between equity and debt. In U.S. GAAP conventional convertible debt is usually recognized entirely as a liability, unless a beneficial conversion feature exists.
- ***Embedded derivatives*** **-** Under Israeli GAAP, no bifurcation of embedded derivatives is required, while under FAS 133, embedded derivatives are bifurcated in some cases from their host contract.

- ***R&D cost*** – Under Israeli GAAP, an intangible asset is recognized separately from goodwill if it represents contractual or legal rights, or is capable of being separated, divided, sold, transferred, licensed, rented or exchanged. Acquired in-process research and development (R&D) is recognized as a separate intangible asset if it meets the definition of an intangible asset and its fair value can be reliably measured. Non-identifiable intangible assets are subsumed within goodwill. Similarly, US GAAP requires acquired in-process R&D to be valued at fair value. However, the acquired in-process R&D is expensed immediately, unless it offers alternative future use. In addition, Israeli GAAP requires internal development costs to be capitalized, if specific criteria are met, and these are applied to all internally developed intangible assets. Under U.S. GAAP, both internal research and development costs are recognized as an expense, when incurred. Special capitalization criteria, different from those stipulated by Israeli GAAP, are applied to software developed for internal use and that developed for sale.

It should be emphasized that several issues exist in respect of which there is no mandated accounting policy. Therefore, in practice, the accounting policy of certain Israeli companies conforms partly to that of United States practices. This includes, inter alia, debt restructuring and measurement of financial instruments.

7. INVESTMENT INCENTIVES AND TRADE ADVANTAGES

7.1. GENERAL

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

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

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

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

Additionally, to promote weak economic regions within Israel, benefits are granted in a differential manner (A, B and Central Israel) - being substantially greater in the priority regions (A, B) than in the center of the country. However, enterprises are eligible for benefits anywhere they are erected, provided they comply with the relevant criteria (see hereinafter).

Additionally, Israel grants foreign investors and large investments increased tax benefits (see hereinafter).

7.2. LAW FOR ENCOURAGMENT OF CAPITAL INVESTMENT

7.2.1. Overview

The government's principal tool in this respect is the Law for the Encouragement of Capital Investment (hereinafter: "the Law").

The Law allows business enterprise promoters to choose their benefit from two alternative courses:

- Tax benefits scheme (in which the enterprise plant is granted the status of "Beneficiary Plant")

- Grants scheme - including tax benefits (in which the enterprise plant is granted the status of "Approved Plant",(excluding geographic areas administratively defined as “Central Israel”, where only tax benefits, but not grants, are available).

The Law applies to industrial enterprises (in diverse branches such as: textiles, food, electronics, chemicals, pharmaceuticals, computer software, biotechnology, etc.), hotels and other tourism ventures, industrial and residential construction, etc. (hereinafter collectively referred to as “Enterprises”).

Based on a broad view of Israel’s labor force, its R&D potential, and the desire to maintain professional and advanced workers within its borders, the Law also applies to industrial development centers located in Israel. These may avail themselves of the full benefits granted by the Law, although they may not comply with the generally accepted definition of “industry”. Industrial R&D for a foreign resident will be recognized as industrial activity if approved by the Head of Industrial R&D Administration.

The main difference between the two tax schemes is outlined below:

- Under the grants scheme, the State shares the risk involved in executing the investment program, by offering the enterprise an actual grant in the process of establishment and/or expansion. Following the said process, tax benefits are also available on income generated by the enterprise established as such. The amount of the grant available in Israel’s priority regions stands today at 24% of the investment.
- Under the tax benefits scheme, the State provides “enhanced ” concessions applying to income generated from the establishment and/or expansion of an enterprise.
- The grants program administered by the Israel Investments Center - a division of the Ministry of Industry, Trade and Labor.
- The Tax Benefits Program administered by the Tax Authorities.

The tax benefits scheme does not necessitate prior approval from the authorities. Accordingly, a company complying with the criteria stipulated by law can realize the tax benefits in its financial reports.

Notwithstanding the aforesaid, in order to provide greater certainty, an enterprise choosing the tax benefits scheme may apply to the tax authority for an advanced (or pre) ruling whereby the company complies with the terms stipulated by law, and also for regulating other issues involved in the application of the law.

The budget for the grants scheme is limited to the framework approved for this course annually through the budget law, contrary to the tax benefits scheme which does not require budget approval.

A further difference exists between the two tax schemes - namely, the need to partially fund an investment generated from equity. Under the grants scheme, the enterprise is required to fund 30% of the scope of approved investment in equity, whereas this is is not required under the tax benefits scheme.

For investors defined as “foreign residents”, the State provides enhanced tax benefits which they are able to enjoy for longer periods (varying from 10 to 15 years, depending on the scope of the investment).

Lately, the Law was comprehensively amended, the procedures for providing tax benefits/concessions were revised and new schemes were introduced for obtaining them. In light of the above Amendment, three schemes presently exist for tax benefits available to enterprises located in National Priority Region A:

1. A scheme allowing tax exemptions during the concession period. The enterprise is not granted a full exemption but allowed to defer tax payment, because when distributing non-taxable profits, the said enterprise will be liable to the tax from which it had been exempted (the rate is dependent on the scope of foreign investments in the company - see below). Apart from the above, withholding tax will also apply in respect of dividend distributed at the rate of 15% or lower, according to the provision of the relevant tax treaty.
   The Tax benefits and the condition for enjoying the benefits are described in section 7.2.1.1 below.
2. The scheme known as the "Ireland Scheme", was added to the Law in the context of a comprehensive amendment recently introduced. In this context, profits are taxed at the rate of 11.5%. On the date of distributing profits as dividend, no supplementary tax will be required from the enterprise. The withholding tax rate in respect of the dividend generated from such profits is 15% for Israeli residents and 4% for foreign residents.

3. The strategic investments scheme known as "Singapore Scheme", was also added to the Law under the said Amendment. Here, the enterprise is granted a full tax exemption during the concession period and not required to pay any supplementary tax when distributing profits as dividend. Furthermore, no withholding tax is to be deducted from the dividend. Such tax benefit is conditional on investing a huge amount of capital, as outlined below.
   The Tax benefits are described in section 7.2.1.3 below.

Tax benefits scheme

7.2.1.1. **Conditions for Enjoying the Tax Benefits Scheme -**

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

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

1. The enterprise must be an industrial plant or hotel.
2. The enterprise is competitive and contributes to the Gross Domesticl Product. An enterprise will be deemed to have fulfilled this condition if it is engaged in biotechnology or nano-technology and has obtained the approval of the Head of Industrial R&D Administration.

   Alternatively, an enterprise will be deemed to have fulfilled this condition if exports amount to 25% at least. An enterprise with "indirect exports" may, under certain terms, also be considered as having fulfilled this condition.
3. Minimum Capital Investment - The scope of such investment is derived from the value of the productive assets of the enterprise at the end of the year preceding the one in which capital was invested.

   With respect to an industrial enterprise, as distinct from a hotel, investment in structures will not be considered an investment in order to meet these conditions. The minimum amount to be invested is NIS 300,000 or a percentage of the value of productive assets, as follows:

   Up to NIS 140 M. - 12%

Above NIS 140 M and up to NIS 500 M. - 7%.

Above NIS 500 M - 5% of value of productive asset, calculated at original cost, less depreciation according to the Depreciation Regulations - 1941.

Tax Exemptions up to Profit Distribution

A company may choose the tax benefit scheme allowing the company to enjoy tax exemptions instead of grants. Only limited liability companies (Ltd.) are entitled to choose this scheme. The tax benefit periods are as follows (years):

	National Priority Region					
	A		B		C	
	Tax Exemption (1)	Reduced Taxes (2)	Tax Exemption (1)	Reduced Taxes (2)	Tax Exemption (1)	Reduced Taxes (2)
Domestic company	10	-	6	1	2	5
Over 25% foreign control	10	-	6	4	2	8

(1) On the undistributed portion only.

(2) The reduced tax rates are identical to the rates outlined in Section 7.2.1.8 above.

Companies with a high foreign investment rate (exceeding 74%, and an approved program of not less than $20 million) are entitled to a longer benefit period (15 years).

The exemption is not total but rather a tax deferment, and it becomes a tax liability when the enterprise distributes tax-exempt profits.

When distributing profits as dividends, the enterprise will be liable for tax at the rate that would have applied if it had not been for the tax exemption. Furthermore, when distributing dividends, withholding tax at a rate of 15% or less will be deducted, according to the relevant tax treaty.

7.2.1.2. Paying Reduced Tax in National Priority Region A

As mentioned earlier, two schemes exist in National Priority Region A for granting tax benefits. One is the scheme described above, and the other is known as the "Ireland Scheme".

An enterprise may choose either of these schemes and must abide by its choice throughout the tax concession period which, as aforesaid, is 10 years. For a company in which the foreign investment is 74%, and in the scope of $20 M. at least - the concession period is 15 years.

According to the "Ireland Scheme", tax at the rate of 11.5% is payable on profits. When distributing dividends, the enterprise will not be required to pay a supplementary tax. 15% withholding tax will be deducted from dividends payable to Israeli residents and 4% to foreign ones.

7.2.1.3. Tax Exemptions on Huge Investments

Pursuant to the aforesaid Amendment, a further concession scheme has been added to National Priority Region A, designed to grant special tax benefits on huge investments. According to this scheme, the enterprise will be completely exempt from tax during the concession period (10 or 15 years, as outlined above). When distributing profits as dividend, the enterprise will not be required to pay any supplementary tax. Furthermore, the distribution of dividend will not be charged with withholding tax.

These benefits are subject to a huge capital investment of NIS 900 M. Also, the company's revenue must amount to NIS 20 billion or it should be included in a consolidated statement whose consolidated income is NIS 20 M.

For enterprises located within certain ranges stipulated in the Law, the investment margin is reduced to NIS 600 M. and the scope of consolidated income - to NIS 13 billion.

7.2.1.4. Accelerated Depreciation

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

Please refer to ***Appendix 5*** for customary depreciation rates, most of which are not eligible for this benefit.

The benefits scheme

7.2.1.5. **General**

Approved Enterprises are entitled to a variety of incentives, and investors may choose from among several combinations to suit their interests. The incentives include:

- Grants of up to 24 % of tangible fixed assets as described in section 7.2.1.7 below.
- Reduced tax rates, tax exemptions, accelerated depreciation and other tax-related benefits.
- Land allocation in National Priority Regions “A” and “B” is also exempt from bids and is offered at reduced prices.

7.2.1.6. **National Priority Regions**

For a map of the National Priority Regions, please refer to *Appendix 1*.

The National Priority Regions by industrial zones are presented in *Appendix 2*.

The National Priority Regions for approved tourism projects are presented in *Appendix 3*.

7.2.1.7. **Grants Scheme**

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

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

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

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

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

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

1. The enterprise must be an industrial plant or a hotel.
2. The enterprise contributes to the independence of the State's economy.
3. The enterprise is competitive and contributes to the gross local product. An enterprise will be deemed to have fulfilled this condition if it is engaged in the fields of biotechnology or nano-technology and has obtained the approval of the Head of Industrial R&D Administration to this effect. Alternatively, if its exports amount to 25% at least.

   The Investments Center Administration has been authorized to approve plans under the grants scheme until 31.12.2008, provided they comply with the said criteria and fall within the approved budget framework.

The grants are as follows (shown as a percentage of investment in fixed assets):

	National Priority Region		
	A*	**B**	**C**
	%	**%**	**%**
Industrial Projects:			
Scope of investment - up to NIS 140 m 35 US$ million)	24	10	-
Scope of investment exceeding NIS 140 m (35 US$ million).	20	10	
Tourism			
Hotels	24	10	-
Other Tourism Projects	15	-	-

(*) Approved Enterprises in the Negev are entitled, under certain conditions, to receive an additional grant - up to 8 % for investments up to NIS 140 m (35 million US$), and up to 10 % grant for investments exceeding NIS 140 m (35 million US$)

Companies choosing this scheme and located in National Priority Region “A”, are tax-free for two years, with a further 5-year period of reduced corporate tax

A company comprising 74% foreign capital at least, and the scope of its approved investment is $20 M. at least, will be entitled to having the concession period extended by 5 more tax years, on fulfilling certain conditions.

Companies located in other regions are entitled to reduced corporate tax for 7 years (10 years if foreign investment exceeds 25 %).

The tax benefits are described in Section 7.2.1.8 below.

An investment will be deemed to be a foreign one if it comprises at least NIS 5 M. generated from a foreign resident in the company owning the enterprise, granting such resident, directly or indirectly, at least 25% of profit-sharing, voting rights and appointment of directors. Foreign capital may also be invested by way of an equity loan for a 3-year period at least.

7.2.1.8. Tax Benefit Period for Grants Scheme

Tax benefits for an Approved Enterprise are granted over a period of 7 consecutive years, commencing in the first year in which the company earned taxable income, provided that 14 years have not elapsed since approval was granted and that 12 years have not elapsed since the enterprise began operating.

In a company where capital invested by foreign residents constitutes 74% and over, and the scope of approved investment is $20 M. at least, the tax concession period is extended by 5 years, after fulfilling further conditions.

Approved Enterprises in National Priority Region "A" are exempt from tax during the first two years of operation.

The reduced tax rates are in accordance with the percentage of foreign control, as follows:

	Not an Approved Enterprise (*)	An Approved Enterprise Percentage of Foreign Control			
		0-49	49-74	74-89	90-100
Taxable income	100.00	100.00	100.00	100.00	100.00
Corporate tax	27.00	25.00	20.00	15.00	10.00
Balance	73.00	75.00	80.00	85.00	90.00
Tax on distributed dividends [1]	18.25	11.25	12.00	12.75	13.50
Total tax burden	45.25	36.25	32.00	27.75	23.50

(*) 2008.

[1] *15 % of the balance for Approved Enterprises, 25% otherwise. Taxes may differ for residents of countries that have tax treaties with Israel.*

The tax benefits do not apply solely to a foreign stockholder but to all stockholders. For more information regarding withholding tax laws and regulations, please refer to Section 8 below.

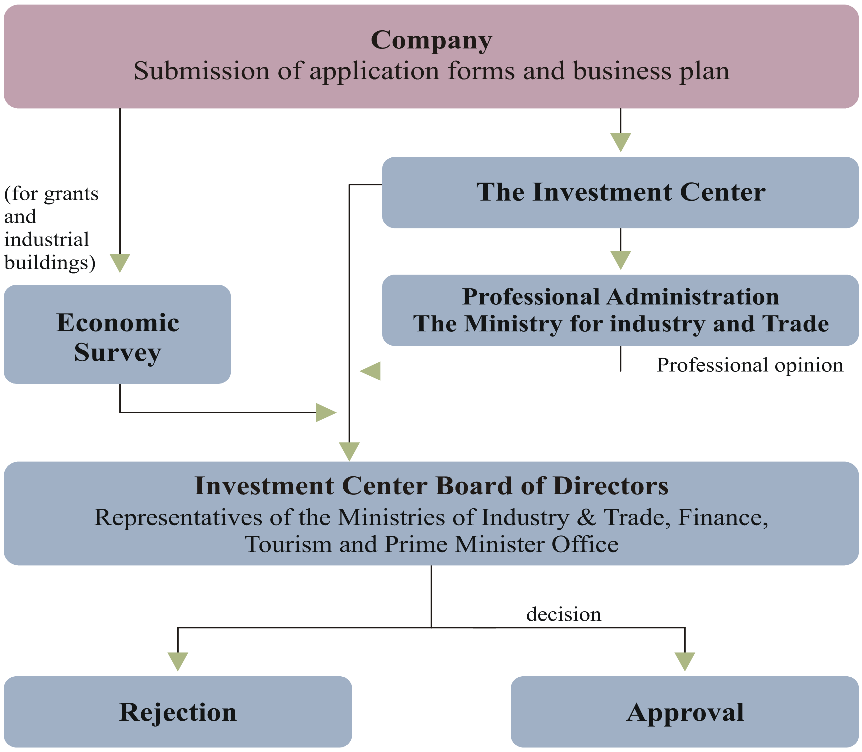
NOTE: If dividends are distributed from tax-free profits, corporate tax (according to the above table) is payable.

7.2.1.9. **The Approval Procedure**

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

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

Below is a description of the process for obtaining the status of "approved enterprise":



7.2.1.10. Grants Scheme - Summary

The following tables summarize the benefits available tor Approved Enterprises in the various schemes:

Industrial Enterprises

	National Priority Region		
	A	B	C
Grants Scheme:			
Grants			
Investment up to NIS 140 million (35 million US$).	24	10	-
Investment exceeding NIS 140 m (35 million US$).	20	10	-
Exemption from corporate tax (years) (*)	2	-	-
Reduced corporate tax:			
For domestic enterprise (years)	5	7	7
For foreign held enterprise (years)	8	10	10
Required paid-in capital (%)	30	30	30

Hotels and Other Tourism Projects

	National Priority Region		
	A	B	C
Grants Scheme:			
Grants (%)	24	10	-
Grants (other tourism projects) (%)	15	-	-
Exemption from corporate tax (years)	2	-	-
Reduced corporate tax:			
- for domestic enterprise (years)	5	7	7
- for foreign held enterprise (years)	8	10	10
Required paid-in capital (%)	30	30	30

7.2.1.11. Tax Benefits Scheme - Summary

The following tabels summarize the Tax Benefits available at the Tax Benefit Scheme:

Priority Region	Benefits Period	Tax During Benefits Period	Tax at Company level due to Distribution of Dividends	Tax at Shareholders Level due to Receipt of Dividends
A	10 years. Company with heavy foreign investments (over 74%) - 15 years on certain conditions)	"Regular course" full exemption Ireland course - 11.5%. Strategic investment course - full exemption	Regular course - tax rate of up to 25% (depending on foreign investment rate). Ireland course - no tax due. Strategic investment course - no tax due.	In exemption course - 15%. In Ireland course: Israeli resident - 15% Foreign resident - 4%. Strategic investment course 0%. All above rates will apply if 12 years have not yet elapsed from the end of benefits period. If enterprise is owned by company in foreign investment, limitation does not exist. In strategic investment course - no limitation.
B	7 years. Company in foreign investments - 10 years. Company with heavy foreign investments - 15 years on certain conditions	6 year exemption. Remaining period - 25% or up to 10%, depending on rate of foreign investment.	In distributing exempt income - tax due at rate of up to 25% (depending on rate of foreign investment).	15% if 12 years have not yet elapsed from end of benefits period. If enterprise is owned by company in foreign investment, limitation does not exist.
Other	7 years. Company in foreign investment - up to 10 years. Company with heavy foreign investments - 15 years.	2-year exemption. Remaining period - 25% or up to 10%, depending on foreign investment rate.	In distributing exempt income - tax due at rate of up to 25% (depending on rate of foreign investment).	15% if 12 years have not yet elapsed from end of benefits period. If enterprise is owned by company in foreign investment, limitation does not exist.

Tax Benefits - Comparative Table

	Tax Exempt Course (regular alternative course)	Ireland Course	Strategic Investments Course
Priority region	All regions	A	Ministers have authority to order that even enterprises not located in Priority Region A will be eligible, under certain conditions, to tax benefits under this course.
Tax on undistributed profits within Company	0%	11.5%	0%
Tax on undistributed profits at Company level	10% - 25% - depending on foreign investment rate	None	None
Tax at shareholders level due to receipt of dividends	15%	15% to shareholder resident in Israel; 4% to shareholder resident abroad	None
Inclusive tax rate	23.5% - 36.25% - depending on foreign investment rate	Israeli resident - 24.775%. Foreign resident - 15.04%.	0

7.3. OVERSEAS MARKETING ENCOURAGEMENT FUND

The Ministry of Industry and Commerce manages a fund for the encouragement of marketing activities abroad. This fund supports new and existing small/ medium-sized exporters.

The Ministry participates in risks to which exporters may be exposed with respect to expenses incurred in promoting their products/services. However, the fund does not participate in any production, packaging (excluding design), or other direct expenses.

The amount of support depends, inter alia, on export volumes, marketing plans, etc.

- New exporter - exports up to US$ 2 million per annum, with total annual turnover not exceeding US$ 4 million. Such an exporter is entitled to a grant of up to 30% of actual expenses, plus up to 50% of specific marketing expenses not exceeding US$ 40,000. The volume of the proposed marketing plan shall not be less than US$ 40,000.
- Small exporter - exports up to US$ 7 million per annum, with total annual turnover exceeding US$ 4 million, or exports exceeding US$ 2 million and less than US$ 7 million per annum, and total annual turnover not exceeding US$ 15 million. Such exporter is entitled to a grant of up to 30% of current marketing expenses plus up to 50% of specific marketing expenses not exceeding US$150,000. The volume of the proposed marketing plan shall not be less than US$ 200,000.
- Medium exporter - exports exceed US$ 7 million and below US$15 million per annum, with total annual turnover not exceeding US$ 30 million. Such an exporter is entitled to a grant of up to 30% of current marketing expenses not exceeding US$ 250,000, plus up to 50% of specific marketing expenses. The volume of the proposed marketing plan shall not be less than US$ 400,000.

The proposed marketing plan is for a 12 month period. The fund may pay in advance up to 30% of the approved grant, and the remainder according to actual payments effected by the company.

Should the eligible company implement less than 40% of the proposed plan, it is obligated to repay the advance payment. Implementing less than 60% of the plan will disqualify the company from obtaining grants for the following year.

The following companies and industries are eligible for assistance under special terms and conditions:

- Export companies (as defined in the fund's guidelines).
- Start-ups.
- International joint projects.
- The film industry.
- E-commerce.
- Diamond merchants and jewelers.

Due to lack of resources, the fund was not active in 2004. It is quite likely that this will also be the situation in the near future.

Instead, the Ministry is establishing a fund under the same principles, to promote marketing activities for companies which have joined forces in order to benefit from the said assistance.

7.4. RESEARCH AND DEVELOMENT

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

7.4.1. Chief Scientist's Office

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

The research committee is entitled to approve a participation grant of 20, 30, 40, or 50% of total R&D expenses. Start-ups may be eligible for increased participation grants of up to 66%, or 70%-75% if located in National Priority Regions.

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

- Regular grant programs, offering up to 50% of R&D expenses. The eligible program should be for know-how, processing and/or manufacturing procedures, the manufacture of new products or a significant improvement on an existing process or product.
- **Magnet** - This program, intended for generic R&D technologies, encourages the formation of a consortia of industry and academic institutions to develop key technological infrastructures. Magnet also supports the integration of advanced technologies into industry through user associations. Grants of 66% of total approved R&D costs for industrial entities, and up to 80% of approved costs for academic institutions are available, with no royalty requirements.
- **Magneton** - This program is similar to the Magnet; however, it encourages cooperation between a single academic institution and an industrial plant. The available grant is up to NIS 3.4 million ≈ US$ 0.85 million.

- **Nofar** - This program is designed to support applied academic research in biotechnology, and to promote the transfer of technology to industry. Grants are available up to 90% of the approved research budget, but not exceeding NIS 420,000 ≈ US$ 105,000.
- Long term R&D programs for companies with intensive R&D investments1 in the know-how industry - R&D of generic technologies used to develop, plan, or produce innovative products, and in the pharmaceutics industry - ethical R&D in preliminary stages.

  The grant is offered, inter alia, to a company that has neither standing repayments to the Chief Scientist's Office nor a royalties agreement, and provided the total grant requested does not exceed 20% of its annual R&D budget.

  Grants of up to 50% of total approved R&D costs are available, and the total sum of long-term R&D grants, coupled with Magnet grants, must not exceed NIS65 million ≈ US$ 16.25 million. Royalty payments are not required.

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

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

If production is relocated overseas, the Chief Scientist's prior consent is required, while 120%-300% of the grant must be repaid respectively, according to the production percentage being relocated. Additionally, the amount of royalties will increase. Relocating expertise (technological knowledge) overseas is not permitted.

In all cases, programs obtaining government assistance from one source are not eligible for assistance from other sources.

1 *Companies employing more than 200 persons in R&D in Israel, or companies with R&D budgets exceeding US$ 20 million together with sales from production in Israel exceeding US$ 100 million in the preceding year.*

7.4.2. Heznek Program - The Government Seed Fund

The Ministry of Industry and Commerce established this program in 2002, to encourage investments in new start-up companies. The program is based on the government matching an investment in a start-up company, proportional to the capital invested by other investors.

The definition of a start-up, for purposes of the program, is a company that complies with the following criteria:

The company's main activity is R&D.

- A company that received no funding beyond shareholders equity (except funding obtained for feasibility studies).
- The company has obtained parallel investment from qualified investors (see below), as defined by the program.
- The company was established no more than 6 months prior to the application, or its total expenditure, by that time, has not exceeded NIS1 million (approximately US$ 250,000).

A qualified investor is an entity that meets all of the following criteria:

- A venture capital fund, or a corporation active in venture capital, or a technological company investing in similar industries.
- An investor who possesses the ability and human resources to oversee the management of a start-up company.
- An investor with sufficient available funds.

The program entitles the company to obtain a government investment of up to 50% of the capital required under the approved work program, where a qualified investor provides the other funding. The maximum investment is NIS 5 million (approximately US$ 1.25 million).

The government is entitled to receive a proportional part of the company's shares. The investor is given an option to purchase the government's shares any time during the first 7 years, at the initial share price, plus interest and linkage differentials.

The company is bound by the stipulations of the R&D law with respect to the transfer of know-how and manufacturing rights overseas.

7.4.3. Aid to Individual Technology Entrepreneurs

- **TNUFA**- The Israel Idea Promotion Center is a non-profit Israeli, government-supported organization, dedicated to helping individual entrepreneurs successfully commercialize their new product ideas by providing seed money grants of 85% or up to NIS210,000 (approximately US$ 52,500) in addition to free legal, marketing and business-management consultations. Most of TNUFA's budget is based on royalties from successful projects.
- The Ministry of Absorption also provides financial aid to immigrant entrepreneurs.

7.4.4. Technological Incubators

7.4.4.1. "Standard" Technological Incubators

Technological incubators provide a supportive framework enabling entrepreneurs with innovations - veteran Israelis and immigrants alike - to develop their ideas into a commercial product, and reach the point at which they can attract capital investments from the private business sector. R&D activities conducted in technological incubators are entitled to grants of up to 85% of the approved program. The grant is limited to NIS 1,300,000 (approximately US$ 325,000) for a two-year period.

The administrative board of each technological incubator is entirely financed by the government, with an annual ceiling of NIS 729,500 (approximately US$ 182,000).

7.4.4.2. Technological Incubators - Pilot Program

"Incubator" projects are financed through a convertible bond. The franchisee finances the administrative board of each technological incubator. Incubators in National Priority Regions are entitled to grants in government convertible bonds of up to 49% of administrative expenses. In each project the franchisee, together with the entrepreneur, determines the latter's holding in the project - representing 35% at least and 70% at most of the project. The government lends the entrepreneur a participation sum of up to 85% of the approved budget. The government grant shall not exceed US$ 400,000 for two years' operation. In

National Priority Regions, this grant shall not exceed US$ 500,000 for two years' operation.

As of November 2003, twelve incubators were approved for the pilot program.

7.4.4.3. Biotechnological Incubators

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

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

The franchisee obtains, for each project, a government loan of up to 85% of the approved budget in the 1st year, up to 80% in the 2nd year and up to 75% in the 3rd year. The approved budget for up to 3 years shall not exceed NIS 8,100,000 (approximately US$ 2,025,000). The franchisee is responsible for raising supplementary funding to cover the rest of the approved budget.

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

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

7.5. INTERNATIONAL COOPERATION

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

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

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

The FP7 budget is still being negotiated between the European Council of Ministers, the European Parliament and the European Commission. It is currently estimated that the overall FP7 budget will be € 49 billion.

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

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

7.5.2. Eureka

Eureka is a Europe-wide network for industrial R&D, uniting 29 countries by promoting 'market-driven' collaborative R&D projects in most fields of advanced civilian technology. An agreement signed in 1993 with the European Eureka Secretariat allows Israeli companies to join this prestigious program.

7.5.3. Bi-National Funds

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

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

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

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

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

7.5.3.4. **BRITECH** - The Israel-Britain Bi-National Fund for the enhancement of technological cooperation and trade between British and Israeli hi-tech companies. BRITECH is a non-profit organization established in 1999 by the British and Israeli governments. The fund operates in three principal fields: firstly, promoting hi-tech industries and technological capabilities in both countries through the enhancement of cooperation; secondly, assisting in locating technological and strategic partners and investors for both British and Israeli companies; and thirdly, supporting joint projects through financial grants. Both governments have contributed a joint sum of £15.5 million ≈ US$ 25 million for **financing joint R&D projects.**

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

7.5.4. Other International Programs

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

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

7.5.4.3. **Bi-National R&D Agreements -** Promotes R&D cooperation between Israeli and foreign companies, while each company is assisted by its home country. These agreements were signed with Austria, Belgium (Flanders), Canada, China, Finland, France, Germany, Hong Kong, India, Ireland, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.

7.6. OTHER INCENTIVE PROGRAMS

7.6.1. Small Business Loan Fund

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

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

The loan extended to a single business is for approximately NIS 500,000 ≈ US$ 125,000, for a five-year period, to fund the purchase of equipment or one year's working capital. The borrower is required to furnish the bank with a lien on the equipment financed by the loan, as well as personal guarantees. To be eligible for the loan, the business must meet certain criteria, as follows:

- The total number of employees must not exceed 70 persons and annual turnover must not exceed NIS 22,000,000 ≈ US$ 5.5 million.
- The loan should be used solely for new activities: establishing a new business or expanding an existing one. The funds should not be used for the purchase real estate, construction activities, or the acquisition of an existing business.
- Paid-in capital should not be less than 20% of the loan.

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

7.6.2. Assistance to industrial plants in financial difficulties

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

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

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

- A recovery plan, its economic feasibility, the financial justification of the plant's existence for the long term, and the ability to introduce recovery measures within a specific period of time.
- The lateral implications.
- The number of employees and minimum employment period.
- The scope of assistance required.
- The participation of other entities, including the owners.
- The ability to reduce the number of employees according to the recovery plan.
- Funding must not exceed NIS 10 million ≈ US$ 2.27 million, and will deprive the plant's eligibility for further government assistance. However, should the plant apply for other financial assistance from a government entity, the plant must repay the loan.
- The salaries of managers and employees must not exceed NIS 50,000 ≈ US$ 12,500.

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

The owners are required to guarantee the loan.

7.6.3. Business Tutorage

The Ministry of Industry and Commerce assists small and medium sized businesses by appointing "tutors" to cater to the specific requirements of each business (e.g. general management, financial management, production management, marketing, information systems, human resources, etc.).

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

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

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

The Ministry of Agriculture allocates funds for "tutorage" of agricultural businesses.

7.6.4. Intra-Plant Training

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

7.6.5. Quality Management Project

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

7.6.6. "Preparation for Exposure" Fund

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

7.6.7. Approved Foreign Expert

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

7.6.8. Capital Intensive Companies

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

- 25% corporate tax.
- 15% withholding tax on dividends.
- Corporate tax refunds in the event of distribution of dividends. In this case, the withholding tax on dividends will be 25 %.
- Tax exemption from sale of shares.

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

7.7. SPECIAL FREE ZONES

7.7.1. Eilat Free Trade Zone

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

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

7.7.2. Free Port Zones

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

- Lower corporate tax rates (in Eilat).
- Lower withholding tax on dividends (in Eilat).

- Exemption from property tax.
- Unrestricted use of foreign currency.

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

7.7.3. Free Processing Zones

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

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

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

- Companies are fully exempt from any direct tax for up to 20 years. Other entities are subject to direct tax of 15 %.
- Withholding tax on dividends will not exceed 15%.
- Full exemption from municipal taxes (including betterment tax) and any indirect taxes (except for passenger vehicles).
- Capital gains on sale of shares are taxable at a rate of up to 15% unless reinvested within six months - in which case, they are fully exempt from capital gains tax.
- There are no custom duties or import restrictions (except in respect of health and environmental regulations, etc.)
- No foreign currency control will be imposed.

8. TAXATION

8.1. GENERAL

A gradual reduction of tax rates for both individuals and companies was implemented.

The latest reform introduced in July 2005 and due to go into effect from 1.1.06 is, to a large extent, a continuation of the previous reform which went into effect on 1.1.03.

8.2. INCOME TAX

8.2.1. Overview

8.2.1.1. Taxation in Israel is based on an individual method. Accordingly, as of 2003, all Israeli residents are liable to payment of tax in respect of their entire income worldwide.

8.2.1.2. The individual method raises, in effect, the tax liability on passive income, such that income generated or derived outside Israel will also be liable to tax - regardless of whether it was received abroad or in Israel.

8.2.1.3. Foreign residents are also liable to tax on income generated or derived in Israel, subject to source rules and the double taxation treaties signed between Israel and the relevant countries.

8.2.2. Companies

8.2.2.1. **Domicile of a Corporate Entity**

The domicile of a corporate entity is determined on the basis of two alternative criteria:

(a) If incorporated in Israel.

(b) The corporate entity is managed and controlled from Israel.

8.2.2.2. **Income Tax Rates**

The taxable income of Israeli companies is subject to 27% corporate tax in 2008; this is expected to gradually decrease to 25% as follows:

2009 - 26%

2010 onward - 25%

8.2.2.3. **Foreign Professional Company**

A foreign company engaging employees from the liberal professions, most of whose income is derived from a “special profession” and at least 75% of whose control is directly or indirectly exercised by Israeli residents, is deemed to be a foreign professional company, subject to fulfilling further conditions. In this framework, such a company is deemed to be managed and controlled from Israel. Income from a “special profession”, up to the part of the Israeli resident's shareholders, will be subject to Israeli corporate tax. Also, credit will be granted in respect of the foreign tax paid.

8.2.2.4. **Taxation of Entities Controlled by Israeli Residents (CFC)**

With respect to passive income earned by Israeli residents, the tax legislation determines that a foreign company would be deemed to be a “foreign controlled company” subject to the following provisions:

(a) The company's shares, or rights thereto, are not listed for trade on the stock exchange; however, if said shares or rights were partly listed, less than 30% thereof were offered to the public.

(b) Most of the company’s income or earnings during the tax year are derived from passive income. For this purpose, passive income shall constitute income from sources including interest or linkage differentials, dividends, royalties, rental fees, and proceeds from the sale of an asset not used by the company for its business.

(c) The tax rate on passive income in foreign countries does not exceed 20%. For this purpose, the tax rate is defined as the amount of tax actually charged in respect of passive income during the tax year, divided by the total amount earned as passive income in that year.

(d) More than 50% of one or more means of control in the company are exercised, directly or indirectly, by Israeli residents or, alternatively, more than 40% of one or more means of control therein are exercised by Israeli residents who, jointly with a relative of one or more of the Israeli residents, owns more than 50% controlling interest in the company. Alternatively, an Israeli resident is entitled to prevent any significant management decisions from being implemented in the company, including those relating to the distribution of dividends and/or liquidation of the company, whether control is held through shares or otherwise, including in trusts. Holdings, through control, are reviewed at the end of, or on any date during the tax year, and also on any date during the following tax year.

Undistributed company profits will be deemed to have been received by the controlling shareholders at the end of the tax year, including credit on the tax to which they would have been subject had the dividend actually been distributed. Special provisions apply to holdings in a chain of companies and to dividends originating from taxable income at a rate exceeding 20%.

8.2.2.5. Source Rules for Generating Income

Following are the principal rules:

Revenue-Bearing Income

(a) The location of income generated from business will be the location at which the revenue-bearing business activity was conducted.

(b) The location of income generated from a transaction or an incidental business transaction of a commercial nature, will be the location at which the transaction or business was conducted.

(c) The location of income generated from the practice of a profession will be the location at which the service was provided.

(d) The location of income generated from work will be the location at which the work was performed.

(e) The location of income generated from interest, discounting fees and linkage differentials will be the location of residency of the payer.

(f) The location of income generated from rental fees or usage fees in respect of an asset will be the location of the use of the asset.

(g) The location of income generated from salary or compensation, including royalties originating from intangible assets, e.g. patent, intellectual property, etc. will be the location of the residency of the payer.

(h) The location of income generated from pension funds, benefits and annuities will be the location of the residency of the payer.

(i) The location of income generated from agriculture will be the location of the revenue-bearing asset.

(j) The location of income generated from a dividend will be the location of the residency of the corporate entity paying the dividend.

(k) There are a number of exceptions to the above rules, e.g. income from interest, discounting fees and linkage differentials, income originating from intangible assets (including royalties), and income from pension funds, benefits and annuities. In all such cases, the source of income will be determined as follows:

In Israel - also when the payer is a foreign resident - if payment constitutes an expense incurred by the foreign resident's permanent establishment in Israel.

Outside of Israel - also when the payer is an Israeli resident - if payment constitutes an expense incurred by the Israeli resident's permanent establishment outside Israel.

All the above is subject to inapplicability of Treaty provisions.

8.2.2.6. Dividends Received by a Company Domiciled in Israel from Income Generated or Derived Abroad

8.2.2.6.1. The tax rate on taxable income of a corporate entity from dividends originating from income generated or derived outside Israel, and dividends originating outside Israel, is calculated according to one of the following:

(a) Default - Corporate tax at the rate of 25%, with receipt of a tax credit in respect of tax withheld at source when distributing the dividend, in any amount up to 25%.

(b) At the company's request, or pursuant to the provisions of a relevant tax treaty, corporate on said income, with receipt of credit in respect of foreign tax withheld at source from the dividend and a credit in respect of foreign tax paid on income from which the dividend was distributed. According to this alternative, the income will be deemed to be a dividend income, with the addition of tax paid on income from which the dividend was distributed.

A company will be entitled to benefit from such an indirect credit on dividend distribution, provided it holds at least 25% of the controlling interest (as defined for the purpose of a "foreign controlled company") in the foreign company. Additionally, an indirect tax credit will be granted in respect of tax paid on the income of a "granddaughter" company - if the subsidiary, which is controlled at a rate of 25% or more, controls the "third tier company" at a rate of 50% or more.

8.2.2.6.2. Dividends paid, inter alia, to Israeli individuals or foreign residents (both individuals and companies) are subject to a 20% withholding tax; however dividends paid to substantial shareholders by private companies are subject to a withholding tax rate of 25%. This rate may be reduced according to a relevant tax treaty.

The tax rate on dividends paid to an individual is 20%, and if such individual was a significant shareholder (holding 10% and more of the distributing company) at the time of receiving the dividend or on any date in the 12 months preceding it - 25%. If paid to a company domiciled abroad - 20% and if such company was a significant shareholder on the date of receiving the dividend or on any date in the 12 months preceding it - 25%. However, those rates may be reduced according to the relevant treaty.

Dividends distributed from an Approved Enterprises and /or to foreign investors may be subject to different tax rates.

8.2.2.7. Adjustments for Inflation

8.2.2.7.1. High inflation rates in the early 1980s formed the basis of enactment of the Income Tax Law (Inflationary Adjustments), 1985. This law regulates calculation of tax according to real income rather than profit resulting from inflation, as measured by the Israeli Consumer Price Index (CPI), thus protecting equity from inflationary erosion.

8.2.2.7.2. We must point out that the provisions of the Adjustments Law were cancelled as from the 2008 Tax Year.

8.2.3. Individuals

8.2.3.1. Definition of an Israeli Resident

Domicile

(a) An individual is deemed to be an Israeli resident if his center of life is in Israel.

(b) In the framework of determining the “center of life", a number of auxiliary qualitative criteria were applied, to demonstrate the family, economic and social relations representing the individual’s “center of life”. This framework includes, inter alia, an evaluation of the following:

(1) Location of permanent home (even if he does not reside therein).

(2) Location of actual home of himself and members of his family , i.e. actual place of residence.

(3) Location of fixed or permanent business or work.

(4) Location of active material economic interests.

(5) Location of activity in organizations, associations or institutions.

(c) In addition to the said qualitative criteria, the legislation prescribes "reinforcements", the existence of which provide evidences of the individual's "center of life" in Israel.

One of the reinforcements prescribes that an individual's presence in Israel for 183 days or more in a certain year is evidence of his "center of life" in Israel during that year.

Another reinforcement prescribes that an individual's presence in Israel for 30 days or more in a certain year, and total presence in Israel of 425 days or more during that year and the two previous ones, is evidence of his "center of life" in Israel during that year.

(d) It should be noted that the above reinforcements may be refuted by either the individual or the tax authorities.

8.2.3.2. **Individual Taxation**

The tax rates on an individual's income from personal effort will be gradually reduced until 2010, while the tax bracket threshold will increase.

8.2.3.2.1. The tax brackets are adjusted in accordance with changes in the CPI.

Income from dividends, interest, rental of residential dwellings, etc. (passive sources), is taxed differently. Allowances or credits are granted for savings in pension funds, life insurance, etc.

The lowest tax rate applies to earnings from personal effort. Income from passive sources is taxed at a rate of 30% or more. Senior citizens' income, even if not derived from personal effort, is taxed at a rate of 10% or more.

8.2.3.3. **Rental Income**

An <u>individual</u> for whom revenue was generated from rental income on a residential apartment, may during the 2008 tax year, opt to become liable to tax in respect of rental income not exceeding revenue from a business, in one of the following alternatives:

A. Income tax charged in accordance with the provisions of the Income Tax Law (Tax Exemption from Renting an Residential Apartment) 5730-1990; tax exemption up to NIS 4,200 per month, or if the apartment and rent exceed NIS 4,200, tax-exempt income up to the current annual ceiling allowed, less the difference between actual rental income and the ceiling.

B. Income tax charged at the rate of 100%, without a tax ceiling or exemption. An individual opting for this alternative may neither deduct depreciation nor amortizations, nor be eligible for credit, deductions or exemptions, provided an advance was paid within 30 days from the end of the tax year in which rental income was generated for the individual.

C. Taxation under the "regular" tax bracket: on rental income under this alternative, the assessee's marginal tax rate applies. Here, the individual may deduct depreciation, amortizations, and also be eligible for credit, deductions or exemptions to which he is entitled.

8.2.3.4. **Rental Income from Outside Israel**

8.2.3.4.1. An individual accruing income derived from rental of property outside Israel, is entitled to pay tax on such income at the rate of 15%, instead of the individual's graduated tax bracket to which the individual is subject, if the said rental income does not reach the level of business income

8.2.3.4.2. However, the individual is not entitled to deduct expenses incurred in generating the rental income, including credit in respect of foreign tax paid abroad, from any amount paid. Notwithstanding the above, depreciation expenses are deductible.

8.2.3.4.3. An individual choosing to pay tax according to the graduated tax bracket to which he is subject rather than at a fixed rate of 15%, will be entitled to deduct all expenses incurred in generating the rental income and to receive a credit on foreign taxes paid, subject to relevant legislation.

8.2.3.5. "Departure" Tax

8.2.3.5.1. An asset owned by an Israeli resident who ceased to be as such, will be deemed to be sold on the day preceding the date on which the assessee ceased to be an Israeli resident.

8.2.3.5.2. Such an Israeli resident who had not paid the capital gains tax upon leaving Israel, will be deemed to have deferred the tax payment until the date of disposal of the asset. As of that date, he will pay the tax on gains derived from disposal of the asset, pro rata to the period of holding the asset until his departure from Israel, with the addition of interest and linkage differentials from the date of actual disposal of the asset until the date of paying the tax.

8.2.3.5.3. However, if payment of tax in Israel was due on the sale of the asset at the time of realization, then the tax due on the capital gains at the time of realization is payable instead of the tax under the provisions of the preceding paragraph.

8.2.3.6. Taxation of Interest Income from the Capital Market

Most of the interest income from bank deposits and savings plans will be subject to tax at rates varying between 20% (15% with respect to deposits not linked to the Index or foreign currency) or marginal tax rate for individuals, if certain conditions are met. Concurrently with the tax liability, exemptions were determined for low income earners and retired persons.

It should be pointed out that if a taxpayer's interest income and additional passive income exceed his business income, such income may be subject to national insurance.

8.2.3.7. Benefits to New Immigrants and Returning Residents

A "new immigrant" is an individual who acquires the status of an Israeli resident for the first time.

A "returning resident" is an individual who ceased to be an Israeli resident and lived outside Israel on a permanent basis during at least three consecutive years after ceasing to be an Israeli resident, subsequent to which he returned to Israel.

8.2.3.8. Business Income

A new immigrant is exempt from income tax for 4 years from the date on which he became an Israeli resident, in respect of business income earned from a business he had outside Israel during at least five years prior to becoming an Israeli resident for the first time.

8.2.3.9. Non-Business Income

(a) A new immigrant is entitled to tax exemption for five years from the date on which he becomes an Israeli resident. The exemption includes income from interest, dividends, royalties, rental fees and pensions which do not constitute business income, so long as the income is derived from assets which he possessed prior to becoming an Israeli resident and which remained in his possession after becoming an Israeli resident.

(b) The exemption regarding non-business income will also be effective for a returning resident in respect of assets outside Israel acquired during his period of residence abroad, after ceasing to be an Israeli resident.

8.2.3.10. Capital Income

(a) An individual who becomes an Israeli resident for the first time will be exempt from capital gains tax on the disposal of an asset which he possessed outside Israel before becoming an Israeli resident, if the asset is disposed of within ten years from the date on which he became an Israeli resident.

The exemption will also be effective for a returning resident in respect of assets outside Israel acquired during the period of his residence outside Israel.

(b) Disposal of an asset after ten years will be subject to tax pro rata to the period of holding the asset as of the end of ten years.

8.2.3.11. **Income Tax Directive (Tax Exemption on Interest Income from Foreign Currency Deposit for Returning Resident), 2003**

According to the recently enacted tax legislation, interest payments to a returning resident in respect of a foreign currency deposit with an Israeli bank are, in certain circumstances, exempt from tax for five years from the date of the resident's return. The legislation is effective for interest payments as of January 1, 2003 onward.

8.2.4. Benefits to Foreign Residents

Foreign residents are subject to the same tax rates as Israeli residents. However, if foreign currency was invested, they may choose to calculate the capital gains in the original currency rather than in Israeli currency.

In addition, the inflationary gain on the sale of shares of an Israeli company or other assets, purchased originally with foreign currency, is exempt from tax if the calculation is based on changes in the specific exchange rates of the Israeli currency.

A foreign resident will be exempt from capital gains tax on capital gains from the sale of shares allocated to the foreign resident in 2003 and onward, in a company designated as a R & D company as of the date of the allocation, in consideration for monetary investment in the company.

A foreign resident will be exempt from capital gains tax in respect of sale of marketable securities, if the capital gains is derived from a non Israeli permanent establishment of the foreign resident in Israel.

Under the recent tax reform, the above exemption will also apply to securities purchased prior to being listed. These will be taxed at sale only on that part of the capital gains developed up until their listing, (capital gains of a notional sale at time of listing).

In addition, the tax reform allows for a specific exemption for residents of a treaty country, under certain conditions (i.e. being a resident of a treaty country for a period of at least 10 years), on the sale of Israeli non-tradable securities, or foreign securities whose main assets are located in Israel. The exemption is limited to securities purchased between July 1, 2005 and December 31, 2008, and is subject to certain requirements.

The exemption will not apply to the sale of the securities of a company, the majority of whose assets, at the time of purchase and for the two years preceding the sale thereof, were comprised of real estate and/or real estate companies.

8.3. CAPITAL GAINS TAX

8.3.1. General

The term "capital gains" is defined as the excess of proceeds from the sale of an asset over its depreciated cost. The Land Betterment Tax Law and the Income Tax Ordinance deal with capital gains taxation. The former deals with taxation of capital gains derived from the sale of real estate in Israel and in the region, while the latter deals with capital gains from all other sources.

8.3.1.1. **Source of Generating or Deriving Capital Gains under domestic rules.**

The source of generating or deriving the capital gains will be deemed to be Israel if:

(a) The asset sold is located in Israel.

(b) The asset sold is located outside Israel and, in principle, constitutes directly or indirectly a right to an asset or inventory, or an indirect right to a property or asset in a real estate association located in Israel, for purposes of the part of the consideration derived from Israel.

(c) The asset is a share or right to a share in a corporate entity domiciled in Israel.

(d) The asset constitutes a right in a foreign-domiciled corporate entity which, in principle, is the holder of a right, directly or indirectly, to an asset located in Israel, for the part of the consideration derived from the asset located in Israel.

8.3.2. Taxable Capital Gains

Decrease in Tax Rates

- Capital gains tax in respect of disposal of non-marketable assets is at the rate of 20% for non-significant individuals shareholders, and 25% for significant individuals shareholders (a significant shareholder is someone who holds, alone or jointly with another, a 10% and over controlling interest in the company.
- Capital gains accrued until January 1, 2003 are subject to tax in accordance with previous tax rates. Disposal of an asset purchased prior to January 1, 2003, is implemented on a linear basis.
- In light of the reduced tax rates and reconciliation in respect of non-marketable assets both for individuals (up to 50% before January 1, 2003) and companies (2008 - 27%, 2009 - 26%, 2010 on - 25%), a change in the existing holding structures should be considered. In light of the above changes and changes in tax arrangements in liquidated companies, a preference currently exists for individual holdings in specific circumstances.

For tax purposes, capital gains include two components:

- Inflationary gain - the part of the gain derived from linkage to the CPI.
- Real gain - the difference between the total capital gain and the inflationary gain.

The inflationary gain has been exempt from tax since January 1, 1994 and is liable to 10% tax on the accrued portion prior to that date. The real gain is liable to regular individual and corporate tax rates as stated above.

8.3.3. Cancellation of Goodwill

According to the reform, the sale of goodwill whose purchase was not paid for as of July 1, 2003 is subject to tax at the rate of 25% for companies and 20% for individuals on capital gains. However, the balance of the goodwill will entitle the buyer to depreciate.

8.3.4. Profits for Distribution

On the sale of shares, including in the framework of liquidating a company, a tax benefit is granted on gains liable to tax on the corporate level, i.e. profits available for distribution. The part of the gain in the amount of the said profits accrued up to December 31, 2002 is liable to a 10% tax rate. Profits available for distribution after December 31, 2002 will be equal to the tax rate imposed on dividends, i.e. 20%/25% for individuals and 0% for companies.

It was also determined in the reform that profit appropriated for distribution in a liquidation will be calculated till the end of completion and not till the date of commencement thereof, as was the case prior to the amendment.

In the context of the transitional provisions, it was determined that calculation until the date of completing the liquidation will be made during 2006 - 2009 only with respect to a share purchased in the 2003 fiscal year onward. In other words, an assessee who purchases a share prior to 2003 and is, in principle, entitled to a calculation of profits appropriate for distribution and liable to 10% tax, will not benefit from extension of the above calculation period.

Additionally, a provision was prescribed whereby the sale of a security purchased prior to 1.1.2003 will be calculated at the realistic capital gain, after deducting profit appropriate for distribution. Pursuant to this provision, the profit for distribution must be deducted from the realistic capital gain and only thereafter should be proportionally split into two components of the realistic capital gain - the one liable to marginal tax or corporate tax and that liable to 25% tax.

8.3.5. Sale of Stocks

8.3.5.1. 8.3.5.1.Taxation of Capital Gains on the Sale of Securities Traded on a Stock Exchange in Israel

Individuals who, until 31.12.02, had been exempt from capital gains tax on the sale of securities traded on a stock exchange in Israel, will be liable to tax on such sale at a rate of between 15% (for unlinked instruments) and 20% (for linked instruments). The said tax rates will remain in effect as long as financing expenses are not claimed. In the event that such expenses are claimed, the tax rate will be 25%.

8.3.6. Setting-off Losses Outside Israel

In principle, a loss in passive income originating outside Israel may be set-off against passive income outside Israel, with the balance carried forward to future years. A foreign business loss may be set-off against business income abroad and, in certain cases, it may be possible to set-off such a foreign loss against business income originating in Israel.

8.3.7. Capital Losses

Capital losses may be set-off against real capital and land betterment gains.

8.3.8. Taxation of Realistic Investments

8.3.8.1. Setting-off Losses from Securities Held by Individuals

8.3.8.1.1. In the context of the tax reform, the possibility of setting-off capital losses deriving from securities (whether negotiable or not) has also been extended to cover income from interest and dividends.

8.3.8.1.2. Accordingly, a capital loss created as of the 2006 fiscal year can be set-off against income from interest and dividends received on the same security from whose sale the loss was created.

8.3.8.1.3. Additionally, a capital loss can be set-off from a maximum income and dividend paid on other securities (whether negotiable or not), provided the tax rate applicable to such interest income or dividend does not exceed 25%.

8.3.8.2. Setting-off Capital Losses from Securities Held by Company

8.3.8.2.1. Prior to the amendment, a capital loss from the sale of a non-negotiable asset could be set-off again capital gains from a negotiable or non-negotiable asset. Under the reform, the possibility of setting off a capital loss deriving from securities (whether negotiable or not) has been extended to include income from interest and dividends.

8.3.8.2.2. Accordingly, a capital loss can be set-off from interest income and dividend paid on the same security in respect of which the loss was created.

8.3.8.2.3. Additionally, a capital loss can be set-off from interest income and dividend paid on other securities (whether negotiable or not) if the tax rate applicable to such interest income or dividend does not exceed 25%.

8.3.8.2.4. Companies can set-off a capital loss against interest only with effect from the 2010 fiscal year, because the interest income they will have earned will be liable to tax at the rate of 25%, similar to the corporate tax due to apply at that time.

8.3.8.3. **Setting-off Capital Losses from the Sale of Negotiable Securities Held by Individuals**

Losses Created With Effect from the 2006 Fiscal Year

8.3.8.3.1. Prior to the amendment, losses from negotiable securities held by individuals who, in determining their chargeable income, the Adjustments Law did not apply, could be set-off only against profit from negotiable securities. Loss from foreign securities could be set-off only against profit from foreign securities. With effect from 2007 fiscal year, the "basket" of losses will be consolidated into a single basket, such that it will be possible to set-off losses against interest and dividends on negotiable securities. Furthermore, this is performed by way of offsetting the tax that would have been paid on the loss against the tax due on the realistic capital gains from the sale of securities (tax versus tax).

8.3.8.3.2. In the context of the reform, the tendency to broaden the "basket" for setting-off losses from securities was advanced to 2006. Accordingly, a capital loss as aforesaid will be set-off in a similar manner to a regular capital loss and furthermore, the loss may be offset against income from interest and dividends. Also, the loss will be set-off against profit and there will be no further deductions by way of "tax versus tax".

8.3.8.3.3. In summary, as far as losses created in the 2006 fiscal year and subsequent fiscal years are concerned, the basket for offsetting losses will be consolidated into a single basket, without distinguishing between negotiable and non-negotiable assets, nor whether the assets are located in Israel or overseas. A loss from negotiable securities created during the 2006 fiscal year and subsequent fiscal years may be offset as follows:

- According to the rule for setting-off capital losses prescribed in the Ordinance - i.e. losses may also be setoff against capital gains from the sale of non-negotiable securities.
- Against income from interest or dividends paid for the said security.
- Against income from interest or dividend paid for other securities if the tax rate applicable to such income did not exceed 25%.

8.3.8.4. **Losses Carried Forward from Securities Traded on the Israel Stock Exchange**

It was determined that losses from negotiable securities that had not been set-off until the end of the 2005 fiscal year, could be set-off, commencing in fiscal year 2007, against profits from the sale of any security and also against interest or dividends from securities, provided the tax rate applicable thereto does not exceed 20%.

8.3.8.5. **Losses Carried Forward from Foreign Securities**

8.3.8.5.1. With respect to losses from foreign securities that had not been set-off by the end of 2005, commencing in the 2007 fiscal year, losses may be set-off as aforesaid against profits from the sale of any security and also against interest or dividends from securities, provided the tax rate applicable thereto does not exceed 20%.

8.3.8.6. Setting-off Capital Losses from Securities Held by A Company Outside the Adjustments Law

8.3.8.6.1. Losses Created with Effect From 2007 Fiscal Year

Prior to the amendment, losses from negotiable securities held by companies outside the law, could be only be set-off against profit from negotiable securities. As of the 2006 fiscal year, these can also be set-off against interest and dividends on negotiable securities, similar to the rules applicable to individuals.

Under the reform, it was determined that, commencing in the 2006 fiscal year, losses from negotiable securities can be set-off against the following sources:

- According to the rules for setting-off capital losses prescribed in the Ordinance - i.e. they may also be set-off against capital gains from realization of non-negotiable securities.
- Against income from interest or dividend paid on the same security.
- Against income from interest or dividend paid on other securities if the tax rate applicable to such income did not exceed 25%.

8.3.8.6.2 Losses Carried Forward from Securities Traded on the Israel or Foreign Stock Exchange

Losses from negotiable securities that had not been set-off by the end of the 2005 fiscal year, and had not been feasible to set-off in the 2006 fiscal year, may, as of the 2007 fiscal year, be set-off against profit from the sale of any security and also against interest or dividend from securities, provided the tax rate applicable thereto does not exceed 20%. Given that tax rates on interest earnings exceed 20% (liable to the full applicable corporate rate of 25%-27%), while inter-company dividend is exempt (0 tax rate), set-off is limited only to profit from securities (both Israeli and foreign), against dividend obtained from an Approved Enterprise (liable to *15% tax).

8.3.8.7. **Setting-off Capital Losses from Securities Held by a Company within the Law's Applicability**

8.3.8.7.1. Losses Carried Forward from Negotiable Securities

Realistic losses from negotiable securities created till the end of the 2005 fiscal year and not set-off by the end of that year, may be set-off solely against profit from the sale of securities traded on the stock exchange, both in Israel and overseas.

8.3.8.7.2. Losses Created With Effect from 2006 Fiscal Year

A loss created after the above date shall be regarded as an ordinary capital loss and will be subject to the same rules for setting-off losses as provided above in regard to companies outside the law.

8.4. THE TRANSFER PRICING REGULATIONS (DETERMINING MARKET PRICE)

8.4.1. The Main Points of the Regulations

The Regulations determine that in order to ascertain whether an international transaction conducted between related parties is at fair market price, market research must be performed whereby the international transaction is compared to similar transactions according to specific comparison methods. Once a comparison method has been selected and the market research performed, the international transaction will be considered as if conducted at the fair market price, insofar as it does not deviate from the specified range of the said market price. If the international transaction does deviate from the specified range, as determined in the Regulations, the reported price of the transaction will be adjusted for tax purposes in the manner stipulated in the Regulations and, consequently, the assessee will be subject to additional tax accordingly.

If the transaction is a one-off international transaction, duly approval as such by the assessing officer, no obligation to perform market research will apply. Nonetheless, a one-off international transaction will not be exempt from some of the reporting requirements outlined below.

8.4.2. Reporting Requirements for an International Transaction

The Regulations obligate an assessee, who is party to an international transaction, to report in his annual tax return, the execution of the international transaction, its actual conditions and price thereof, and the conditions and price of the transaction at fair market value, on the predetermined form.

In addition, and at the assessing officer's request, the assessee must present, within 60 days, a comprehensive report detailing the international transaction. The said reporting obligation will apply to all assessees, regardless of the size of the particular international transaction or the overall turnover of the assessee's transactions. As such, according to the Regulations, even transactions for which special conditions apply between small businesses and the other non Israeli party to the transaction, the small businesses will be obliged to comply with the reporting requirements.

8.4.3. Coming Into Effect and Transitional Regulations

The Regulations came into effect in respect of international transactions executed from publication date thereof (29 November 2006). Market research performed before the Regulations came into effect will be considered as market research according to the Regulations, if performed within two years from publication thereof and provided it was performed within the OECD accepted guidelines or the guidelines of OECD member states.

8.5. TAXATION OF TRUSTS

8.5.1. Prior to the tax reform implemented in 2006, the issue of trusts was clouded with uncertainty due to lack of specific classifications and regulations. Thus, foreign investors approached this particular structure with great apprehension, if at all.

8.5.2. Under the said tax reform, clear and concise conditions have been specified, on the basis of which foreign and domestic investors may determine the appropriate category of the trust to be set up, to meet their particular needs.

8.5.3. In addition, under the new regulations an Israeli trustee can manage a foreign trust without the need to report its income to the Israeli tax authorities. Needless to say, the foreign trust's income is generally not taxable in Israel.

8.5.4. Foreign resident trust

8.5.4.1. As opposed to Israeli resident trusts, two main categories exist for a trust to be considered foreign resident, with different tax implications in each case:

- "Foreign Resident Settlor" Trust - A trust, whether irrevocable or not, will be considered foreign resident if, during the relevant tax year, all its settlors and beneficiaries are foreign residents, or at the time of its establishment and the relevant tax year all its settlors are foreign residents, irrespective of the of the beneficiaries' residency

- The tax implications - There are no tax liabilities when assets are transferred to the trust. Assets transferred from the trust to the beneficiaries will be considered as if transferred directly from the settlors to the beneficiaries and taxed accordingly (as such, there will be no tax liability for Israeli and foreign beneficiaries). The trust's income will be taxable whether or not transferred to the beneficiaries, as if it were the foreign settlors' income (even if the beneficiaries are Israeli residents). As such, income generated outside Israel would not be taxable nor would it need to be reported in Israel.
- "Foreign Resident Beneficiary" Trust - If a trust was established, inter alia, by an Israeli resident as irrevocable, and all the beneficiaries during the relevant tax year are identified foreign residents, the trust will be considered a foreign resident beneficiary trust.
- The tax implications - Assets transferred to the trust will be considered as if transferred directly to the beneficiaries and taxed accordingly. There will be no capital gains tax when the trust's assets are transferred to the beneficiaries. The trust's income will be taxable whether or not transferred to the beneficiaries, as if it were the foreign beneficiaries' income. As such, income generated outside Israel would not be taxable nor would it need to be reported in Israel. Should there be no locally generated income, the trustee will be required to sign a declaration to this effect for the tax authorities.

8.5.5. Underlying Companies

As mentioned above, the reforms allow for an Israeli trustee to manage a foreign trust, without creating any tax liabilities in Israel or even the need to report the trust's income to the tax authorities. In addition, to broaden the opportunities available to the trustee in regard to the trust assets and their management, underlying companies will be considered as holding and managing the assets of the trust for the trustee. Within this classification an Israeli underlying corporation of a foreign resident trust will neither have to declare nor will it be taxable for foreign sourced income.

8.6. PARTICIPATION EXEMPTION FOR ISRAELI HOLDING COMPANY

The tax reform includes a participation-exemption regime for Israeli holding companies, under specific conditions. Israeli holding companies will be exempt from tax on dividends received from foreign subsidiaries and from capital gains tax upon sale of such subsidiaries. Furthermore, Israeli holding companies will be exempt, inter alia, from tax on interest received on bank deposits in Israel and on income (interest, dividend and capital gains) from traded securities. Foreign shareholders will benefit from a reduced withholding tax on dividends of merely 5%.

8.6.1. Definitions:

- Israeli holding company -
  - (a) Registered in Israel and managed and controlled from Israel.
  - (b) The company is privately owned and not a transparent or family company (similar although not identical, to the U.S. S-Corp). Additionally, the company is not a financial institution.
  - (c) Its investment in foreign subsidiaries for at least 300 days of the tax year amounted to at NIS least 50 million (app. US$12.5 million).
  - (d) For at least 300 days of the tax year, 75% or more of its assets constitute the subsidiaries (incl. loans granted to subsidiaries).
  - (e) The holding company has no business income except for services, including management services, provided to the subsidiaries.
  - (f) The holding company submits a request to be recognized as such to the assessing officer within the timeframe stipulated.

- Subsidiary for participation exemption purposes -
  - (a) Resident of a treaty country (and files tax returns in its resident country), irrespective of the corporate tax rate of the particular country. If the subsidiary is resident in a non-treaty country only if the corporate tax rate on business income of the non-treaty country is 15% or more at the time the shares were purchased.
  - (b) At least 10% of rights to profits of the subsidiary are owned by the Israeli holding company for 12 consecutive months.

(c) At least 75% of the subsidiary's income derived abroad is business income.

(d) Israeli assets and Israeli income of the subsidiary may not comprise more than 20% of the subsidiary's total assets/income, respectively.

8.6.2. There are no limitations as to the identity of the holding company's shareholders.

8.6.3. Dividends distributed by the holding company:

8.6.3.1. A foreign shareholder will pay a 5% flat tax rate on dividends distributed by the holding company, regardless of their legal status (individual, corporation, trust etc.), and regardless of the source of income from which the dividend is distributed. Double tax treaties may improve this tax rate - the Israel- Sweden DTT, for example, has set a 0% tax rate for said dividends.

8.6.3.2. An Israeli individual shareholder will pay 20% to 25% on the dividends distributed, whereas for an Israeli corporation shareholder, this will depend on the source of income from which the dividend is distributed.

8.7. VALUE-ADDED-TAX (VAT)

8.7.1. General

Value-added-tax (VAT) is an indirect tax levied on the consumption of goods and services in Israel.

VAT is levied at each stage of the sale, including imports, based on the added value at each stage.

At each stage, VAT is collected from the buyer and transferred to the Customs and Excise Division of the Ministry of Finance, after deducting the VAT amount paid to suppliers. Thus, the end consumer bears the VAT cost charged by the supplier without being able to recover it.

8.7.2. VAT Rates

The current 15.5% VAT rate in Israel is uniform for all taxable transactions (since 1.7.06).

However, the following goods and services are not subject to VAT:

1) Exported goods.
2) Sale of intangible assets to non-residents.
3) Sale of goods to licensed warehouse owners for transferring them to the warehouse, if transferred.
4) Sale of goods to a licensed warehouse by residents leaving Israel.
5) Certain services rendered to non-residents.
6) Certain services concerned with the arrival/departure of planes and ships to and from Israel.
7) Services rendered by a dealer whose principal work is in Israel.
8) Hotel services and car rentals to tourists who pay in foreign currency.
9) Sale of goods to people arriving in Israel and are exempt from purchase tax.
10) Sale of the right to travel from one country to another.
11) Transport of cargo and passengers to and from Israel.
12) Sale of fresh fruit and vegetables.
13) Certain structural alterations.

8.7.3. Payroll Taxes

Financial institutions, mainly banks and insurance companies, pay 15.5% profit tax instead of VAT.

Financial institutions approved as non-profit organizations pay 7.5% payroll tax instead of VAT.

These two types of institutions are not considered VAT dealers, hence they cannot recover the VAT amount paid to suppliers.

8.8. REAL ESTATE TAXES

8.8.1. Introduction

On March 23, 2002 a comprehensive real estate tax reform was introduced. The revision went into effect retroactively - from November 7, 2001.

8.8.2. Acquisition Tax

Real estate purchased in Israel is subject to acquisition tax payable by the buyer. Generally, a 5% tax rate is imposed on the value of real estate. In a number of limited cases, the applicable tax rate, based on the purchase price of the asset, is as follows:

Residential dwellings	-	0.5% - 5%
Other	-	3.5% - 5%

Certain transactions are entitled to reduced tax rates.

8.8.3. Betterment Levy

A betterment levy at the rate of 50% is imposed on the increased value of real estate as a result of changes in building rights. The levy is payable upon issue of a building permit or disposal of the asset.

8.8.4. Land Betterment Tax

As previously stated, the sale of real estate may be subject to capital gains tax. The regulations applicable to the sale of real estate are almost identical to those mentioned above.

The land betterment tax was reduced from November 7, 2001 as follows:

1) The tax on land betterment, accrued until November 7, 2001 will be at the marginal rate of up to 47% for individuals and 27% for companies (in 2008).
2) The tax on land betterment, accrued after November 7, 2001 will be at the rate of 20% for individuals (in 2007 onward), and 25% for companies.

Distribution of land betterment among the various periods will be implemented on a linear basis.

The sale of residential real estate by individuals is exempt from land betterment tax if certain conditions are fulfilled.

Spefic rules apply to the sale of shares and rights in companies whose principal assets consist of real estate ("Real Estate Entities").

8.8.5. Sales Tax

Sales tax was implemented on real estate transactions executed after November 7, 2001.

8.8.6. Real Financing Expenses

The Israeli Supreme Court has resolved that real financing expenses are tax-deductible. However, real interest expenses attributed to the acquisition of real estate purchased prior to November 7, 2001 will be deductible upon fulfillment of the following conditions:

1) The real financing expense relating to the specific loans taken for their purchase or betterment, or for repayment of a loan relating to the estate, are tax-deductible from the betterment upon their sale;
2) Regarding individuals whose assets are not shown in the accounting records managed in the two sided recording - only real financing expenses on loans taken close to the purchase or betterment date and guaranteed by a mortgage, will be tax-deductible;
3) The benefit does not apply to a loan from relatives.

8.8.7. Real Estate Companies

Tax on the sale of shares in real estate companies shall conform to the provisions of Chapter E of the Income Tax Ordinance (ITO).

Chapter E2 of the ITO with respect to taxes on structural alterations, shall apply to alterations in which the real estate company is involved.

Stock allocations in a real estate company are exempt from tax only if the stocks had not been purchased earlier by the real estate company and the value of the allocation was not paid, directly or indirectly, to the shareholders.

Purchase tax and sales tax shall conform to the fair value of the real estate.

8.8.8. Foreign residents

Pursuant to Israeli real estate tax regulations, foreign residents are eligible for tax benefits on investments which contribute to the stability of the Israeli market, creation of jobs for Israeli residents and to generating business activity.

8.9. OTHER TAXES

8.9.1. National Insurance (Social Security)

Both employers and employees pay national insurance in Israel. The employee's share includes compulsory health insurance.

National insurance rates are based on gross monthly income, as follows:

		Monthly Salary (NIS)	
	year	**0 - 4,598**	**4,598- 36,760**
Employee's share	2008	3.5%	12%
Employer's Share	2008	3.85%	5.43%

These rates refer to Israeli residents. The tax brackets are usually updated on an annually basis and are valid for January 2008.

8.9.2. Customs Duties

Certain goods imported to Israel are subject to customs duties. The rates vary and are usually based on CIF value. Various trade agreements with the United States, European Community and EFTA reduce duties in comparison with imports from other countries.

8.9.3. Purchase Tax

Certain goods sold in Israel are subject to purchase tax.

8.9.4. Municipal Tax

Municipalities impose annual taxes on real estate. The rates usually depend on the location and actual built area.

8.9.5. Estate Tax

As of the date of this publication, Israel has no estate tax.

8.10. TAX TREATIES

Israel has entered into tax treaties with the following countries: Austria, Belgium, Byelorussia, Brazil, Bulgaria, Canada, Croatia, The Czech Republic, Denmark, Ethiopia, Finland, France, Germany, Greece, Hungary, India, Ireland, Italy, Jamaica, Japan, Latvia, Lithuania, Luxemburg, Mexico, Moldova, the Netherlands, Norway, People's Republic of China, Philippines, Poland, Portugal, Romania, Russia, Singapore, Slovakia, Slovenia, South Africa, South Korea, Spain, Sweden, Switzerland, Thailand, Turkey, Ukraine, the United Kingdom, the United States of America, and Uzbekistan.

Treaty with Vietnam has been signed but not yet ratified.

8.10.1. Treaty Withholdings

The following table summarizes withholding tax rates on dividends, interest and royalties in accordance with various tax treaties. It should be noted that the data listed below are subject to specific provisions of each treaty.

	Dividends %	Interest %	Royalties %
Non-treaty countries	20/25	25	25
Austria	25	15	0/10
Belgium	15	15	0/10
Byelorussia	10	5/10	5/10
Brazil	10/15	0/15	10/15
Bulgaria	10/12.5	0/5/10	12.5
Canada	15	0/15	0/15
Croatia	5/10/15	0/5/10	5
China	10	7/10	10
Czech Republic	5/15	0/10	5
Denmark	5/15/25	25	10
Ethiopia	5/10/15	0/5/10	5
Finland	5/10/15	0/10	10
France	5/10/15	0/5/10	0/10
Germany	25	15	0/5
Greece	0/25	10	10
Hungary	5/15	0	0
India	10	0/10	10
Ireland	10	5/10	10

	Dividends %	Interest %	Royalties %
Italy	10/15	10	0/10
Jamaica	15/22.5	0/15	10
Japan	5/15	0/10	10
Latvia	5/10/15	0/5/10	5
Lithuania	5/10/15	0/10	5/10
Luxemburg	5/10/15	0/5/10	5
Mexico	5/10	0/10	10
Moldova	5/10	0/5	5
Netherlands	5/10/15	10/15	5/10
Norway	5/15/25	25	10
Philippines	10/15	0/10	Up to 15
Poland	5/10	5	5/10
Portugal	5/10/15	0/10	10
Romania	15	0/5/10	10
Russia	10	0/10	10
Singapore	5/10	0/7	5
Slovakia	5/10	2/5/10	5
Slovenia	5/10/15	0/5	5
South Africa	25	25	15
South Korea	5/10/15	0/7.5/10	2/5
Spain	10	0/5/10	5/7
Sweden	0/5/15	25	0
Switzerland	5/10/15	0/5/10	5
Thailand	10/15	0/10/15	5/15
Turkey	10	0/10	10
Ukraine	5/10/15	0/5/10	10
United Kingdom	15	15	15/0
United States of America	12.5/15/25	10/17.5	10/15
Uzbekistan	10	10	5/10

In addition to the above, limited transport and shipping treaties exist in various jurisdictions.

9. FOREIGN EXCHANGE CONTROL AND PREVENTION OF MONEY LAUNDERING

9.1. FOREIGN EXCHANGE CONTROL

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

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

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

Under the general permit, some reporting restrictions are imposed on banks, financial brokers, and institutional investors.

Since March 1999, additional reporting requirements have been imposed on individuals and the private sector. These requirements include the furnishing of information to the financial broker executing the transaction and reporting directly to the Controller of Foreign Currency, as outlined below.

An Israeli resident engaging with a foreign resident using a financal broker, is required to report to the financial broker on the nature of the engagment

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

A financial broker is required to report to the Controller of Foreign Currency several kinds of events, including the following ones:

- An engagment between an Israeli resident and a foreign resident carried out with his involvment.
- A transaction made by a foreign resident in Israeli currency in excess of a certain amount.
- A holding of listed Israeli securites by a foreign residet in excess of a certain amount.

9.2. THE PREVENTION OF MONEY LAUNDERING

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

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

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

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

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

10. ISRAEL LAND ADMINISTRATION

10.1. RESPONSIBILITIES

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

The management policy is based on the following laws and regulations:

- ***Basic Law: Israel Land (1960)*** - which states that State-owned land may not be sold or leased.
- ***The Land of Israel Law (1960)*** - regulates change of ownership of State land.
- ***The Israel Land Administration Law (1960)*** - grants the Israel Land Administration responsibility for managing State land.
- ***The Treaty between the State of Israel and KKL (1961)*** - provides that the Israel Land Administration will manage State land, as defined above.

10.2. MAIN ACTIVITIES

- ***Marketing and development*** - planning and development of land is implemented in accordance with goals set by the Government of Israel and the Israel Land Administration Council, in coordination with relevant ministries and authorities (housing and construction, tourism, industry and trade, municipalities, etc.). Planning and development goals include, inter alia, creation of housing and jobs, and provision of recreation facilities. Land is generally sold or leased in accordance with issued tenders and occasionally by drawing lots.
- ***Acquiring land*** - on behalf of the State, especially when the State is interested in developing areas for communal purposes, such as roads, schools, cultural centers, etc.

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

10.3. ISRAEL LAND ADMINISTRATION OFFICES

Headquarters:
6 Shamay Street
Jerusalem
Telephone: (02) 620-8422
Fax: (02) 620-8427

Northern District:
Plaza Hotel, Carmel Street
Upper Nazareth17000
Telephone: (04) 655-8211
Fax: (04) 655-8213

Haifa District:
15 Pal Yam Street
Haifa 33095
Telephone: (04) 863-0855
Fax: (04) 864-5537

Jerusalem District:
216 Jaffa Street
Jerusalem 91361
Telephone: (02) 531-8888
Fax: (02) 531-8706

Tel Aviv District
125 Menachem Begin Road
Tel Aviv
Telephone: (03) 763-2222
Fax: (03) 763-2132

Central District:
125 Menachem Begin Road
Tel Aviv
Telephone: (03) 763-2222
Fax: (03) 763-2132

Southern District:
4 Tikva Street
Beer Sheba 84101
Telephone: (08) 626-4333
Fax: (08) 626-4250

Eilat Branch:
Red Sea Shopping Center
Eilat 88110
Telephone: (08) 637-6665

Judea and Samaria District:
Civil administration building
POB 43, Beit El 90631
Telephone: (02) 997-7706
Fax: (02) 997-7770

The Negev's Beduin Administration:
60 Hebron Road
Beer Sheba
Telephone: (08) 623-2293
Fax: (08) 628-9597

11. BDO INTERNATIONAL

11.1. ABOUT BDO

BDO International is a worldwide network of professional accountancy and consulting firms serving global and national organizations. Since its establishment in 1963, BDO has grown to become the fifth largest firm in this sector worldwide. From its European roots, BDO has developed a global network of 626 offices in 110 countries. More than 30,000 BDO partners and staff provide auditing, accounting, tax, financial and management advisory services in its locations around the world.

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

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

11.2. KEY FIGURES FOR SEPTEMBER 30, 2007

11.2.1. Global Income

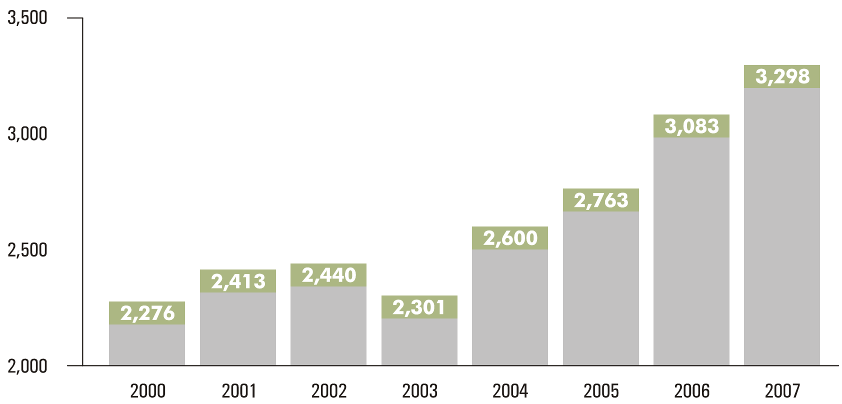
BDO is a multinational organization founded in Europe in 1963 and has been since commited to service excellence and client satisfaction.

The organization has member firms throughout Europe, North and South America, Asia and the South Pacific, Middle East and Africa, and continues to expand.

The following diagram presents BDO's income development in the years 2000 – 2006 and for September 30, 2007:

Sep. 2007 – 3,298 Euro million

Fee Income (EURO millions)

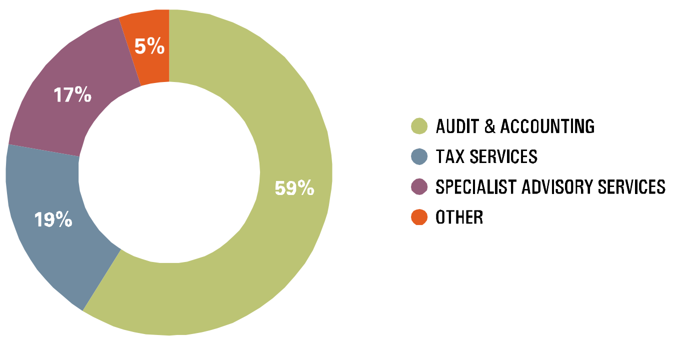


Global fee income shows an increase of more than 7% last year.

11.2.2. Income by Discipline

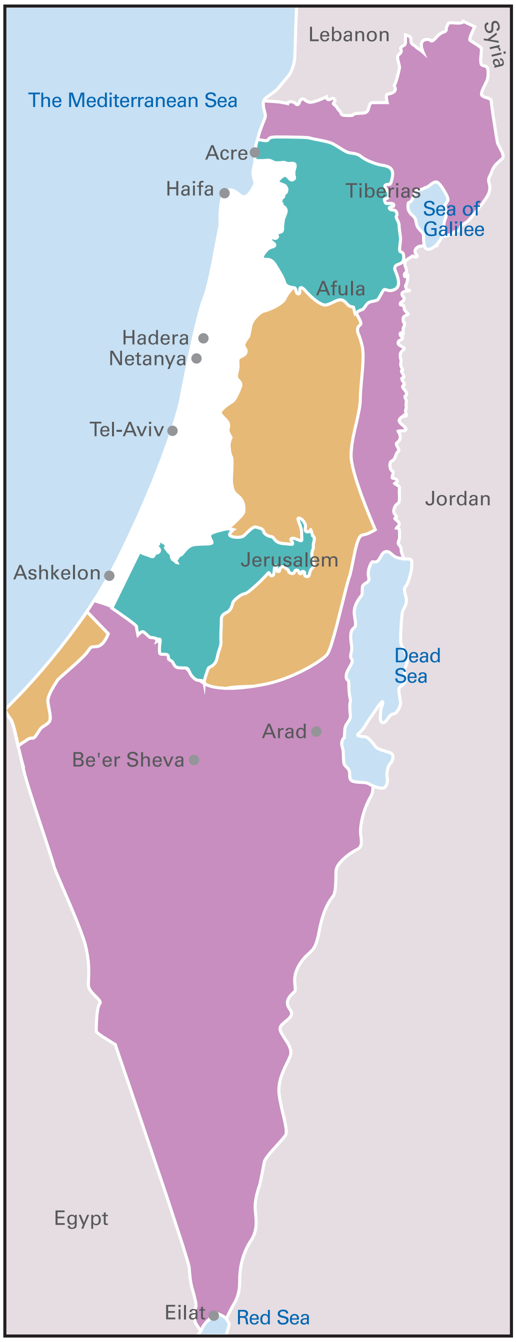
BDO is a full-service organization that offers a range of professional auditing, accounting, tax, financial and management advisory services.

The following diagram presents the BDO's fee split by discipline in 2007:



Appendix 1

MAP OF ISRAEL - NATIONAL PRIORITY REGIONS



LEGEND

- National Priority "A" Region
- National Priority "B" Region
- Judea, Samaria and Gaza Strip

There are areas and settlements that have different priorities than their surroundings.

Jerusalem is granted with National Priority "A" for hi-tech only.

Judea, Samaria and Gaza Strip - only Israeli settlements.

Some changes are expected in the future.

Appendix 2

INDUSTRIAL NATIONAL PRIORITY REGIONS

North

Industrial Zone	Municipal Authority	National Priority
Abu Sanan	Abu Sanan	A
Afula	Afula, Emek Izrael	A
Arabe	Arabe	A
Bar Lev (Tsiklon)	Misgav, Mateh Asher, Karmiel	A
Bet She’an	Bet She’an	A
Bohina	Bohina	A
Daliat El Carmel	Daliat El Carmel	A
Delton	Marom Hagalil, Zefat	A
Dir Hanna	Dir Hanna	A
Goren	Maale Yossef, Shlomi	A
Ichsael	Ichsael	A
Julis	Julis	A
Karmiel	Karmiel	A
Katzrin	Katzrin, Ramat Hagolan	A
Kefar Kaneh	Kefar Kaneh	A
Kiryat Shmona	Kiryat Shmona, Galil Elion	A
Ma’ar	Ma’ar	A
Maalot Tarshicha	Maalot Tarshicha, Maale Yossef	A
Mashhad	Mashhad	A
Nahariya	Nahariya	A
Nazareth Illit	Nazareth Illit	A
Peki’in-Kirsa-Smia	Peki’in-Kirsa-Smia	A
Ramma Sajour	Ramma Sajour	A
Sagi 2000 Ha’emeqim	Migdal HaEmeq, Emeq Izrael	A
Sakhnin	Sakhnin	A
Shaked	Shomron, Tal Hiron (Katsir Harish)	A
Shefar’am	Shefar’am	A
Tamra	Tamra	A
Tefen	Industrial Council	A

Industrial Zone	Municipal Authority	National Priority
Teradion	Misgav	A
Um El Fahem	Um El Fahem	A
Yokneam	Yokneam	A
Zarzir	Zarzir	A

Central

Industrial Zone	Municipal Authority	National Priority
Ashkelon	Ashkelon	A
Immanu'el	Immanu'el	A
Jerusalem – Har Hozvim	Jerusalem	A
Jerusalem - Atarot	Jerusalem	A
Karnei Shomron	Immanu'el	A
Kiryat Arba	Kiryat Arba, Har Hebron	A
Kiryat Gat	Kiryat Gat, Yoav, Shapir	A
Ma'ale Efrayim	Ma'ale Efrayim, Bikat Hayarden	A
Ma'ale Adummim	Ma'ale Adummim	A
Sha'ar Benyamin	Mateh Benyamin	A
Shilo	Mateh Benyamin, Ali-Shilo-Levona	A
Ariel	Ariel	A

South

Industrial Zone	Municipal Authority	National Priority
Arad	Arad	A
Aru'ar	Aru'ar	A
Avshalom	Eshkol	A
Beer Sheva	Beer Sheva	A
Dimona	Dimona	A
Eilat	Eilat	A
Erez	Hof Azza (Gaza Shore)	A
Hora	Hora	B

Industrial Zone	Municipal Authority	National Priority
Mishor Rotem	Tamar, Dimona	A
Mizpe Ramon	Mizpe Ramon	A
Netivot	Netivot, Azzata	A
Ofakim	Ofakim	A
Omer	Omer	A
Raet	Raet	A
Ramat Hanegev	Ramat Hanegev	A
Ramat Hovev	Industrial Municipality	A
Sderot	Sderot	A
Shaar Hanegev	Shaar Hanegev	A
Shagav Shalom	Shagav Shalom	A
Tel Sheva	Tel Sheva	A
Yeruham	Yeruham	A

** Source: Ministry of Industry and Trade.*

NOTICE: This publication is intended to provide general, initial and non binding information. The information in this publication does not supplement, alter or replace any valid law, regulation or procedure currently in force. In any case of contradiction or doubt the provisions of the law shall prevail. The Ministry of Industry and Trade bears no obligation for the information therein.

Appendix 3

TOURISM NATIONAL PRIORITY REGIONS

Area or City (1)	Luxury Hotels (2)	Tourist Hotels (3)	Other Tourist projects and Attractions
Eilat, Eilot	C	C	A
Arava, Mount Negev, Dead Sea	C	A	A
Southern Coast	B	A	A
Be’er Sheva	C	B	A
Eastern Negev, Southern Negev	C	A	A
Jerusalem	A	A	A
Judea Mountains	C	B	A
Central Coast, Northern-Central Coast	C	C	C
Northern Coast	C	B	C
Central Areas, Valleys	C	C	C
Sea of Galilee Surroundings	C	B	A
Golan Heights	C	A	A
Upper Galilee – Frontier	C	A	A
Western Lower Galilee	C	C	A
Nazareth	B	A	A
Western Upper Galilee	C	A	A
Northern Shore of the Dead Sea	A	A	A
Shore of the Sea of Galilee	B	A	A
Eilat (East Lagoon)	B	B	A
Judea, Samaria and Gaza Strip	A	A	A

(1) City limits, according to city maps published by the Ministry of Tourism.

(2) Level “A” hotels.

(3) Level “B” to “D” hotels, holiday villages, camping sites and hostels.

Appendix 4

EXAMPLES OF CALCULATING THE CAPITAL GAINS TAX

The following table consists of four examples for the purpose of calculating capital gains tax.

Example A	-	Inflationary and real capital gains.
Example B	-	Inflationary gain
Example C	-	Inflationary gain
Example D	-	Inflationary loss.

BASIC DATA:

Date of Purchase:	January 1, 1991
Date of Sale:	December 31, 2007
Known index on purchase date:	175.6
Known index on December 31, 1993:	251.3
Known index on date of sale (estimated):	460

	Example A NIS	Example B NIS	Example C NIS	Example D NIS
CAPITAL GAIN (LOSS):				
Depreciated balance as of December 31, 2007	100	100	100	100
Proceeds from sale	330	150	130	60
Capital gain (loss)	230	50	30	(40)
INFLATIONARY AMOUNT:				
Depreciated balance	100	100	100	
	×	×	×	
Increase in CPI as of December 31, 2007	2.62	2.62	2.62	
(460:175.6)	262	262	262	
Less depreciated balance	(100)	(100)	(100)	
Adjusted increase	162	162	162	
INFLATIONARY TAXABLE AMOUNT:				
Depreciated balance	100	100	100	
	×	×	×	
Adjustment to December 31, 1993 (251.3:175.6)	1.43	1.43	1.43	
	143	143	143	
Less depreciated balance	(100)	(100)	(100)	
Inflationary taxable amount (smaller than or equal to capital gain)	43	43	30	
EXEMPT INFLATION AMOUNT:				
Inflationary amount	162	162		
Less inflationary taxable amount	(43)	(43)		
Total exempt inflationary amount	119	(*) 7		
(*) Taxable and exempt inflationary amount of capital gain				
REAL CAPITAL GAIN:				
Capital gain	230			
Less inflationary amount	(162)			
	68			
REAL CAPITAL GAIN UP TO 31.12.2002: 12/17 x 68	48			
REAL CAPITAL GAIN AFTER 31.12.2002: 5/17 x 68	20			
TAXES DUE:				
Real capital gain up to 31.12.2002 (48 x 29%)	13.92	-	-	-
Real capital gain after 31.12.2002 (20 x 25%)	5	-	-	-
Inflationary taxable amount (43 x 10%)	4.3	4.3	(30 x 10%) = 3	-
Total taxes due	23.22	4.3	3	-

Appendix 5

DEPRECIATION RATES

The following table contains a sample of most common depreciation rates used for tax purposes.

	Straight line method %
Industrial Entities:	
Machinery and equipment operating in: One shift Two shifts Three shifts	 20 30 40
Buildings	5
Patents and know-how	12.5
R&D expenditures	33 - 100
Hotels:	
Buildings	5
Equipment	20
Other Businesses:	
Machinery and equipment	7 - 10
Electric equipment and computerized equipment	15
Computers and software	25 - 33
Trucks and commercial vehicles	20
Passenger vehicles	15
Furniture and office equipment	6 - 7
Buildings	1.5 - 4

Industrial enterprises may choose the declining balance method for calculating the depreciation on their machinery and equipment as follows:

Years	Number of daily shifts		
	1	2	3
	%	%	%
1	30.0	40.0	50.0
2	21.0	24.0	25.0
3	14.7	14.4	25.0
4	10.3	21.6	-
5	24.0	-	-
	100.0	100.0	100.0

Appendix 6

USEFUL ADDRESSES IN ISRAEL

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

A. MINISTRIES AND GOVERNMENT OFFICES:

Prime Minister's Office
3 Kaplan St. Hakirya,
Jerusalem 91950
Telephone: (02) 670-5555
Facsimile: (02) 670-5475
E-mail: pmo.heb@it.pmo.gov.il

Ministry of Agriculture
13 Heleni Hamlka Street
Jerusalem 91990
P.O Box 184
Telephone: (02) 629-0100
Facsimile: (02) 629-0156
E-mail: pniot@moag.gov.il

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

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

Ministry of Environment
5 Kanpey Nesharim Street
Giv'at Shmuel, Jerusalem 95464
Telephone: (02) 655-3777
Facsimile: (02) 695-1303
E-mail: pniot@sviva.gov.il

Ministry of Finance
1 Kaplan Street
Kyriat Ben Gurion
P.O.Box 883
Jerusalem 91036
Telephone: (02) 531-7111
Facsimile: (02) 561-1105
E-mail: pniot@mof.gov.il

Ministry of Health
29 Ribka Street
Jerusalem 93461
Telephone: (02) 568-1318
Facsimile: (02) 672-5836
E-mail: pniot@moh.health.gov.il

Ministry of Industry, Trade And Labor
Jenery 1 Building
5 Bank Israel Street
Jerusalem 91036
P.O.Box 299
Jerusalem 91002
Telephone: (02) 666-2000
Facsimile: (02) 624-2901
E-mail: pniot@moit.gov.il

Ministry of Justice
29 Tsalch Adin Street
Jerusalem 91490
Telephone: (02) 646-6666
Facsimile: (02) 670-6357
E-mail: pniot@justice.gov.il

Ministry of Social Affairs
2 Kaplan Street
Kiryat Ben Gurion
P.O.Box 915
Jerusalem 91008
Telephone: (02) 675-2311
Facsimile: (02) 566-6385
E-mail: pniot@mos.gov.il

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

Ministry of Science, Culture and Sports
Government Offices, Building C
Hakirya Hamizrachit
P.O.Box 49100
Jerusalem 91490
Telephone: (02) 541-1182
Facsimile: (02) 532-3497
E-mail: sima@most.gov.il

Ministry of Tourism
Jenery 1 Building
5 Bank Israel Street
P.O.Box 1018
Jerusalem 91009
Telephone: (02) 666-4200
Facsimile: (02) 624-1870
E-mail: pniot@tourism.gov.il

Bank of Israel
2 Kaplan Street
Kiryat Ben Gurion
P.O.Box 780
Jerusalem 91007
Telephone: (02) 655-2211
Facsimile: (02) 652-8805

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

Foreign Trade Administration
30 Agron Street
Jerusalem 94190
Telephone: (02) 622-0289
Facsimile: (02) 624-3005

Income Tax Commission
5 Kanfei Nesharim Street
Jerusalem
Telephone: (02) 655-9559
Facsimile: (02) 652-5327
E-mail: pniotmas@mof.gov.il

Investment center
8 King David Street
Jerusalem 94101
Telephone: (02) 622-0373/4/5
Facsimile: (02) 623-1468

The Office of the Chief Scientist
5 Bank Israel Street
P.O.Box 2197
Jerusalem 91036
Telephone: (02) 666-2000
Facsimile: (02) 666-2901

Patent Registry
4 Hasadna Street
Talpiot
P.O.Box 93420
Jerusalem 91533
Telephone: (02) 565-1660
Facsimile: (02) 565-1770

Securities Authority
22 Kanfei Nasharim Street
Jerusalem 95464
Telephone: (02) 655-6555
Facsimile: (02) 651-3646

B. OTHER USEFUL ADDRESSES:

Bank Hapoalim Ltd.
50 Rothschild Blvd.
Tel Aviv 66883
Telephone: (03) 567-3697
Facsimile: (03) 567-6504

Bank Leumi Le-Israel B.M.
32 Yehuda Halevi Street
Tel Aviv 65136
Telephone: (03) 954-4555
Facsimile: (03) 514-8688

Israel Discount Bank Ltd.
27 Yehuda Halevi Street
Tel Aviv 65546
Telephone: (03) 514-5555
Facsimile: (03) 514-5365

United Mizrahi Bank Ltd.
48 Lilienblum Street
P.O.Box 309
Tel Aviv 61002
Telephone: (03) 567-9211
Facsimile: (02) 567-9246

First International Bank of Israel Ltd.
9 Ahad Ha'am Street
P.O.Box 29036
Tel Aviv 65251
Telephone: (03) 519-6111
Facsimile: (03) 510-0316

Industrial Development Bank of Israel Ltd.
2 Dafna Street
P.O.Box 33480
Tel Aviv 61334
Telephone: (03) 697-2727
Facsimile: (03) 697-2893/0

Federation of Israel Chamber of Commerce (Tel Aviv-Jaffa)
84 Hahashmonaim Street
Tel Aviv 667132
Telephone: (03) 563-1010
Facsimile: (03) 561-9025

Institute of Certified Public Accounts (Israel)
20 Shefer Street
Tel Aviv 65166
Telephone: (03) 516-1114
Facsimile: (03) 510-3103

Israel Export Institute
Industry House
29 Hamered Street
P.O.Box 50084
Tel Aviv 68125
Telephone: (03) 514-2830
Facsimile: (03) 514-2902
E-mail: pniot@export.gov.il

Israel Hotel Association
Industry House
29 Hamered Street
P.O.Box 50066
Tel Aviv 61500
Telephone: (03) 517-0131
Facsimile: (03) 510-0197

Israel - US Binational Industrial Research and Development Foundation
2 Alharizi Street
P.O.Box 7677
Jerusalem 91076
Telephone: (02) 561-7314
Facsimile: (02) 563-3287

Manufactures' Association of Israel
Industry House
29 Hamered Street
P.O.Box 50022
Tel Aviv 61500
Telephone: (03) 519-8787
Facsimile: (03) 516-2026

MATIMOP
Israel Industry Center for R&D
29 Hamered Street
P.O.Box 50364
Tel Aviv 61500
Telephone: (03) 511-8111
Facsimile: (03) 517-7655

Tel-Aviv Stock Exchange
54 Ahad Ha'am Street
Tel Aviv
Telephone: (03) 567-7411
Facsimile: (03) 510-5379

The Kibbutz Industries Association
13 Leonardo da Vinci St.
Tel Aviv 64000
Telephone: (03) 695-5413
Facsimile: (03) 695-1464

Tourist Industry Development Corporation Ltd.
36 Keren Hayesod Street
P.O.Box 7285
Jerusalem 71072
Telephone: (02) 561-8211
Facsimile: (02) 561-8217

The Small Business Authority of Israel
29 Hamered Street
Tel Aviv 65811
Telephone: (03) 796-8100
Facsimile: (03) 510-7557

Appendix 7

USEFUL ADDRESSES ABROAD

ANGOLA

Embassy of Israel
Rua Rainka Ngina 34
Edificio Edificio Siccalluanda
Luanda
Telephone: (2) 22-331-501
Facsimile: (2) 22-396-366

ARGENTINA

Embassy of Israel
Ave. de Mayo 701, 10th Floor
1084 Buenos Aires
Telephone: (11) 4338-2500
Facsimile: (11) 4338-2555
E-mail: buenosaires@israel.org

AUSTRALIA

Embassy of Israel
6 Turnna Street
Yarralumla
Canberra, A.C.T. 2600
Telephone: (2) 6215-4500
Facsimile: (2) 6215-4555
E-mail: info@ carrebna .mfa.gov.il

Consulate General of Israel
6th Level, 37 York Street
Sydney NSW, 2000
Telephone: (2) 9262-3943
Facsimile: (2) 9262-5242
E-mail: yendys@israel.org

AUSTRIA

Embassy of Israel
Anton Frankgasse 20
Vienna 1180
Telephone: (1) 4764-6500
Facsimile: (1) 4764-6510
E-mail: info@vannei.israel.gov.il

Permanent Mission of Israel
To the United Nations
Anton Frankgasse 20
Vienna 1180
Telephone: (1) 4764-6500
Facsimile: (1) 4764-6555

AZERBAIJAN

Embassy of Israel
Hyatt tower 3, 7th floor
Izmir st. 1033
Baku
Telephone: (12) 490-7881/2
Facsimile: (12) 490-7892
E-mail: baku@israel.org

BELARUS

Embassy of Israel
Partizanski Prospekt 6A
Minsk 220002
Telephone: (17) 211-4431
Facsimile: (17) 298-4403
E-mail: minsk@israel.org

BELGIUM

Embassy of Israel
40, avenue de l'Observatoire
Brussels 1180
Telephone: (2) 373-5500
Facsimile: (2) 373-5617
E-mail: info@brussels.mfa.gov.il

BOLIVIA

Embassy of Israel
Avenida Mariscal Santa Cruz 2150
Edificio "Esperanza", Piso 10
Casilla No. 1309-1320
La Paz
Telephone: (22) 391-126
Facsimile: (22) 391-712
E-mail: lapaz@israel.org

BRAZIL

Embassy of Israel
Avenida Das Nacoes, Lote 38
Brazilia D.F.
Telephone: (61) 210-50-500
Facsimile: (61) 210-50-555
E-mail: brazilia@israel.org

Consulate General of Israel
Avenida Brigaderio Faria Lima 1713
Sao Paulo SP 01452
Telephone: (11) 3814-5369
Facsimile: (11) 3815-7293
E-mail: saopaulo@israel.org

Consulate General of Israel
Avenida N.S. Copacabana 680/COB
P.O.Box (Caixa Postal) 12353
Rio de Janeiro 22050-000
Telephone: (21) 548-5432
Facsimile: (21) 257-3390
E-mail: rio@israel.org

BULGARIA

Embassy of Israel
1 Bulgaria Square, NDK
Administrative Building, 7^{th} Floor
Sofia 1463
Telephone: (2) 951-5044
Facsimile: (2) 952-1101
E-mail: sofia@israel.org

CAMEROON

Embassy of Israel
P.O.Box 5934
Yaounde
Telephone: 2201-644, 2211-291
Facsimile: 2210-823
E-mail: yaunde@israel.org

CANADA

Embassy of Israel
50 O'Connor Street, Suite 1005
Ottawa, Ontario K1P 6L2
Telephone: (613) 567-6450
Facsimile: (613) 237-8865
E-mail: awatto@israel.org

Consulate General of Israel
180 Bloor Street West, Suite 700
Toronto, Ontario M5S 2V6
Telephone: (416) 640-8500
Facsimile: (416) 640-8555
E-mail: totnoro@israel.org

Consulate General of Israel
1155 Blvd. Rene Levesque W,
Suite 620
Montreal, Quebec H3B 4S5
Telephone: (514) 940-8500
Facsimile: (514) 940-8555
E-mail: mlaertnol@israel.org

CHILE

Embassy of Israel
San Sebastian 2812, Piso 5
Santiago de Chile
Telephone: (2) 750-0500
Facsimile: (2) 750-0555
E-mail: sogaitna@israel.org

CHINA
(PEOPLE'S REPUBLIC OF)

Embassy of Israel
No. 17 tian ze lu chaoyang
districtbeijing
Beijing 100600
Telephone: (10) 8532-0500
Facsimile: (10) 8532-0555
E-mail: info@beijing.mfa.gov.il

Consulate General of Israel
Room 703 New Town Mansion
No. 55 Loushanoguam Road
Shanghai 200335 PRC
Telephone: (21) 6209-8008
Facsimile: (21) 6209-8010
E-mail: shanghai@israel.org.il

Consulate General of Israel
Admiralty Center,
Tower 2, Room 701
G.P.O. Box 245
Hong Kong
Telephone: 2821-7500
Facsimile: 2865-0220
E-mail: hongkong@israel.org

COLOMBIA

Embassy of Israel
Edificio Caxdac
Calle 35, 7-25, Piso 14
Bogota
Telephone: (1) 327-7500
Facsimile: (1) 327-7555
E-mail: bogota@israel.org

COSTA RICA

Embassy of Israel
Edificio Centro Colon
Paseo Colon Calle 38
San Jose C.R.
Telephone: 221-6011/6444
Facsimile: 257-0867
E-mail: sanjose@israel.org

CYPRUS

Embassy of Israel
4 Gripari Street
P.O.Box 25159
Nicosia
Telephone: (22) 369-500
Facsimile: (22) 663-486
E-mail: naisoci@israel.org

CZECH REPUBLIC

Embassy of Israel
Badeniho Street 2
Prague 7, 17000
Telephone: (2) 3309-7500/1
Facsimile: (2) 3309-7529
E-mail: prague@israel.org

DEMOCRAT REPUBLIC OF CONGO

Embassy of Israel
141 Boulevard du 30 Juin
Gombe-Kinshasa
Telephone: 9933-053
Facsimile: 8807-494

DENMARK

Embassy of Israel
Lundevangsvej 4
2900 Hellerup
Copenhagen
Telephone: (45) 8818-5500
Facsimile: (45) 8818-5555
E-mail: copenhaguen@israel.org

DOMINICAN REPUBLIC

Embassy of Israel
Pedro Henriquez Urena 80
Apartado Postal 1404
Santo Domingo
Telephone: (809) 472-0774/5/6
Facsimile: (809) 472-1785
E-mail: santodomingo@israel.org

ECUADOR

Embassy of Israel
12 De Octubre Y Salazar
Quito
Telephone: (2) 2237-474
Facsimile: (2) 2238-055

EL SLAVADOR

Embassy of Israel
Centro Financiero Gigante,
Torre B Piso 63 Avenida Sur Y
Alameda Roosevelt
San Salvador
Telephone: 2211-3434
Facsimile: 2211-3443
E-mail: sansalvador@israel.org

ERITREA

Embassy of Israel
Ogdan Street 32
P.O.Box 5600
Asmara
Telephone: (1) 188-626
Facsimile: (1) 188-550
E-mail: asmara@israel.org

ETHIOPIA

Embassy of Israel
Higher 16 Kebele 22
House No. 283
P.O.Box 1266
Addis Ababa
Telephone: (11) 646-0999
Facsimile: (11) 646-1961
E-mail: addisababa@israel.org

EGYPT

Embassy of Israel
6 Sharia Ibn El-Maleck
Giza
Cairo
Telephone: (2) 361-0528
Facsimile: (2) 361-0414
E-mail: cairo@israel.org

EGYPT (Cont.)

Consulate General of Israel
15 Mina Street
Kafar Abdon Roushdy
Alexandria
Telephone: (3) 544-9501
Facsimile: (3) 544-8136
E-mail: aairdnaxel@israel.org

FINLAND

Embassy of Israel
Yrjonkatu 36A
00100 Helsinki
Telephone: (9) 681-2020
Facsimile: (9) 135-6959
E-mail: hiknisle@israel.org

FRANCE

Embassy of Israel
3 Rue Rabelais
75008 Paris
Telephone: (1) 4076-5500
Facsimile: (1) 4076-5555
E-mail: paris@israel.org

Consulate General of Israel
146 Rue Paradis
Marseilles 13006
Telephone: (4) 9153-3987
Facsimile: (4) 9153-3994
E-mail: mselliesra@israel.org

GEORGIA

Embassy of Israel
61 Agmashenabeli Avenue
Tbilsi 380002
Telephone: (32) 964-457
Facsimile: (32) 955-555
E-mail: info@tbilisi.mfa.gov.il

EUROPEAN UNION

Mission
40, Avenue de L'Observatoire
Brussels 1180
Belgium
Telephone: (2) 373-5500
Facsimile: (2) 373-5617
E-mail: eubrussels@israel.org

FEDERAL REPUBLIC OF GERMANY

Embassy of Israel
Auguste Victoria Strasse 74-75
Berlin 14193
Telephone: (30) 8904-5500
Facsimile: (30) 8904-5555
E-mail: berlin@israel.org

Consulate General of Israel
Simrockallee 2
Postfach 200230
53173 Bonn
Telephone: (228) 934-6500
Facsimile: (228) 934-6555

Israel Trade Center
Widenmayerstrasse 11
80538 Munich
Telephone: (89) 299-880/091
Facsimile: (89) 298-445

Israel Trade Center
24 Hansaring
D-50670 Koln
Telephone: (221) 120-053
Facsimile: (221) 132-169

FEDERAL REPUBLIC OF GERMANY (Cont.)

Consulate General of Israel
'Kailas' 50 G, Deshnukh Marg
Cuballa Hill
Bombay 400026
Telephone: (22) 386-2793/4/5
Facsimile: (22) 387-0963
E-mail: byabmo@israel.org

GREECE

Ebassy of Israel
1 Marathonodromou Street
15452 Paleo Psychico
P.O.Box 65140
Athens
Telephone: (210) 671-9530/1
Facsimile: (210) 674-9510
E-mail: info@athens.mfa.gov.il

GUATEMALA

Embassy of Isarel
13 Avenida 14-07, Zona 10
Colonia Oakland
Guatemala City
Telephone: (502) 2333-4624
Facsimile: (502) 2333-6950

HUNGARY

Embassy of Israel
Fullank Utca 8
1026 Budapest 2
Telephone: (1) 392-6200
Facsimile: (1) 200-0783
E-mail: btsepadu@israel.org

THE HOLY SEE

Embassy of Israel
Via Michle Mercati 12
Rome 00197
Telephone: (6) 3619-8690/1/2
Facsimile: (6) 3619-8626
E-mail: vnacita@israel.org

INDIA

Embassy of Israel
3 Aurangzeb Road
New Delhi 110011
Telephone: (11) 3041-4500
Facsimile: (11) 3041-4555
E-mail: delhi@israel.org

IVORY COAST (COTE D'IVOIRE)

Embassy of Israel
Avenue Chardy
Immeuble Nour-El-Hayat, 9e etage
B.P. 1877
Abidjan 01
Telephone: 2021-4953
Facsimile: 2021-8704
E-mail: abidjan@israel.org

IRELAND

Embassy of Israel
Carrisbrook House
122 Pembroke Road
Ballsbridge
Dublin 4
Telephone: (1) 230-9400
Facsimile: (1) 230-9446
E-mail: info@dublin.mfa.gov.il

ITALY

Embassy of Israel
Via Michle Mercati 14
Rome
Telephone: (6) 3619-8500
Facsimile: (6) 3619-8555
E-mail: info@roma.mfa.gov.il

JAPAN

Embassy of Israel
3 Nibancho, Chiyoda Ku
Tokyo 102-0084
Telephone: (3) 3264-0911
Facsimile: (3) 3264-0832
E-mail: info@tokyo.mfa.gov.il

JORDAN

Embassy of Israel
47 Maysaloun Street
Rabiya
P.O.Box 950866
Amman 11195
Telephone: (6) 550-3500
Facsimile: (6) 552-4689
E-mail: amman@israel.org

KAZAKHSTAN

Embassy of Israel
Dgeltoxan Street 87
Almati
Telephone: (3272) 506-284
Facsimile: (3272) 506-283
E-mail: almaata@israel.org

KENYA

Embassy of Israel
Bishops Road opp. Fair View Hotel
P.O.Box 30354
Nairobi
Telephone: (20) 271-0381
Facsimile: (20) 271-5966
E-mail: niboria@israel.org

REPUBLIC OF KOREA (SOUTH)

Embassy of Israel
18th Fl.Cheonggye 11 Building 149
Seorin-Dong, Jongro-Guseoul 110-726
Seoul
Telephone: (2) 739-8666
Facsimile: (2) 739-8667
E-mail: seoul@israel.org

LATVIA

Embassy of Israel
2 Elizabetes Street
Riga, LV 1340
Telephone: 732-0737/9
Facsimile: 783-0170
E-mail: riga@israel.org

MAURITANIA

Interest Office of Israel,
Spanish Embassy
Nouakchott
Telephone: 5254-610
Facsimile: 5258-235
E-mail: nouakchott@israel.org

MEXICO

Embassy of Israel
Sierra Made 215
P.O.Box 11000
Lomas De Chapultepec
Mexico City (10 D.F.)
Telephone: (55) 5201-1500
Facsimile: (55) 5201-1555
E-mail: mexico@israel.org

MOROCCO

Bureau de Liaison
Boulevard Mehdi Ben-Barka 52
Souissi
Rabat
Telephone: (7) 657-680
Facsimile: (7) 657-683
E-mail: rabat@israel.org

THE UNION OF MYANMAR (BURMA)

Embassy of Israel
15 Khbaung Street
Yangon
Telephone: (1) 515-115
Facsimile: (1) 515-116
E-mail: yangon@israel.org

NEPAL

Embassy of Israel
Bishramalaya House
Lazimpat Street
G.P.O. Box 371
Kathmandu
Telephone: (1) 4411-811
Facsimile: (1) 4413-920
E-mail: info@kathmandu.mfa.gov.il

NETHERLANDS

Embassy of Israel
Buitenhof 47
2513 AH The Hague
Telephone: (70) 376-0500
Facsimile: (70) 376-0555
E-mail: hague@israel.org

NEW ZELAND

Embassy of Israel
6 Turrana Street
Yarralumla, Act, 2600
P.O.Box 2171
Canberra
Telephone: (4) 6215-4500
Facsimile: (4) 6215-4555
E-mail: info@canberra.mfa.gov.il

NIGERIA

Embassy of Israel
636 Adeyemu Alakija Street
Cowrie House, Victoria Island
Lagos
Telephone: (1) 262-0121
Facsimile: (1) 262-0051
E-mail: lagos@israel.org

NORWAY

Embassy of Israel
Parkveien 35
0258 Oslo
Telephone: 2101-9500
Facsimile: 2101-9530
E-mail: oslo@israel.org

OMAN

Israel Trade Representation Office
P.O.Box 194
Aladhaiba
Muscat P.C. 130
Telephone: 604-857
Facsimile: 694-302
E-mail: muscat@israel.org

PANAMA

Embassy of Israel
Edificio Grobman
Calle Manuel Maria Icasa, Piso 5
P.O.Box 6357
Panama City 5
Telephone: 208-4700
Facsimile: 208-4755
E-mail: panama@israel.org

PARAGUAY

Embassy of Israel
Calle Yegros 437 C/25 de Mayo
Edificio San Rafael, Piso 8
P.O.ox 1212
Asuncion
Telephone: (21) 496-043/4, 495-097
Facsimile: (21) 496-355
E-mail: asuncion@israel.org

PERU

Embassy of Israel
Natalio Snachez 125, Piso 6
Santa Beatris
Lima 1
Telephone: (1) 433-4431
Facsimile: (1) 433-8925
E-mail: lima@israel.org

PHILIPPINES

Embassy of Israel
Trafalgar Plaza, 23 Floor
105 H.V. De La Costa Street
Salcedo Village
Manila
Telephone: (2) 894-0441/3
Facsimile: (2) 894-1027
E-mail: manila@israel.org

POLAND

Embassy of Israel
Krzywicikogo 24
Warsaw 02-078
Telephone: (22) 597-0500
Facsimile: (22) 825-1607
E-mail: wasra@israel.org

PORTUGAL

Embassy of Israel
Rua Antonio Enes 16
1000 Lisbon
Telephone: (21) 355-3640
Facsimile: (21) 355-3658
E-mail: lisboa@israel.org

QATAR

Israel Trade Representation Office
15 Al Buhturi Street
P.O.Box 22183
Doha
Telephone: 4689-074
Facsimile: 4685-258
E-mail: doha@israel.org

ROMANIA

Embassy of Israel
B-Dul Dimitrei Cantemir 1
Tronson 2+3, Bucharest 2
Telephone: (21) 318-9416/7
Facsimile: (21) 318-9402
E-mail: tserahcub@israel.org

RUSSIAN FEDERATION

Embassy of Israel
56 Bolshaya Ordynka Street
101000 Moscow
Telephone: (95) 230-6700
Facsimile: (95) 230-6768
E-mail: moscow@israel.org

SENEGAL

Embassy of Israel
3 Place de L'independence
B.P. 2096
Dakar
Telephone: 823-3561
Facsimile: 823-6490
E-mail: dakar@israel.org

SINGAPORE

Embassy of Israel
58 Dalvey Road
Singapore 1025
Telephone: 6834-9200
Facsimile: 6733-7008
E-mail: seropagni@israel.org

SOUTH AFRICAN REPUBLIC

Embassy of Israel
428 Kings Highway Lynnwood
Pretoria
Telephone: (12) 348-5204
Facsimile: (12) 348-4216
E-mail: pretroria@israel.org

State of Israel Trade Center
33 Bath Avenue, Rosebank
Nedbank Gardens, 5th Floor
Johannesburg 2196
P.O.Box 52541
Saxonwold 2132
Telephone: (11) 788-1700/3
Facsimile: (11) 447-3104

SPAIN

Embassy of Israel
Calle Velasquez 150-7
28002 Madrid
Telephone: (91) 782-9500
Facsimile: (91) 782-9555
E-mail: mdirda@israel.org

SWITZERLAND

Embassy of Israel
Alpenstrasse 32
3006 Bern
Telephone: (31) 356-3500
Facsimile: (31) 356-3556
E-mail: bern@israel.org

Permanent Mission of Israel to the United Nations
1-3 Avenue de La Paix 1202
Geneva 1216
Telephone: (22) 716-0500
Facsimile: (22) 716-0555
E-mail: geneva@israel.org

SWEDEN

Embassy of Israel
Torstenssongatan 4
P.O.Box 14006
10440 Stockholm 14
Telephone: (8) 5280-6500
Facsimile: (8) 5280-6555
E-mail: stockholm@israel.org

TAIWAN

Israel Economic and Cultural Office
Suite 2408 24f int`l trade
No. 333 Keelung Road,
Taipei
Telephone: (2) 2757-9692
Facsimile: (2) 2757-7247
E-mail: info@taipei.org.il

THAILAND

Embassy of Israel
"Ocean Tower 2", 25th Floor
75 Sukumvit Soi 19
Bangkok
Telephone: (2) 204-9200
Facsimile: (2) 204-9255
E-mail: info@bangkok.mfa.gov.il

TUNISIA

Israel Interest Office
9 Bis Rue Apulee
Notre Dame
Tunis
Telephone: (1) 795-695
Facsimile: (1) 849-381

TURKEY

Embassy of Israel
Mahatma Gandhi
50K. 85, Gaziosmanpasa
Ankara
Telephone: (312) 446-3605
Facsimile: (312) 446-8071
E-mail: aarakn@israel.org

Consulate General of Israel
Valikonagi Caddesi No. 73
Nisantas
Istanbul
Telephone: (212) 317-6500
Facsimile: (212) 317-6555
E-mail: ilubnatsl@israel.org

UKRAINA

Embassy of Israel
Lesi Ukrainu 34 GPS-S
Kiev 252195
Telephone: (44) 686-1500
Facsimile: (44) 585-1555
E-mail: kiev@israel.org

UNITED KINGDOM

Embassy of Israel
2 Palace Green
London W8 4QB
Telephone: (20) 795-79500
Facsimile: (171) 795-9555
E-mail: info@london.mfa.gov.il

UNITED STATES OF AMERICA

Embassy of Israel
3514 International Drive NW
Washington DC 20008
Telephone: (202) 364-5500
Facsimile: (202)-364-5607
E-mail: washington@israel.org

UNITED STATES OF AMERICA (Cont.)

Consulate General of Israel
111 E. Wacker Drive, Suite 1308
Chicago, IL 60601
Telephone: (312) 297-4800
Facsimile: (312) 297-4855
E-mail: chicago@israel.org

Consulate General of Israel
24 Greenway Plaza, Suite 1500
Houston, TX 77046
Telephone: (713) 627-3780
Facsimile: (713) 627-0149
E-mail: houston@israel.org

Permanent Mission to the UN, Consulate General
800 second Avenue
New York, NY 10017
Telephone: (212) 499-5400
Facsimile: (212) 499-5555
E-mail of permanent mission:
un@israel.org
E-mail of consulate:
newyork@israel.org

Consulate General of Israel
230 South 15th Street
Philadelphia, PA 19102
Telephone: (215) 546-5556
Facsimile: (215) 545-3986
E-mail: paihpledalih@israel.org

Consulate General of Israel
1100 Spring Street NW, Suite 440
Atlanta, GA 30309-2823
Telephone: (404) 487-6500
Facsimile: (404) 487-6555
E-mail: aatnalt@israel.org

Consulate General of Israel
20 Park Plaza, Suite 1020
Boston, MA 02116
Telephone: (617) 535-0200
Facsimile: (617) 535-0255
E-mail: boston@israel.org

URUGUAY

Embassy of Israel
Bulevar Artigas 1585/89
Montevideo
Telephone: (2) 400-4164
Facsimile: (2) 409-5821
E-mail: moedivetno@israel.org

VENEZUELA

Embassy of Israel
Avenida Francisco de Miranda
Centro Empresarial Miranda
Piso 4 Oficina D Los Ruices
Caracas
Telephone: (212) 239-4510/1
Facsimile: (212) 239-4320
E-mail: caracas@israel.org

VIETNAM

Embassy of Israel
68 Nguyen Thai Hoc
P.O.Box 003
Hanoi
Telephone: (4) 8433-3140/1/2/3
Facsimile: (4) 8435-5760
E-mail: info@Hanoi.mfa.gov.il

Consulate General of Israel
456 Montgomery Street, Suite 2100
San Francisco, CA 94104
Telephone: (415) 398-8885
Facsimile: (415) 398-8589
E-mail: sanfrancisco@israel.org

REPUBLIC OF USBEKHISTAN

Embassy of Israel
3 A. Kahhar Street
Tashkent
Telephone: (71) 120-5808/9
Facsimile: (71) 120-5812
E-mail: tnekhsat@israel.org

FEDERAL REPUBLIC OF YUGOSLAVIA

Embassy of Israel
Bulevar Mira 47
Dedinje Beograd
Belgrad 11070
Telephone: (11) 367-2400
Facsimile: (11) 367-0304

ZIMBABWE

Embassy of Israel
Three Ancor House, 6th floor
54 Jason Mayo Ave.
P.O.Box CY3191, Causeway
Harare
Telephone: (4) 756-808
Facsimile: (4) 756-801
E-mail: herara@israel.org

Appendix 8

BDO INTERNATIONAL

INTERNATIONAL OFFICE:

Boulevard De La Woluwe 60
B-1200 Brussels
Belgium

Telephone: 32-2-778-0130
Facsimile: 32-2-778-0143

Website: http://www.bdoglobal.com
E-mail: bdoglobal@bdoglobal.com

WORLDWIDE OFFICES (MEMBER FIRMS ONLY)

Argentina
Australia
Austria
Bahamas
Bahrain/Qatar
Belgium
Bolivia
Brazil
British Virgin Islands
Cayman Islands
Bulgaria
Canada
Chile
China (PRC)
Colombia
Croatia
Cyprus
Czech Republic
Denmark
Dominican Republic
Ecuador
Egypt
El Salvador
Estonia
Fiji
Finland
France
Germany
Gibraltar
Greece
Guatemala
Guernsey
Hong Kong (Macao)
Hungary
India
Indonesia
Ireland
Isle of Man
Israel
Italy
Jamaica
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Peru
Philippines
Poland
Portugal
Angola
Mozambique
Cape Verde
Romania
Russia
Saudi Arabia
Senegal
Serbia
Singapore
Slovak Republic
Slovenia
South Africa
Botswana
Zambia
Spain
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Suriname
Sweden
Switzwerland
Liechtenstein
Taiwan
Thailand
Trinidad & Tobago
Tunisia
Turkey
Turkmenistan
Ukraine
UAE
United Kingdom
United States of America
Uruguay
Vanuatu
Venezuela
Vietnam
Zimbabwe