

LEGAL UPDATE – MAY 2012

NEW REGULATIONS UNDER THE RESEARCH & DEVELOPMENT LAW – CEILING FOR PAYMENTS IN THE EVENT OF TRANSFER OF TECHNOLOGY OUTSIDE OF ISRAEL

On May 4, 2012, the Finance Committee of the Knesset approved new Regulations for Encouragement of Research and Development in Industry (Ceiling for Payments in connection with Transfer of Know-How Pursuant to Section 19B(b)(1) and (2) of the Law), 5762-2012 (the “**Regulations**”). The Regulations were enacted pursuant to Section 19B(b1) of the Law for Encouragement of Research and Development in the Industry, 5744-1984 (the “**R&D Law**”), which authorized the Ministers, subject to the approval of the Finance Committee, to set a maximal amount for payments under Section 19B(b)(1) and (2) of the R&D Law.

The Regulations provide for a maximum payment amount with respect to the transfer outside of Israel of know-how developed under OCS funded programs (the “**Know-How**”), in connection with the sale of the Know-How and/or the company holding such Know-How, pursuant to Sections 19B(b)(1) and (2) of the R&D Law.

The ceiling was determined in order to increase the certainty among companies that received or will receive funding from the Office of the Chief Scientist in the Ministry of Industry, Trade and Labor (the “**OCS**”) and potential acquirers of those companies. In addition, a reduced ceiling was introduced for cases where the research and development activities of the Israeli companies will remain in Israel following the acquisition, in order to incentivize potential acquirers to maintain those activities in Israel.

General Background – Overseas Transfer of Know-How Under the R&D Law

The R&D Law restricts the overseas transfer of Know-How, unless permitted under Section 19B of the R&D Law.

Pursuant to Section 19B, the Research Committee of the OCS is authorized, in its discretion, to approve overseas transfer of Know-How in connection with the acquisition of the Know-How and/or a company that received OCS funding, as a result of which the company “ceases to be a legal entity incorporated in Israel” (the “**Acquired Company**”), subject to payment to the OCS in accordance with the formulas set forth in the R&D Law. In general, the amount payable is the greater of:

- (a) the amount of grants received from the OCS, plus annual interest, less royalties previously paid to OCS; or
- (b) an amount calculated on the basis of the OCS percentage of the aggregate investments, as follows:
 - (i) Know-How Transaction: An amount equal to the sales price of the Know-How multiplied by a fraction calculated on the basis of the percentage of the OCS grants out of the total investments in the Know-How.
 - (ii) Acquisition of the Acquired Company: An amount equal to the sales price of the Acquired Company multiplied by a fraction calculated on the basis of the percentage

of the OCS grants out of the total R&D investments in the Acquired Company.

The amounts under this section (b) are subject to depreciation on the basis of the number of years that have passed since the OCS supported project was completed as set forth in Section 19B(g) of the R&D Law and the regulations promulgated thereunder.

Prior to the adoption of the Regulations, depending on the nature of the acquisition transaction the maximum amounts payable under the above formulae were often unknown until the consummation of the acquisition and determination of the payment amount by the OCS, a situation that created considerable uncertainty in acquisition transactions.

The New Regulations

Ceiling for Payment in the event of Transfer of Know-How under Section 19B(b)(1) and (2) of the R&D Law. Pursuant to the new Regulations, the maximum amount payable to the OCS upon *transfer of Know-How* shall be limited to six (6) times the amounts granted by the OCS with respect to the Know-How under all applicable OCS programs, plus annual interest. If the Know-How is transferred in the course of the acquisition of the Acquired Company, the maximum payment amount would be limited to six (6) times the OCS grants received by the Acquired Company, plus annual interest.

Reduced Ceiling if R&D Activities Remain in Israel. In cases where the acquirer makes a commitment to maintain the research and development activities in Israel even following the transfer of Know-How, the Research Committee of the OCS may approve a lower payment ceiling equal to three (3) times the aggregate amounts received from the OCS in connection with the Know-How plus annual interest. If the Know-How is transferred in the course of the acquisition of the Acquired Company, the maximum repayment amount would be limited to three (3) times the OCS grants received by the Acquired Company, plus annual interest. The Research Committee may require appropriate security to guarantee full payment if the acquirer fails to comply with its undertaking to continue R&D activities in Israel.

In order to be entitled to the reduced ceiling, at least 75% of R&D-related positions in the Acquired Company during the six month period prior to the application for the transfer of Know-How must be maintained for at least three years from the date the transfer of Know-How overseas is approved.

If the payment amount under the formulas of Section 19B(b)(1) and (2) to the R&D Law is lower than the new ceiling amount, payment will be in accordance with the formulas set forth in those sections, as detailed above.

Additional Information – Contact Details

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