Israel

Financial Assistance

IBA Corporate and M&A Law Committee 2022

Contact

Mayer Winkler
Barnea Jaffa Lande & Co Law Offices, Tel Aviv
mwinkler@barlaw.co.il

Contents

INTRODUCTION

This article sets out an overview of Israel's laws and regulations addressing financial assistance to both private and public companies.

GENERAL OVERVIEW

What should be understood as financial assistance under Israeli law?
Israel's Companies Law, 5759-1999 (the Companies Law) defines financial assistance as being the direct or indirect grant of funding by a company for the purchase of its own shares, including a grant by a subsidiary or any corporate body controlled by it.

Such a grant is grouped together with a dividend distribution, and both are considered to be a distribution under the Companies Law. An indirect grant of funding will typically preclude a company from providing even support to obtain funding – such as a guarantee or security.

Is financial assistance allowed under Israeli law?
Since 'financial assistance' is considered to be a distribution, it is governed by the same rules relating to a dividend distribution. The Companies Law prescribes that a company may carry out a distribution if two criteria are met:

- *the profit test:* the distribution must be produced out of the profit balance or profits accrued by the company in the previous two years, whichever is greater; and
- *the solvency test:* this examines whether there is a reasonable concern that the distribution may prevent the company from being capable of paying its existing and foreseeable debts.

While the profit test is a retrospective quantitative test, which is relatively easy to perform, the solvency test is a prospective qualitative test whose performance is more detailed and subject to the judgement of the company's board of directors.

Any distributions that are not compliant with these tests are considered unlawful distributions.

Solutions or ways to avoid the distribution tests
Section 303 of the Companies Law provides that, even if the company does not meet the profit test, the company may still make a distribution subject to the court's approval – provided that the company meets the solvency test.

This route is tested and grants certainty to a company, but it is often impractical because of the length of time it takes to obtain court approval.

An alternative solution to achieve the same result is to use a reverse triangular merger, whereby the leveraged buyout-related debt is undertaken by a special purpose vehicle (SPV). The SPV is then absorbed, together with the debt, into the target company. Because the target company has not provided any financial assistance directly or indirectly, and as long as the court has sanctioned the entire merger process, it is arguable that the limitations on financial assistance are not applicable.

CONSEQUENCES OF PROVIDING FINANCIAL ASSISTANCE

What are the consequences of providing financial assistance?

In the event it is determined that an unlawful distribution was made, the shareholder that received the distribution is required to return the entire distribution, unless it is established that the shareholder did not know and could not have known in the exercise of reasonable diligence that the distribution was unlawful.

Further, anyone who was a director at the time of the distribution is deemed to have breached their fiduciary obligations, unless they have met certain criteria established by law, and such breaches are not able to be indemnified or insured against. The company that made the unlawful distribution would also be subject to derivative claims made by a creditor of the company.

Lastly, tax considerations will need to be taken into account in any funding or deal structure, but these are beyond the scope of this article.