

## **U.S. FEDERAL INCOME TAX CONSIDERATIONS**

The following is a summary of the principal U.S. federal income tax consequences to U.S. Holders (as defined below) of ADRs who hold such securities as capital assets. For purposes of this summary, a "U.S. Holder" means a holder of an ADR that is:

- a citizen or resident of the United States;
- a corporation (or another entity taxable as a corporation for U.S. federal income tax purposes) created or organized in the United States or under the laws of the United States or any political subdivision thereof;
- a trust, if a U.S. court is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or, if the trust was in existence on August 20, 1996, and has elected to continue to be treated as a U.S. person; or
- a person whose worldwide income or gain is otherwise subject to U.S. federal income tax on a net income basis.

This summary of United States income tax laws is based on the United States Internal Revenue Code (the "Code"), its legislative history, existing and proposed regulations thereunder, judicial decisions and published positions of the Internal Revenue Service, all as of the date of this annual report and all of which are subject to change (including changes in interpretation), possibly with retroactive effect.

The discussion set forth below is intended only as a summary of the principal U.S. federal income tax consequences to U.S. Holders of ADRs and does not purport to be a complete analysis of all potential tax consequences of owning ADRs. In particular, this discussion does not take into account the specific circumstances of any particular investor (such as tax-exempt entities, certain insurance companies, broker-dealers, investors subject to the alternative minimum tax, investors that actually or constructively own 10% or more of the voting securities, investors that hold ordinary shares or ADRs as part of a straddle or hedging or conversion transaction, or investors whose functional currency is not the U.S. dollar), some of which may be subject to special rules. Investors are advised to consult their tax advisors with respect to the tax consequences of the ownership of ADRs, including the consequences under applicable state and local law and federal estate tax law, and the application of foreign laws or the effect of nonresident status on U.S. taxation.

### **Holder for U.S. Federal Income Tax Purposes**

For purposes of the Code, a holder of ADRs will be treated as the beneficial owner of the underlying ordinary shares represented by the ADRs.

### **Taxation of Dividends**

The amount of any distribution paid to a U.S. Holder, including any Israeli taxes withheld from the amount of such distribution, will be subject to U.S. federal income taxation as ordinary income to the extent paid out of current or accumulated earnings and profits, determined for U.S. federal income tax purposes. Special rules apply, however, to dividends paid to individuals with respect to taxable years beginning on or before December 31, 2008. Such dividends are eligible for taxation at the rates generally applicable to long-term capital gains for individuals (currently at a maximum rate of 15%), provided that

the individual receiving the dividend satisfies certain holding period and other requirements with respect to the ADRs. Dividends subject to these special rules are not actually treated as capital gains, however, and thus are not included in the computation of an individual's net capital gain and generally cannot be used to offset capital losses. The amount of any distribution of property other than cash will be the property's fair market value on the date of the distribution. To the extent that an amount received by a U.S. Holder exceeds that U.S. Holder's allocable share of current and accumulated earnings and profits, such excess will be applied first to reduce that U.S. Holder's tax basis in the shares and then, to the extent the distribution exceeds that U.S. Holder's tax basis, will be treated as capital gain. Any dividend received will not be eligible for the dividends-received deduction generally allowed to U.S. corporations in respect of dividends received from U.S. corporations.

U.S. Holders may claim the amount of any Israeli income taxes withheld as either a deduction from gross income or as a dollar-for-dollar credit against their U.S. federal income tax liability. Individuals who do not claim itemized deductions but instead utilize the standard deduction may not claim the amount of the Israeli income taxes withheld as a deduction from their gross income, but such amounts may be taken as a credit against the individual's U.S. federal income tax liability. The Code sets forth complex limitations on the amount of the credit, which varies in application from taxpayer to taxpayer. These limitations include rules which limit foreign tax credits allowable for specific classes of income to the amount of U.S. federal income taxes otherwise payable on each class of income. The total amount of allowable foreign tax credits in any year may not exceed the pre-credit U.S. tax liability for the year attributable to foreign source taxable income. However, pursuant to a *de minimis* exception, certain individuals may claim a credit of up to \$300 (\$600 for joint filers) without being subject to these limitations.

U.S. tax law provides that foreign tax credits are not allowed for withholding taxes imposed in respect of short-term or hedged positions in securities or in respect of arrangements in which a U.S. Holder's expected economic benefit, after non-U.S. taxes, is insubstantial. U.S. Holders should consult their tax advisors concerning the application of these rules in light of their particular circumstances.

#### **Taxation of the Disposition of ADRs**

Upon the sale or exchange of ADRs, a U.S. Holder will generally recognize capital gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized and the U.S. Holder's tax basis in the ADRs. There are different tax rates that may apply depending upon the date of sale, the holding period and the individual's marginal rate of tax. In general, the capital gain of a non-corporate U.S. Holder is subject to tax at ordinary rates for ADRs held for one year or less and to a maximum tax rate of 15% for ADRs held for more than one year.

The surrender of ADRs in exchange for ordinary shares, or vice versa, will not be a taxable event for U.S. federal income tax purposes, and U.S. Holders will not recognize any gain or loss upon such an exchange.

## **U.S. Information Reporting and Backup Withholding**

A U.S. Holder generally will be subject to information reporting with respect to dividends paid on, or proceeds from the sale or other disposition of, an ADR unless the U.S. Holder is a corporation or comes within another category of exempt recipients. If it is not exempt, a U.S. Holder may also be subject to backup withholding with respect to dividends or proceeds from the sale or disposition of an ADR unless a taxpayer identification number is provided and the other applicable requirements of the backup withholding rules are complied with. Any amount withheld under these rules will be creditable against the U.S. Holder's U.S. federal income tax liability or refundable to the extent that it exceeds this liability, provided that the required information is furnished to the Internal Revenue Service.

U.S. Holders should review the summary below under "Israeli Taxation" for a discussion of the Israeli taxes which may be applicable to them.

## **ISRAELI TAXATION**

### **Corporate Tax Rate**

The regular corporate tax rate in Israel is 36% for undistributed earnings. However, Teva's effective consolidated tax rates (before deduction of one-time charges) for the years ended December 31, 2001, 2002 and 2003 were 19.6%, 17.0% and 20.8%, respectively, since part of Teva's income is derived from Approved Enterprises (as discussed below) and operations outside of Israel, where Teva has enjoyed lower tax rates.

### **Law for the Encouragement of Industry (Taxes), 1969 (the "Industry Encouragement Law")**

Teva and certain of its Israeli subsidiaries currently qualify as Industrial Companies pursuant to the Industry Encouragement Law. As such, Teva and these subsidiaries qualify for certain tax benefits, including a deduction of 12.5% per annum of the purchase price of a good-faith acquisition of a patent or of certain other intangible property rights and the right to file consolidated tax returns. Currently, Teva files consolidated tax returns together with certain Israeli subsidiaries. The tax laws and regulations dealing with the adjustment of taxable income for local inflation provide that industrial enterprises such as those of Teva and its subsidiaries which qualify as Industrial Companies can claim special rates of depreciation such as up to 40% on a straight line basis for industrial equipment.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any government authority. Teva cannot assure you that Teva or any of its Israeli subsidiaries that presently qualify as "Industrial Companies" will continue to qualify as such in the future, or that the benefits will be granted in the future.

### **Law for the Encouragement of Capital Investments, 1959 (the "Investment Law")**

Industrial projects of Teva and certain of its Israeli subsidiaries have been granted the status of an "Approved Enterprise" under the Investment Law. This law provides that capital investments in production facilities may, upon application to the Israel Investment Center, be designated as an Approved Enterprise. Each certificate of approval for an Approved Enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, i.e., the equipment to be purchased and utilized pursuant to the program. The tax benefits derived from any such certificate of approval relate only to taxable profits attributable to the specific program, based upon criteria set in the certificate of approval. In addition, certain financial

benefits are available (as discussed below). In the event that Teva and its subsidiaries which have been granted Approved Enterprise status are operating under more than one approval or that their capital investments are only partly approved (a "Mixed Enterprise"), their effective corporate tax rate will be the result of a weighted combination of the various applicable rates.

Income derived from an Approved Enterprise is subject to a tax rate of 25%, rather than the usual rate of 36%, for a period of seven years, commencing with the year in which the Approved Enterprise first generates taxable income. This period cannot extend beyond 12 years from the year of commencement of operations or 14 years from the year in which approval was granted, whichever is earlier.

Teva is a "Foreign Investors Company" ("FIC"), as defined by the Investment Law, and is entitled to further reductions in the tax rate normally applicable to Approved Enterprises. Because its current level of foreign ownership is more than 49%, its Approved Enterprise income is taxable at a 20% rate. The period of such benefit is ten years, commencing with the year in which the Approved Enterprise first generates taxable income. This ten-year period cannot extend beyond 12 years from the year of commencement of operations or 14 years from the year in which approval was granted, whichever is earlier. Unless extended, benefits under the Investment Law are granted to enterprises seeking approval not later than June 30, 2004. Teva cannot assure you that it will continue to qualify as an FIC in the future, or that the benefits will be granted in the future.

Most of the projects of Teva and certain of its subsidiaries were granted Approved Enterprise status for which the companies elected to apply for alternative tax benefits – waiver of grants in return for tax exemptions on undistributed income. Upon distribution of such exempt income, the distributing company will be subject to corporate tax at the rate ordinarily applicable to the Approved Enterprise's income. Such tax exemption on undistributed income is for a period limited to two to ten years, depending upon the location of the enterprises. During the remainder of the benefits period (until the expiration of ten years), a corporate tax rate of 20% as above will apply.

Dividends paid by companies owning Approved Enterprises, the source of which is income derived from an Approved Enterprise during the benefits period, are generally taxed at a rate of 15% (which is withheld and paid by the company paying the dividend) if such dividends are paid during the benefits period or at any time up to 12 years thereafter. The 12-year limitation does not apply to a FIC.

#### **Taxation of Non-Israeli Subsidiaries**

Non-Israeli subsidiaries are generally taxed based upon tax laws applicable in their countries of residence.

#### **Income Taxes on Dividends Distributed by Teva to Non-Israeli Residents**

Dividends distributed by an Israeli company to non-Israeli residents are subject to a 25% tax to be withheld at source (15% in the case of dividends distributed from the taxable income attributable to an Approved Enterprise), unless a different rate is provided in a treaty between Israel and the shareholder's country of residence.

Under the U.S.-Israel Tax Treaty, the maximum Israeli tax and withholding tax on dividends paid to a holder of ordinary shares who is a resident of the United States is generally 25%, but is reduced to 12.5% if the dividends are paid to a corporation that holds in excess of 10% of the voting rights of Teva during Teva's taxable year preceding the distribution of the dividend and the portion of Teva's taxable year in which the dividend was distributed. Dividends of an Israeli company derived from

the income of an Approved Enterprise will still be subject to a 15% dividend withholding tax; if the dividend is attributable partly to income derived from an Approved Enterprise, and partly to other sources of income, the withholding rate will be a blended rate reflecting the relative portions of the two types of income. The withheld tax is the final tax in Israel on dividends paid to non-residents who do not conduct a business in Israel. The current rate of tax withheld on the dividend is 21%.

A non-resident of Israel who has interest or dividend income derived from or accrued in Israel, from which tax was withheld at the source, is generally exempt from the duty to file tax returns in Israel in respect of such income, provided such income was not derived from a business conducted in Israel by the taxpayer.

#### **Capital Gains and Income Taxes Applicable to Non-Israeli Shareholders**

Israeli law generally imposes a capital gains tax on the sale of securities and any other capital asset. The basic capital gains tax rate applicable to corporations effective until December 31, 2002 had been 36%, and the maximum tax rate for individuals was 50%. Effective January 1, 2003, the capital gains tax rate imposed upon sale of capital assets acquired after that date was reduced to 25%; capital gains realized from assets acquired before that date are subject to a blended tax rate based on the relative periods of time before and after that date that the asset was held.

In addition, if the ordinary shares are traded on a recognized stock exchange (including the Tel Aviv Stock Exchange and the NASDAQ), gains on the sale of ordinary shares held by non-Israeli tax resident investors will generally be exempt from Israeli capital gains tax. Notwithstanding the foregoing, dealers in securities in Israel are taxed at regular tax rates applicable to business income.

The U.S.-Israeli Tax Treaty exempts U.S. residents who hold an interest of less than 10% in an Israeli company, including Teva, and who held an interest of less than 10% during the 12 months prior to a sale of their shares, from Israeli capital gains tax in connection with such sale. Certain other tax treaties to which Israel is a party also grant exemptions from Israeli capital gains taxes.

#### **Recent Tax Reform Legislation**

In July 2002, the Israeli Parliament approved a law introducing extensive changes to Israel's tax law generally effective January 1, 2003. Among the key provisions of this reform legislation are (1) changes which may result in the imposition of taxes on dividends received by an Israeli company from its foreign subsidiaries; and (2) the introduction of the controlled foreign corporation concept according to which an Israeli company may become subject to Israeli taxes on certain income of a non-Israeli subsidiary if the subsidiary's primary source of income is passive income (such as interest, dividends, royalties, rental income or capital gains). An Israeli company that is subject to Israeli taxes on the income of its non-Israeli subsidiaries will receive a credit for income taxes paid by the subsidiary in its country of residence.

**DOCUMENTS ON DISPLAY**

Teva files annual and special reports and other information with the SEC. You may inspect and copy such material at the public reference facilities maintained by the SEC, 450 Fifth Street, N.W., Washington, D.C. 20549. You may also obtain copies of such material from the SEC at prescribed rates by writing to the Public Reference Section of the SEC, 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room.

The SEC maintains an Internet website at <http://www.sec.gov> that contains reports, proxy statements, information statements and other material that are filed through the SEC's Electronic Data Gathering, Analysis and Retrieval ("EDGAR") system. Teva began filing through the EDGAR system beginning on October 31, 2002.

Teva's ADRs are quoted on the NASDAQ National Market. You may inspect reports and other information concerning Teva at the offices of the National Association of Securities Dealers, Inc., 1735 K Street, N.W., Washington, D.C. 20006.

Information about Teva is also available on its website at <http://www.tevapharm.com>. Such information on its website is not part of this annual report.