Equity and Heter Iska: When is it Not Allowed?

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Case: A person was offered an opportunity to invest in a start-up company for $2o0,000, for which he would receive a 5% annual return using a *heter iska* as well as 20% equity in the company.
Question: Would such an agreement pose a halachic problem of *ribbis*?
Answer: This scenario does indeed pose a problem of *ribbis,* and a typical *heter iska* does not even help to avoid *ribbis* in this situation. In order to understand why, let us first present a brief description of how a *heter iska* works.

A true investment is one where the investor gives the money over to another person for managerial purposes but the money still belongs to the investor. Therefore, the gains or losses are those of the investor, not of the manager. In contrast, in the case of a loan, the lender has full security from the borrower that the money will be paid back regardless of what is done with the money.

Since most investments come with full security for the investor such that he is guaranteed his money will be returned, an investment should have the status of a loan, which creates a problem with any profit received by the investor, which would be considered like interest. The *heter iska* avoids this by stating that if a loss occurs, it must be verified by two kosher witnesses; otherwise, the manager must still return the money to the investor. Since most losses are not easily verified by two kosher witnesses, the investor can still receive his money back while retaining the status of an investor who can potentially suffer losses.

In addition, we must also ensure that real profits are relevant to maintain the status of the investment as such, rather than as a loan with full security. Therefore, the *heter iska* instructs the manager to take a *shevua de'oraisa* if there is no gain, but the *shevua* is abolished if the manager pays the amount of the investment. Thus, even in a case where there is no true profit, the *heter iska* allows the manager to return the money since a *shevua de'oraisa* was not taken to confirm the lack of a profit.

An additional issue that is addressed by the *heter iska* is the question of the manager doing work for the investor. This also presents a *ribbis* problem, since the work itself could be viewed as interest given by the manager to the investor in addition to returning the money itself. To solve this problem, it is customary for the investor to give a dollar beforehand to the manager that serves as payment for the work done.

In the question raised above, a *heter iska* would not be effective, since the investor is receiving the 20% equity in the company **at the time** of the investment. A *heter iska* though cannot take effect on profit received at the time of the investment. The reason is that the idea of the agreement is only that a return received later can be classified as a profit rather than payment for a loan, but profit received at the time of the agreement can only be classified as interest, as no profit has yet been made.

The Bris Yehuda (a contemporary *sefer* on the laws of *ribbis* written by Rav Yeshaya Blau) notes that the same issue occasionally arise with banks in Eretz Yisrael, which are generally owned by Jews and require a *heter iska* in order to operate halachically. He says that any time the bank offers a promotion that a new customer will receive a special benefit, the *heter iska* would not cover this, since it is a profit that is received initially at the beginning of the agreement, and a ***heter iska* only allows profits at a later point**.