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## Encouraging R&D and IP Asset Retention Remains the Trend in Israel

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**Israel ascribes much importance to the innovation and creation of intellectual property assets intended to remain within Israel's borders, advance its industry and create jobs and livelihoods for the country's citizens. Encouraging research and development is one way of encouraging such innovation. Some of the ways to encouraging R&D and the retention of intellectual property assets in Israel is by amending relevant laws or providing benefits and incentives. Below you will find details about major changes recently made in this regard.**

### **Tax Relief for Technology Enterprises**

Several developments have taken place in recent years in order to encourage expanding research and development, by putting in place significant tax breaks on capital derived from research and development in Israel.

At the end of 2016, amendment no. 73 to the Encouragement of Capital Investment Law was made law and recognizes for the first time on record Israel's knowhow-rich industry as one of its most important engines of growth. The amendment encourages the expansion of research and development in Israel by introducing major tax breaks specific to tech establishments, which make up part of Israel's knowhow-rich industry.

This amendment was followed by the Encouragement of Capital Investment Regulations (Preferred Income from Technology and Capital Gain for Technology Enterprises), which were signed into law in 2017 and govern how the law's amendment is to be applied while, among other things, setting down rules for calculating income from knowhow generated in Israel (or technology income) which would be entitled to tax relief<sup>[1]</sup>.

### **Authorizing use abroad of knowhow developed under Innovation Authority-funded program**

In May 2017 the Innovation Authority (formerly the Office of Chief Scientist) in Israel's Ministry of Science and Technology published new directives for authorizing the use outside of Israel of knowhow produced as part of an Innovation Authority program; the directives also relate to royalties for such permission and the rules governing their payment.

The biggest change in these directives is that an entity participating in an Innovation Authority-funded program may be permitted to use, outside of Israel, knowhow brought about by government-backed research and development. The directives prescribe that this permission is subject to approval by a research committee for the Innovation Authority and may be granted on the condition that **it does not concern**: (1) a right to use a product developed under such program or (2) misappropriation of the Israeli

company's knowhow (including via ownership transfer) – all subject to payments and royalties specified in the directives.

Derestricting the authorization of use and transfer of knowhow from an Innovation Authority-funded program to outside of Israel could increase, rather significantly, collaboration with the Innovation Authority and encourage researching and developing knowhow within Israel while at the same time easing the concern of knowhow being transferred abroad for business needs and so forth.

### **Authorizing use by multinational company of knowhow developed under Innovation Authority-funded program**

At the end of August 2018 the Innovation Authority issued directives for authorizing use of knowhow abroad, including a special track laid out for permitting Israeli multinational companies and Israeli companies held by such companies to use developed knowhow financed by the Innovation Authority for the needs of multinational companies or companies owned only by them.

The new directives define a multinational company as a company (which is not registered in Israel as a foreign company) whose annual consolidated revenue exceed two billion US dollars for the calendar year preceding the date the request was submitted to transfer the knowhow by granting authorization under the new directives.

The research committee may approve the transfer of knowhow to a multinational company when it is convinced that the permission granted neither restricts nor harms the financing entity's activity and that the exceptional return the Israeli economy stands to gain from granting approval would be considerably higher than had such authorization not been granted. Approval is subject to payment of royalties from all revenue resulting from such permission[2].

These new directives provide for, among others, the use of knowhow developed in this manner, which the government encourages, as well as the registration and retention of intellectual property in Israel.

### **Israel Tax Authority's new track for changing company ownership structure without tax liability**

Last but not least, on 2 October 2018 Israel's Tax Authority announced the start of a new shortened, expedited procedure (known in Israel as the 'green track') for cases when an Israeli company's shareholders seek to change the company ownership structure such that their holdings in the company will be through a foreign company. Subject to satisfying certain conditions,[3] the change in ownership structure will not be taxed on the date it was performed, but rather at a deferred date.

The tax deferral is specified as possible when changes to a company's ownership structure bear no economic realization inherently justifying tax liability since the company would, in fact, not be transferring assets, activity and/or intangible assets abroad; the tax due is deferred until the date of realization[4].

The purpose of the break is, among other reasons, to encourage starting Israeli companies, investing in Israeli companies, and performing various transactions while **keeping the knowhow, assets and intellectual property in Israel.**

The new track, for instance, relieves entrepreneurs from having to make a decision regarding the company's place of incorporation and provides them with favorable conditions beforehand should they wish in the future to transfer the company's ownership abroad, for business purposes such as finding investors/raising foreign capital, regulatory environment for public offerings and others.

Additionally, many companies maintain research and development in Israel, yet their intellectual property

is registered abroad. The green track, which encourages retaining assets in Israel, would also make way for the Israeli economy to profit from paying tax on a company's knowhow, viz. intellectual property, which could yield considerable return.

The position of Israel's Tax Authority is that opening this route is particularly important in view of the global trend in capital availability, increase in investments and changes in tax policies for attracting/preserving investment and capital. The 2017 US tax reform similarly encourages Americans to invest in US companies by imposing higher taxes on Americans investing in foreign companies<sup>[5]</sup>.

The above makes it markedly safe to conclude that the Israeli lawmaker and the authorities responsible for spurring innovation in Israel are aware of the need to give relief and incentives for building and retaining intellectual property in Israel, from all angles. Time will tell whether the legislation, procedures and adjustments made in Israel will indeed deliver the long awaited-for change. We will continue to follow and report on the developments in these areas.

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[1] Accountant and attorney Daphna Gilat wrote [a newsletter on the changes to the Encouragement of Capital Investment Law and the respective regulations](#), published on our website on 24 May 2017.

[2] Importantly, the committee's approval does not exempt the one receiving approval from paying royalties to the Innovation Authority in accordance with section 21 of the Encouragement of Capital Investment Law and the provisions of the Innovation Authority's Incentive Track 1 - R&D Funding.

[3] For example, the foreign company to which the holding is transferred will be a resident of a country Israel has a tax treaty with, Israel preserves its tax rights, and so forth.

[4] The green track prescribes that the holders of rights in an Israeli company, who are transferring all of the rights to a company in a country with which Israel has a tax treaty, in exchange for allocation of shares only in the absorbing company, in accordance with the provisions of section 104B(a) of the Income Tax Ordinance (New Version), 5721-1961, shall not be charged tax under the Ordinance at the time of full transfer of the rights in the transferred asset, except on the date the asset is realized (i.e. the date the transferred rights are sold either by the foreign company or indebted rights holders).

[5] [https://taxes.gov.il/About/SpokesmanAnnouncements/Pages/Ann\\_021018\\_1.aspx](https://taxes.gov.il/About/SpokesmanAnnouncements/Pages/Ann_021018_1.aspx)

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