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Global Tax Alert

Israel expands its Innovation Box Regime to pharmaceutical companies

On 1 July 2019, the Israeli Finance Minister published a Tax Order (the Order) which essentially broadens the applicability of Israel's intellectual property (IP) preferential tax regime (the Israeli Innovation Box Regime). The Order specifically expands the definition of a qualifying IP asset to also include products registered under the Israeli Pharmaceutical Ordinance or approved by foreign compatible laws. Where prior to the Order, pharmaceutical companies could only have had access to the IP tax incentives with respect to patented products, this development widens the applicability of the law to also include certain products (either patented or not) which are approved by the health regulators in Israel or in other countries. The Order entered into force retroactively for the 2019 tax year.

The Order amended the 2017 Israeli Innovation Box Regime which can provide for a 6% corporate tax rate on certain IP-based income and on capital gains from the future sale of the IP, as well as a 4% withholding tax rate for dividend distributions.[1] In the commentary of the Order, the Finance Minister emphasized that as part of Israel's commitment to the Organisation for Economic Co-operation and Development (OECD) principles on countering harmful tax regimes, the expansion was specifically discussed and approved by the OECD to ensure compliance with Action 5 of the Base Erosion and Profit Shifting (BEPS) plan.

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Under the Order, the inclusion of registered regulated products as qualifying IP basically refers to certain medicinal products for humans or animals, as defined under the Israeli Pharmaceutical Ordinance. With respect to registering non-Israeli products, the Israeli Pharmaceutical Ordinance requires approval from the relevant foreign regulators and refers directly to the United States Food and Drug Administration (FDA) approval or the European *Conformité Européenne* (CE) Marking. Accordingly, pharmaceutical companies and other life sciences companies may now be able to access the Israeli Innovation Box Regime with respect to income generated from a potentially wide range of regulator approved products.

In this context it should be noted that in accordance with the OECD guidelines for IP regimes, the Israeli incentives are generally conditional based on the extent of the research and development (R&D) activities undertaken by taxpayers receiving benefits. As Israel is a global R&D center for hundreds of multinationals, including many life sciences companies, this development may provide additional opportunities to qualify for the benefits in a BEPS-compliant manner. Moreover, even companies with limited activity in Israel may be able to qualify through a transfer of certain IP and related business activity to Israel.

The publication of this Order is a result EY's continuous work with the Israeli Ministry of Finance on the development of the Israeli Innovation Box Regime, as its official advisors for this tax legislation.

Impact

As this Order reflects the Israeli Ministry of Finance's efforts to build the most beneficial BEPS-compatible tax regime, pharmaceutical companies and other life sciences companies should carefully examine this unique feature of the Israeli Innovation Box Regime, and consider potential benefits to their Israeli operation and their global IP structure.

Endnote

1. The 6% rate would apply to a qualifying Israeli company that is part of a group whose global revenue is over ILS10 billion (US$2.5 billion). A qualifying company whose group's global revenue is below ILS10 billion would be subject to a 12% tax rate. However, if the Israeli operation is located in Jerusalem or in certain northern or southern parts of Israel, the tax rate is further reduced to 7.5%. Additionally, withholding tax on dividends distributed to foreign shareholders holding at least 90% of the shares, shall be subject to a reduced rate of 4% for all qualifying companies (regardless of size or location).

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