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How Israeli Companies Can Take Advantage of the U.S. R&D Tax Credit

IF YOUR COMPANY HAS RECENTLY IMPROVED, DEVELOPED OR DESIGNED A FORMULA, TECHNIQUE, SOFTWARE, PROCESS OR PRODUCT, RELATED COSTS CAN OFFSET YOUR TAX OBLIGATION DOLLAR FOR DOLLAR.

This was made possible by Congress in 1981, when it enacted a Research and Development (R&D) tax credit. Then, in 2015, with passage of the PATH Act, Congress leveled the playing field for small to medium businesses to take advantage of the R&D tax credit. Many states have followed the Federal government and created state-level R&D credits, compounding the benefit for the company.

Qualifying Costs and Activities

Many of the actions your employees perform on a daily basis could make you eligible for the R&D credit. Eligible activities are broadly defined as developing new technologies or improving upon existing ones. The wages paid to employees engaged in, supporting, supervising or directing these activities are all eligible for a credit. Additionally, the fees paid to outside contractors for development who perform any of this work may be eligible. The key is these costs must be incurred in the United States.

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So how does a U.S. subsidiary of an Israeli company, whose R&D is primarily in Israel, take advantage of these tax savings? The guidance for this credit is inclusive of those individuals who are either directly supporting or directly supervising individuals performing R&D activities. So let's take a common structure for an Israeli tech company and see how it works.

How Does an Israeli Company Capitalize on the R&D Credit?

A common structure is an Israeli tech company with a U.S subsidiary (although it doesn't matter if the U.S. entity is the parent), where the C-suite and the R&D are based in Israel. In the United States is a sales team, client success team, management personnel and product visionaries who support development functions in the United States.

While the R&D is headquartered in Israel, the U.S. team plays an integral role in the continued improvement of the quality, functionality, reliability or performance of the software/technology/product. How often does the U.S. team discuss product specifications and requirements and brainstorm solutions, including methods to solve issues customers face, additional applications they'd like to see out of the software or other uses and functionality suggestions relayed from end users? Then the U.S. team sits with the CTO or CXO and discusses these same issues, which are brought back to the development team. All this time and energy costs the company money – and may be classified as R&D dollars spent in the United States.

We can assist your company in identifying and tracking the time spent that is considered R&D spend under U.S. tax law, calculating the credit and helping your company monetize the credit, even if you do not have revenue in the United States.

In simple terms, assume a company has 20 U.S. employees directly supporting or supervising the R&D performed in Israel at a cost of $2 million annually. After some work and validation, it's determined that 15 percent of the cost of the U.S. employees qualifies as R&D – that's $300,000 of eligible expenses. The company can claim a credit (dollar for dollar reduction) in tax liability of around 6 percent on these eligible dollars.

A young Israeli company operating in the United States might not have taxable profits. What then? Assuming it qualifies under the new guidance, this credit can be used as an offset to payroll taxes, resulting in approximately 12 percent savings in payroll tax liability (in the example above).

About Aprio

Since 1952, clients throughout the U.S. and across more than 40 countries have trusted Aprio for guidance on how to achieve what's next. As a premier, CPA-led professional services firm, Aprio delivers advisory, assurance, tax and private client services to build value, drive growth, manage risk and protect wealth. With proven expertise and genuine care, Aprio serves individuals and businesses, from promising startups to market leaders alike.

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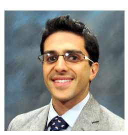
Independent member

For more information about the R&D Tax Credit or if you would like a free consultation to see if your company qualifies, contact:



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