Understanding the Taxation of IP

Virtual Round Table Series

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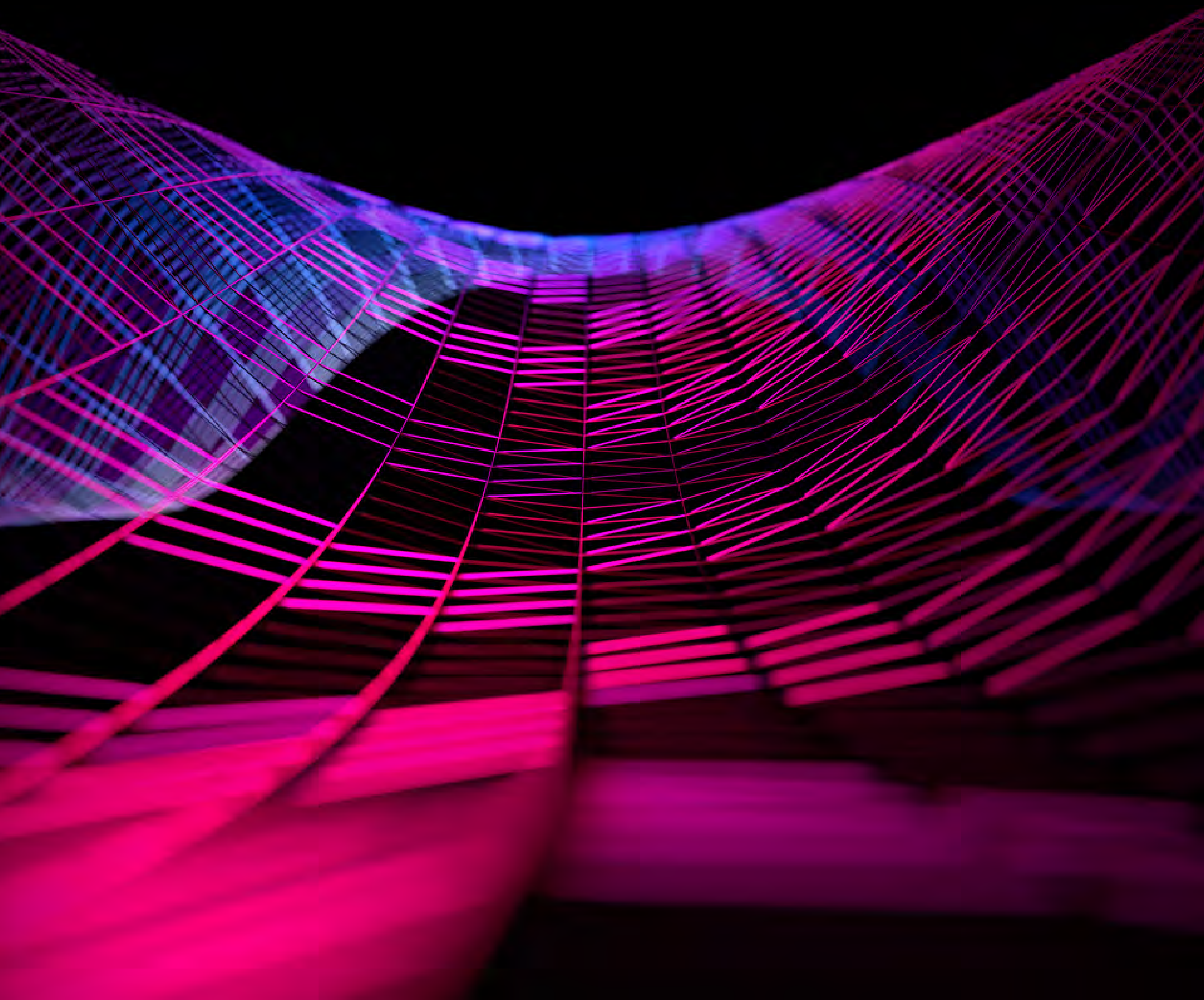

Understanding the Taxation of IP

Optimising the value and revenue-generating capability of intellectual property (IP) is critical to almost all businesses.

IP lawyers will focus on managing the validity and enforceability of IP in order to optimise its value. This is a process that must be prioritised, but equally important is efficient tax structuring, to ensure that the revenue generated by IP is isolated and appropriately taxed by the specific regime under which it is governed.

Ideally, the various types of IP within a business will be held in an optimal structure, that allows for royalties and revenues earned from that IP to flow back to the business in the most tax efficient manner possible.

There are several different issues to consider when assessing such a structure. Initially we might look at tax incentive schemes, such as IP boxes, which allow for corporation tax deductions on IP-related income. They are designed to attract businesses with significant research and development spend, which are deemed to be healthy for the economies they are part of. Not all countries use IP boxes, but they are a powerful tool for boosting the attractiveness of a jurisdiction.

According to figures from the Tax Foundation, there are currently 13 out of 28 EU member states that have a patent box regime in place. The reduced corporation tax rates on qualifying income, provided under these patent box regimes, ranges from 0 per cent in San Marino and Hungary to 13.95 per cent in Italy. In Belgium, for example, the statutory corporate income tax rate is 29.58 per cent, while under the patent box scheme, it is just 4.44 per cent - a significant saving.

The Organisation for Economic Cooperation and Development (OECD) views some long-standing IP box regimes as potentially harmful and has implemented recommendations to make them fairer. These changes have generally focused on narrowing the definition of qualifying IP and limiting the tax benefits to IP generated in the country in question.

Beyond special tax regimes, there are other ways to structure tax efficiently, including deductions and tax credits. In the US, for example, patent box schemes do not exist, however costs incurred in the development of know-how qualifies for a 20 per cent credit against tax, called the Research and Development Credit. Expenses are also usually deductible from taxable income.

It is also possible in certain countries, to break down the revenue from product sales and apportion a certain amount of that to IP, thus taxing that value at a lower rate. This process involves ascertaining the residual value of IP and is linked to transfer pricing.

The sale or acquisition of IP also needs to be carefully structured from a tax perspective. Capital gains tax on the sale of IP such as patents and copyrights can be substantially reduced in some jurisdictions, while the cost of acquired IP can be amortised over its lifetime, therefore reducing the tax burden.

Another area of concern is the flow of IP-related royalties to owners, whether they are individuals or corporations. Payments of royalties to foreign jurisdictions may be subject to withholding taxes, unless the appropriate double taxation treaties exist to mitigate this.

Transferring IP to low-tax jurisdictions, in order to avoid tax on revenues, is another possible structuring method. Taxes on controlled foreign corporations are designed to mitigate this tactic, in circumstances where the bulk of the corporation's operations are in a higher tax country.

It is clear from these examples, that understanding the taxation of IP is a complex process which requires significant expertise to master. Maximising the value of IP is critical to a healthy business, and tax structuring plays a major role in that.

Over the following pages, you will hear from seven experts in IP taxation. They will offer insight specific to their own jurisdiction, on the most efficient methods of tax structuring with regard to IP, highlighting any potential challenges and opportunities IP owners might want to be aware of when operating in their country.

The View from IR

Thomas Wheeler

Founder

Our Virtual Series publications bring together a number of the network's members to discuss a different practice area-related topic. The participants share their expertise and offer a unique perspective from the jurisdiction they operate in.

This initiative highlights the emphasis we place on collaboration within the IR Global community and the need for effective knowledge sharing.

Each discussion features just one representative per jurisdiction, with the subject matter chosen by the steering committee of the relevant working group. The goal is to provide insight into challenges and opportunities identified by specialist practitioners.

We firmly believe the power of a global network comes from sharing ideas and expertise, enabling our members to better serve their clients' international needs.

NETHERLANDS

Friggo Kraaijeveld

Partner, KC Legal

31 20 333 0130
fkraaijeveld@kclegal.nl

Friggo Kraaijeveld holds degrees in Tax Law and Civil Law and Philosophy from the University of Amsterdam. He also holds a postgraduate LLM in International Tax Law from the International Tax Centre of the University of Leiden.

Friggo worked in international taxation at PWC before joining a leading Dutch law firm. He specialises in tax issues with an international dimension, such as private equity structuring, cross-border investments, international trade and labour.

Friggo is a member of the Dutch Order of Attorneys (NOvA), the Dutch Association of Tax Advisors (NOB), the International Bar Association (IBA) and the International Fiscal Association (IFA).

NEW ZEALAND

Richard Ashby

Partner, Gilligan Sheppard

64 9 365 5532
richard@gilshep.co.nz

Richard Ashby has more than 31 years' experience with New Zealand taxation matters, starting his career with the New Zealand Inland Revenue before eventually becoming tax partner at Gilligan Sheppard, an accounting practice he has been with now for over 20 years.

Richard particularly enjoys dealing with land tax issues and the New Zealand GST regime. Richard deals with clients of all types and sizes and provides tax opinions on the application of New Zealand tax legislation to client scenarios, assists clients with Inland Revenue risk reviews and audits and can assist clients who are having difficulties meeting their tax payment obligations to make suitable repayment arrangements with the Inland Revenue. Richard also does a fair amount of cross-border tax work, providing tax and structuring advice either to clients looking to expand their activities offshore or to non-residents entering the New Zealand jurisdiction.

More recently Richard has commenced providing an advisory service to predominantly Auckland based accountancy practices, who either may not have their own internal tax resource, or they do but are just looking for a second opinion.

BELGIUM

Sébastien Watelet

Partner, Law Tax

32 2 329 50 50
swa@lawtax.be

Sébastien advises his clients on issues relating to tax law in general, financial criminal law and business law. In the disputes between his clients and the tax authorities, he intervenes at all stages from pre-litigation to administrative litigation and legal proceedings. He regularly negotiates with the tax administration or with members of the Cabinet of the Minister for Finance.

He has developed expertise in intellectual property taxation. In this regard, he advises businesses of all sizes as well as their directors, on strategy in the field of valuation of intellectual property and in particular of copyright. He has secured a number of advance rulings on the tax treatment of royalties for professions such as journalists, computer experts, advertising agency creative talents, conference speakers or artists. He regularly gives conferences on the subject.

U.S - ARIZONA

Todd Skinner

Principal, Skinner + Company

1 480 398 3785
todd@skinnercpas.com

Todd graduated early from high school to focus on a career in accounting, graduating from Brigham Young University with a Bachelor in Science and a Masters in Accountancy.

Following receipt of his CPA qualification, he took a job at Ernst and Whinney in Los Angeles, and now has 30 years of experience as a trusted advisor to clients, providing insight and the tools to help them successfully achieve their goals.

Todd's true love is giving back to his local community, where he serves on the board of a New Leaf and is a co-founder of youth organisation, Lucky Sevan. He is a member of both the American Institute of Certified Public Accountants and the Arizona Society of Certified Public Accountants. When Todd is not working he spends time with his wife and two granddaughters, on the prowl for his next culinary experience, playing Scrabble with family and friends, or planning his next excursion overseas.

UGANDA

Cephas K. Birungyi

Partner, Birungyi, Barata& Associates

256 414 348 669
cbirungyi@taxconsultants.co.ug

Cephas K. Birungyi is a highly qualified and distinguished tax expert, and a leading tax advisor in Uganda, Africa and internationally. Mr. Birungyi is the expert witness for Heritage Oil and Gas limited in the ongoing arbitration in London.

He is the managing partner of Birungyi, Barata and Associates, and has previously worked for the Ugandan government in various capacities including as Deputy Commissioner of Domestic Direct Taxes in the Uganda Revenue Authority. He has represented the country in the negotiations and drafting of several double taxation agreements with multiple countries. He is the head of the tax department of the firm and regularly advises, consults for and represents major local and international corporations, governments, international agencies and financial institution in Uganda, Africa and all around the world.

He holds various specialist qualifications from the UK and South Africa. He is a member of the Uganda Law Society, East African Law Society, the International Bar Association, the Institute of Taxation and the Institute of Corporate Governance.

MALTA

Dunstan Magro

Managing Partner, WDM International

356 21 232 096
dmagro@wdm.com.mt

Dunstan is the founder and managing partner of WDM International, a multidisciplinary professional services firm. His specialist practice areas are audit, tax, business and corporate advisory, and he also holds directorships and acts as a company secretary in a varied portfolio of clients.

Dunstan graduated as an accountant in 1997 from the University of Malta after carrying out research and writing a dissertation entitled "The Financial Implications of Joint Ventures and Mergers within the Perspective of the Competition Act".

He has served as the Honorary Treasurer and as a council member of the Malta Institute of Management, and has served as a Member of the Prevention of Money Laundering and Financing of Terrorism sub-committee of the Institute of Financial Services Practitioners. Currently Dunstan is a Committee Member of the Small & Medium-Sized Practices of the Malta Institute of Accountants.

Dunstan has delivered numerous lectures and presentations, both in Malta and overseas, focusing on business ethics and the prevention of money laundering.

SPAIN

José María Dutilh

Managing Partner, LeQuid, Social Enterprise and Business Law Firm

34 914 184 352
jose.maria.dutilh@lequid.eu

Jose Maria is managing partner of the reputed Lequid, Social Enterprise & Business Law Firm located in Madrid Spain and partner in charge of the Insolvency Administration of I-LEY Jurídico y Financiero.

He graduated in Business Studies (ICADE – E1), with a Master degree in Corporate Insolvency Law from San Pablo CEU University and a Masters in General Business Administration from ESDEN Madrid.

He also has a Masters in Legal Advice for Companies (IE-Instituto de Empresa) and a Masters in Tax Advice for Companies (IE-Instituto de Empresa).

Jose Maria is specialised in the fields of Mergers & Acquisition, Restructuring, Corporate Governance, Dispute Resolutions, Acquiring companies and business units through the Bankruptcy Law, and Family Protocol. He is also a mediator in civil, commercial and insolvency areas and an arbitrator specialised in corporate conflicts.

Currently, he is Secretary General of the Benelux Chamber of Commerce in Spain and president of AELAC (Asociación Española Letrados Administradores Concursales).

SESSION ONE - IP BOXES

What special tax regimes exist for the taxation of IP revenues in your jurisdiction? How do they work?

Netherlands – Friggo Kraaijeveld (FK) Many years back The Netherlands introduced an IP box, but it was not the only jurisdiction that introduced them. It was followed by many other countries within the European Union, including Luxembourg and Malta.

The idea behind it was to stimulate innovative activities. It was not designed to create a separate tax regime or to lower the tax rate, but just to reduce the tax base by allowing deduction for taxable profits related to IP. Only a fifth of that IP-related income was taxable under the regime, effectively going to down to a minimum tax rate of 5 per cent (current rate is 7 per cent).

The regime had already existed for quite a long time, when the Organisation for Economic Cooperation and Development (OECD), starting its Base Erosion and Profit Shifting (BEPS) project.

A lot of these IP boxes they were seen as potentially harmful to tax competition and had to be amended under international law. As a consequence, the Netherlands' IP Box regime is now only open to certain types of IP income developed in the Netherlands.

This includes patents, software developments and seeding rights, but only for self-developed IP in the Netherlands. If the income from outsourced activities exceeds a certain level, which is 23 per cent, then the IP Box regime is not available anymore.

It cannot be used as a mere hub for outsourcing all types of research or R&D activity. There needs to be sufficient nexus with the Netherlands in the creation of the IP network, in order to make use of the regime. Flying in IP, or moving IP from the US to the Netherlands and then claiming it sits in an IP box, doesn't work.

The tax benefits are only available for true IP, so brand names and trademarks are not considered to be innovative enough to benefit.

Belgium – Sébastien Watelet (SW) Initially our IP box regime only concerned the revenue of patents.

After BEPS, Belgium started to modify its regime. Starting on 1st of July 2016, we have a new version of this IP box called Innovation Income Deduction. The idea is to give tax incentives to IP resulting from research and development.

Belgium applies what we call the nexus approach, which means that the tax incentive is linked to the ratio of research and development in the country.

The tax incentive operates for Belgium companies or for a Belgian establishment of foreign companies. It applies to IP revenue from everywhere in the world and to a wider range of IP, not just patents.

One of the biggest Improvements is that the regime can apply to copyrights on software resulting from research and development. I can see in my practice that software is very, very important. We have a lot of questions about it, because some software has a very high value in areas such as machine learning and AI.

Netherlands – FK The Germans wanted to have software left out, since they believed it should only apply to things made of steel or metal. The northern jurisdictions of Europe voted to keep software within the remit.

Belgium – SW Subject to the nexus coefficient, the principle of the deduction for innovation income is based on the deduction of an amount corresponding to 85 per cent of the net income from the intellectual property concerned. Today in Belgium, you have about 4 per cent corporation tax on IP, if you can apply the deduction, so it is very interesting.

U.S, Arizona – Todd Skinner (TS) Some states have their own tax incentives, but incentives are offered mainly on a federal level. There is no favourable taxation on royalties from IP, as royalties are taxed along with all other ordinary income.

Individuals who sell IP such as patents or copyrights can receive capital gain treatment, which creates a favourable tax rate of 15 to 20 per cent as opposed to 37 per cent on ordinary income.

The US does have benefits on the deduction side, where costs that are incurred in generating a patent or developing know-how are deductible against other taxable income.

A portion of these expenses also qualify for a 20 per cent direct credit against tax. This is called the Credit for Increasing Research and Experimentation Expenses.

New Zealand – Richard Ashby (RA) In New Zealand, IP revenues (most commonly in the form of royalties) are taxable under general income tax rules. The tax rate to be levied on the revenues, is in essence determined by the type of ownership vehicle that holds the rights to exploit the IP, whether that be a company (28 per cent), trust (max. 33 per cent) or individual (max 33 per cent).

On the tax credit side, we have the research and development (R&D) type credits that can apply to eligible IP development expenditure. We have one specific tax credit regime for start-up companies known as a "tax loss cash out", of assistance to new companies who are often in a tax loss position and consequently need all the funding they can get to survive.

Historically, tax loss companies would simply accumulate and carry forward tax losses from one income year to the next, until they reached the point (if they managed to survive that long) they become profitable. Those profits then able to be offset by the prior year losses before the company would commence paying any income taxes to Inland Revenue. Under the new regime however, eligible companies are now entitled to cash out their tax losses, which results in an extra funding boost to their cash flows.

Commencing 1st of April this year, New Zealand has introduced a new R&D tax credit regime, broader in application than the "tax cash loss out" regime, with any business type incurring eligible expenditure, entitled to claim a 15 per cent tax credit up to certain caps. Naturally the R&D tax credit will firstly offset any income taxes payable by the claimant business for the relevant year, however to the extent that the credit amount exceeds the annual tax liability, the business will receive a refund cheque from Inland Revenue for the excess.

The new R&D tax credit regime has been introduced by the current Government, to facilitate and encourage as many New Zealand businesses as possible, to undertake research and development activities.

It is not the first time that New Zealand has had an R&D tax credit regime, similar legislation repealed back in 2009 by the Government of the day, who considered the monies paid out on the tax credits could be better spent elsewhere, funding personal tax rate cuts at that time. The old regime also had a lot of uncertainty surrounding it, compliance costs high as taxpayers struggled to understand the eligibility definitions and consequent scope for claiming therefore. A lot of work has been put into the regime this time around however, including the development of an online eligibility tool by Inland Revenue, which businesses can utilise to determine relatively quickly, whether or not they may have a claim entitlement.

Belgium – SW Todd spoke a little bit about individuals. In Belgium, we have also a tax incentive for individuals. For a few years now, we have offered authors a very low tax rate on the copyright revenue. The individual will be subject to a tax of 15 per cent of the net revenue up to (around) EUR60,000 a year.

The software industry frequently uses both this individual tax incentive and the corporate tax incentive. We transfer the copyright from the individual author to the company. The company will also enjoy an Innovation Income Deduction on the same software if this software is resulting from R&D, so you can combine both systems.

Malta – Dunstan Magro (DM) Historically, legislation relating to IP in Malta dates back to the 1800s. The vesting of rights to IP owners has been possible in Malta since 1911 in respect of copyright and since 1899 in respect of inventions, trademarks and designs.

Malta ratified the Paris Convention for the Protection of Industrial Property in 1967 and the Berne Convention for the Protection of Literary and Artistic Works in 1964. In 1969 Malta ratified the Universal Copyright Convention and in 1977 joined the World Intellectual Property Organisation. In 1994 Malta became a founder member of the World Trade Organisation and was thus bound by the Agreement on Trade Related Aspects of Intellectual Property Rights as from 2000. That very same year the century old laws governing copyright, patents and trademarks were repealed and replaced by new legislation. In 2002 new legislation concerning design was also introduced.

Malta is a very tax efficient jurisdiction where to set up companies to hold IP such as patents, trademarks, trade names, copyrights and other IP rights.

Article 12(1)(v) of the Maltese Income Tax Act (ITA), further enhanced by Legal Notice 429 of 2010 which introduced the 'Exemption on Royalties derived from Patents Rules', exempts from tax, any advances, royalties and similar income obtained from;

- Patents in respect of inventions;
- Copyrights; and
- Trademarks

The exemption incentive is administered by Malta Enterprise and the Inland Revenue Department, issuing an Entitlement Certificate for tax exemption with a validity of up to three years.

However, in order to address issues in relation to harmful tax practices and aggressive tax planning, and to complement the EU and OECD initiatives on tax transparency, Malta has currently suspended this incentive.

A new Patent Box Regime compliant with the EU Code of Conduct (Business Taxation) and OECD proposals on the Modified Nexus Approach is currently being developed by the Government.

Spain – José Maria Dutilh (JMD) Spain has a modern IP legal system. It adheres to the main international IP treaties, including the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, the Agreement on Trade-Related Aspects of Intellectual Property Rights, the Madrid Agreement Concerning the International Registration of Marks, and the European Patent Convention.

The main IP rights recognised by Spanish law are copyrights. The subject matter of copyrights are works of authorship. For a work of authorship to be protected. The Spanish Intellectual Property Act also grants protection to neighbouring rights (including the rights of producers of phonograms and videograms, performers, and broadcasting companies) and to sui generis database rights.

Industrial properties such as trademarks, industrial designs, patents and utility models are also recognised.

Article 35 Act 27/2014, of 27 November, on the Corporation tax regulates the activities considered as research and development and technological innovation for the purposes of the deduction for expenses incurred in their undertaking.

Research is considered to be an original and planned inquiry that pursues the discovery of new knowledge and broader understanding in scientific and technological fields. It is the development of the applications of research or other types of scientific knowledge in order to manufacture new materials or products or to design new processes or systems of production, as well as for the substantial technological improvement of pre-existing materials, products, processes or systems.

Technological innovation is considered an activity that results in a technological advance in the acquisition of new products or production processes, or substantial improvements to those that already exist. New products or processes are considered those whose features or applications are substantially different from those that already exist, from a technological point of view.

This activity includes the elaboration of new products or processes in a plan, arrangement or design, including the creation of an initial prototype that cannot be used commercially, initial demonstration projects or pilot projects, including those pertaining to animation and video games; and textile samples in the footwear, tanning, leather products, toys, furniture and wood industries, provided they cannot become or be used for industrial applications or commercial exploitation.

Spanish legislation also sets out a number of incentives for R&D activities and technological innovation (TI). In this regard, the following R&D tax incentives are applicable for Spanish companies/ permanent establishments.

- Spanish R&D and TI tax credits (RDTC)
- Reduction of social security contributions for R&D dedicated staff
- Spanish 'Patent Box' regime
- Free depreciation for R&D activities.

These incentives are compatible among them.

SESSION TWO - THE MECHANICS OF IP TAXATION

How is IP commonly taxed in your jurisdiction? What methods of accounting for its value are used? Any examples?

Netherlands – FK IP itself for valuation purposes is valued at fair market value, so an increase in value should be taken into account when determining taxable profits.

IP can be depreciated if there's reduced value in the IP. Normally the depreciation regime has a statutory term of five years, and calls for maintenance of IP are directly deductible and will not be added to the cost price of the IP itself, so its deductible in the same year.

At this moment, there is no deduction limitation for the use of IP, since that doesn't fall under the EBITDA rule. In Europe, we have a deduction limitation for interest, but I think that doesn't apply yet for royalty payments.

The Netherlands currently doesn't levy withholding taxes on royalties, but the Netherlands will be introducing a withholding tax on royalties and interest for payments to low-tax jurisdictions (probably in 2021).

Low-tax jurisdictions are jurisdictions with a tax rate of less than 9 per cent and also blacklisted countries.

Those on the European Black List, include US Virgin Islands and the United Arab Emirates among others.

The withholding tax rate will be 20.5 per cent, which could be considered very punitive because the value isn't created in the Netherlands.

Belgium – SW I would say the same thing as in the Netherlands, we need to determine the market value.

Maybe I can say more about the Innovative Income Deduction, because five different kinds of revenue are taken into consideration for the application of this deduction.

The first is revenue from licensing, namely the royalties that a company receives for the use of the IP. If it is licensed to a third party, which is not linked to the owner of the other IP, then it will not be difficult to verify that the market value is correct.

The second category is the IP income which is embedded in the sales price of manufactured products, where the company is actually using its own IP to create revenue. Here, we need to ascertain what percentage of the price is revenue from the use of the IP, which is something we are often doing with the tax administrations regarding transfer pricing rules.

In Belgium, the tax administration very much like to know the residual value. To calculate this, we will take the selling price of a product and then we will deduct everything else other than the IP. The result will be the value of the IP.

The third category is the IP income which is embedded in the use of the production process linked to this IP (notionele royalty).

There is also a tax deduction for damage received for IP fragments which is really interesting.

The last one is capital gains on the IP. If you transfer the property of the IP, you can claim a tax deduction, verified against the market value.

With regard to the tax authorities, it is very important for the client to be secure because there is a lot of money in the game.

Because of the high rate of deduction, it is easier to have a conversation with the tax administration and get a ruling on the figures that will be accepted. We can see that they are looking into all the processes around the real value of IP.

If you don't do that, you risk a lot of discussion with the tax auditors. So I think it is very important for the client to know the value of the IP and the acceptable tax deduction.

U.S, Arizona – TS The royalties generated from IP in the US are taxed along with all other ordinary income taxed at normal rates. There are no favourable rates for any royalty income.

On the sale of all the rights associated with IP, we have capital gain treatment available for individuals, which is a tax rate ranging from 15 per cent to 20 per cent.

For corporations, there is no special capital gains treatment for income. Whether royalties or capital gains, the income is taxed at 21 per cent.

As for the creation of IP, or the acquisition of IP; if created internally, the expenditures are generally fully deductible. In addition, a direct credit against tax is available. This credit is allowed for increasing research and experimentation expenses over a base threshold. The credit is equal to 20 per cent of the expenses incurred.

If IP is acquired from a third party, the cost base generally can be amortized over 15 years, or under certain circumstances, across the life of the IP. This applies to most types of IP.

Payments of royalties to foreign jurisdictions are subject to withholding tax at a base rate of 30 per cent. For US tax treaty partners, the rate can be as low as zero or just 5 or 10 per cent. depending on the treaty.

A big issue in the US is the transfer of IP to foreign jurisdictions or low-tax jurisdictions.

In the last couple of years, the US has implemented new tax regimes to reach out and tax in the US IP income generated in foreign jurisdictions. The income is taxed at a favourable rate of 10.5 per cent. This applies to income generated to controlled foreign corporations.

A tax is also imposed on the shareholders of those controlled foreign corporations for royalty income generated outside the US to those foreign corporations.

New Zealand – RA Most IP will qualify for a depreciation deduction, provided it meets a depreciable intangible property definition.

Friggo Kraaijeveld pictured at the 2019 IR 'On the Road' Conference in Chicago

These deductions are most often claimed over the life of the IP, on a straight-line basis, although certain types of IP may have its own special depreciation rate laid down by the Inland Revenue. Valuations-wise, most IP is reflected in the financial statements, particularly those businesses undertaking special purpose reporting solely for tax return filings, based on historical cost, with deductions claimed accordingly. On occasion a business will undertake a revaluation of its IP, however more often than not, this is usually to improve the balance sheet of the business for the purpose of making the business more attractive when seeking funding capital, either from the banks or new investors.

New Zealand looks to impose taxes on non-residents who have licensed their IP to New Zealand based businesses, via a non-resident withholding tax (NRWT) regime. Payments going offshore that meet a royalty definition, are subject to a standard NRWT deduction by the payer of the royalty of 15 per cent, although most of New Zealand's double tax treaty agreements will reduce the NRWT rate to 10 per cent or less.

Naturally, like most taxing jurisdictions now involved in the OECD's BEPS project, New Zealand is very focused on cross-border payments, and the risk that any non-arms-length payments between related parties may have to the New Zealand tax base. In this regard, where IP payments are going offshore, New Zealand's transfer pricing legislation will be used by Inland Revenue, to adjust the tax filing positions of New Zealand taxpaying businesses, where it is considered that similar payments would not have occurred, if the offshore party was not associated in any way to the New Zealand payer.

In New Zealand there is presently no capital gains tax. To the extent that you sell some IP, with the exception of a patent, a non-taxable capital gain may arise. With respect to patents however, any income you receive from the disposal of the asset is subject to taxation at standard income tax rates.

In situations where the IP sold was a depreciable asset to which depreciation deductions have been claimed, a disposal of the IP for an amount in excess of the assets historical cost, will create depreciation recovery income to the extent of the depreciation deductions previously claimed, but with any excess amount being a tax free capital gain in most cases.

Payments made to use an offshore IP owner's computer software program via a software as a service (SAAS) platform is unlikely to be seen to be a royalty and therefore subject to New Zealand's NRWT regime, however we have seen a number of foreign taxing jurisdictions changing their stance in this regard, so it will be a question of whether New Zealand follows suit at any time in the near future.

With respect to the internal development of IP by a business, the expenditure may be deductible to a certain point within the lifecycle of the IP. This will usually be to the point where the IP has reached the stage where the asset has created an enduring advantage to the business and has proven commercial application. At that point, usually any additional costs incurred in its creation will be capitalised and you'll get a depreciation deduction on the newly created asset going forward, once the depreciation deduction timing eligibility rules have been satisfied.

Uganda – Birungyi Cephas (BC) We don't have a special tax regime in Uganda for IP, but we tax IP as an intangible asset

Most of the IP is taxation is done using withholding taxes because most of the development is mainly from incoming IP. The standard rate is 15 per cent withholding tax, unless there is a double taxation treaty.

We also have an imported service VAT, which makes it quite a high rate. This is 18 per cent added to the initial 15 per cent. It is expensive because it is treated in most cases as a transfer pricing issue.

We do grant deductions against the amortisation of the useful life of an asset, but otherwise, there is no special regime for intellectual property. We don't have IP boxes.

Spain – JMD Tax deductions can be applied by any corporate taxpayer who performs innovative activities, regardless of their size, turnover and activity sector. The tax deductions for R&D and TI aim to reward the effort made by companies in the development of innovative activities, allowing to reduce the total amount of corporate tax up to 100 per cent. This increases their competitiveness and encourages the continuous improvement of their products and processes.

The base of the deduction will consist in the amount of the research and development expenses and, where relevant, by investments in tangible and intangible fixed assets, excluding buildings and land.

Research and development expenses are considered to be those carried out by the taxpayer, including the depreciation of assets assigned to the aforementioned activities, insofar as they are directly related to those activities and are applied effectively in their elaboration, and are itemised specifically by product.

The base of the deduction will be reduced by the amount of the subsidies received to promote said activities, and are taxed as income during the tax period. The investments will be understood to have been made when the capital assets are put into operating condition.

Thus, only the expenses that are directly attributable to the research and development project will form part of the base of the deduction. For this reason, the deduction cannot be applied to indirect expenses (such as general company structure expenses or financial expenses), nor to those that are not individualised, despite having a direct relation to the aforementioned activity; i.e., those that are distributed among the various projects that benefit from the deduction, along with the other activities of the company that can be elaborated.

The deduction percentages applicable to expenses incurred on R&D activities are, in general, 25 per cent of the expenses incurred in the tax period under this heading.

If the expenses incurred in the performance of research and development activities in the tax period are greater than the average of those made in the two previous years, the percentage established in the previous paragraph will be applied up to this average, and 42 per cent on any excess over it.

In addition to the corresponding deduction in accordance with the previous paragraphs, an additional deduction of 17 per cent will be made from the amount of the company's personnel expenses corresponding to qualified researchers assigned exclusively to research and development activities.

The percentage of the costs included in the base for assessment is deductible for activities related to TI 12 per cent of the expenses made during the tax period for this concept. R&D tax credits apply in the annual corporate income tax return which is due 6 months and 25 days following the end of the financial year. Unused R&D Tax Credit may be carried forward for 18 years.

As of 1 January 2013, taxpayers who are in a tax loss position or have reached the annual limit on tax credits applications, can claim a cash refund of their R&D tax credit (or the part in excess).

The CIT law also specifies that the taxpayer will apply for only 80 per cent of the original R&D tax credit. The refund will be limited up to EUR5 million for R&D and TI activities and EUR1 million in the case of TI activities only. Note that the bill for 2015 will increase the EUR3 million cap to EUR5 million for companies with R&D costs that are more than 10 per cent of their turnover.

Malta – DM Malta is an interesting jurisdiction for IP companies. Malta enjoys a full imputation tax system and the standard rate of tax for companies in Malta is 35 per cent. However, the tax refund mechanism can reduce the effective Malta tax burden (subject to satisfaction of certain conditions, such as no ownership of real estate or rights thereon in Malta). The amount of refund depends upon nature of profits being distributed and whether double tax relief (DTR) was claimed in Malta. Moreover, Malta has no withholding taxes on outbound interest and royalties to non-residents, as well as on dividends, provided that

(i) a non-resident person is not engaged in trade or business in Malta through a permanent establishment (PE) situated there and where the IP in respect of which the royalties are paid is effectively connected with such a PE; and

(ii) the non-resident is not owned and controlled, directly or indirectly, nor does the non-resident act on behalf of an individual/individuals who is/are ordinarily resident and domiciled in Malta.

Royalties are the income derived from the use of or the right to use of IP. However, it is significant to distinguish between active and passive royalties. In the Malta ITA active royalties are taxed under Article 4(a) which refers to gains or profits from any trade whereas passive royalties are taxed under Article 4(b) as royalties arising from property.

Looking more closely to companies involved in active and passive royalties, there are several important scenarios to consider. A couple are very briefly presented hereunder.

in the case of a Malta incorporated company deriving trading royalties, the Malta Company would own and actively license its IP. The Malta Company is subject to Malta income tax on its worldwide income and capital gains at 35 per cent (less any deductible expenses). However, upon a distribution of profits by Malta Company, the shareholders (which may be a holding company) may claim a six-sevenths (6/7ths) refund of the Malta tax suffered by Malta Company on the distributed profits. This means that the effective tax burden would be around 5%. The effective tax burden may be even reduced further where DTR is claimed.

In the case of a Malta incorporated company deriving passive royalties, royalty income is considered of a passive nature if it is not derived from a trade or business. In practice, if royalty income is derived from a few licensees (typically not more than 2-3) and the IP is not actively marketed, then it is likely to be considered passive in nature. The Malta Company pays income tax in Malta at 35 per cent subject to refund possibilities at the level of a Holding Company or any other shareholder. Upon a distribution of profits to the shareholder(s), when the Malta Company has not claimed DTR, the shareholders should be entitled to claim a five sevenths (5/7ths) refund of the Malta tax suffered by the Malta Company on the distributed profits. Thus the maximum effective tax burden would be around 10 per cent. However, where the Malta Company claims the Flat Rate Foreign Tax Credit (FRFTC), the effective tax burden may be reduced to around 6.25 per cent.

Other considerations in relation to IP which are worth to take note of include:

Malta has recently introduced a Notional Interest Deduction (NID) on risk capital. It enables equity funded Maltese companies, partnerships and PEs to significantly reduce their effective tax rate. Through NID, IP companies can be taxed on the difference between the royalty income received on IP contributed to the Malta IP Company and the combination of the NID on the qualifying equity of the Malta IP company; and a deduction on the contributed IP over the life of the IP.

A step up provision upon migration of foreign IP companies to Malta, allows the IP to be raised from historical cost to fair market value at the date of the migration. IP rights can then be amortised using the new fair market value over a three-year period.

Roll-over relief is also applicable where IP which has been used in a business for at least three years is transferred and replaced within one year by an asset that is used solely for a similar purpose in the business. In this case, the gain derived from the first transfer will not be taxed. Taxation on such a gain will be postponed to when the second or subsequently acquired IP is sold and not replaced.

R&D tax amortisation is available in Malta at 150 per cent, providing certain specific conditions are met. SMEs may also be eligible for R&D tax credits.

Access to EU Directives and to more than 70 double taxation treaties (DTTs), particularly those which grant exclusive right to tax to the country of residence of the beneficiary, where foreign royalty income received by a Malta resident company or individual shall only be taxed in Malta, thus benefitting from the above-mentioned tax incentives.

Sébastien Watelet pictured at the 2018 IR Global Annual Conference in London

SESSION THREE - LIQUIDATION

In the event of liquidation, what are some of the challenges specific to retail in terms of asset disposal?

Netherlands – FK It's usually an entrepreneur that creates IP. At a certain point during its life cycle, you would decide the corporate income tax facility and the wage tax facility. Wages taxes are not included in R&D activity.

That's your first stepping stone to get entrance to the IP Box.

You can decide to make funds available for R&D activities using this wage tax regime. At this point you decide whether you want to make use of the IP Box regime or not.

If you do not make use of the IP box regime to develop IP and you sell it to a third party, it is valued at arm's length and capital gains will be taxable at a normal rate.

If you license it out, then the income also becomes taxable. If it is licensed to a foreign entity, there may be withholding taxes due on it. At the end of the life cycle, you can depreciate the IP against a normal rate. The normal life cycle is five years by way of law.

If you've chosen to use an IP box, it's important to obtain a ruling. You cannot just merely apply the IP box; you need to obtain a ruling from the tax authority which you agree up front. This stipulates which part of the income that you earn from with the exploitation of your IP relates to the IP itself.

You must divide income between general operational income, sales and IP. In principle, no more than one-third of your overall income can be attributed to IP, and you need to agree with the tax authorities up front what that amount is. This is a transfer pricing study that requires transfer pricing expertise.

Belgium – SW What is really important now, is the relationship between the IP box and R&D. You will not find an IP box in Europe without any link with R&D. If other countries see that there is enough research and development activity in Belgium, then they will accept the application of the tax deduction.

What I want to add about Belgium, is that it is important to know the regime for tax deduction applies only for patents that are registered after 1st of January 2007. For other forms of IP, it applies after 1st of July 2016.

With software, for example, it would only apply for software sold after the 1st of July 2016. The tax administration will apply the deduction to older software, if we can show that there is a renewal of the software after the 1st of July 2016.

It is also important to apply for a temporary exemption for the process when you are asking to deliver the patents. The process is quite long, so the Belgian Tax Administration will grant a temporary exemption, so deductions can be applied once it is received.

You can also carry forwards the tax deduction, so if you don't have enough revenue, you can carry forwards the tax deduction. This is quite important for companies which are in the process of R&D.

Regarding software, this needs to be developed as part of project of a program of research and development. You have to prove that process of R&D for the development of the software.

U.S, Arizona – TS Once the IP is developed or acquired, then frequently transfers among related parties occur for various tax reasons. Transfer pricing can become an issue and the value of the IP may need to be worked through with the taxing authorities.

An arm's length transfer between unrelated parties usually avoids transfer pricing issues, but establishing value between related parties, because of the potential for manipulation, can be of special concern to taxing authorities.

Transfer pricing is an issue domestically, but it can also be an issue with transfers outside the US, especially to low-tax jurisdictions. We have seen famous cases in the EU concerning tech giants and their IP.

New Zealand – RA When the IP is acquired or developed, we will consider an appropriate ownership structure for the IP, particularly if the likely exploitation is going to derive offshore revenues for the business.

New Zealand has what we call an imputation credit regime applying to companies. How that operates, is that any income tax paid by the company to the Inland Revenue normally creates a credit, so when the company pays a dividend to shareholders, it just ensures the shareholder does not pay the tax again.

The problem with the imputation credit regime, is that no credit arises in respect of a foreign tax credit, which has been claimed by the company to reduce the New Zealand taxes payable on the foreign IP income received. So in essence, the company ends up with un-imputed retained earnings, which results in further taxes payable upon dividend distributions to the shareholders – often increasing the effective tax rate on the foreign income to somewhere in excess of 50 per cent.

If a company is licensing its IP offshore and, in most cases, satisfying the royalty definition in the foreign jurisdiction, which will result in a NRWT deduction by the foreign payer, the aforementioned scenario will arise, because while the NRWT deduction will constitute a foreign tax credit claimable against the New Zealand taxes payable on the royalty income, no imputation credit will arise for the company in respect of the foreign earnings. If we are aware of the potential for this scenario to arise, we will look at alternative ownership structures for the IP, often limited partnerships and to a lesser extent trusts, neither of these taxpayer types subject to an imputation credit regime, and consequently an opportunity for us to cap the effective tax rate on the foreign income to 33 per cent.

In respect of software, I mentioned the increasing use of SAAS products by non-resident software suppliers. In this regard, from a New Zealand GST (VAT) perspective, in October 2016 we introduced a remote services GST regime, which can create an obligation for a non-resident suppliers of remote services (which in essence includes any type of digital download or streaming services via the internet) to register for New Zealand GST. We often refer to this new remote services regime as the "Netflix tax".

The GST registration obligation may arise, where the annual supplies of remote services to NZ based consumers by the non-resident supplier are likely to exceed NZD60,000. It's not a very high registration threshold, and consequently we have seen a number of non-resident suppliers being caught out unexpectedly, unfortunately then having to wear the GST cost (plus penalties and interest) themselves, unable to recover the GST assessed on the past revenues derived, from the customer.

With respect to the ultimate liquidation of the IP owning entity, usually any capital gains that have been derived from a disposal of the IP as part of the winding up procedure, can be paid out to the business owners tax free.

Uganda – CB What's important in Uganda is the cost base, while the other determinant is the ascertainable useful life of the IP.

Of course, that means that you need to have an advanced ruling in case you're going to transfer the IP and capital gains tax related to this.

There's no special regime for it, so it would be a corporate rate in most events. What needs to be considered is the cost base and revaluation is not possible.

Spain – JMD Intellectual property rights are assets, and may therefore be assigned, encumbered or transferred by any means provided by law.

Licenses are the contracts most frequently used in this area, through which a third party is authorised to use the rights granted in exchange for payment.

On July 1st, 2016, the new regulation of the Patent Box in CIT law came into force, where it is intended to boost the economic growth of companies through technological intangible assets such as patents, drawings or models, plans, secret formulas or procedures allowing the reduction, in a high percentage, of the income to be included in the tax base (immediate tax exemption) from the assignment of the right to use exploit or transfer said intangible assets.

With the old regulation contemplated in the Law 27/2014 of the Tax on Companies, the percentage of reduction of the income to integrate in the taxable base was of 60 per cent, conditioned to the requirement that the licensor or seller had generated the assets at least by 25 per cent.

The new wording of Article 23 of the CIT Law, the income from the transfer of the right to use or exploitation of patents, designs, plans, formulas or secret procedures, rights over relative information to industrial, commercial or scientific experiences, they will be entitled to a reduction in the tax base resulting from multiplying 60 per cent by the result of a coefficient calculated based on creation, acquisition and subcontracting expenses.

This reduction of 60 per cent would also apply to the net income in case of sale or transfer (only in unrelated operations) of technological intangible assets such as industrial property. In this case, unrelated entities are considered those that owe less than 25 per cent of the direct shareholding.

This is intended to benefit from the tax reduction, to a greater extent, those taxpayers who prove to have directly developed an inventive activity with respect to those who are limited to ordering or buying from third parties, in Spain or abroad, the result of that activity inventor.

A deduction of 8 per cent can be made on investments in tangible and intangible fixed assets, excluding buildings and land, provided that they are exclusively assigned to research and development activities.

The amounts paid to carry out research and development or technological innovation activities in Spain or in any member state of the European Union or the European Economic Area will have the right to the deduction for those activities, assigned to the taxpayer, individually or in collaboration with other entities.

With respect to the expenses from activities carried out abroad, only those related to activities carried out in Spain or in any other member state of the European Union or the European Economic Area will form part of the deduction base.

Malta – DM Capital gains are only taxable if they are derived from a transfer of a capital asset. Article 5(1)(a)(ii) of Maltese ITA includes the transfers of IP assets, which therefore are subject to capital gains tax, even upon a company liquidation.

However, the transfers of IP between two companies that form part of the same group are not subject to Malta tax. In order for companies to be considered to form part of the same group, they must either have a parent subsidiary relationship, or both companies must be more than 50 per cent owned by a parent company. Two companies that are more than 50 per cent owned by the same shareholders (including individuals) also form part of the same group for the purpose of transferring IP without the payment of any tax.

Malta recently also introduced Exit Taxation rules as part of the transposition of the EU Anti-Tax Avoidance Directives (ATAD). These rules will take effect from January 1, 2020. In line with ATAD, exit taxation will be triggered in cases where a taxpayer;

a. transfers assets from the head office/PE in Malta to a PE/head office outside Malta;

b. becomes tax resident in another state, provided that their assets will not be effectively connected to a PE in Malta;

c. transfers the business carried on by its PE from Malta to another state.

The exit tax will be charged in terms of the domestic income tax on capital gains and will be calculated by deducting the value of the transferred assets for tax purposes from their market value at time of transfer.

Todd Skinner pictured at the 2019 IR 'On the Road' Conference in Tokyo

Contacts

UK HEAD OFFICE

IR Global
The Piggery
Woodhouse Farm
Catherine de Barnes Lane
Catherine de Barnes B92 0DJ

Telephone: +44 (0)1675 443396

www.irglobal.com
info@irglobal.com

KEY CONTACTS

Thomas Wheeler
Founder
thomas@irglobal.com

Rachel Finch
Channel Sales Manager
rachel@irglobal.com

Nick Yates
Editor
nick@irglobal.com

CONTRIBUTORS

Friggo Kraaijeveld (FK)
KC Legal – Netherlands
www.irglobal.com/advisor/friggo-kraaijeveld

Richard Ashby (RA)
Gilligan Sheppard – New Zealand
www.irglobal.com/advisor/richard-ashby

Sébastien Watelet (SW)
Law Tax – Belgium
www.irglobal.com/advisor/sebastien-watelet

José María Dutilh (JMD)
LeQuid, Social Enterprise and Business Law Firm – Spain
www.irglobal.com/advisor/jose-dutilh

Todd Skinner (TS)
Skinner + Company – U.S - Arizona
www.irglobal.com/advisor/todd-skinner

Dunstan Magro (DM)
WDM International – Malta
www.irglobal.com/advisor/dunstan-magro

Cephas K. Birungyi (CB)
Birungyi, Barata& Associates – Uganda
www.irglobal.com/advisor/cephas-k-birungyi

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