



Innovation

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E X P E C T E X C E L L E N C E

OCTOBER 2010

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*This document contains a general summary of developments and is not a complete or definitive statement of the law. Specific legal advice should be obtained where appropriate.*

## Tax and Intellectual Property Groups Guide Choosing Ireland as a location for your Intellectual Property Trading Company

Ireland offers many advantages to companies seeking to establish a base in Ireland to exploit intellectual property.

There is a low corporation tax rate in Ireland and it has what is considered to be a business-friendly taxation regime. In certain circumstances a company carrying on a trade of exploiting intellectual property which it has acquired can reduce its effective corporation tax rate on income arising from the intellectual property to as low as 2.5%. Ireland is a common law jurisdiction with an independent and efficient court system, a wide range of legal protections for the creators/owners of Intellectual Property Rights and the possibility of obtaining generous state grant assistance with research and development projects.

Ireland’s highly educated, English-speaking workforce provides a wealth of human capital. A long-standing member of the European Union, it has strong trading links both in Europe and with the rest of the world. It also boasts a unique relationship with the USA, which has resulted in significant rates of foreign direct investment and research and development over recent decades.

We have set out below a brief overview of some of the tax, legal and funding advantages that Ireland has to offer companies looking at locating in Ireland to exploit or develop intellectual property.

### Tax Issues

#### The Rate of Corporation Tax

One of the primary advantages that Ireland has to offer is its low rate of corporate tax. The standard rate of corporation tax on trading profits in Ireland is 12.5%. A rate of 25% applies to non-trading and foreign source income. As a result of recent legislative changes an Irish resident investment company in receipt of certain trading dividends can elect to treat such dividends as also being subject to tax at the 12.5% rate of tax.

In order to avail of the 12.5% rate of corporation tax that applies to trading income, a company would have to derive income from a trade that is actively carried on in Ireland. It is generally essential therefore that the profit making apparatus of the trade is located in Ireland and that the activity is controlled in Ireland. It is generally feasible for a company established in Ireland to exploit intellectual property to avail of the 12.5% rate if the company has sufficient personnel located in Ireland with the appropriate expertise and skills required to be in a position to manage the relevant portfolio of intellectual property. If a company is established in Ireland and it is actively involved in developing intellectual property and in promoting and licensing out the rights for its use to multiple third party users then invariably this company should be regarded as carrying on a trade that should qualify for the 12.5% rate of corporation tax.

Whilst company capital gains are generally subject to corporation tax, the gains are re-worked to ensure that the tax is charged at an effective 25% rate. Ireland has a participation exemption which exempts disposals of shares in certain companies provided certain conditions are met.

### Tax Relief for Capital Expenditure on Intangible Assets

Since 2009 capital allowances can now be claimed on capital expenditure incurred by companies on the provision of certain “specified intangible assets”. The definition of specified intangible assets as originally enacted was widely drafted and includes, inter alia, the acquisition of or the licence to use:

1. patents and registered designs;
2. trademarks, brands, brand names, domain names and services marks;
3. certain plant breeders rights;
4. copyright or related rights;
5. know-how, generally related to manufacturing or processing;
6. any authorisation required in order to sell a medicine or product or any design, formula, process or invention for the purpose it was intended;
7. any rights derived from research prior to authorisation on the effects of items covered directly at point 6 above; and
8. goodwill to the extent that it is directly attributable to specified intangible assets.

The Finance Act 2010 (the “Act”) extends the list of assets that will fall to be regarded as “specified intangible assets” so that it will now cover:

9. computer software or a right to deal in or use such software; and

10. applications for grant or registration of patents, trademarks, copyrights etc.

In addition, the definition of know-how will be broadened under the proposed amendments to include know-how related to industrial, commercial or scientific experience whether protected or not. This ties in more closely with the OECD definition in Article 12 of its Model Tax Convention.

The tax write off will be granted as a capital allowance and the write off will be available in line with the depreciation or amortisation for accounting purposes. Alternatively, a company can elect to take the write off against its taxable income over a 15 year period. Here a rate of 7% will apply for years 1-14 and 2% for year 15. There will be a clawback of the capital allowances claimed if the intellectual property is sold within 15 years of its acquisition. The Act reduces this clawback period to 10 years once enacted.

The capital allowances that are available can only be offset against income generated from exploiting intangible assets or as a result of the sale of goods or services that derive the greater part of their value from the intangible assets (referred to as a “**relevant trade**”). The aggregate amount of deductible allowances that are available will be capped at 80% of profits from the relevant trade in a given accounting period. Unused allowances can be carried forward and treated as an allowance in succeeding accounting periods. The new provisions will not apply where the expenditure incurred on the asset exceeds an arm's length amount.

The introduction of this relief coupled with the 12.5% rate of corporation tax helps to provide a valuable incentive to companies looking at locating in Ireland to exploit intellectual property given that they have the effect of reducing the effective rate of tax on income from intellectual property. In optimum situations the effective rate of corporation tax can be reduced to as low as 2.5%.

### Research & Development Expenditure

Ireland also offers significant incentives to companies looking at locating their research and development (“R&D”) activities in Ireland. There are two major incentives granted to companies that engage in expenditure on R&D within Ireland and within the EEA generally (subject to certain conditions and limitations).

Firstly, a company that incurs expenditure on R&D may avail of a tax credit of 25% on R&D in excess of base year expenditure, which base year is 2003. For companies establishing in Ireland after 31 December 2003 the base year expenditure would be zero and therefore all qualifying R&D expenditure incurred by such companies should qualify for the R&D credit.

The R&D credit reduces a company's corporation tax liability for the current year. The tax credit is in addition to the corporation tax deduction available at 12.5% for qualifying expenditure. The combined effect of these

provisions is that it is possible to obtain tax relief at an effective rate of 37.5% for incremental expenditure on R&D. The tax credit is available for offset against the current year corporation tax liability of the company and any unused credit can be carried forward indefinitely to future periods. Excess credits can also be carried back against corporation tax paid in the previous period. Alternatively, a company may, provided certain conditions are satisfied, claim to have any remaining excess credit paid to it by the Revenue. The amount of money that a company can claim to have repaid from the Revenue is limited to the greater of:

- (a) the corporation tax paid by the company for the preceding 10 accounting periods; or
- (b) the payroll liabilities (i.e. PAYE, PRSI and levies) accounted for by the company in the accounting period in which the qualifying R&D expenditure was incurred.

The tax credit is available on a group basis in respect of group expenditure on R&D. There are two situations where the law provides for relief for a company that has not carried on the R&D itself:

1. A company which incurs expenditure on R&D can claim credit for certain amounts paid to a university to carry out R&D activities on its behalf. Relief in this case will be restricted to so much of the payment to the university as does not exceed 5% of the expenditure incurred by the company itself on R&D activities; and
2. A company which incurs expenditure on R&D can claim credit for certain amounts paid to another unconnected person (a person other than a university) to carry out R&D activities on its behalf. Relief in this case will be restricted to much of the payment to the other person as does not exceed 10% of the expenditure incurred by the company itself on R&D activities.

In addition to the above relief, Irish tax legislation also allows for a tax credit for capital expenditure on buildings or structures used for the purpose of carrying on R&D activity. Expenditure in this context extends to spending on the construction or refurbishment of a building or structure to be used to facilitate R&D. The tax credit amounts to 25% of the cost of the construction or refurbishment and is available on a proportional basis if at least 35% of the building is used for R&D facilities. The full R&D credit of 25% may be claimed in the year in which the expenditure was incurred. A 10 year claw back exists where the building or structure is sold or ceases to be used by the company for the purposes of R&D or for the purposes of the same trade.

### Finance Act 2010

In addition to the changes outlined on page 2, the Act introduced a number of other amendments to tax legislation which will be of benefit to companies seeking to establish a base in Ireland to exploit intellectual property.

### Credit Relief for Foreign Royalty Income

The Act extends unilateral credit relief in respect of foreign withholding taxes on royalty income from non-treaty countries to all trading companies in respect of royalties which are taxable as trading income (see “The Rate of Corporation Tax” on page 1).

### Withholding Tax on patent royalty payments

The Act, provides that, with effect from 4 February 2010, a company may make patent royalty payments to a foreign company free of withholding tax. In order for the relief to apply:

- » The recipient must not be resident in Ireland; and
- » The recipient must be resident for the purposes of tax in a relevant territory (another EU Member State or in country which has entered into a double taxation agreement with Ireland) which imposes a tax that generally applies to royalties receivable in that territory from outside sources.

In addition to being exempt from withholding tax if the above conditions are met, the recipient of the payment will not be subject to Irish income tax on the amount received provided it is not received in connection with a trade carried on by that recipient through a branch or agency in Ireland.

The introduction of these changes highlights the continued commitment of the Irish Government to making Ireland a destination of choice for entities looking to establish operations to exploit and develop intellectual property.

### Exemption from Corporation Tax on certain patent income

As we have outlined under “The Rate of Corporation Tax” on page 1, patent income received by an Irish resident patent holding company from licensees would in general be subject to Irish corporation tax at the rate of either 12.5% or 25% depending on whether the patent holding company was carrying on a trade. However, in addition to the above low corporate tax rates pursuant to Section 234 of the Taxes Consolidation Act, 1997 income received by Irish-resident companies in the form of royalties from patents where the research, testing and development for those patents was carried out in Ireland or any European Economic Area (“EEA”) state (currently the 27 EU Member States and Iceland, Liechtenstein and Norway) will be exempt from corporation tax provided certain conditions are met. Since 1 January 2008, a cap of €5 million applies to the amount of patent royalties a company can receive in a calendar year free of corporation tax under this exemption. Any patent royalty income received in excess of this limit will be taxable in the normal manner (see “The Rate of Corporation Tax” on page 1).

In addition to the above exemption if a patent holding company benefits from the exemption set out above, the patent holding company may be able to distribute some or all of the patent income received from the licensees, to its shareholders, free from the requirement to deduct dividend withholding tax. In addition, shareholders should not be subject to Irish income tax, Pay Related Social Insurance or health levy on receipt of such dividends (the Irish income levy may still apply). This exemption offers employers a significant opportunity to provide tax efficient incentives to senior executives or inventors that are tax resident in Ireland.

### Withholding Tax

Although Irish resident companies must deduct withholding tax at 20% on dividends there are numerous domestic exemptions from the requirement to withhold dividend withholding tax. In particular provided certain declarations are filed with an Irish resident company the following categories of shareholders will be entitled to receive dividends free from dividend withholding tax from an Irish resident company:

1. Individuals who are residents of an EU Member State (other than Ireland) or a territory with which Ireland has a double tax agreement in force or that is signed and which will come into force once all ratification procedures have been completed (hereinafter referred to as a “**Relevant Territory**”) provided that the individual is neither resident nor ordinarily resident in Ireland. (A declaration of entitlement to the exemption sworn by the individual is also required.);
2. Companies which are resident in a Relevant Territory and which are not ultimately under the control of Irish residents;
3. Non-resident companies which are ultimately controlled by persons who are resident for tax purposes in a Relevant Territory;
4. Non-resident companies that are quoted and traded on a recognised stock exchange in Ireland, a Relevant Territory or on such other approved stock exchanges (or whose 75% parent, or, if owned by two or more companies, each of its 100% parents, are so quoted and traded).

As a result of the above exemptions it is generally possible to extract profits from an Irish resident company without suffering dividend withholding tax.

### Stamp Duty

Transfers of intellectual property are specifically exempted from stamp duty in Ireland. This exemption makes it feasible to transfer intellectual property to an Irish resident company without incurring a documentary tax.

### Transfer Pricing

Prior to the introduction of the Act, Ireland had limited transfer pricing rules which were rarely invoked in practice. By virtue of the Act, provisions for the application of international transfer pricing norms are to be brought into effect which require that transactions between associated entities be entered into “at arm’s length.” The provisions largely implement the OECD Transfer Pricing Guidelines and are relevant to IP trading companies to the extent that they are licensing IP to group companies or connected persons. The rules do not apply to contracts entered into or terms and conditions agreed prior to 1 July 2010. The regime only applies to trading transactions and there is an exemption for small and medium sized enterprises, specifically companies with fewer than 250 employees and either turnover of less than €50 million or assets of less than €43 million.

### Controlled Foreign Company (“CFC”) and Thin Capitalisation Rules

Unlike many jurisdictions Ireland does not have any CFC or thin capitalisation rules.

## Irish Intellectual Property Protection Laws

The distribution of products/services that depend upon Intellectual Property Rights for a significant proportion of product value (books, film/video, music, software for example) from an Irish distribution base is a business activity that will enjoy significant and practical protection from Irish law. Indeed, the provisions of the Irish **Trade Marks Act 1996** and the **Copyright and Related Rights Act 2000** can be said to be “State of the Art” legislation. Owners of Intellectual Property will find that Irish law is better than the laws found in many of our major European partners. Better both in the sense that Irish law is up to date and in the sense that because Irish law is also based on the common law tradition it will be more familiar to North American, British and Commonwealth Businesses. Irish law meets the requirements of leading international texts such as the **Berne Convention**, the **TRIPS Agreement** and the 1996 **Geneva Copyright treaties**, as well as all relevant IP E.U. Directives. Ireland is one of the world’s largest exporters of computer software and appropriate protections have been enshrined in Irish law to protect Intellectual Property Rights.

### The Irish Copyright Landscape

The Irish copyright laws are informal; there is no need to register that a copyright exists. Protection for original literary and artistic works normally vests in the author

and copyrights are freely transferable through licence agreements and assignments. Irish copyright law now gives protection to original databases and, combined with the new 15 year protection against unauthorised copying of the contents, the creators of multimedia works enjoy greater protection under Irish law than under most other copyright regimes. The publishers of works in electronic format enjoy copyright protection in the form of film, sound recording and cable programme copyrights and broadcast organisations enjoy copyright protection for all kinds of distribution (cable, satellite). Internet distribution of works is specifically protected in the form of the “making available” right. Performers of works - musicians, actors, singers - enjoy copyright protection through a balanced system that involves contractual arrangements between performers and film, recording, and broadcasting industries. Irish right holders operate within a well established and sophisticated network of collecting societies that have international links with similar organisations worldwide.

#### **Ireland and Copyright Enforcement**

A right holder seeking to enforce copyright in Ireland enjoys the benefits of a very sympathetic enforcement regime. A few of these features are worth highlighting:

- » self-help powers of search and seizure;
- » presumptions in court proceedings that the work is original and that the plaintiff is the owner of copyright in the work “unless the contrary is proved”;
- » the ability to protect whistleblowers by concealing the identity of a source;
- » admissibility of hearsay evidence;
- » criminal penalties of up to five years imprisonment and/or a fine of up to €127,000;
- » extensive court powers of search, seizure, confiscation and destruction of pirated copies;
- » wide powers to order payment of damages based upon conversion principles as well as the power to award punitive damages; and
- » speedy injunctive reliefs.

#### **Patents**

Under the Irish Patents Act 1992 (the “1992 Act”), full and short-term patents can be sought by registering an application with the Irish Patents Office. Alternatively, a patent may also be registered with the European Patents Office, provided the applicant has elected Ireland as a designated jurisdiction. In addition to setting out the application procedure, the 1992 Act enunciates the statutory prohibition against direct/indirect infringement of a patent and/or contributory infringements. A full-term patent lasts for 20 years, while a short term patent has a duration of 10 years.

#### **Registered Designs**

While Irish design law meets international standards in all respects, it has been specifically tailored to encourage inward investment and innovation in manufacturing (specifically spare parts) by limiting protection for functional, ‘must-fit’ and ‘must-match’ designs.

#### **Trade Marks**

The area of Trade Marks is regulated in Ireland by the Trade Marks Act 1996. In addition to domestic legislation, Ireland is also a party to the Community Trade Mark System, which provides for the registration of EU wide trade marks.

## **Research, Development and Innovation (RD&I) Support Programme<sup>1</sup>**

The Irish Government offers a range of financial support/grants for R&D carried out in Ireland. The Research and Development Grant Scheme run by two Irish State Agencies (IDA Ireland and Enterprise Ireland) was launched on 24 January 2008, making €500m available to Irish and multinational companies across all sectors over the remainder of the Government’s Strategy for Science, Technology and Innovation (2008-2013).

Eligible product and process innovation projects must contribute to a sustained process of innovation within the company and have well defined plans as regards resources required for development, and commercialising of the results of the research and development (typically within one year of completion of the project).

Eligible projects are those which can be defined as “Experimental Development” - the acquiring, combining, shaping and using of existing scientific, technological, business and other relevant knowledge and skills to produce plans and arrangements or designs for new, altered or improved products, processes or services - or “Industrial Research” - planned research or critical investigation aimed at the acquisition of new knowledge and skills for developing new products, processes or services or for bringing about a significant improvement in existing products, processes or services. Projects can contain one or more of the above two categories.

<sup>1</sup> The legal basis for the RD&I Programme is the Community framework for state aid for research and development and innovation (“the Framework”) (2006/C 323/01), which has largely been implemented into law by Commission Regulation (EC) No 800/2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (the Block Exemption Regulation). The definitions of “Experimental Development” and “Industrial Research” and the limits placed on aid in the RD&I Programme are consistent with the measures in the Block Exemption Regulation, and in the Framework.

For large companies, the grant is restricted to 25% of the costs of the project, or 50% if the research is considered Industrial Research. This can be increased by 15% where there is collaboration between two companies, subject to a maximum grant of 50%. RD&I support is subject in all cases to an upper limit in respect of a particular industrial undertaking of the higher of €2,500,000, or €2,500,000 in excess of the aggregate amount of research grants for which the permission of the Government has previously been obtained by the Authority. Limits also apply to the extent to which grants will cover particular categories of expenditure. Applications for support of up to €450,000 should be made to the R&D Fund Committee, and for amounts greater than that to the Investment Committee of Enterprise Ireland. While generally, the maximum R&D grant a company can receive is €450,000, projects in excess of this amount are evaluated on a case by case basis and higher grants are capable of being awarded.

### Other Research Support Programmes

The Feasibility and Training Support Programme provides support for first time research and development activity, while the Innovation Partnership Initiative provides financial support to encourage companies to undertake collaborative projects with Irish third-level institutions.

See:

<http://www.idaireland.com/home/index.aspx?id=65>

for further detail on IDA Ireland R&D Grant assistance;

and:

[http://www.sfi.ie/content/content.asp?section\\_id=184&language\\_id=1](http://www.sfi.ie/content/content.asp?section_id=184&language_id=1)

for further detail on grants available from Science Foundation Ireland.

## Contacts

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Alan advises on the tax aspects of capital markets, structured finance, financial products, banking, mergers and acquisitions, reorganisations, restructurings and a wide range of other international and domestic tax matters. He has a particular focus in the area of intellectual property and has advised a wide range of domestic and international clients on the tax aspects of setting up operations in Ireland to exploit and develop intellectual property.

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