



# ROYALTIES - A way to save taxes

## Corporation Tax

Royalty income acquired by a company in the UK is subject to Corporation Tax (CT). CT is chargeable on earnings. Therefore in the case where there are royalty payments made to a head licensor, CT is payable on the margin between royalties receivable and royalties payable, for example on a margin of 10% to 15%.

## Withholding tax on royalty payments from the UK

- Three types of royalties are within the charge of withholding tax in the UK. These are:
- Annual Payments relating to royalties
- Patent Royalties
- Copyright Royalties

If a UK company holds a license to an item of intellectual property, from which it earns royalties, providing the income earned does not arise in the UK, no withholding tax applies to payments made to the non UK licensor of the intellectual property.

So as to be reasonably confident that the payment has a number of non-UK features thus making it free of UK withholding tax, the royalty payments should satisfy a number of factors. The factors to be considered are the following:

- (a). The agreement between the UK resident company and the non UK licensor of the intellectual property should state that it is to be governed by and interpreted in accordance with the law of an overseas territory with the Courts of that territory having exclusive jurisdiction. It should also be entered into abroad;
- (b). The foreign rights producing the income paid out by the UK company should arise under or exist by virtue of foreign law;
- (c). The royalties paid to the non UK licensor by the UK company should be for entitlement to use or exploit overseas rights wholly outside of the UK. The aim of business activities through the exploitation of this right should only be carried out abroad, so any documentation should exclude the UK from the territories of operation;
- (d). Some sort of overseas 'security' for the royalty payments should be given to the non UK licensor by the licensing contract as the payments fall due. An example would be that a charge is put over the bank account into which the UK company receives its sub-licensing income.



(e). The licensing contract should be performed as a deed under seal with an obligation therein specifying an overseas location where each party must keep their original copy;

(f). The UK company should hold an overseas bank account into which it receives its sub-licensing income and pays the royalties to a foreign bank account of the non UK licensor.

(g). The royalty obligation should be designated in foreign currency.

## **Conclusion**

If a UK company goes into a license agreement for the license of an item of intellectual property, no charge to Withholding Tax is applied if the laws governing the agreement exclude the UK, the intellectual property is registered outside the UK and the actual transfer of funds passes through bank accounts outside the UK. Furthermore in the case where the IP is licensed to the UK company by a non-UK licensor, CT is only payable on the UK profit margin.

## **Malta: Exemption on Royalties Derived from Patents Rules, 2010**

### **Overview: LN 429 of 2010**

Legal Notice 429 of 2010 has introduced an income tax exemption on royalties and income derived from qualifying patents in respect of inventions. The principal elements constituting this exemption are the following:

- Royalties and similar income;
- Derived on/after 01.01.10;
- From qualifying patents;
- In respect of inventions;

### **Article 12:**

*Royalties and similar income derived from patents in respect of inventions, whether in the course of a trade, business, profession or vocation or otherwise, subject to the satisfaction of such terms and conditions (including any limits on the maximum amount of the exempt income) and obtaining such determinations as may be prescribed:*

*Provided that where any income which is exempt from tax in terms of this paragraph is derived by a company, the distribution of the particular profits by way of dividend by such company shall also*



*be exempt from tax in the hands of the shareholders, so however that where the person in receipt of such dividend is itself a company (hereinafter referred to as "the second company"), any dividend paid to the members of the second company shall, to the extent that such dividend is paid out of profits which are exempt in terms of this paragraph, not be charged to tax under this Act, and where a member of the second company is again a company, the provisions of this proviso shall apply mutatis mutandis as though references to the second company were references to that member, and the principle set out in this proviso shall continue to be applied for as long as the exempt profits referred to in this paragraph are distributed by way of dividends:*

### **Procedure:**

1. An application is made to the Malta Enterprise Corporation
2. The Malta Enterprise Corporation issues a determination that it is satisfied that the invention exists and is not in breach of any public policy objectives in Malta.
3. The determination is submitted to the Commissioner of Inland Revenue together with the income tax return whereby the exemption is being claimed

The person claiming the exemption must refrain from declaring the royalty income in the income tax return since in such a case the exemption would be lost.

If the exempt income is derived by a company, such income will remain exempt in the hands of the shareholders upon dividend distribution.

### **Conclusion**

The royalty exemption for income derived from patents is complemented by certain other aspects of Malta's tax system, allowing for the tax efficient structuring of intellectual property holding and licensing activities via Malta, specifically:

- No withholding taxes on outbound dividends, interest or royalties paid from Malta;
- Possible mitigation of source country withholding taxes on royalties paid to Malta under the EC Interest and Royalties Directive or one of Malta's 60 tax treaties;
- An optional step-up in the base cost of assets from historic cost to fair market value for persons transferring their residence to Malta, as well as for companies formed by way of an EU cross-border merger;



- A possible exemption from capital gains derived from a disposal of intellectual property in one of the following situations:
  - An intragroup transfer (with no clawback on subsequent disposals by the related party transferee where the transferee is a non- Malta-resident);
  - Upon a disposal of the intellectual property where the Malta resident entity is not incorporated under the laws of Malta; and
  - Migration out of Malta of the Maltese intellectual property company.

## **Appendix A**

The Patents and Designs Act specifies that Inventions which are new, involve an inventive step and are susceptible of industrial applications, shall be patentable. Such inventions shall also be patentable even if they concern an item consisting of or containing biological material or a process by means of which biological material is produced, processed or used. Every development shall be considered novel if it does not form part of anything which, before the filing date was available to the public. Moreover, an invention shall be considered to involve an inventive step if it is not obvious to a person skilled in the art.

This notwithstanding, the acts makes a list of inventions which do not qualify as inventions, and that thus in relation to which the exemption elaborated on in this research does not apply:

- (a). discoveries, scientific theories and mathematical methods;
- (b). aesthetic creations;
- (c). schemes, rules and methods for performing mental acts, playing games or doing business and programs for computers;
- (d). presentations of information.

### **The Patents and Designs Act also lists activities which do not give rise to the granting by the relevant authority of a patent:**

- (a). an invention the exploitation of which would be contrary to public order or morality: Provided that exploitation shall not be deemed to be so contrary merely because it is prohibited by law or regulation;
- (b). the human body, at the various stages of its formation and development, and the simple discovery of one of its elements, including the sequence or partial sequence of a gene:



Provided that an element isolated from the human body or otherwise produced by means of a technical process, including the sequence or partial sequence of a gene, may constitute a patentable invention, even if the structure of that element is identical to that of a natural element;

(c). processes for cloning the human body, processes for modifying the germ line genetic identity of the human body and uses of the human embryo for industrial or commercial purposes;

(d). processes and products for modifying the genetic identity of animals which are likely to cause them suffering without any substantial medical benefits to man or animal;

(e). varieties of plants and animals:

Provided that patents shall not be granted for plant varieties only after a new form of plant variety protection is introduced in such form as may be prescribed:

Provided further that a patent may still be granted for a plant variety in respect of which a patent application is still pending on the date that a new form of plant variety protection is prescribed;

(f). essentially biological process of the production of plants or animals:

Provided that this is without prejudice to the patentability of inventions which concern a microbiological or other technical process or a product obtained by means of such a process;

(g). DNA sequence not containing any technical information and in particular any indication of its function.

For more information please contact us at [info@trust4trust.com](mailto:info@trust4trust.com)