



The Malta IP Box

2013

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A. INTRODUCTION

In order to further develop and motivate the creation of new knowledge, intellectual capital must be protected and nurtured. To this effect, Intellectual Property (IP) development has warranted that such IP rights lead to economic earnings to the owner and also ensures that the knowledge is utilised and exploited. Malta has taken advantage of IP rights in a successful attempt to transform the island into a royalty holding jurisdiction.

In line with the above, local fiscal development has led to the formation of a number of particularly enticing royalty schemes – **the IP Box Scheme**. Those meriting the limelight include –

- The "Patent Rules" which were introduced in 2011 in order to provide for an exemption on royalties and similar income derived from patents and inventions.
- The "Copyright Exemption" that was announced in May of 2012 to cater for a similar exemption on copyrightable intellectual property.

Malta's system of refunds afforded to the shareholder of a Malta IP Holding Company help to further make Malta even more interesting in the scenarios where royalty income does not qualify for the above schemes. This comprises income derived from patents, copyright and trademarks.

As a whole, this ideal environment has helped Malta to develop into an IP Holding jurisdiction, with companies holding rights in a variety of IP fields, ranging from patents covering computer software designs, remote gaming software, pharmaceutical products to simple royalty routing structures dealing with copyright.

B. QUALIFICATION UNDER THE PATENT RULES

The IP Box Scheme applies to both natural persons (individuals) as well as to body-corporates that own rights to patented intellectual property and derive royalty income therefrom.

The patent may be granted in Malta or otherwise. However, in order to qualify under the scheme, the invention to which the patent applies must be –

- Considered patentable under Maltese Law; or
- Is the result of Fundamental Research, Industrial Research or Experimental Development.

The following criteria must be adhered to –

- The royalty must emanate through a licensing agreement or similar agreement which allows for the exploitation of knowledge under a qualifying patent.
- Such qualifying patent must relate to research, planning, processing, experimenting, testing, devising, designing, developing or similar activity leading to the relevant invention irrespective as to whether such was carried out in Malta or elsewhere.
- When the patent owner is an individual, he must have been engaged in carrying out, solely or together with another person, the research or other similar activity leading to the invention which is the subject of the qualifying patent.
- In any case the licence must be granting to an enterprise for using the patent in a productive economic activity, such as manufacturing, software development and data processing.

Licensing of the patented intellectual property to linked enterprises¹ is also allowable as long as –

- The arm's length principle is observed, and thus the royalty paid does not exceed the amount that would have been paid if the enterprises were not related; and
- The linked enterprise acquiring the license must be directly involved in a productive economic activity such as manufacturing, software development and data processing.

C. APPLICATION PROCESS AND ANNUAL SUBMISSIONS

In order to benefit from the IP Box Scheme, the applicant must beforehand -

- apply to Malta Enterprise for each separate licensing agreement;
- attach with the application any supporting documentation which may be requested by Malta Enterprise;
- submit the following declarations, i.e. –
 - that the arms' length principle has been respected; and
 - that to his knowledge, the patent is not utilised in activities that conflict with public policy.

Upon approval, Malta Enterprise shall issue an 'Entitlement Certificate' which stipulates that any royalty payments received by the patent holder from the licensee are to be exempt from income tax in Malta.

¹ Enterprises are deemed to be linked when any of the following relationships is in existence –

- a) One enterprise holds a majority of the shareholders' or members' voting rights in the other;
- b) One enterprise is entitled to appoint/remove the majority of the Board of Directors of the other;
- c) A contract between the enterprises, or the provision of a clause in the corporate statute of one of the enterprises enables one to exercise a dominant influence over the other;
- d) One enterprise is able, by agreement, to exercise sole control over a majority of shareholders' or members' voting rights in the other.

Such a certificate will be valid for three years after which the applicant may re-submit an application for renewal.

The holder of the Entitlement Certificate can commence to benefit on the income gained from such patent licensing agreement from the year of assessment as stipulated in the said certificate.

Annually, the applicant must submit to the Maltese Commissioner of Inland Revenue the subsequent documentation –

- A declaration that the documentation submitted to Malta Enterprise upon application in respect of which the Entitlement Certificate was issued is still valid; and
- A copy of the Entitlement Certificate.

D. EXTENSION OF THE EXEMPTION TO ROYALTIES FROM COPYRIGHT

The new amendments of 2012 also exempts royalties and similar income derived from copyright. According to the Maltese Copyright Act, the following works are eligible for copyright –

- Artistic works such as paintings, maps, plans, works of sculpture and architecture, photographs not comprised in an audio-visual work;
- Audio-visual works;
- Databases;
- Literary works; and
- Musical works.

A legal notice is expected to be published shortly in order to give the criteria to benefit from the scheme relating to royalty income derived from Copyright.

E. INTELLECTUAL PROPERTY COMPANIES

The above schemes can also be availed of by IP Holding Companies which are resident in Malta. In fact, these attractive schemes have noticeably attracted foreign companies to relocate to Malta.

Coupled to the above, Malta also boasts the following fiscal pluses –

- The distribution of the particular profits by way of dividend by the Malta company shall also be exempt from tax in the hands of the shareholders;
- No withholding taxes on outbound dividends, interest or royalties paid from a Malta IP Company;
- Under the Interest/Royalties Directive or under of Malta's tax treaties, there is the possible mitigation of source country withholding taxes on royalties paid to Malta;
- Capital gain exemption upon the disposal of intellectual property in an intra-group transfer.

F. ALTERNATIVE STRUCTURES TO THE IP BOX

As mentioned above, the royalty income from Patents or Copyright is not automatically exempt from Maltese income tax. Such and income must be *qualifying royalty income*. Whenever the IP Box criteria are not satisfied, Maltese companies may also benefit from the advantageous fiscal treatment wherein following a dividend distribution, a shareholder of the Maltese company may apply for refunds equivalent to 6/7th of the income tax paid at corporate level, leaving the tax leakage at 5% for trading income. This scenario however does not apply in the occurrence of 'Passive Interest and Royalties'.

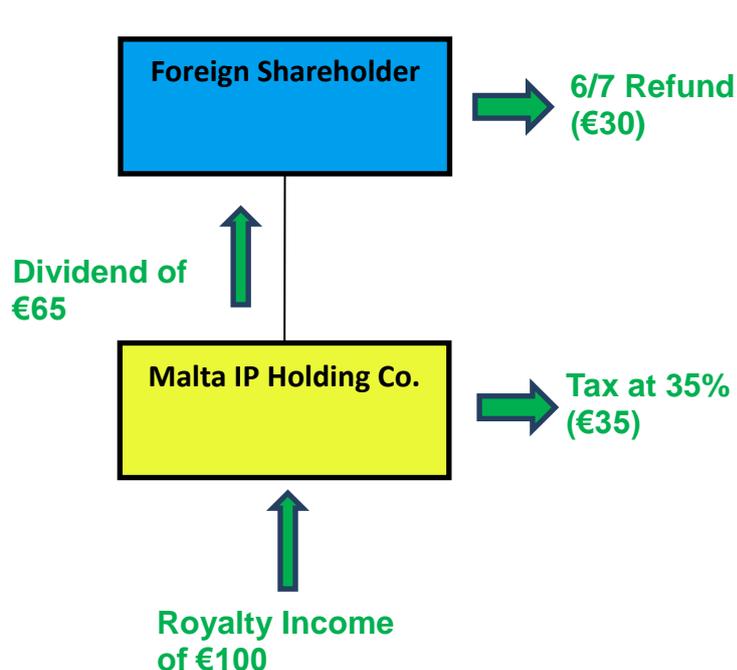
The term 'Passive Interest and Royalties' has been defined as interest or royalty income which is not derived, directly or indirectly, from a trade or business, where such interest or royalties have not suffered or suffered any foreign tax,

directly, by way of withholding, or otherwise, at a rate of tax which is less than 5%.

In the scenario that the income is deemed to be passive interest or royalties, the refund rate is of 5/7th of the Malta tax paid. Hence the effective tax rate will be of 10%.

The above is explained in the following graphical representation -

Basic IP Holding Structure



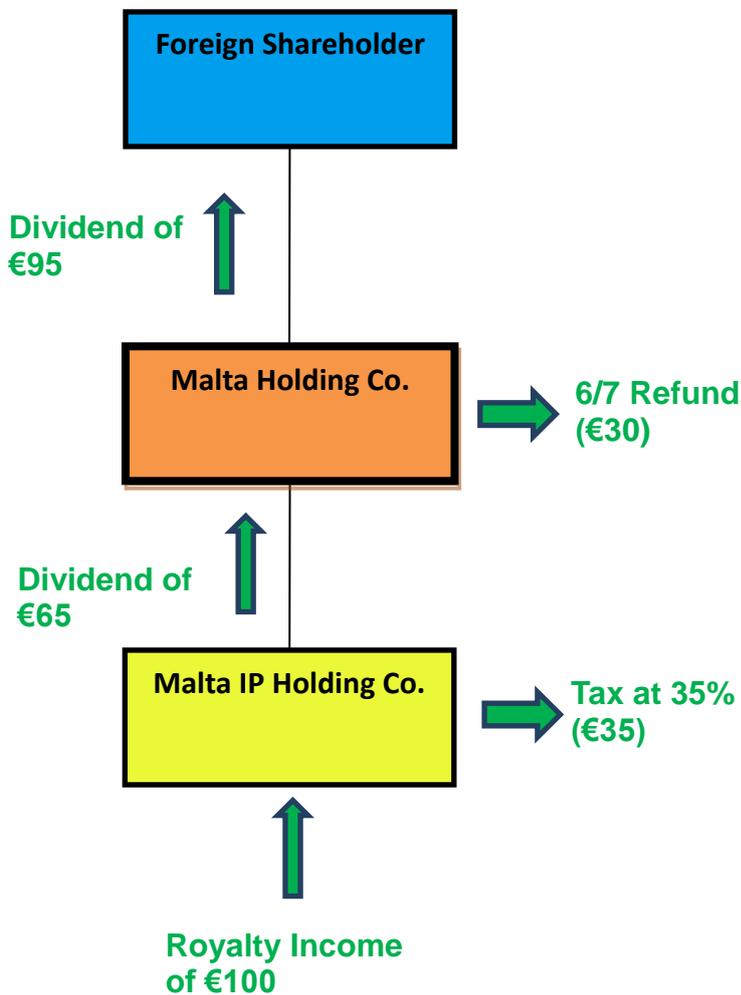
The structure on the left will feature the following -

- Malta IP Holding Co is the holder of a royalty-generating right that does not qualify under the IP Box
- Malta Tax of 35% on the royalty income
- Upon a distribution of dividends, the foreign shareholder may claim a 5/7 refund of Malta tax paid by the company
- No Malta tax is imposed on the dividend
- No Malta WHT on dividends
- Malta Tax leakage – maximum of 5% in case of active royalties

A Maltese Holding Company can be inserted on top of the Malta IP Holding Co. in the above scenario in order for the Maltese Holding Company to be able to claim the refunds itself (as opposed to the foreign shareholder).

This is reflected in the two-tier structure that is explained in the following diagram:

Two-Tier IP Structure



The structure on the left will feature the following –

- Malta IP Holding Co is the holder of a royalty-generating right that does not qualify under the IP Box
- Malta Tax of 35% on the royalty income
- Upon a distribution of dividends, the shareholder, i.e. the Malta Holding Co. may claim a 6/7 refund of Malta tax paid by the company
- No Malta tax is imposed on the dividend
- No Malta WHT on dividends
- Malta Tax leakage – maximum of 5% in case of active royalties

G. SERVICES

We provide support and assistance by:-

- Giving preliminary advice on the scheme and structuring;
- Liaising and meeting with the Malta Enterprise officials;
- Incorporating and administrating the Maltese legal entity;
- Corporate, Tax, Accounts and VAT services to the Maltese legal entity;
- Any related assistance.

H. CONCLUSION

The Malta tax refund mechanism has resulted in the lowest corporate tax rate in the whole of the EU. In addition, the introduction of the IP Box gives unsurpassable benefits to qualifying Patents and Copyrights as it totally exempts such from income tax in Malta.

I. DISCLAIMER

This publication has been prepared as a general guide and for information purposes only. It is not a substitution for professional advice. One must not rely on it without receiving independent advice based on the particular facts of his/her own case. No responsibility can be accepted by the authors or the publishers for any loss occasioned by acting or refraining from acting on the basis of this publication.

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