The “Knowledge Development Box”

Background

The concept of a patent box has been available in many EU member states since France first introduced the concept in 2000. The patent box was developed as part of a general use of tax planning to attract and retain income from intellectual property activities. These patent boxes offer a substantially reduced corporation tax rate or income derived from patents and often other kinds of intangible assets. At the beginning of 2015, 11 member states of the EU as well as Liechtenstein and the Swiss Canton of Nidwalden operated an IP Box regime. Tax rates for eligible income vary between 0% (Malta) and 15% (France).

Within this background, the Irish government’s intent to establish a competitive new tax regime for intellectual property which was publicly announced in October 2015 was no surprise. For many years Ireland has promoted the knowledge economy and Ireland’s version of the patent box, the “Knowledge Development Box” (KDB) came into effect on 1 January 2016.

The ”Knowledge Development Box” explained

The Knowledge Development Box (KDB) regime provides a 6.25% corporate tax rate for income generated from commercialising particular types of intellectual property. This rate of corporation tax is well below Ireland’s normal headline rate (12.5%) of corporation tax and provides a company with further incentives to generate and exploit intellectual property within and from Ireland. As is detailed by IDA Ireland, the KDB enhances Ireland’s “best-in-class” offering for R&D.

The KDB applies to accounting periods between 1st January 2016 and 31st December 2020. Claims must be submitted within two years of the relevant accounting period.

In order to qualify for the KDB tax rate, the intellectual property (IP) must be the result of R&D activities carried out in Ireland, as defined by specific R&D tax credit legislation, and the income generated from the IP must flow into the same entity that undertook the R&D activity.

The “Modified nexus” approach

Many patent box systems were heavily criticised for being used merely as a tax avoidance tool. In September 2013, the OECD published a Base Erosion and Profit Shifting (“BEPS”) Project report which recognised that preferential regimes needed to be dealt with more effectively and transparently and proposed that a direct link should exist between the income receiving benefits and the expenditures contributing to that income with the intention that the expenditure would prove substantial R&D activity was actually taking place as intended.

The KDB introduced by Ireland was the first such regime to comply with the OECD’s “modified nexus” standards, as set out in the final BEPS report. The “modified nexus” approach allows a company to benefit from the KDB relief only to the extent that the company itself incurred qualifying research and development expenses that gave rise to the Intellectual Property (“IP”) income. Specialist advice is therefore needed in determination of how and when a company can avail of the benefits derived from the KDB.
Qualifying IP

The KDB legislation details that only certain types of IP qualify – some patents, certain computer programs, plant breeder rights, supplementary protections for medicinal or plant protection products. A “qualifying patent” includes a patent which was granted following a substantive examination for novelty and inventive steps. In this regard, it is important to note that not all patents- for example the Irish Short Term Patent- will qualify for inclusion in a KDB.

Small companies may be entitled to exceptional KDB tax relief on inventions that are certified by the Controller of Patents, Designs and Trademarks as being novel, non-obvious and useful. A small company for this purpose is defined as an SME with an income from IP of less than €7.5m in a 12-month period, and if a member of a group, group turnover is less than €50m.

Establishing Qualifying Income

Establishing qualifying income from your IP can be quite difficult, in particular where the IP is one of only a number of components in a product. For large companies, this is likely to require an economic analysis and a transfer pricing study to be carried out by an expert. Companies are required to document a clear link between the various elements of the KDB for the qualifying criteria to be met.

The Revenue Commissioners allow smaller companies, where this type of study is not feasible, to claim a notional royalty rate of 10%. This provision only applies to small and micro companies (with fewer than 50 employees and turnover or balance sheet of less than €10m) but does not extend to medium-sized companies.

Conclusion

The KDB is an important relief in terms of encouraging R&D activity in Ireland.

Hanna Moore + Curley are experienced in working with tax specialists in this area and can review your business and advise if you have, or could apply for, qualifying patents or other suitable intellectual property that could benefit from the KDB. As the provisions are based on tax legislation, we strongly recommend that companies also always seek appropriate advice from a suitably qualified tax advisor to ensure they are appropriately informed and correctly positioned to avail of the benefits of the KDB.

For any further specific questions, please contact any one of our European Patent and Trade Mark Attorney team at Hanna Moore + Curley. This guidance document provides general information only and does not constitute legal advice.

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