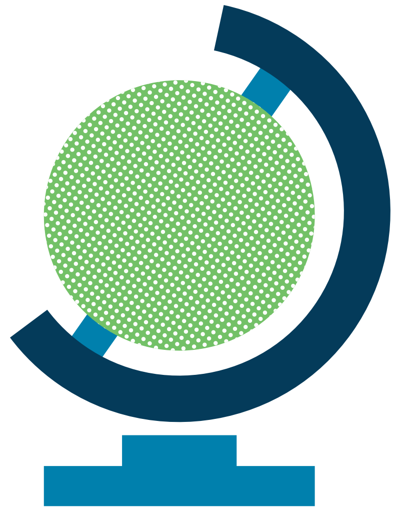

INTERNATIONAL TIDBIT:

Exploiting IP Globally While Thinking *Inside* the Box

With the addition of the United Kingdom to the lengthening roster of countries offering tax-advantaged ways to exploit intellectual property ("IP") – the so-called patent box – it is an opportune time to explore some of these arrangements and how they might be treated from a U.S. tax perspective.

HISTORY OF THE PATENT BOX

The patent box did not begin life as a repository for tax savings. Popular in Victorian England, patent boxes were made of wood and lined with luxurious fabrics. Known for intricate compartments and ingenious locking mechanisms, patent boxes were designed to safeguard valuable papers and property. An ad for one, published in the Economist in 1870, contained the following assessment, "a neat and ingenious contrivance. These boxes are very cheap, and will be found exceedingly useful." This may also be said of the figurative, modern patent box offering tax savings, but requiring careful selection on a case-by-case basis.

Since 1992, a number of European countries have introduced variations of the tax-oriented patent box, including Belgium, France, Hungary, Ireland, Luxembourg, the Netherlands, and Spain.

WHAT'S IN THE BOX?

Generally, the patent box is a mechanism designed to isolate income and deductions related to the development (or purchase) and the exploitation of IP by a company resident in the patent box country. Once that income is determined, a preferential corporate income tax rate applies to it. The IP eligible for entry into the patent box may be broader than that protected by patent. For example, some countries permit unpatented technology such as know-how, software, copyrights, and even valuable marketing intangibles such as trademarks and trade names to enter the patent box. And while there may be a requirement to undertake ongoing R&D, it does not necessarily have to be done in the country where the patent box resides. Therefore it may be possible to combine benefits of R&D-related incentives offered in another country with deductions taken in determining taxable income in the patent box country.

ONE SIZE BOX DOESN'T FIT ALL

Before deciding whether to use a patent box, it is important to weigh not only the advantages but also the responsibilities and costs of complying with a patent box regime, and then to compare the specifics of each country's program. It may also be worthwhile to consider countries not offering a patent box as such, but whose low rates of corporate income tax, coupled with other incentives and a robust treaty network, might prove equally advantageous. For example, Cyprus applies its general corporate income tax rate of 10% to net royalty income while Ireland applies its preferential 12.5% corporate tax rate in certain situations and also offers R&D incentives although its patent box regime ended in 2011.

Factors to consider include:

- Type of IP – is the box limited to patents?
- Must the IP have been developed after a certain date?
- Must the company using the patent box own the IP or can it license IP from someone else, including a related person?
- Must the patents be acquired from a third party, or can they be developed in-house or acquired from a related party?
- Must a patent be granted by the country in which the patent box is located?
- Can income qualify if it is earned before the patent is finally granted?
- Is a separate profit and loss statement required to reflect activity in the patent box?
- How is income determined, including what deductions are allocated to the box as opposed to income outside the box and which may be taxed at a higher rate?
- Is income from the sale of products or the performance of services included?
- Is income from the sale of IP included, and if so, must any previous benefits be recaptured?
- Are damages from infringement cases included in the patent box?
- Is there a requirement to engage in R&D activities?
- Is there a phase-in period before full benefits of the patent box are available?
- Must there be employees and infrastructure in the patent box country?
- Are there other incentives available, such as for job-creation and training of workers?

- Are there limits, in terms of maximum amount of benefits or number of years, to the patent box scheme?

- Does the country have an attractive network of double taxation treaties to reduce withholding taxes on royalties?

- Are foreign tax credits usable to reduce the already low tax applied to income in the patent box?

- Is it likely that the rules could change and the patent box may become less attractive?

- Is it possible (or advisable) to obtain a ruling from the tax authorities to lock in the savings?

In considering the new U.K. patent box, Roy Maugham, Tax Partner at UHY Hacker Young in London, indicates "Our international pharmaceutical clients are now gearing themselves up to adopt the patent box regime to improve the financing of future projects." Of interest to clients in the Energy Industry in Houston, especially oil field service companies reliant on valuable technology, Ian Williams, Partner-in-Charge of Campbell Dallas in Aberdeen, Scotland offers the following comments. "It is a very important time for Energy Companies who are engaged in R&D to examine how they are structured, in order to optimize the considerable tax and cash flow benefits that the new U.K. patent box will provide. Campbell Dallas has teamed-up with Jumpstart, who are market leaders in the UK tax industry around R&D, to provide relevant advice to Energy businesses on how they should be structured within the generous R&D Tax and patent box environment in the UK."

CHALLENGES TO UNLOCKING THE SAVINGS

While the introduction of the U.K. patent box has prompted lots of attention in the media and among tax advisors, is a foreign patent box a good idea for a U.S. based multinational? In addition to pondering the factors listed above, a U.S.-based company also has to consider U.S. tax implications under the anti-deferral rules contained in Subpart F and other provisions of the Internal Revenue Code ("IRC"). For example, using a controlled foreign corporation to license or sell IP may result in Foreign Personal Holding Company Income under IRC §954(c), taxed currently to the U.S. shareholder. Moreover, if transfer of the IP to the foreign patent box is in the form of a contribution to capital of a foreign corporation, IRC §367(d) may come into play and treat the property as having been sold in exchange for payments contingent upon productivity, use or disposition of the IP. The amounts recognized by the U.S. transferor on that deemed sale are commensurate with income attributable to the IP. This implicates transfer pricing and valuation issues both in the U.S. and the other countries involved in a transaction. As a result of these U.S. tax considerations, the patent box may prove more attractive for developing new technology offshore for exploitation outside the U.S., rather than for pre-existing IP developed and owned in the U.S.

PICKING THE RIGHT BOX

UHY International is a network of member firms across the globe, consisting of 250 offices in over 80 countries including all of the countries mentioned in this article. In conjunction with our colleagues in those firms, UHY in Houston can help evaluate various patent boxes and other arrangements designed to reduce taxes on income from exploitation of IP outside the U.S., while keeping an eye on the U.S. anti-deferral rules designed to counteract many of those advantages.