\

The Knowledge Development Box

A submission to the Department of Finance

8 April 2015

Table of contents

Key Recommendations and Message

Budget 2015 announced that Ireland would be introducing a “knowledge development box” similar to other patent and innovation boxes in place in other countries once the EU and OECD discussions on patent box regimes conclude. It was announced that the knowledge development box would be “best in class” and would be a “key element in attracting future foreign direct investment to Ireland”. The EU and OECD have subsequently agreed that innovation and patent box regimes should be designed in line with the so-called ‘modified nexus approach’ and on 6 February 2015 published the agreement reached in this regard, which is useful in considering the design issues for the Knowledge Development Box (KDB). These are addressed further on in our response to this public consulation.

In order for the knowledge development box to in fact be “best in class”, it is important that it applies to the broadest possible base with a highly competitive rate applicable. In our view, there is a broad scope of intellectual property assets that should be considered functionally equivalent to patents and our comments in this regard are set out at 1.0 of this response. Indeed, the OECD is expected to produce further guidance on the types of intellectual property assets that should be considered functionally equivalent to patents which will aid in finalising the design of the knowledge development box regime. Regarding the applicable rate for the regime, we believe a 2.5% rate would give Ireland a competitive offering in attracting future foreign direct investment to Ireland, which is of course one of the key goals of introducing this new regime.

We believe that there are fundamental issues with the current formula proposed under the modified nexus approach, particularly regarding the 30 per cent uplift in qualifying expenditure for certain IP acquisition costs and outsourced R&D to related parties. The formula is ‘bottom heavy’ and this uplift will inevitably result in smaller countries, like Ireland, being penalised for not having the R&D capacity of some larger countries throughout the EU (e.g. Germany or the UK).

A fairer approach in ensuring that the income receiving benefits under the knowledge development box regime is linked to the underlying qualifying expenditure would be to allow a reduction in the formula for any accounting amortisation booked in the accounts relating to the IP assets qualifying for the knowledge development box regime. Alternatively, some form of fixed-rate depreciation in the formula could be allowed similar to that already available under s291A TCA 1997. The formula, as it stands under the modified nexus approach, puts Ireland at a distinct disadvantage and therefore needs to be addressed if the knowledge development box regime is to be as attractive as initially envisaged when announced.

Regarding the definition of “qualifying expenditure” under the knowledge development box regime, in our view the definition should not be linked to the definition of research and development under the R&D tax credit regime contained in Irish tax law but rather should be defined more broadly, perhaps based on the pre-existing definition of “scientific research” within s763 TCA.

In addition, “overall expenditure” in the Knowledge Development Box formula should be defined to include overall expenditure incurred by the taxpayer itself rather than on a group-wide basis as the latter definition would give rise to significant practical difficulties in terms of double counting in the formula.

It is important that the knowledge development box regime does not affect the operation of existing reliefs available, such as the R&D tax credit and s291A TCA 1997. In our view, the R&D tax credit should operate in conjunction with the knowledge development box regime while s291A TCA 1997 should continue to be available with the possibility of making an election to apply the Knowledge Development Box as an alternative for intellectual property assets that potentially qualify for benefits under both regimes.

Given the reduced rate applicable under the knowledge development box regime, it is important that current reliefs available for foreign tax suffered and for losses are unaffected. This should be the case by applying the modified nexus formula to the results from the activities of the trade which relates to KDB activities. We would recommend that relief for losses be available on a value basis and that pooling provisions be introduced for foreign tax suffered whereby foreign tax suffered on profits taxable under the knowledge development box regime can be pooled against other such profits with any unutilised amount being available to carry forward to future accounting periods.

Regarding embedded royalties, we recommend that in allocating income for the purposes of the KDB a 30 per cent hurdle rate should be applied such that where greater than 30 per cent of the income from the sale of goods or services derive their value from qualifying IP all of such income would be attributed to the KDB trade. There is support for such an approach in other patent box regimes in operation in the EU (e.g. The Netherlands).

In order to ensure that the knowledge development box regime is attractive to Irish indigenous companies, we believe that consideration should be given to extending the regime to individuals and partnerships or alternatively a reduced tax rate/enhanced credit could be offered to shareholders who receive dividends paid out of profits qualifying for benefits under the knowledge development box regime.

Ireland's tax policy is "playing fair but playing to win" (Michael Noonan, Minister for Finance) and it is important that Ireland now positions itself to maintain its competiveness as an intellectual property location on the international stage. We cannot afford to stand still. Ireland needs to stand tall and continue to play to win; otherwise, we will be left with the 'crumbs from the table' that will not sustain our economy in the medium term.

1. Responses to consultation questions

1.0 Question 1

It appears likely that the benefits of income-based IP regimes will be limited to income derived from "patents and assets that are functionally equivalent to patents" while marketing intangibles will be excluded. Please provide a description of the assets that you believe to be functionally equivalent to patents and the basis for that belief.

1.1. Overview

The question of what assets will qualify for the Knowledge Development Box regime in Ireland is one of great significance for MNCs with a presence in Ireland and Irish indigenous companies with valuable intellectual property.

In the OECD's September 2014 progress report on Action 5 of the BEPS Action Plan, they stated that:

"Under the nexus approach as contemplated, the only IP assets that could qualify for tax benefits under an IP regime are patents and other IP assets that are functionally equivalent to patents if those IP assets are both legally protected and subject to similar approval and registration processes, where such processes are relevant…. Under the nexus approach, marketing related IP assets such as trademarks cannot qualify for tax benefits under an IP regime."

Subsequent to the issue of this progress report by the OECD, the UK and Germany put forward a proposal for a modified nexus approach which has now been endorsed by all OECD and G20 countries. This revised proposal makes no changes to the categories of assets that should qualify for IP regimes, such as the KDB regime that is the subject of this public consultation.

On 6 February 2015, the OECD published the agreement that has been reached on the modified nexus approach that incorporates a list of items requiring further work in the first half of 2015 and includes the following additional commentary on the definition of qualifying IP assets:

"The FHTP recognises the need for clarity on the definition of qualifying IP assets. The FHTP will therefore produce further guidance on this definition, addressing in particular the exact scope of IP assets, for example, the treatment of copyrighted software or innovations from technically innovative development or technical scientific research that do not benefit from patent protection, always provided of course that such assets have been developed with significant nexus."

This additional guidance will be welcome in providing additional clarity on the types of assets that can constitute qualifying IP for the purposes of the KDB regime. The above commentary would appear to support the view that IP assets outside of a strict patent context could qualify for the KDB regime.

We have outlined our view in section 1.2 below of what assets we believe could constitute qualifying IP of a KDB regime, based on the OECD commentary currently available.

1.2 Assets functionally equivalent to patents

From the OECD commentary published to date in respect of Action 5 of the BEPS project, we understand that IP assets should be considered functionally equivalent to patents if they are both legally protected and subject to similar approval and registration processes where such processes are relevant. For something to be functionally equivalent, it must perform essentially the same functions and, therefore on the basis that a patent performs the function of providing legal protection for the asset that is the subject of the patent, other IP assets that also provide legal protection for the assets concerned should be considered functionally equivalent to patents.

Regarding the latter criterion noted above of registration and approval, the requirement appears to be that the IP asset is subject to similar approval and registration processes as is the case for patents; but notwithstanding that there are no approval and registration processes for the IP asset in question, then such absence, of itself, should not preclude the IP asset from qualifying for the benefits of the preferential regime. This criterion would appear to be satisfied in the majority of cases and would only seem to apply where there are registration and approval procedures with certain conditions that need to be met in order to be entitled to register the IP asset in question. One example here would be designs which must be new and have individual character in order to be subject to the registration procedures (see section 1.2.1 below). Where designs do not meet this test in order to be registerable it would appear that the ‘functionally equivalent to patents’ test would not be satisfied.

The other criterion that the IP asset concerned needs to be legally protected in order to qualify for the benefits of a preferential IP regime requires a more in-depth analysis. The question of legal protection should be determined in accordance with the applicable legal principles. We have provided a summary below of the IP assets that we believe could qualify for the benefits of a preferential IP regime, such as the Knowledge Development Box, along with the basis of their legal protection under Irish law.

1.2.1 Registered design

According to the Irish Patents Office, design means:

“the appearance of the whole or a part of a product resulting from the features of, in particular, the lines, contours, colour, shape, texture or materials of the product itself or its ornamentation.”

Designs are subject to registration procedures and the requirements for a design to be registerable are that the design must be new and have individual character, and in this regard the Irish Patents Office has stated that:

- A design is considered to be new if no identical design has been made available to the public before the date of filing of the application for registration or, where priority is claimed, the date of priority
- The requirement to have ‘individual character’ is met if the overall impression produced by a design on an informed user differs from the overall impression produced on such a user by any earlier design which has been made available to the public.

The Irish Patents Office has also confirmed on its website that designs that relate to how a product functions or for parts that in normal use are not visible, or designs that are contrary to public policy or to accepted principles of morality or which constitute an infringement of a copyright work may not be registered.

According to the Irish Patents Office, design registration grants a statutory right, subject to certain conditions, to prevent others from using the design without the registered proprietor's permission (i.e. to prevent infringement) and confers an exclusive right to authorise others, by means of licensing, to use the design.

When a design is registered, protection is granted initially for five years. Protection can then be renewed for four further periods of five years each (on payment of the prescribed fee), giving a maximum of 25 years of protection from the date of registration.

There is an application process in place for the registering of designs which needs to be followed.

Therefore, based on the above, registered designs are legally protected and are subject to similar approval and registration processes, as is the case for patents, which are relevant in the case of designs. On this basis registered designs should be considered functionally equivalent to patents and should, therefore, be included within the definition of qualifying IP for the purposes of the KDB regime.

1.2.2 Design right

Registering a design creates a property right known as a design right and the registered proprietor is the owner of the design right as per the Irish Patents Office website.

Our comments at 1.2.1 above refer in this regard and on the basis outlined above design rights should therefore be considered functionally equivalent to patents and should, therefore, be included within the definition of qualifying IP for the purposes of the KDB regime.

1.2.3 Invention

One would expect a lot of inventions with value to be protected by patent, which would be within the definition of “qualifying IP” for the purposes of the KDB regime. However, the question arises as to whether inventions not covered by patent are covered by some other legal protection similar to patents with the result that these inventions could be said to be functionally equivalent to patents.

The question of whether a non-patented invention is legally protected is a question of fact. For example, a lot of valuable inventions, while not in the public domain, would contain confidential information and, provided any employees or contractors who may have access to this information have been given notice that such information is confidential, then a duty of confidence arises which is a form of legal protection. The legal basis for this protection is the “law of confidence” which is a judge-made law that has been developed through a broad range of case law. Logically, once an invention has entered the public domain the legal protection provided for under the law of confidence no longer exists in the absence of patent protection being granted at that stage or some other form of legal protection.

Other examples of where non-patented inventions could be covered by legal protection would be where the details of these inventions are only disclosed under confidentiality agreements or non-disclosure agreements.

No approval or registration procedures are applicable in relation to non-patented inventions, which are otherwise legally protected.

Therefore, in our view, inventions which are legally protected should be provided for within the definition of “qualifying IP” for the purposes of the KDB regime. It will be recalled that Action 5 of the BEPS plan speaks about “approval and registration process” but “where such processes are relevant.” Such processes would not appear relevant in this instance.

1.2.4 Copyright or related right

In Ireland, copyright protection is automatic and no registration or approval is required.

According to the Irish Patents Office website, the act of creating a work also creates the copyright, which then subsists in the physical expression of the work. Copyrights are protected by law and illegal use of these rights can be contested in the courts; the technical term for this misuse being ‘infringement’. No protection is provided for ideas while the ideas are in a person’s mind; copyright law protects the form of expression of ideas, not the ideas themselves.

Copyright subsists in original literary, dramatic, musical or artistic works, sound recordings, films, broadcasts or cable programmes, typographical arrangements and databases. In addition, software is principally protected by copyright as source code in computer programs is treated as a literary work under Irish law.

As copyright protection is automatic, the copyright asset itself (or a related right) and the underlying assets that are the subject of the copyright protection (for example software, publishing titles, databases, musical rights, etc.) should be considered to be legally protected and therefore to be functionally equivalent to patents. Once again, it will be recalled that Action 5 of the BEPS plan speaks about “approval and registration process” but “where such processes are relevant.” Such processes would not appear relevant in this instance. On this basis, they should be included within the definition of qualifying IP for the purposes of the KDB regime.

1.2.5 Software

As noted in section 1.2.4 above, software code covered by copyright should be included within the definition of qualifying IP for the purposes of the KDB regime on the basis that it is legally protected by copyright.

For completeness, it should be noted that certain types of software may be patentable in which case, if actually patented, the assets would constitute qualifying IP for the purposes of the KDB regime without the need to rely on the legal protection offered by copyright. This would be relevant, for example, where certain aspects of the software asset were not covered by copyright but could be covered by patent (i.e. elements of the software asset separate to the underlying software code).

1.2.6 Supplementary protection certificates

A supplementary protection certificate may be obtained in relation to individual medicinal and plant protection products disclosed in a patent. The certificate extends the protection conferred by the patent beyond its 20 year term for a period of up to five years. Recent European legislation also provides supplementary protection certificate holders with the possible additional reward of a six-month term extension in return for conducting paediatric studies.

Supplementary protection certificates are not patent extensions; they are distinct IP rights of their own that extend the legal protection conferred by the patent.

An application must be made in order to obtain a supplementary protection certificate in Ireland.

Therefore, on the basis that supplementary protection certificates are both legally protected and subject to a registration and approvals process (as these processes are relevant for this type of IP asset), these IP rights should be included within the definition of qualifying IP for the purposes of the KDB regime.

1.2.7 Plant breeders’ rights

Plant breeders’ rights are a form of IP designed specifically to protect new plant varieties. The system allows the breeder of new varieties of agricultural, horticultural and ornamental plants to legally register the right to control the propagation and marketing of those varieties.

As set out on the Department of Agriculture, food and the Marine’s website, rights are valid for 25 years for most species and 30 years for varieties of trees, vines and potatoes.

Plant breeders’ rights are registered by the office of the Controller of Plant Breeders’ Rights, a corporate body, which is staffed by the Department of Agriculture, Fisheries & Food. A variety is eligible for rights if it is distinct, stable, uniform, and new, and if it has an approved name. Once a right has been established for a variety, the onus is on the holder of the right to enforce it, if necessary by legal action.

Therefore, on the basis that plant breeders’ rights are both legally protected and subject to a registration and approvals process (as these processes are relevant for this type of IP asset), plant breeders’ rights should be included within the definition of qualifying IP for the purposes of the KDB regime.

1.2.8 Secret processes or formulae or other secret information concerning industrial, commercial or scientific experience, including know-how

Currently Ireland does not have laws specifically protecting trade secrets or other confidential information, including know-how, and the owner of these IP assets that have been misappropriated must rely on either contract law, where for example a confidentiality agreement or non-disclosure agreement has been entered into with the parties concerned, or on judge-developed law on confidentiality (section 1.2.3 above refers). In the absence of a written contract, a legally enforceable obligation of confidentiality may exist because of the type of relationship between the parties, for example in the case of an employer/employee relationship.

No approval or registration procedures are applicable in relation to trade secrets or other confidential information, including know-how, and which are legally protected under either contract law or the law of confidence.

Therefore, in our view, trade secrets and other confidential information, including know-how, which are legally protected should be provided for within the definition of "qualifying IP" for the purposes of the KDB regime.

As noted above, Irish law already has a well developed action for breach of confidence under the law of confidence (and, where applicable, contract law) which is designed to protect confidential information such as trade secrets and know-how from misappropriation, misuse or unauthorised disclosure. This legal protection currently provided on an equitable/common law basis is likely to be further enhanced over the next two to three years through the implementation of a proposed Trade Secrets Directive, which was initially proposed by the European Commission at the end of 2013 and which is currently making its way through the EU Parliament and Council in 2015. This directive aims to protect trade secrets, know-how and confidential information from unlawful acquisition, use and disclosure. The final directive is expected to be published later this year, at which point Member States will have a further two years to implement the proposals.

1.2.9 Certain licences of IP assets

To the extent that IP assets which are licensed into Ireland on an exclusive basis are themselves patents or other IP assets functionally equivalent to patents and which have been identified above, in our view these assets should constitute qualifying IP for the purposes of the KDB regime. This is on the basis that the right to use the IP assets (to the extent that these assets constitute patents or IP assets functionally equivalent to patents) under the relevant licence agreement is itself an asset which is functionally equivalent to a patent.

1.2.10 Compliance

It is noted that the above definitions may present compliance difficulties from a Revenue perspective. It will be recalled that the former effective 10 per cent rate activities applicable to certain IFSC entity profits was required to be certified by a taxpayer's auditors. The following is an extract from the Appendices to the1991 text, "Taxation of International Financial Services Transactions in Ireland", produced by the Taxation Administration Liason Committee and outlining an example of such a certificate:

"The Company, in the course of the trading operations to which the certificate refers, will not either directly or indirectly acquire assets from or avail of services provided by persons who would be treated as connected with the Company for the purposes of the Acts as defined in Section 86(1)(a) of the Finance Act, 1989 ("the connected persons") unless the assets are acquired and the services are provided on an arm's length basis and, where the connected persons are ordinarily resident in the State or are Irish branches of non-resident companies or are under the control of Irish residents,

(i) "the Company and the connected persons have first established formal procedures, which will be subject to approval from time to time by the Revenue commissioners, to ensure compliance with this requirement, and

(ii) *“a report from the Company’s auditors, in terms satisfactory to the Revenue Commissioners, on the adequacy of these procedures for the purpose of ensuring such compliance is obtained annually and made available to the Revenue Commissioners, and the auditors are required to express an opinion in this report as to the degree of adherence or otherwise to the procedures in question by the Company and the connected persons;”.*

We would submit that a similar certificate could be produced by a taxpayer’s auditors outlining their agreement that the IP concerned was regarded as qualifying IP for KDB pruposes. This would ensure that a separate independent review and certification of the assets contained in each KDB claim was necessary.

2.0 Question 2

In designing the Knowledge Development Box it is necessary to consider the following items:

- ***a) The method of calculation of the income qualifying for the preferential rate***
- ***b) The interaction of the regime with current loss relief legislation***
- ***c) The interaction of the regime with double taxation relief.***

Please comment on the above items and on any other design issues that should also be considered (that are not mentioned in any of the other questions).

2.1 The method of calculation of the income qualifying for the preferential rate

Under the modified nexus approach which the KDB regime must comply with, the amount of income receiving tax benefits under the KDB regime is to be calculated as follows:

$$\frac{\text{Qualifying expenditures incurred to develop IP asset}}{\text{Overall expenditures incurred to develop IP asset}} \times \text{Overall income from IP asset} = \text{Income receiving tax benefits}$$

In order to further understand how this formula would work in practice it is necessary to consider the guidance given on the meanings of “qualifying expenditure”, “overall expenditure” and “overall IP income from IP asset” under the modified nexus approach as it stands. Further comments regarding our recommendations on how “qualifying expenditure” and “overall expenditure” and how “overall IP income from IP asset” should be defined for the purposes of the KDB regime are set out below under Questions 3 and 5, respectively.

<u>“Qualifying expenditures”</u> – This is currently defined to include the types of expenditure currently granted R&D credits under the applicable tax laws of multiple jurisdictions. This would not include interest payments, building costs, acquisition costs or any costs that could not be directly linked to an IP asset but would include all outsourcing to unrelated parties, whether or not they were within the jurisdiction, and no outsourcing to related parties. Where a payment is made through a related party to an unrelated party then the payment can be included in qualifying expenditures. In addition, a 30 per cent uplift will be permitted to qualifying expenditures for the amount of acquisition costs and R&D outsourced to related parties and such uplift cannot exceed 30 per cent of the qualifying expenditures incurred by the taxpayer for the period in question.

<u>“Overall expenditures”</u> – This comprises the sum of all expenditures that would count as qualifying expenditures if they were undertaken by the taxpayer itself. It includes all qualifying expenditure, acquisition costs and

expenditures for outsourcing that are not included within qualifying expenditures. The 30 per cent uplift to qualifying expenditures should not be included in overall expenditures. We would argue the "type" of expenditure outlined above in "qualifying expenditure" refers to that incurred by the relevant company and to their nature rather than looking to the rest of the corporate group to ascertain the levels of expenditure and the reference therein to the question of expenditure qualifying if it were undertaken by the taxpayer itself is necessary to include all subcontracted expenditure but does not go beyond that. Anything else would give rise to potentially multiple levels of double counting which is discussed later in this paper.

"Overall income from IP asset" – This may include royalties, capital gains, other income from the sale of an IP asset and embedded IP income from the sale of products directly related to the IP asset. Overall income should not be defined as gross IP income from the IP asset but should be adjusted by deducting IP expenditures referable to IP income.

Therefore, the formula seeks to ensure that the benefits of a preferential IP regime are only available to the proportion of income that arises from qualifying expenditures carried on by the taxpayer receiving the benefits. Put another way, the modified nexus approach seeks to ensure that there is a direct nexus between the income receiving tax benefits and the expenditures contributing to that income. Essentially therefore, where the return from qualifying IP assets is wholly attributable to qualifying expenditures carried out by the taxpayer in question then that taxpayer should be entitled to treat the whole of such return as income qualifying for benefits under the preferential IP regime in question. Unfortunately, the current formula does not achieve this fundamental objective as it discriminates against taxpayers who buy in IP assets into Ireland and subsequently develop and exploit that IP asset. The 30 per cent uplift is based on the quantum of qualifying expenditure incurred by the taxpayer in question which inevitably results in smaller countries like Ireland being penalised for not having the R&D capacity of some larger countries throughout the EU like, say, Germany or the UK. For example, according to a report published by Eurostat, the statistical office of the European Union, in 2013 the level of R&D spend in Ireland amounted to €2.723 billion while the corresponding levels of R&D in Germany and the UK amounted to €82.482 billion and €32.784 billion, respectively.

Basing the uplift on qualifying expenditures (which excludes acquisition costs) automatically puts larger countries at a distinct advantage, given their larger R&D capacity and does not appear to be consistent with one of the main objectives of Action 5 of the BEPS Action Plan, which is to require substantial activity for any preferential regime. Instead, the revised proposal offers larger countries with greater R&D capacity a competitive advantage in an IP context over smaller countries such as Ireland.

The logic behind the formula is clearly that the OECD is taking the view that expenditures act as a proxy for substantial activities, but in calculating the proportion of income from the IP asset that is attributable to the qualifying expenditures carried out by the taxpayer in receipt of such IP income no account is taken of the fact that certain IP assets, and in particular technology IP assets, have a limited useful life. Therefore, in reality, the income attributable to an actual buy-in payment for an IP asset that has reached the end of its useful life should be minimal; however, this commercial reality is not factored into the above formula as currently drafted.

The question is how could the formula be adjusted to account for the diminishing value and returns over time attributable to bought-in IP assets with a limited useful life which would give rise to a fairer method of determining the extent of IP income attributable to qualifying expenditure undertaken by a taxpayer when compared with the current proposal, which in our view is designed to negate any negative impact of the nexus approach in larger jurisdictions. One way is to look at the accounting amortisation of the IP assets in question. The accounting amortisation is essentially spread over the period in respect of which future economic benefits are expected to be derived from the asset in question and, therefore, it is an appropriate method of looking at the extent to which the IP income could be said to be attributable to the relevant IP expenditures concerned. In order to achieve the fundamental objective of the modified nexus approach of only granting tax benefits under the preferential IP regime to the return generated by qualifying expenditures incurred by the taxpayer, the formula should be adjusted to allow for IP acquisition costs or costs relating to subcontracted R&D to related parties (subject to our comments at 3.1 below regarding the exclusion of such costs from the definition of qualifying expenditures) which are included within overall IP expenditures in the denominator of the formula to be reduced by any related accounting amortisation/impairment booked to the accounts of the taxpayer company on an annual basis, or over a straight-line basis, whichever is shorter.

The reference to a straight-line period here is important to ensure that some consistency can be achieved regarding the application of the formula since the accounting amortisation is by its very nature subjective (in that it requires estimation of useful life, etc.). It should be noted that precedent for such writing off of IP expenditure over a straight line or accounting amortisation basis exists in a different context in s291A; but nonetheless, in our view it would be incorrect to continually attribute IP income to bought-in IP expenditures over the life of the income arising on bought-in and subsequently developed IP. Say a company bought in IP five years ago and has consistently incurred additional expenditure over those years in improving the bought-in IP. It may be the case that in year five the income is more closely related to the expenditure incurred in year five than anything to do with the expenditure relating to the IP bought in. In effect, time moves on and it could be the case that, say, product 5.0 (which was based on the developments to the bought in IP) has more value in year five than product 1.0 (which is based predominantly on the bought-in IP) has in that year, such that more income should be attributed to the IP used to generate product 5.0. This can only be achieved by allowing the amortisation of the original bought-in IP. This works both ways in that if bought-in IP is required on, say, product 3.0 then that will affect the overall expenditure in the denominator in, say, year three, being the year in which that buy-in occurs. Of course, it is not possible to achieve a solution that will be applicable to all IP assets given their very nature, but we would argue that allowing for amortisation of acquired and subsequent developments in that IP goes some way towards restoring the balance between countries with less R&D capabilities and the larger economies. In both instances, over time it is possible that the ratio of qualifying expenditures to overall expenditures in the suggested formula can approximate to 1:1. Without such amortisation, smaller countries would always be hampered by the acquisition costs in overall expenditures irrespective of the true value of that acquired IP vis-à-vis the related income.

The remainder of this section of the paper looks at examples, assuming the financial statement amortisation and the straight-line legislative basis are the same for ease of reference.

By way of example:

- On 1 January 2016 IrishCo buys in software from a group company for €10,000,000 to be used for commercial exploitation
- The software acquired has a useful economic life of five years and on this basis will be amortised for accounting purposes over a five-year period, with it becoming obsolete after this time
- IrishCo incurs ongoing research and development expenditure on the software of €2,000,000 per annum, which also has a useful life of five years and which is also amortised for accounting purposes over a five-year period
- IrishCo generates IP income attributable to the software IP bought in and subsequently developed of €4,000,000 per annum
- On the basis of the above, from 31 December 2020, assuming all expenditure incurred on the software asset post acquisition constitutes qualifying expenditure by IrishCo, the full return would be expected to qualify for tax benefits under the preferential IP regime.

Calculation of IP income receiving tax benefits under current formula

Year	Qualifying expenditure (cumulative)	Overall expenditure (cumulative)	Uplift in qualifying expenditure (cumulative)	IP income	Income receiving tax benefits
2016	€ 2,000,000.00	€ 12,000,000.00	€ 600,000.00	€ 4,000,000.00	€ 866,666.67
2017	€ 4,000,000.00	€ 14,000,000.00	€ 1,200,000.00	€ 4,000,000.00	€ 1,485,714.29
2018	€ 6,000,000.00	€ 16,000,000.00	€ 1,800,000.00	€ 4,000,000.00	€ 1,950,000.00
2019	€ 8,000,000.00	€ 18,000,000.00	€ 2,400,000.00	€ 4,000,000.00	€ 2,311,111.11
2020	€ 10,000,000.00	€ 20,000,000.00	€ 3,000,000.00	€ 4,000,000.00	€ 2,600,000.00
2021	€ 12,000,000.00	€ 22,000,000.00	€ 3,600,000.00	€ 4,000,000.00	€ 2,836,363.64
2022	€ 14,000,000.00	€ 24,000,000.00	€ 4,200,000.00	€ 4,000,000.00	€ 3,033,333.33
2023	€ 16,000,000.00	€ 26,000,000.00	€ 4,800,000.00	€ 4,000,000.00	€ 3,200,000.00
2024	€ 18,000,000.00	€ 28,000,000.00	€ 5,400,000.00	€ 4,000,000.00	€ 3,342,857.14
2025	€ 20,000,000.00	€ 30,000,000.00	€ 6,000,000.00	€ 4,000,000.00	€ 3,466,666.67

Calculation of IP income receiving tax benefits under adjusted formula to allow adjustment to overall expenditure for amortisation relating to IP acquisition costs or costs relating to subcontracted R&D to related parties rather than 30 per cent uplift

Year	Qualifying expenditure	Overall expenditure adjusted for amortisation	IP income	Income receiving tax benefits
2016	€ 2,000,000.00	€ 10,000,000.00	€ 4,000,000.00	€ 800,000.00
2017	€ 4,000,000.00	€ 10,000,000.00	€ 4,000,000.00	€ 1,600,000.00
2018	€ 6,000,000.00	€ 10,000,000.00	€ 4,000,000.00	€ 2,400,000.00
2019	€ 8,000,000.00	€ 10,000,000.00	€ 4,000,000.00	€ 3,200,000.00
2020	€ 10,000,000.00	€ 10,000,000.00	€ 4,000,000.00	€ 4,000,000.00
2021	€ 12,000,000.00	€ 12,000,000.00	€ 4,000,000.00	€ 4,000,000.00
2022	€ 14,000,000.00	€ 14,000,000.00	€ 4,000,000.00	€ 4,000,000.00
2023	€ 16,000,000.00	€ 16,000,000.00	€ 4,000,000.00	€ 4,000,000.00
2024	€ 18,000,000.00	€ 18,000,000.00	€ 4,000,000.00	€ 4,000,000.00
2025	€ 20,000,000.00	€ 20,000,000.00	€ 4,000,000.00	€ 4,000,000.00

As demonstrated above, by allowing an adjustment for the amortisation relating to IP acquisition costs or costs relating to subcontracted R&D to related parties rather than 30 per cent uplift it is possible to more closely align the IP return to the underlying qualifying expenditure, which achieves the fundamental objective of ensuring that the income qualifying for benefits under a preferential IP regime is directly linked to the qualifying expenditure undertaken by that taxpayer. This would incentivise bringing IP onshore, which is the objective of the KDB in the first instance. The current formula is excessively punitive for Irish taxpayers that buy in IP with a limited useful life and acts as a disincentive for taxpayers to bring IP onshore. Therefore, we strongly believe this should be addressed in designing the KDB regime. That said, it should be recognised that if no subsequent development work is incurred on the IP asset then it is likely that there will be no qualifying expenditure in the first instance, such that amortisation of an asset's acquisition cost in the formula should be of no consequence.

The above example clearly demonstrates the disadvantage that a country such as Ireland with limited R&D capacity is faced with should the current modified nexus approach remain unchanged. To illustrate, if you were to take the above example and assume instead that annual R&D expenditure would amount to €8 million (as may be the case for countries with a larger R&D capacity) with IP income generated from the IP asset of €6 million, the income qualifying for IP benefits would be:

Year	Qualifying expenditure (cumulative)	Overall expenditure (cumulative)	Uplift in qualifying expenditure (cumulative)	IP income	Income receiving tax benefits
2016	€ 8,000,000.00	€ 18,000,000.00	€ 2,400,000.00	€ 6,000,000.00	€ 3,466,666.67
2017	€ 16,000,000.00	€ 26,000,000.00	€ 4,800,000.00	€ 6,000,000.00	€ 4,800,000.00
2018	€ 24,000,000.00	€ 34,000,000.00	€ 7,200,000.00	€ 6,000,000.00	€ 5,505,882.35
2019	€ 32,000,000.00	€ 42,000,000.00	€ 9,600,000.00	€ 6,000,000.00	€ 5,942,857.14
2020	€ 40,000,000.00	€ 50,000,000.00	€ 10,000,000.00	€ 6,000,000.00	€ 6,000,000.00
2021	€ 48,000,000.00	€ 58,000,000.00	€ 10,000,000.00	€ 6,000,000.00	€ 6,000,000.00
2022	€ 56,000,000.00	€ 66,000,000.00	€ 10,000,000.00	€ 6,000,000.00	€ 6,000,000.00
2023	€ 64,000,000.00	€ 74,000,000.00	€ 10,000,000.00	€ 6,000,000.00	€ 6,000,000.00
2024	€ 72,000,000.00	€ 82,000,000.00	€ 10,000,000.00	€ 6,000,000.00	€ 6,000,000.00
2025	€ 80,000,000.00	€ 90,000,000.00	€ 10,000,000.00	€ 6,000,000.00	€ 6,000,000.00

As can be seen from the above, based on the current formula in the modified nexus approach, larger countries with greater R&D capability are rewarded for having that greater R&D capacity than smaller countries, which is inherently unfair. This example demonstrates that the modified nexus approach as currently drafted does not go far enough in ensuring that the income receiving benefits under a preferential IP regime is based on its nexus to the qualifying expenditure carried out by the taxpayer in question.

The alternative approach based on allowing for certain amortisation of IP expenditure is a fairer approach given that it does not discriminate against smaller countries with reduced R&D capacity.

2.2 Interaction of the regime with current loss relief legislation

In order to make sure that the KDB regime to be introduced is as competitive as possible and to perhaps make up for some shortcomings of the proposed regime in light of the fact that there appears to be an exclusion on sub-contracted R&D to related parties from the definition of qualifying expenditure, it is imperative that current loss reliefs available are not negatively affected by the KDB regime. This should be the case where only the KDB income is extracted from the computation of taxable profits. Thereafter, loss relief could be allowed on a form of value basis such that trading losses could be utilised against KDB profits. Such relief would be within the spirit of current loss relief principles under Irish law and could be available on a current-year basis only, as is the case for other value-based loss-relief claims.

2.3 The interaction of the regime with double-taxation relief

In our view, the issue of double tax relief for foreign tax suffered on income falling within the KDB regime is a significant issue that should be addressed.

Currently, where foreign royalties are received and the relevant double-taxation treaty does not reduce the withholding tax rate to nil, or where the foreign royalties are received from a non-treaty country, withholding tax will be suffered on the gross royalty income received, while the level of double-tax relief is restricted to the Irish corporate tax attributable to the foreign income computed in accordance with Irish tax principles. Where the Irish tax liability attributable to these foreign royalties is further reduced by the relief offered under the KDB regime, this would have the effect of further restricting the level of double-taxation relief available.

Schedule 24, Paragraph 9DB currently allows for a type of pooling of unrelieved foreign tax attributable to certain trading royalties as a foreign tax deduction, but only on a current-year basis with no possibility of carrying forward unutilised relief. To enhance Ireland’s position in this area, we would recommend that the relief provided under Schedule 24, Paragraph 9DB be broadened to allow both pooling of unrelieved foreign tax attributable to certain trading royalties as a credit and also to allow any unutilised foreign tax to be carried forward to future accounting periods and to be available as a credit in those years against trading royalties.

A similar type of relief to that proposed above for royalties is already available for certain dividends and branch profits. To enhance Ireland's offering as an IP location, this form of relief could now be extended to royalties as well.

2.4 Other design issues

The other design issue not referenced specifically in any other question in this consultation is the rate applicable to the KDB regime. It is important that Ireland maintains its competitiveness as an IP location and one way of strengthening Ireland's competitiveness in this regard is through the rate.

We believe a 2.5 per cent rate applicable to income qualifying for benefits under the KDB regime being 20 per cent of the Irish headline rate of 12.5 per cent, would position Ireland well in the international landscape, which is extremely competitive and would aid in ensuring that Ireland introduces a "best in class" KDB regime in accordance with the Government's intentions and assurances. The Netherlands, Belgium and Luxembourg also offer rates under their current patent boxes at circa 20 per cent of the headline rates of corporation tax (circa 5 per cent, 7 per cent and 6 per cent respectively).

In addition, up until *Finance Act 2014*, s291A TCA 1997, which provides relief for capital expenditure on certain intellectual property assets, provided for a minimum effective rate of 2.5 per cent on profits related to IP activity. This restriction has now been removed such that a minimum effective rate of zero per cent is now achievable on certain IP profits under s291A TCA 1997. Nevertheless, taking into account our recommendations regarding losses and double tax relief and the interaction of same with the KDB regime, we believe a KDB rate of 2.5 per cent would present Ireland with a very competitive offering as an international IP location even as multinational companies consider moving IP onshore in the short to medium term in light of the recent closure of the so-caled 'double Irish'.

3.0 Question 3

What expenditure should be included in the definitions of "qualifying expenditure" (see paragraphs 10 & 11 of Annex I) and "overall expenditure" under the modified nexus approach? Please also provide an explanation of why the expenditure should be included.

3.1 Definition of "qualifying expenditure"

We have summarised in 2.1 above the current OECD guidance regarding what is meant by *"qualifying expenditure"* and what can be included therein. For ease of reference, we have reproduced the relevant OECD commentary on qualifying expenditures here:

"Qualifying expenditures must have been incurred by a qualifying taxpayer, and they must be directly connected to the IP asset. Jurisdictions will provide their own definitions of qualifying expenditures, and such definitions must ensure that qualifying expenditures only include expenditures that are necessary for actual R&D activities. They would include the types of expenditures currently granted R&D credits under the tax laws of multiple jurisdictions. They would not include interest payments, building costs, acquisition costs, or any costs that could not be directly linked to a specific IP asset."

Under the modified nexus approach, we are also permitted to allow for an uplift in qualifying expenditures for acquisition costs and subcontracted R&D to a related party, subject to the limitation that such uplift cannot exceed 30 per cent of qualifying expenditures in a given year.

Regarding the requirement that the types of expenditure to be included within the definition of qualifying expenditures should include the types of expenditures currently granted R&D credits in multiple jurisdictions, the OECD stated in their September 2014 report on Action 5 of the BEPS Action plan that:

"Qualifying expenditures could therefore include salaries and wages, direct costs, overhead costs, costs of supplies, and depreciation (not including depreciation or amortisation of acquisition costs) so long as all of these costs arise out of activities undertaken to advance the understanding of scientific relations or technologies, address known scientific or technological obstacles or otherwise increase knowledge or develop new applications."

Therefore, it seems clear that the definition of qualifying expenditures for the purposes of the KDB regime should be broader than the current definition of "research and development activities" for the purposes of s766 TCA 1997, which defines research and development activities as:

"…systematic, investigative or experimental activities in a field of science or technology, being one or more of the following –

- *i. Basic research, namely, experimental or theoretical work undertaken primarily to acquire new scientific or technical knowledge without a specific practical application in view,*
- *ii. Applied research, namely, work undertaken in order to gain scientific or technical knowledge and directed towards a specific practical application, or*
- *iii. Experimental development, namely, work undertaken which draws on scientific or technical knowledge or practical experience for the purpose of achieving technological advancement and which is directed at producing new, or improving existing, materials, products, devices, processes, systems or services including incremental provisions thereto:*

but activities will not be research and development activities unless they –

- *I. Seek to achieve scientific or technological advancement, and*
- *II. Involve the resolution of scientific or technological uncertainty;"*

Furthermore, S766 is very limiting in that it has to be "expenditure incurred **wholly and exclusively in the carrying on by it**" (emphasis added) of R&D activities. In light of recent Revenue guidelines, interpretation of this is leading towards the exclusion of expenditure relating to certain supporting activities and indirect activities.

Therefore, as can be seen from the above, this definition is considerably more restrictive than the definition that could be permitted for qualifying expenditures for the purposes of the KDB regime based on OECD guidelines and therefore, in our view, should not be followed.

The OECD have also stated in their 2014 progress report that:

"…general and speculative R&D can be included in qualifying expenditures so long as taxpayers can show that there is a direct link between the R&D and the IP asset that was produced."

Therefore, based on the above OECD guidance from their September 2014 report on Action 5 of the BEPS action plan, in our view qualifying expenditure under the KDB regime should be broadly defined and should not be based on the existing definition provided for under s766 TCA 1997. One way of achieving this broad scope would be to link the definition to that which already exists for scientific research. "Scientific research" is defined in s763 TCA 1997 as:

"…any activities in the fields of natural or applied science for the extension of knowledge."

For example, qualifying expenditures for the purposes of the KDB regime could be defined as any expenditure incurred by the taxpayer on scientific research linked to a qualifying IP asset (as separately defined) arising out of activities undertaken to advance the understanding of scientific relations or technologies, address known scientific or technological obstacles or otherwise increase knowledge or develop new applications. A separate definition could be provided for excluded expenditure to include related-party, sub-contracted R&D, as well as interest payments, building costs or acquisition costs.

We believe that such a definition of qualifying expenditure in the Irish KDB regime would be in line with OECD guidelines and would present Ireland with a competitive offering as an intellectual property location.

In addition, we would recommend that the exclusion from qualifying expenditure of connected party subcontracted R&D should be revisited.

Given the restrictions currently at issue regarding the costs incurred in acquiring IP into Ireland under the modified nexus approach, particularly in light of our limited R&D capacity, our recommendation would be for annual royalty payments for the licensing of qualifying IP to be specifically included in the definition of qualifying IP.

3.2 Definition of "overall expenditure"

As is the case for qualifying expenditures, we have summarised in 2.1 above the current OECD guidance regarding what is meant by "overall expenditure" and what can be included therein. Again for ease of reference, we have reproduced the relevant OECD commentary on qualifying expenditures here:

"Overall expenditures should be defined in such a way that, if the qualifying taxpayer incurred all relevant expenditures itself, the ratio would allow 100% of the income from the IP asset to benefit from the preferential regime. This means that overall expenditures must be the sum of all expenditures that would count as qualifying expenditures if they were undertaken by the taxpayer itself. This in turn means that anything that would not be included in qualifying expenditures even if incurred by the taxpayer itself (e.g., interest payments, building costs, acquisition costs and other costs that do not represent actual R&D activities) cannot be included in overall expenditures and hence does not affect the amount of income that may benefit from an IP regime. IP acquisition costs are an exception, since they are included in overall expenditures and not in qualifying expenditures. Their exclusion is consistent with the principle of what is included in overall expenditures, however, because they are a proxy for expenditures incurred by a non-qualifying taxpayer. Overall expenditures therefore include all qualifying expenditures, acquisition costs, and expenditures for outsourcing that do not count as qualifying expenditures.

"Often, overall expenditures will be incurred prior to the production of income that could qualify for benefits under the IP regime. The nexus approach is an additive approach, and the calculation requires both that "qualifying expenditures" include all qualifying expenditures incurred by the taxpayer over the life of the IP asset and that "overall expenditures" include all overall expenditures incurred over the life of the IP asset. These numbers will therefore increase every time a taxpayer incurs an expenditure that would qualify for either category. The proportion of the cumulative numbers will then determine the percentage to be applied to overall income earned each year."

The question of how overall expenditures should be defined is a difficult one. Based on the above OECD guidance, overall expenditure should be defined to include all qualifying expenditure, as defined above, and all expenditures for outsourcing that do not count as qualifying expenditures because they are classed as, for example, related-party outsourcing expenditures. Acquisition costs incurred by the Irish taxpayer should also be included in the definition of overall expenditure. Of great importance is that "overall expenditures" is defined to include overall expenditures incurred by the Irish taxpayer as opposed to overall expenditures incurred on the IP asset on a group-wide basis, which would lead to significant practical difficulties in terms of double counting of certain expenditures, such as R&D expenditures incurred by group affiliates (which would be included in overall expenditures where group-wide expenditures are included) with the IP arising out of this R&D later being sold into Ireland (at which point the buy-in payment would be included in overall expenditures as an acquisition cost).

The above point is best illustrated by way of example. Take the situation where a U.S. group affiliate of an Irish company incurs €20 million developing a qualifying IP asset and subsequently sells the IP asset arising out of this

R&D to Ireland for €25 million, at which point the Irish company incurs €3 million per annum on the ongoing development of this IP.

Assuming overall expenditure is defined based on expenditures incurred by the Irish taxpayer, the Irish company would compute the income eligible for benefits under the KDB in year 1 based on:

$$\frac{\text{Qualifying expenditure incurred (€3M)}}{\text{Overall expenditure incurred (€25M + €3M)}}$$

This ensures that the Irish company only receives benefits for the IP income attributable to the qualifying expenditure incurred by the Irish company. This is subject to the point in relation to amortisation of acquisition costs made earlier in this paper. However, take the situation where the definition of overall expenditure is drafted in such a way that group-wide expenditures on the IP asset are included; the Irish company would compute the income eligible for benefits under the KDB in year one based on:

$$\frac{\text{Qualifying expenditure incurred (€3M)}}{\text{Overall expenditure incurred (€25M + €20M + €3M)}}$$

As can be seen from the above, this interpretation of the meaning of overall expenditures is not workable as the €20 million of R&D expenditure incurred in the United States is counted twice in the formula as overall expenditure, once in respect of the R&D expenditure incurred on the IP asset within the group and again through the sale of the resultant IP to the Irish company. This situation clearly needs to be avoided through the definition applied to overall expenditure for the purposes of the KDB regime.

4.0 Question 4

How should the Knowledge Development Box interact with current legislation in the area of intellectual property and research and development, including the tax credit for R&D expenditure and capital allowances for intangible assets?

In our view, relief available under the KDB regime should be granted by way of a preferential rate applicable to profits qualifying for the KDB regime in line with the formula discussed in further detail under 2.0 of this paper.

Regarding the interaction of the KDB regime with the existing relief granted for capital expenditure on specified intangible assets provided for in s291A TCA 1997, it should be provided that taxpayers would be required to elect into the KDB regime at which point relief under s291A TCA 1997 would no longer be available.

With respect to the interaction of the KDB regime with Ireland's R&D tax credit regime, the KDB regime should operate alongside the existing R&D tax credit regime such that R&D tax credits would continue to be available to further reduce any Irish tax payable on KDB profits after the quantum of relief has been computed under the KDB regime. This is required to maintain the competiveness of Ireland's offering as an IP location.

5.0 Question 5

How should IP income be defined – for example, in relation to royalty income embedded in sales of goods and services (see paragraph 17 of Annex I)?

In considering how IP income should be defined, it is useful to consider the relevant OECD guidelines provided in the September 2014 progress report on Action 5 of the BEPS Action Plan:

“Overall income should be limited to IP income: Overall income should only include income that is derived from the IP asset. This may include royalties, capital gains and other income from the sale of an IP asset, and embedded IP income from the sale of products directly related to the IP asset.

“Income benefitting from the regime should be proportionate: Overall income should be defined in such a way that the income that benefits from the regime is not disproportionately high given the percentage of qualifying expenditures undertaken by qualifying taxpayers. This means that overall income should not be defined as the gross income from the IP asset, since such a definition could allow 100% of the net income of qualifying taxpayers to benefit even when those taxpayers had not incurred 100% of qualifying expenditures. Overall income should instead be adjusted by subcontracting IP expenditures allocable to IP income and incurred in the year from gross IP income incurred in the year.”

Therefore, based on the above, IP income should be defined to include net income derived from the IP asset after deducting relevant IP expenditures.

For the purposes of defining IP income in a KDB context, we believe that the definition currently included within s291A TCA 1997 should be used as a starting point and that the following adjustments should be made:

- The definition should be expanded to include capital gains or other income from the sale of qualifying IP (this will in turn require a corresponding adjustment in the formula for calculating the quantum of relief given the rate differential on capital gains)
- The hurdle rate applicable to embedded IP income in the sales of products or services should be reduced to 30 per cent (i.e. where income of a company comprises the sale of goods or services which are goods or services that derive 30 per cent of their value from qualifying IP, then the whole of that income should be qualifying income for the purposes of the KDB)

In conjunction with the introduction of the KDB regime, we would recommend that similar adjustments are made to the definition of IP income for the purposes of s291A TCA 1997.

6.0 Question 6

How should the tracking element of the regime operate to ensure that income benefitting from the preferential rate is traceable to qualifying expenditure but also user-friendly for both companies and Revenue

The modified nexus approach will require companies to track innovation expenditure on an asset-by-asset basis. Clearly, there are concerns in relation to the practicality of such a measure, which has the potential to significantly increase compliance costs for Irish taxpayers. Therefore, it is essential that a practical approach is adopted that is both easy to administer from a Revenue perspective, and not overly burdensome to comply with from a taxpayer’s perspective.

Essentially what the tracking and tracing seeks to achieve is that the income qualifying for benefits under the KDB regime can be traced back to the underlying expenditure incurred by the taxpayer. Where the 30 per cent uplift in qualifying expenditure is permitted for certain acquisition costs and sub-contracted R&D to related parties, and where the income and expenditure attributable to the qualifying IP is not separately identifiable, then the need for detailed tracking and tracing of income to the underlying expenditures is required to avoid potential abuse. However, taking into account our comments under 2.0 of this paper in relation to the adjustment to the formula (i.e. whereby instead of allowing the 30 per cent uplift in qualifying expenditures companies would be allowed to deduct from qualifying expenditures/overall expenditures the amount of accounting amortisation booked in a given year in respect of those expenditures), in our view this adjustment would more closely align the income qualifying for benefits with the underlying qualifying expenditure, which is precisely what the tracking and tracing mechanism seeks to achieve.

Furthermore, we would argue that only relevant expenditures incurred following the commencement of the KDB regime should be included in “overall expenditure” as a method of reducing this requirement further. This would ensure that tracking and tracing can be achieved on an ongoing basis without the need for other costly, burdensome and unnecessary tracking and tracing methodologies, which would only serve the purpose of reducing Ireland’s competitiveness as an IP location.

7.0 Question 7

Are there any provisions that should be included in the regime to specifically encourage small indigenous enterprises?

7.1 Overview

In order to develop, grow and maintain a viable small indigenous enterprise sector, it is imperative that an equitable and encouraging tax system is in place.

Given that patents and other assets that are functionally equivalent to patents, as discussed in 1.0 of this paper, are often to the fore of the SMEs’ business operations, just as they are to MNCs, it is imperative that the KDB regime is designed in such a way as to ensure that SMEs, including small indigenous enterprises, can also reap the benefits of the KDB regime.

7.2 Proposed provisions

The Italian patent box regime is to be available to companies, individuals and partnerships. For the reasons mentioned above, the Irish KDB regime should likewise extend its application beyond corporate entities.

In the case of the SME sector, there may be a single person or a small group of people operating the business. Such individuals that receive company profits by way of dividend will be taxed on such amounts at their marginal rate of income tax, which may be up to 52/55 per cent. In addition, such individuals will be taxed on any chargeable gains arising on the ultimate sale of their shares in the company at a rate of 33 per cent.

To reduce these disincentives to conduct R&D, we would propose that the KDB regime should apply to individuals and partnerships as it does to corporate entities and that the following be provided for:

- In the case of an individual/partnership, qualifying IP profits (as defined) should be taxed at the standard rate
- Dividends received from an Irish tax-resident company and which are paid out of profits taxed under the KDB regime should be taxed at the standard rate of income tax in the hands of the individual shareholders and
- The standard rate of tax should also be applied on the portion of chargeable gains relating to qualifying IP assets on the sale of shares in the company by the Irish tax-resident individual shareholders.

7.3 Impact of provisions

Individuals/partnerships being taxed at a preferential rate would result in further financial resources being made available for reinvestment and future expansion.

This would encourage and incentivise individuals and non-corporate entities who may be involved in the maintenance, enhancement and development of qualifying IP. Furthermore, this would promote growth and offer support to small indigenous enterprises.

Cork

No. 6 Lapp's Quay
Cork
Ireland

Tel: +353 21 490 7000
Fax: +353 21 490 7001
E-mail: info@deloitte.ie

Dublin

Earlsfort Terrace, Hatch Street & Hardwicke House
Dublin 2
Ireland

Tel: +353 1 417 2200
Fax: +353 1 417 2300
E-mail: info@deloitte.ie

Limerick

Charlotte Quay
Limerick
Ireland

Tel: +353 61 435500
Fax: +353 61 418310
E-mail: info@deloitte.ie

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. With over 210,000 professionals globally, Deloitte is committed to becoming the standard of excellence.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the “Deloitte Network”) is, by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2015. For information, contact Deloitte Touche Tohmatsu Limited.