SUBSIDIARY LEGISLATION 123.194

PATENT BOX REGIME (DEDUCTION) RULES

1st January, 2019

LEGAL NOTICE 208 of 2019.

Citation and commencement.

1. (1) The title of these rules is Patent Box Regime (Deduction) Rules.

(2) These rules apply to qualifying income derived from qualifying intellectual property, hereinafter referred to as "qualifying IP" on or after the 1st day of January 2019.

Interpretation.

2. (1) In these rules, unless the context otherwise requires:

"beneficiary" means the person entitled to claim the deduction referred to in article 14(1)(p) of the Act;

"Corporation" means Malta Enterprise as established in terms of the Malta Enterprise Act;

Cap. 463.

"Patent Box Regime deduction" means the deduction referred to in article 14(1)(p) of the Act;

"qualifying IP" means:

(a) a patent or patents, whether issued or applied for, or where the issue of the patent is still pending and extensions of patent protection, so however that in the case of a patent which has been applied for and is pending, but where the application is eventually rejected, such patent shall cease to constitute qualifying IP *ab initio*; or

(b) (i) assets in respect of which protection rights are granted in terms of national, European or international legislation, including those relating to plants and genetic material and plant or crop protection products and orphan drug designations; or

(ii) utility models; or

(iii) software protected by copyright under national or international legislation;

(c) in respect of a small entity, other intellectual property assets as are non-obvious, useful, novel and having features similar to those of patents, to the satisfaction of the Corporation, which shall determine this through a transparent certification process in terms of guidelines issued by the

Corporation:

Provided that marketing-related intellectual property assets including brands, trademarks and trade-names shall not constitute qualifying IP;

"small entity" means a beneficiary which -

(a) has a total turnover on a group basis amounting to not more than fifty million euro (€50,000,000), or equivalent; and

(b) does not itself earn more than seven million and five hundred thousand euro (€,500,000) or equivalent in gross revenue from all its intellectual property assets,

which thresholds shall be calculated in respect of each beneficiary on the basis of the applicable figures over an average five year period.

Entitlement to the deduction.

3. (1) Entitlement to the deduction set out in article 14(1)(p) of the Act shall be subject to the satisfaction of all the following conditions:

(a) subject to the provisions of rule 5, the research, planning, processing, experimenting, testing, devising, designing, development or similar activity leading to the creation, development, improvement or protection of the qualifying IP, shall be carried out wholly or in part by the beneficiary, solely or together with any other person or persons or in terms of cost sharing arrangements with other persons, whether these are resident in Malta or otherwise:

For the avoidance of doubt, any activity leading to the creation, development, improvement or protection of the qualifying IP or its improvement include among others:

(i) functions carried out in the course and as part of the above-mentioned activities which are performed by employees of other enterprises, which employees are acting under the specific directions of the beneficiary in a manner equivalent to that of employees of such beneficiary;

(ii) functions carried out through a permanent establishment (including a branch) situated in a jurisdiction other than the jurisdiction of residence of the beneficiary, where such permanent establishment derives income which is subject to tax in the jurisdiction of residence of the beneficiary;

(b) the beneficiary shall be the owner of the

qualifying IP or the holder of an exclusive license in respect of the qualifying IP. For the avoidance of doubt, even where the beneficiary creates, develops, improves or protects the qualifying IP together with any other person or persons or in terms of cost sharing arrangements with other persons, the beneficiary must own or share in the ownership of the qualifying IP or be the holder of an exclusive license in respect thereof in order to satisfy this condition;

(c) the qualifying IP is granted legal protection in at least one jurisdiction;

(d) the beneficiary maintains sufficient substance in terms of physical presence, personnel, assets or other relevant indicators, as is commensurate with the type and extent of activity being carried out in the relevant jurisdiction in respect of the qualifying IP;

(e) where the beneficiary is a body of persons, such beneficiary is specifically empowered to receive such income; and

(f) the beneficiary requests the Patent Box Regime deduction in computing his income or gains in the return made pursuant to article 10 of the Income Tax Management Act. Cap. 372.

(2) Where a benefit under these rules has been claimed in respect of a patent that is still pending, and the application in respect of such patent is eventually rejected, any such benefit claimed shall be reversed by making the appropriate adjustment in the year in which it is ascertained that the particular patent is not being issued.

Calculation of Patent Box Regime deduction.

4. (1) The Patent Box Regime deduction shall be calculated on the basis of the following formula:

$$95\% \times \left(\frac{\textit{Qualifying IP Expenditure}}{\textit{Total IP Expenditure}} \times \text{Income or Gains derived from qualifying IP} \right)$$

(2) The income or gains which shall be taken into account for the purpose of determining the income or gains derived from qualifying IP referred to in sub-rule (1) shall comprise the total income falling within the purport of articles 4 or 5 of the Act and which is derived from the use, enjoyment and employment of the qualifying IP, royalty or similar income whether this is embedded in the consideration for the sale of goods and, or services or otherwise, advances and similar income derived from the qualifying IP, any sum paid for the grant of a licence or similar empowerment to exercise rights under qualifying IP, compensation for infringements in respect of qualifying IP whether such compensation is granted through judicial means or otherwise, gains on disposal of qualifying IP and such other similar or related income as is derived from the qualifying

IP and as being calculated after deducting such expenditure, whether of a capital nature or otherwise, as is deductible from income derived from the qualifying IP:

Provided that in all cases, the determination of the above-mentioned income or gains shall be made on the basis of a Transfer Pricing method which is appropriate for this purpose in terms of the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

(3) "Total IP Expenditure" comprises expenditure directly incurred in the acquisition, creation, development, improvement or protection of the qualifying IP, being the sum of:

(a) all expenditure actually incurred by the beneficiary and constituting qualifying IP expenditure and any other expenditure incurred by any other person which would constitute qualifying IP expenditure had it been incurred by the beneficiary, including, for the avoidance of doubt, those referred to in rule 5(1)(b); and

(b) acquisition costs and expenditure for outsourcing activities made to related parties.

Costs which shall be taken into account.

5. (1) The costs which shall be taken into account for the purpose of calculating the qualifying IP Expenditure shall be established at the time when they are incurred and shall consist of the following:

(a) expenditure incurred directly by the beneficiary for, or in the creation, development, improvement or protection of, the qualifying IP;

(b) expenditure incurred by the beneficiary for activities related to the creation, development, improvement and protection of the qualifying IP subcontracted to persons which are not related to the beneficiary; and

(c) where expenditure has been incurred which does not fall within paragraphs (a) and (b), an amount equivalent to the lower of:

(i) the costs actually incurred in the acquisition, creation, development, improvement or protection of the qualifying IP, excluding expenditure falling within the purport of paragraphs (a) and (b), and

(ii) thirty per cent (30%) of the total of the amounts referred to in paragraphs (a) and (b):

Provided that in no case shall the qualifying IP Expenditure

comprised in paragraphs (a), (b) and (c) exceed the Total IP Expenditure:

Provided further that, except for acquisition costs included in paragraph (c)(i), expenditure consisting of interest payments, building costs, acquisition costs or any costs that could not be directly linked to a specific qualifying IP asset shall be excluded in making the above calculation:

Provided further that expenditure for general and speculative research and development which cannot be included in the qualifying IP expenditure of a specific qualifying IP asset can be divided *pro rata* across all the qualifying IP assets to the extent that they are incurred for the creation, development, improvement or protection of such qualifying IP:

Provided further that expenditure referred to in paragraphs (a), (b) and (c), which is attributable to a permanent establishment of a beneficiary situated in a jurisdiction other than that in which such beneficiary has its head office, shall not be deductible against income earned by that beneficiary which is attributable to its head office, unless the permanent establishment to which such expenditure is attributable is in operation at the time that the beneficiary earns the said income.

(2) For the purposes of sub-rule (1):

(a) an individual is deemed to be related to a body of persons, if that body of persons is directly or indirectly controlled or beneficially owned as to more than twenty-five per cent (25%) by the said individual;

(b) an individual is deemed to be related to another individual, if the relationship between the said individuals falls within the purport of article 5(2)(e)(i) of the Act;

(c) two bodies of persons are deemed to be related if they are, directly or indirectly, controlled or beneficially owned as to more than twenty-five percent (25%) by the same individuals.

(3) A beneficiary shall maintain appropriate records (including any relevant underlying documentation) to prove the total expenditure and the qualifying IP expenditure incurred in respect of any qualifying IP, the years in which such expenditure is incurred, income and gains derived from any qualifying IP and such other details as may be required in terms of guidelines which may be issued by the Corporation.

Loss.

6. (1) Where a beneficiary incurs a loss in respect of the qualifying IP which he is entitled to set-off against his income or

gains in terms of article 5 or article 14 of the Act and such beneficiary claims the benefit of such loss, he shall be entitled to elect to benefit from any one of the following:

(a) in lieu of the entitlement set out in article 5 and article 14 of the Act, a deduction corresponding to five per cent (5%) of the loss which would otherwise be available for deduction in terms of the said provisions of the Act in respect of the qualifying IP; or

(b) a deduction corresponding to the full amount of the loss which would be available for deduction in terms of the provisions of article 5 or article 14 of the Act, so however that the following conditions shall apply where the beneficiary elects for this treatment:

(i) he shall not be entitled to claim the tax treatment referred to in paragraph (a) for any subsequent year of assessment; and

(ii) where in any basis year following that in which a loss is claimed in terms of this paragraph, the beneficiary derives income or gains from the qualifying IP in respect of which he has claimed such loss, the amount of the deduction claimed in terms of rule 4 in that basis year shall be determined as if the term "Income or Gains derived from qualifying IP" was a reference to the income or gains derived from the qualifying IP in that basis year less the amount of losses claimed in prior years in respect of the qualifying IP and where the amount of losses incurred in prior years is such that it cannot be wholly set off against the income or gains for that basis year, it shall, to the extent to which it cannot be so set off against income or gains for the said year, be carried forward and set off against what would otherwise have been the income or gains derived from the qualifying IP in subsequent years.

(2) An election in terms of sub-rule (1) shall be made in such form and manner as the Commissioner may determine and shall be irrevocable.

Submission of documentation to the Commissioner.

7. (1) Whenever so requested by the Commissioner, for every item of qualifying IP in relation to which income is derived and against which the Patent Box Regime deduction is claimed, the beneficiary claiming such deduction shall submit to the Commissioner in such form and manner as the latter may deem fit to request:

(a) a copy of a confirmation issued by the Corporation describing the particular qualifying IP, confirming

that the qualifying IP is actually in existence and confirming the amount of qualifying expenditure to which the Patent Box Regime deduction is applicable and the Total IP Expenditure;

(b) documentary evidence which demonstrates to the satisfaction of the Commissioner the amount of the Patent Box Regime deduction and how it was calculated for the particular year of assessment as well as the income or gains derived from qualifying IP and the costs and expenditure constituting the qualifying IP Expenditure and the Total IP Expenditure;

(c) evidence which demonstrates to the satisfaction of the Commissioner that profits or gains derived from transactions relevant in the context of these rules and carried out between parties who are related in the sense set out in rule 5(2) are calculated as if the parties to the relevant transactions are independent enterprises operating in similar conditions and at arm's length; and

(d) such additional supporting documentation as may be laid down in guidelines issued by the Corporation or as may be otherwise requested by the Commissioner in respect of each year of assessment in which the Patent Box Regime deduction is claimed.

(2) Without prejudice to the provisions of sub-rule (1), the Corporation shall forward to the Commissioner such information as may be in possession of the Corporation and as may be requested by the Commissioner for the purpose of the performance of his duties under the Income Tax Acts.

(3) Any beneficiary shall maintain at all times sufficient proof of the continued satisfaction of the provisions of these rules and of any guidelines issued thereunder by the Corporation and shall make such proof available to the Commissioner and to the Corporation whenever so required.

(4) Any beneficiary shall furnish to the Corporation a copy of any tax return and of all supporting documentation filed with the Commissioner in respect of any year of assessment in which a Patent Box Regime deduction is claimed.

(5) The Commissioner shall spontaneously exchange information on beneficiaries claiming the Patent Box Regime deduction in respect of assets referred to in paragraph (c) of the definition of "qualifying IP" in rule 2.

Issue of confirmation.

8. The confirmation referred to in rule 7(1) shall be issued by the Corporation in terms of guidelines issued by the Corporation, when the Corporation is satisfied that the qualifying IP complies with

the provisions of these rules and after it has obtained all such information and documentation and made such ascertainment as it has considered necessary for this purpose.