International Tax Newsletter

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Ireland expands withholding tax exemption on royalties

The Irish tax authorities have issued a practice statement as part of a suite of incentive measures to increase Ireland's attractiveness as a location for intellectual property. The practice statement, which takes effect from 26th July 2010, allows patent royalties to be paid by an Irish tax resident company to a foreign company, including an entity that is resident in a non-treaty jurisdiction, without Irish withholding tax, ie patent royalties can be paid to Cayman/ Bermuda Companies free of withholding tax.

It should no longer be necessary to use back to back conduit structures by using locations such as Luxemburg or Malta.

The previous requirement was that 20% withholding tax was required to be operated on payment of patent royalties where it was being paid to a patent holder who was resident in a non EU/DTA State.

This change, which is being introduced by administrative practice, directly follows the change in the Finance Act 2010 which exempted Irish companies from having to deduct withholding tax on paying patent royalties to a company resident in an EU/DTA State. Accordingly, this removes the requirement to rely on a treaty provision and, in some cases, can produce a better result than a specific treaty provision.

The exemption from the requirement to deduct withholding tax is available in the following circumstances:

- the recipient is the beneficial owner of the royalty payment and is a company which is neither resident in the State nor carrying on a trade in the State through a branch or agency; and
- the royalties are payable in respect of a foreign patent under a licence agreement that is executed in a foreign territory and subject to the law and jurisdiction of a foreign territory, and;
- the payment is made in the course of the Irish paying company's trade and the payment is not part of a back to back or other conduit arrangement.

A foreign patent is defined as a patent originally registered outside the State in relation to an invention developed outside the State. Advance approval is required from the Irish tax authorities and the application should be made to the tax office of the Irish company paying the royalty.

Tax Department

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Statement of Practice:

Corporation Tax, Statement of Practice, SP - CT/01/10
Treatment of Certain Patent Royalties Paid to Companies Resident Outside the State

1. Tax treatment of royalties paid in respect of the user of a patent

1.1 Payments of patent royalties are subject to section 238(2) Taxes Consolidation Act 1997 ("TCA 1997"). On making a payment of a royalty or other sum paid in respect of the user of a patent, the payer is obliged to deduct out of the payment a sum representing the amount of income tax on the payment at the standard rate. However,

- Chapter 6 of Part 8 of the TCA 1997[1] provides that withholding taxes will not apply to royalty payments that meet the requirements of that Chapter. Essentially these are payments made to associated companies resident in another EU Member State.[2]

- Section 242A TCA 1997[3] provides that withholding tax will not apply to royalties paid by a company in the course of a trade or business to a company resident in a treaty country.[4]

1.2 Under section 238 TCA 1997 tax must be withheld on all patent royalty payments by a company with the exception of payments that are within in the scope of Chapter 6 of Part 8 or section 242A TCA 1997.

1.3 Under Chapter 6 of Part 8 and section 242A TCA 1997 the payee company will not be chargeable to tax in respect of patent royalty payments within the scope of that Chapter or section.

2. Charge to Tax in the Case of Non-Resident Companies

2.1 A non-resident company is chargeable to income tax in respect of the profits arising or accruing from any property whatever in the State (section 18 TCA 1997). This is modified by Chapter 6 of Part 8 and section 242A TCA 1997, as mentioned above, and by the terms of double taxation agreements ("DTA's"). To maintain a charge to income tax in the case of a royalty, paid to a non-resident, from which tax is deductible on payment, the royalty must constitute profits accruing from property in the State.

2.2 The Revenue Commissioners accept that a patent royalty paid to a non-resident company does not give rise to a charge to income tax under section 18 TCA 1997 on the payee where the payment is made—

- in respect of a foreign patent, i.e. a patent originally registered outside the State in relation to an invention developed outside the State, and

- under a licence agreement
  - executed in a foreign territory, and
  - subject to the law and jurisdiction of a foreign territory.

3. Administrative Practice.

3.1 The Revenue Commissioners are prepared to grant permission to a company paying a royalty, out of which it would otherwise be required to deduct tax, to make the payment without deducting that tax in the following circumstances:

3.1.1 The payee is—
- a company which is neither resident in the State nor carrying on a trade in the State through a branch or agency (notwithstanding that the payment may be unconnected with that branch or agency), and
- the beneficial owner of the royalty payment;

3.1.2 the royalty is payable—
- in respect of a foreign patent, i.e. a patent originally registered outside the State in relation to an invention developed outside the State, and

o under a licence agreement
- executed in a foreign territory, and
- subject to the law and jurisdiction of a foreign territory;

3.1.3 the payment is being made in the course of the paying company's trade; and

3.1.4 the payment is not part of a back-to-back or conduit arrangement whereby the payment represents all or substantially all of the income received or receivable by the paying company in connection with licensing of the same foreign patent.

3.2 Where such permission is granted by the Revenue Commissioners, the fact that tax was not deducted on payment will not preclude the paying company obtaining relief which would otherwise be due under section 238 TCA 1997 in respect of the payment.

4. Making a Claim

4.1 Application should be made by the payee for permission to receive the first payment due under a licence agreement without tax being deducted:

4.1.1 The application should identify the paying company and should be made to the Region or Division for that company.

4.1.2 The application should include the necessary information and documentation required to show that—
- the payee is not resident in the State and not trading in the State through a branch or agency;
- the payee is the beneficial owner of the royalty payment; and
- the royalty is payable—
  - o in respect of a foreign patent, i.e. a patent originally registered outside the State in relation to an invention developed outside the State, and
  - o under a licence agreement
    - executed in a foreign territory, and
    - subject to the law and jurisdiction of a foreign territory.

4.1.3 The application should also contain sufficient information and documentation to show that the payment is made by the paying company in the course of its trade and that the payment is not part of a back-to-back or conduit arrangement whereby the payment represents all or substantially all of the income received or receivable by the paying company in connection with licensing of the same foreign patent.

4.2 On being satisfied that the application is in order, Revenue will write to the paying company (copying to the payee) granting permission to make the first payment, and subsequent payments under the licence agreement, without deduction of tax.

5. Commencement

5.1 This Statement of Practice will come into effect from 26 July 2010.

5.2 The practice set out in this Statement should be relied upon only to the extent that the royalty payments concerned are made in good faith and for purposes that do not include tax avoidance. The Revenue Commissioners reserve the right to amend or withdraw this Statement of Practice as respects royalty payments made from a date not earlier than the date of notice of any amendment or withdrawal.

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1. Chapter 6 implements the EU Interest and Royalties Directive (Council Directive 2003/49/EC of 3 June 2003, as amended)
2. For the purposes of this Statement of Practice a payment to a non-resident company is treated as not including a payment to a company carrying on a trade in the State through a branch or agency.
3. Inserted by section 55 FA 2010.
4. The treaty country must impose a tax that applies generally to royalties receivable from sources outside that country.

Significant Simplification Measure – Irish funds

Ireland has a system of withholding tax operating in respect of Irish investors in Irish funds. It does not apply to non-residents provided certain declarations are obtained.

In a significant move to decrease the costs of administering Irish funds the Irish tax authorities are publishing rules that will enable Irish funds to dispense with the non-resident declaration ("NRD") requirement to avoid the withhold.

Prior to this each fund participant was required to complete an NRD to confirm that they were not Irish tax resident. Following a significant lobbying effort by the Irish funds industry the Finance Act 2010 contained a measure that would dispense with the requirement for non Irish residents to complete a NRD.

The requirements in order to avail of this waiver to complete an NRD are:

- the fund would undertake not to actively promote units/shares for sale in Ireland. The Irish tax authorities acknowledge that it is not possible to prohibit a fund from being marketed to Irish residents. Where the fund receives an application from an investor who has an Irish address or bank account the fund is required to treat the investor as Irish tax resident unless they complete the relevant NRD;

- the terms and conditions on the application form must outline the obligation of each investor to notify the fund if the investor becomes Irish resident;

- the fund must undertake to fully comply with all its obligations under Irish tax law and Revenue practice including its requirements in relation to Irish residence or ordinary residence of investors.

Any fund wishing to apply for waiver from the NRD requirement should apply to the Financial Services Unit of the Irish tax authorities confirming their compliance with these conditions and enclosing a copy of the application form.

The NRD waiver equivalent measures document to be issued by the Irish tax authorities is available here.

Appendix I(c)

Non-resident declarations and Intermediary declarations:

Equivalent measures

In order to obtain written notice of approval from the Revenue Commissioners to the effect that subsection (7) or (9) of section 739D of the Taxes Consolidation Act 1997 is deemed to be complied with as respects any unit holder or class of unit holders, an investment undertaking is required to confirm each of the following matters to a nominated officer of the Revenue Commissioners[1]:

1. The investment undertaking will verify an investor's identity by complying with applicable anti money laundering procedures.
2. While an investment undertaking cannot prohibit Irish residents from subscribing for units, the investment undertaking will not actively promote the units concerned to Irish investors or in Ireland nor will it actively distribute in Ireland any offering material in connection with such units.
3. Every time an investor makes an initial application to subscribe for units in the investment undertaking (a) in its capacity as an investor on its own behalf or (b) in its capacity as intermediary, that application is required to be made by way of completion of an Application Form that must contain an address for the proposed investor that will be entered on the unit holder register of the investment undertaking (for this purpose the "Registered Address"). An investor may provide an additional address on the Application Form for other purposes, e.g. correspondence. If the investment undertaking receives an Application Form from an investor who provides a Registered Address that is Irish or an Irish address for any purpose, the investment undertaking will for Irish tax purposes treat

that investor as if that investor were Irish resident, unless that investor provides the investment undertaking with a signed non-resident declaration or intermediary declaration, as the case may be, in the prescribed form and the investment undertaking is not in possession of any information which would reasonably suggest that the information contained in that declaration is not, or is no longer, materially correct.

Each Application Form must contain terms and conditions which will include language to the effect that: "*Every applicant applying for units on the applicant's own behalf is hereby obliged to notify the Investment Undertaking or an agent of the Investment Undertaking appointed for this purpose, as the case may be, in writing if the applicant is or becomes resident or ordinarily resident in Ireland. An individual is ordinarily resident in Ireland if the individual has been resident in Ireland for each of the 3 preceding years of assessment (i.e. calendar years) and that individual continues to be ordinarily resident in Ireland until the individual has not been resident in Ireland in each of the 3 preceding years of assessment.*"

4. Every investor is required to provide details of one or more bank accounts into which payments to that investor may be made. If an investor provides details of any Irish situate bank account, the investment undertaking will for Irish tax purposes treat that investor as if that investor were Irish resident, unless that investor provides the investment undertaking with a signed non-resident declaration or intermediary declaration, as the case may be, in the prescribed form and the investment undertaking is not in possession of any information which would reasonably suggest that the information contained in that declaration is not, or is no longer, materially correct.
5. Each intermediary with respect to the holding of units in the investment undertaking, is obliged from the time of completion of an Application Form, as a matter of contract, to notify in writing the investment undertaking or the administrator of the investment undertaking, as the case may be, if it is, or becomes, aware that a person who is beneficially entitled to any units issued by the investment undertaking to that intermediary may be resident or ordinarily resident in Ireland or may have become resident in Ireland. Where an intermediary makes such a notification, the investment undertaking will for Irish tax purposes treat the relevant investor as if that investor were Irish resident, unless that investor provides the investment undertaking with a signed non-resident declaration in the prescribed form and the investment undertaking is not in possession of any information which would reasonably suggest that the information contained in that declaration is not, or is no longer, materially correct.

   Each Application Form must contain terms and conditions which will include language to the effect that: "*Every applicant applying for units on behalf of another person is hereby obliged to notify in writing the Investment Undertaking or an agent of the Investment Undertaking appointed for this purpose, as the case may be, if the applicant is, or becomes, aware that any person who beneficially entitled to any of those units may be resident or ordinarily resident in Ireland or may have become resident in Ireland. An individual is ordinarily resident in Ireland if the individual has been resident in Ireland for each of the 3 preceding years of assessment (i.e. calendar years) and that individual continues to be ordinarily resident in Ireland until the individual has not been resident in Ireland in each of the 3 preceding years of assessment.*"
6. The investment undertaking will comply fully with all of its obligations in accordance with the provisions of Irish tax law and Revenue practice, including but not limited to, its obligations in respect of all Irish resident or ordinarily resident investors; persons treated as Irish resident investors pursuant to each of 3, 4 and 5 above; and each unit holder in respect of whom it is in possession of any information which could reasonably suggest that the unit holder is resident or ordinarily resident in Ireland.

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[1] Each reference to units and unit holders in this document is to be construed in accordance with Section 739B(1) TCA 1997 so that references to units and unit holders include *inter alia* references to shares and shareholders. In particular, the language to be included in Applications Forms, as set out in paragraphs 3 and 5 of this document should refer to units or shares as appropriate.

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