UIA Union Internationale des Avocats
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BLOMBERG
LEGAL & TAX

DEVELOPMENT AND CROSS-BORDER SALE OF TECHNOLOGY

TAX CONSIDERATIONS FOR TECHNOLOGY TRANSFER

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BLOMBERG Legal & Tax

INTRODUCING… THE MAIN PLAYERS

licence agreement

licence fee €

Licensor – **LOR**

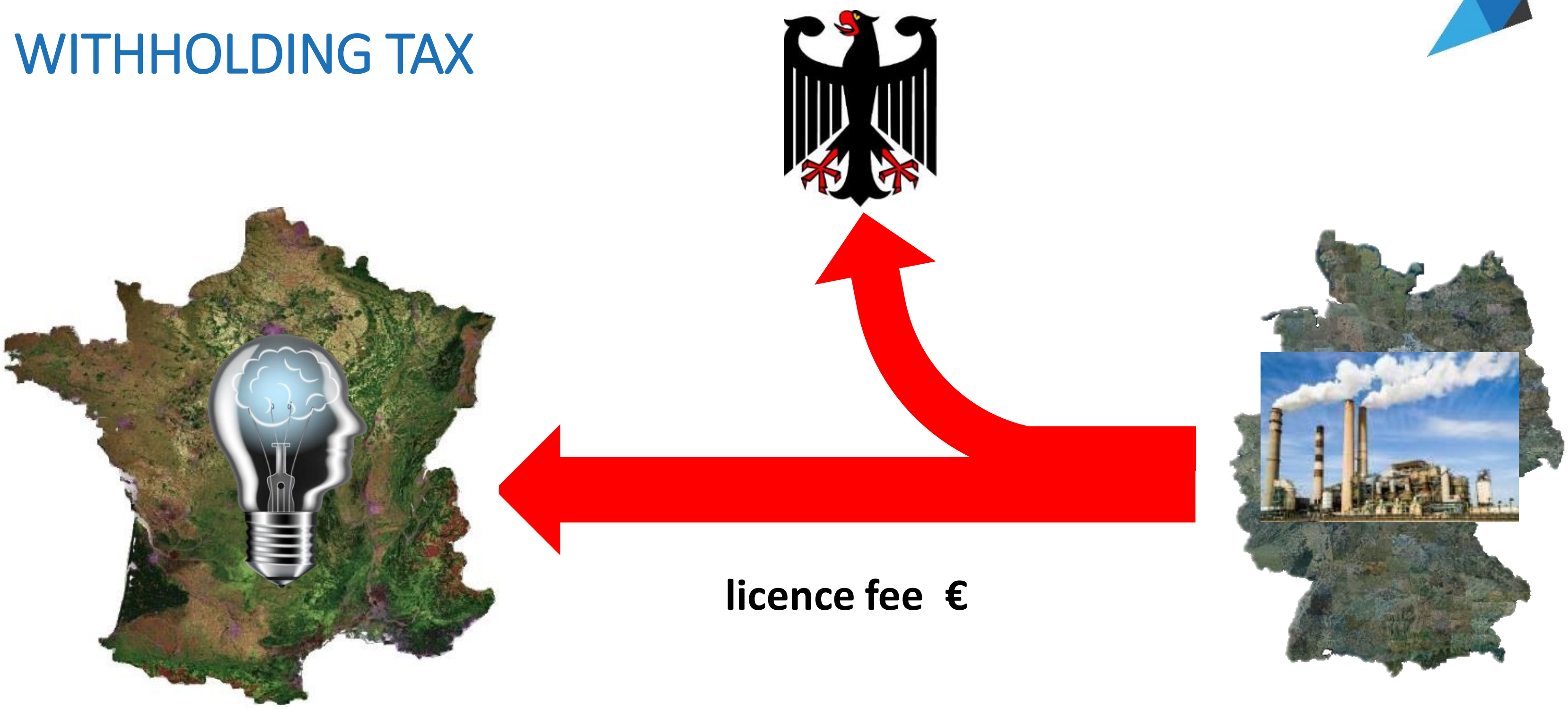
IP-Owner

Licensee - **LEE**

LICENCE AGREEMENTS

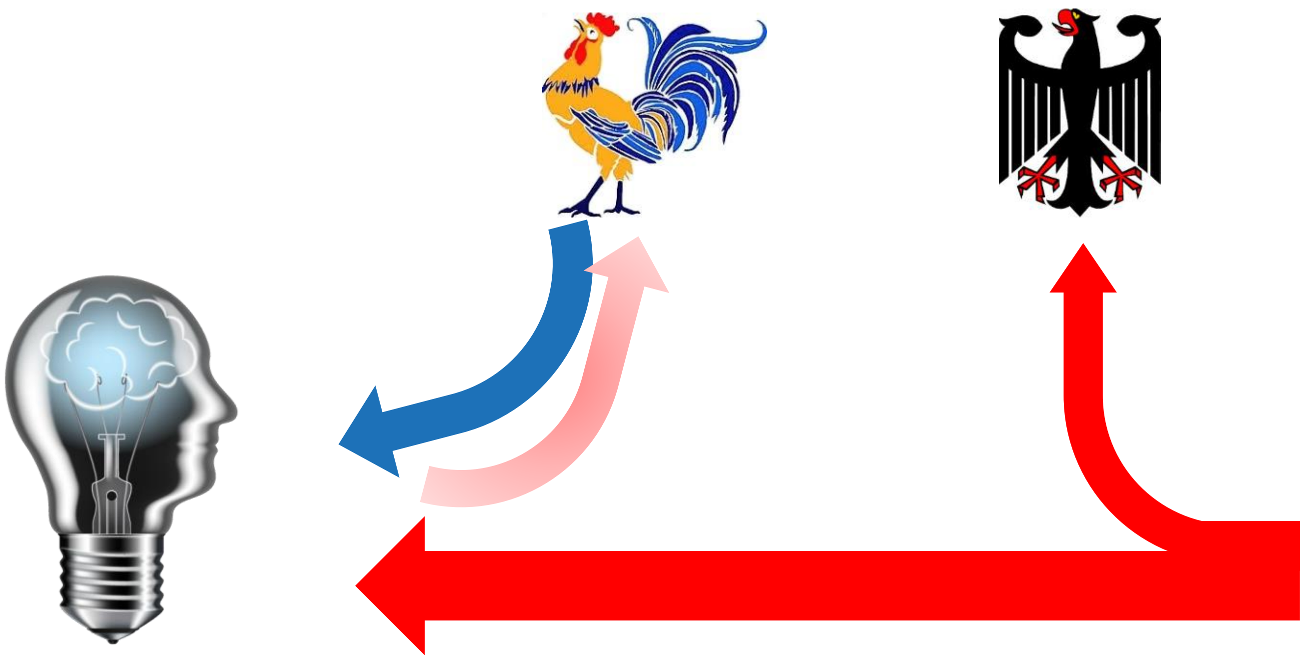
WITHHOLDING TAX

WITHHOLDING TAX



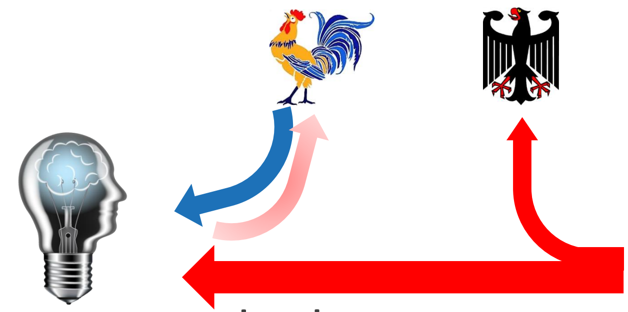
- Germany levies **withholding tax** (WHT) on licence fees.
- LEE must pay **15.8%** of licence fees to tax authorities.
- Legally tax burden of LOR.

YOU ONLY PAY ONCE – TAX CREDIT



- At home LOR has to pay taxes on income from licence fees.
- LOR should get **credit** for WHT.
- LOR should only pay once!

CONCEPT MEETS REALITY – THE TAX SURPLUS



- LOR has to pay employees, rent, lawyers and other expenses.
- **LICENCE FEES ≠ GAIN**
- WHT can be higher than domestic income tax.
  → No reimbursement.
- OVERTAXATION:

  Licence fee: €1,000,000; WHT: €158,000;

  Expenses: €600,000; (pre-tax) gain: €400,000

  Income Tax (30%): €120,000; **EXCESSIVE TAX: € 38,000**

DOUBLE TAXATION TREATY

- WHT: 0% (sec. 12 OECD Modell Treaty) to 10% (sometimes higher).
- However: Deduction required, **reimbursement** to LOR on request.
- Release possible if applied for in advance. **Exemption order**.
- EU directive: Only intra-group licences are exempt from WHT.

DON'T CHEAT THE STATE! – ANTI-ABUSE RULE

- If shareholder of LOR did not have treaty protection:
- ► **Substance requirements.**
- LOR has to have own substance!
- Substance will be checked carefully by financial authorities.

CONTRACT LAWYER: DON'T FORGET THE WHT!

- LEE must deduct WHT.
- In case of noncompliance: Liability of LEE.
- In tough cases: **personal liability** of LEE's **managing director**!
- It is important to clearly define whether contract is a licence agreement.

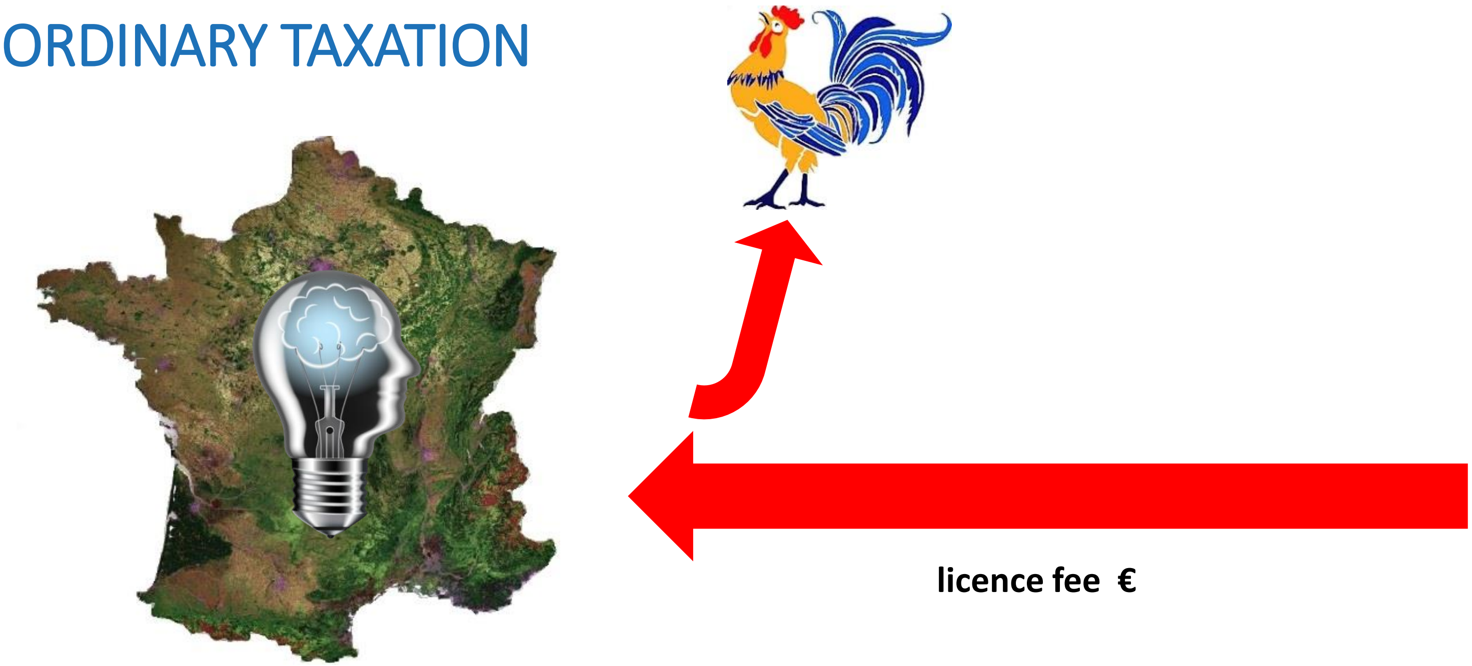
LEE'S CONTRACT LAWYER: DON'T GROSS UP (IF POSSIBLE)

- **GROSS-UP CLAUSES:**
- ***"Contractual licence fee is net of WHT."***
- Treaty protection → Everything is fine?
- You cannot rely on a double taxation treaty, you have to first see the exemption order.
- Substance requirements – not under control of LEE!
- At least: If LOR gets WHT reimbursed or credited, LOR should reimburse LEE.

LICENCE AGREEMENTS

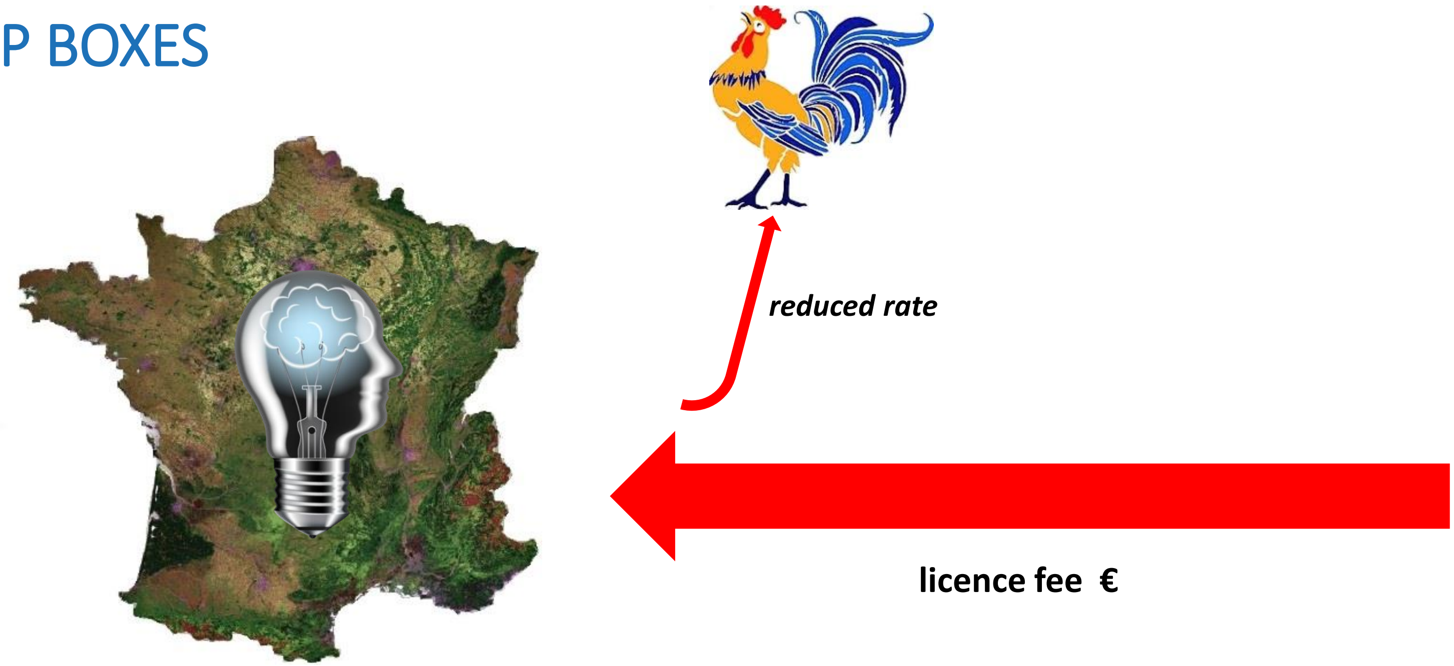
LICENSOR'S SIDE – SPECIAL EFFECTS

ORDINARY TAXATION



- Ordinary income.
- Ordinary taxation.

IP BOXES



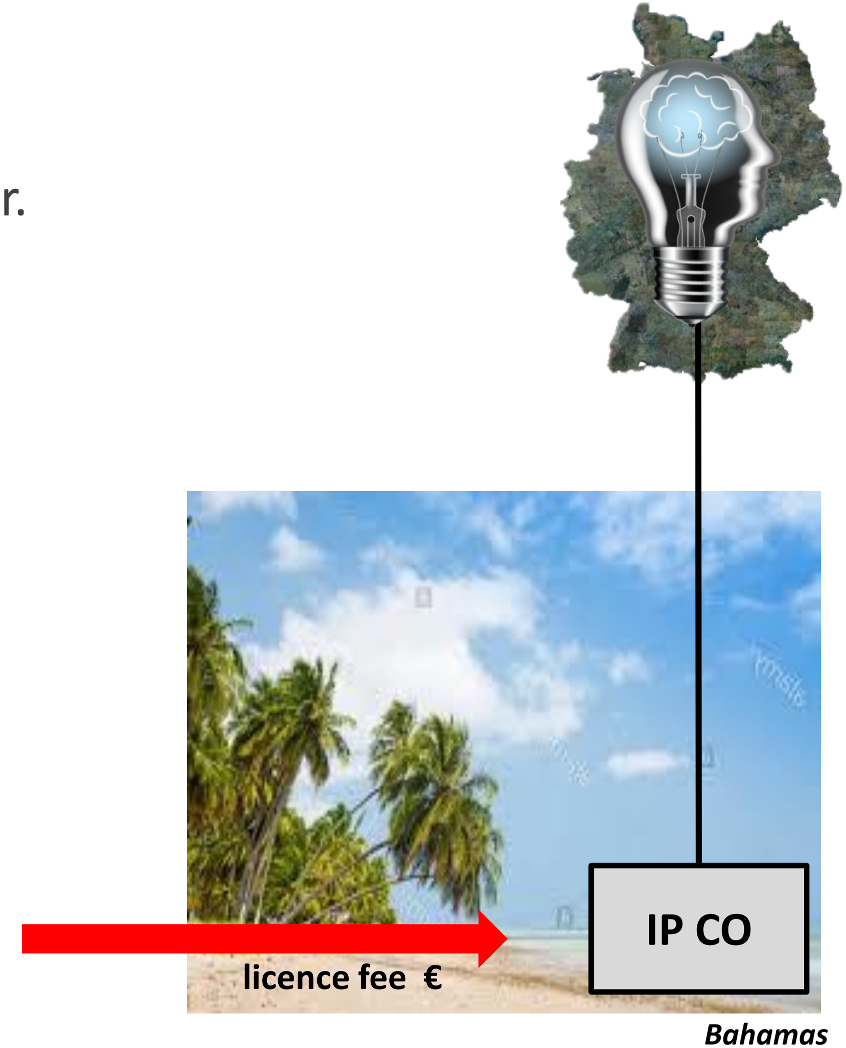
- IP is the most important growth driver.
- Tax incentives to attract innovative businesses.
- IP boxes: **Reduced tax rate** on income from IP.
- OECD: Only if self-developed (“**nexus approach**”).
- Not only IP-managing companies go abroad, but whole RD departments!

IP BOXES IN EUROPE

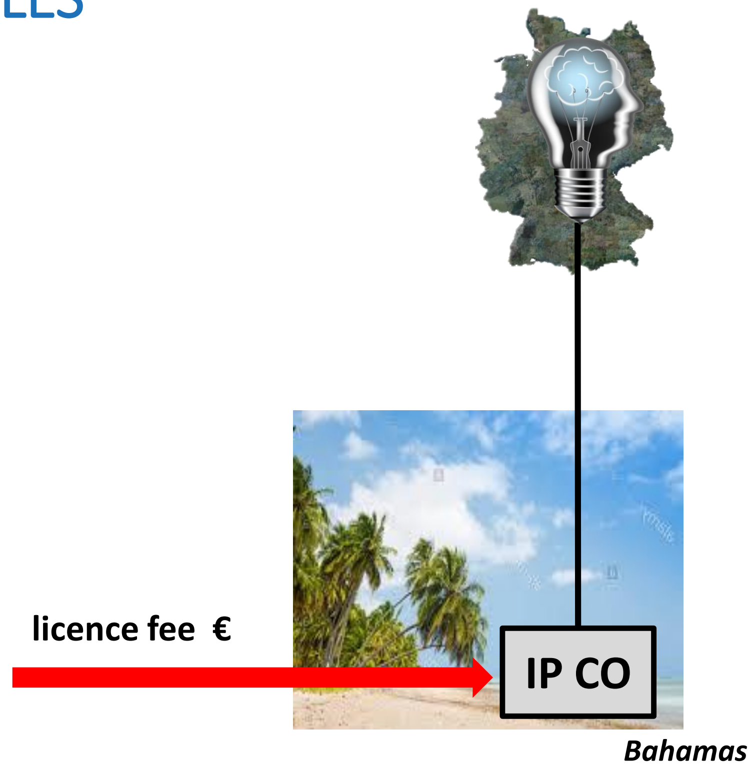
Country	IP box tax rate	ordinary tax rate
Belgium	6.8	34
Cyprus	2.5	12.5
France	15	33.33
Hungary	9.5	19
Ireland	6.25	12.5
Italy	15.7	31.4
Liechtenstein	2.5	12.5
Luxembourg	5.72	29.63
Malta	0	35
Netherlands	5	25
Portugal	11.5	23
Spain	10	30
Switzerland, Canton of Nidwalden	8.8	12.60
United Kingdom	10	22

LICENCE ON THE BEACH

- German based ingenieur.
- IP Co on Bahamas.
- IP Co grants licence.
- No taxation?



LICENCE ON THE BEACH - THE CFC RULES



- Income from licences in no/low tax country (< 25%).
- Not self-developed.
- German major shareholding.

CFC rules:

- Licence income is taxable in Germany with German shareholder.
- Hardly applicable within EU.
- Worldwide approach with big differences.

CROSS-BORDER IP SALE

BASIC RULES AND WHT

- Gain from sale: **ordinary income**, no special capital-gains regime available (in Germany).
- IP-Box income in other countries.
- Typically **no WHT** (sec. 13 DTT OECD)!

WHAT ARE WE DOING HERE? – THE CONTENT OF THE CONTRACT

ATTENTION CONTRACT LAWYERS!

- Sometimes **IP sale** is qualified for tax purposes as **IP licence**. (E.g.: in Germany beneficial ownership of copyright may not be fully transferred).

- ► Purchase price becomes **subject to WHT**. Liability of purchaser!

- Risk of gross-up clauses.

- Distinction required for tax purposes:

Services – IP Licence – IP Sale

- All to be seen from a tax perspective!

WHERE IS MY IP? - IP IN FOREIGN BRANCH

- **Contract Lawyers: Pay attention how you write seller´s address!**
- IP owner resident in F.
- **Branch / permanent establishment** in G.
- IP developed or used in G branch
- Sales gain is taxable where?
- If IP is **allocable** to branch → taxable in G.
- Tax exemption in F or tax credit in F for tax in G.

PURCHASE OF A TECHNOLOGY COMPANY

BASIC RULES – ASSET DEAL VS SHARE DEAL

SHARE DEAL

- Usually **special regime** for capital gain:
- **No taxation** if co. sells another co., **reduced tax rate** if individual sells co.
- Purchaser has **no** additional **depreciation**!

ASSET DEAL

- Usually **ordinary** regime for capital gain.
- **Additional** tax burden by **distribution** of purchase proceeds to shareholder.
- Purchaser has **additional depreciation**! → **higher purchase price justified.** But often ignored in practice.

ASSET DEAL – SPECIAL TRAP FOR IP COS

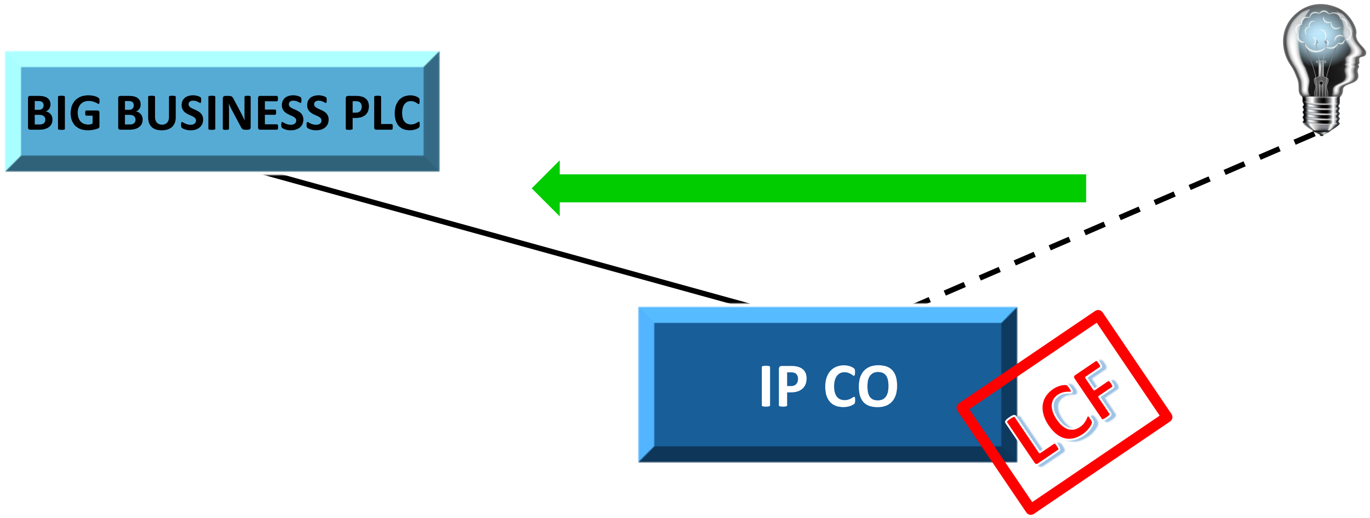
- Company **cannot activate** self-developed IP in its tax books.
- Proceeds from sale become gain.
- Cost for developing has become tax loss carry-forward (LCF).
- Sale gain may be offset with loss carry-forwards.
- But: **minimum taxation rule**! Only €1 million can be fully offset; 40% of exceeding gain remains taxable despite LCF.

IP developing cost: €20 m; sale price €22 m; economical gain €2 m.

Tax LCF: €20 m; tax gain: €22 m; offset with LCF only €13.6 m (€1 m + (21x60% = €12.6 m)). Taxable gain: €8.4 m; tax (30%) = €2.5 m.

Tax is higher than total gain!

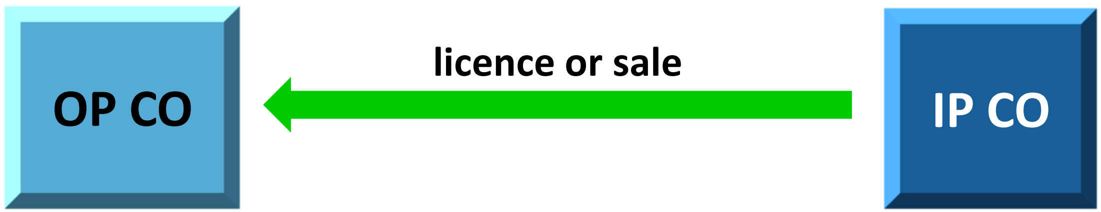
SHARE DEAL – THE OTHER TRAP



- Company has no activated (self-developed) IP in its tax books.
- Company may have **tax loss carry-forwards** (LCF).
- LCF may be lost by share transfer / **change of control**.
- No deduction of acquisition cost for shares.
- Any future proceeds out of the IP (licence fees, sales gains) become fully taxable in future → **High income tax burden on cash flow!**

TECHNOLOGY DEVELOPMENT AGREEMENT

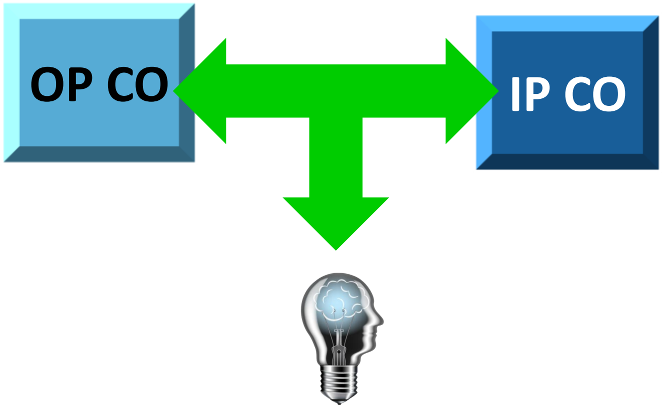
THE TAX INEFFICIENT IP TRANSFER



- IP CO develops IP.
- For (tax or other) reasons IP shall be used by OP CO.
- IP may be **sold** to OP CO → **taxable gain for IP CO,** fair market value of IP.
- IP may be **licenced** to OP CO → **taxable income for IP CO**, third party licence fee.

► **Taxable gain triggered by transfer to OP CO.**

THE TAX EFFICIENT IP TRANSFER



- OP CO undertakes a technology development agreement with IP CO.
- OP CO becomes **owner of IP**.
- IP CO gets only reimbursement of development **cost** plus **gross up**.
- **Joint development contract** possible as well → **Co-ownership**.
- This is how Apple and others managed to have IP outside the USA even though IP is only developed in California.

INTRA-GROUP IP AGREEMENTS

THE REALLY FUN STUFF

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