



**INDUSTRY
RESEARCH & DEVELOPMENT
GROUP**

UNDERSTANDING THE PATENT ROYALTY SCHEME

March 2009

1. TARGET AUDIENCE

Companies engaged in R&D.

2. OBJECTIVES OF THE DOCUMENT

- To show companies how to implement and use the Patent Royalty Scheme.
- To provide key facts and information on the scheme.

3. KEY ISSUES

- a) There must be a valid patent which could be the short and/or long version. The age of the patent is not relevant.
- b) A qualifying patent is one in relation to which the research, planning, processing, experimenting, testing, devising, design and development work leading to the invention was carried on in an EEA state (in respect of income arising on or after 1st January 2008). To be entitled to have income from a qualifying patent exempted from tax an individual must have carried out such work, either solely or jointly with another person.
- c) Patentees may keep or assign their patent rights to the company they work for.
- d) The conditions applying to this relief are those that are current and can change in the future by way of Finance Act amendments.
- e) If another company purchases the company with the patent, qualifying royalty payments can be made as normal to that other company.
- f) Tax-free royalty payments can only be made in respect of registered patents. The patent may be Irish registered or registered abroad. A look-back is allowed whereby royalty payments made after the complete specification for the patent was filed with a relevant authority may be exempted where the patent is subsequently granted.
- g) The aggregate maximum annual amount of income from qualifying patents of a company or individual is €5m. Where persons are connected the €5m limit also applies to the aggregate income of such persons.

- h) In the case of royalty payments between **connected** persons, the royalty must be paid for the purposes of activities qualifying for the 10% corporation tax rate for manufacturing and certain internationally traded services. Also, the exemption only applies in respect of what royalty would be paid between persons transacting at arm's length. In the case of royalty payments between **unconnected** persons, such payments must be for bona-fide commercial reasons and not part of any tax avoidance scheme. The following are examples of connected persons –
- an individual and his/her spouse
 - an individual and a relative of the individual
 - an individual and a relative of the individual's spouse
 - an individual and the spouse of a relative of the individual
 - an individual and the spouse of a relative of the individual's spouse
 - a person and a business partner of the person
 - a person and the spouse of a business partner of the person
 - a person and a relative of a business partner of the person
 - a company and another company where the same person has control of both companies
 - a company and another company where a person has control of one company and persons connected with that person or that person and persons connected with that person have control of the other company
 - a company and another company where a group of 2 or more persons has control of each company and the groups consist of the same persons or could be regarded as consisting of the same persons if a member of either group was replaced by a person connected with that member
 - a company and a person where the person has control of the company or the person and persons connected with the person control the company
- i) From its qualifying exempt patent income, a company may make tax-exempt dividend payments to shareholders holding eligible shares or to individuals who performed the R&D work for the patented invention, subject in all cases to the overall limit of €5m per annum.
- j) In the case of royalty payments received by a company from a **connected** person in respect of activities eligible for the 10% corporation tax rate, the company can make tax- exempt distributions out of exempt royalty income up to an amount which does not exceed the total research and development expenditure incurred by the company, its group companies and companies under common ownership in the relevant accounting period and the previous two accounting periods (i.e. over 3 years). Alternatively, the company can apply to the Revenue Commissioners for a determination that the patented invention involved **radical innovation** and was patented for bona fide commercial reasons and not primarily for the purpose of avoiding liability to tax. If such a determination is made, the restriction limiting the amount of tax-exempt distributions to 3 years research and development expenditure will not apply, but the aggregate limit of €5m will still apply.
- k) For the purposes of ascertaining group R&D expenditure under paragraph 10 above, two companies are in the same group if one is a 75 per cent subsidiary of the other or the two companies are 75 per cent subsidiaries of a third company or or 75 per cent owned by the same individual(s).

- l) Tax exemption in respect of patent royalties is claimed on a self-assessment basis. In other words, the individual or company states on its annual tax return that it is in receipt of exempt patent income and should indicate the amount in its return. The return is subject to audit and claims for exemption will be examined. It is not necessary to get prior clearance to claim the patent royalty exemption unless a person is seeking a determination from Revenue that the patented invention involved “radical innovation”, in which case an application should be submitted to Revenue’s Income and Capital Taxes Division, Business Income Tax Branch, Stamping Building, Dublin Castle.
- m) I have discussed a number of members’ queries about the Patent Royalty Scheme with the Revenue Commissioners, particularly about paying royalty payments to individual in companies and the outcome is as follows:
1. Royalty payments can be made tax – free to the shareholders in a patent company as a dividend distribution.
 2. Royalty payments can be made tax-free to individuals who hold a patent i.e. the company pays a licence fee to the patent-holders who could be part of the company.
 3. All other payments (e.g. bonus) made to individuals in a company are regarded by Revenue as taxable income.
- n) This is a working document which will be amended and updated to reflect issues and questions as they arise

4. USEFUL CONTACTS

- Dick Kavanagh at IRDG, dick_kavanagh@irdg.ie / 01-237 4671
- Revenue Commissioners (for general inquiries relating to this document):
John Fanning - john.fanning@revenue.ie/ 01-6748606 or
John Watkins - jwatkins@revenue.ie/01-6475000.
 - Case-specific enquiries should be directed to the relevant tax district.

5. ACKNOWLEDGEMENTS

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