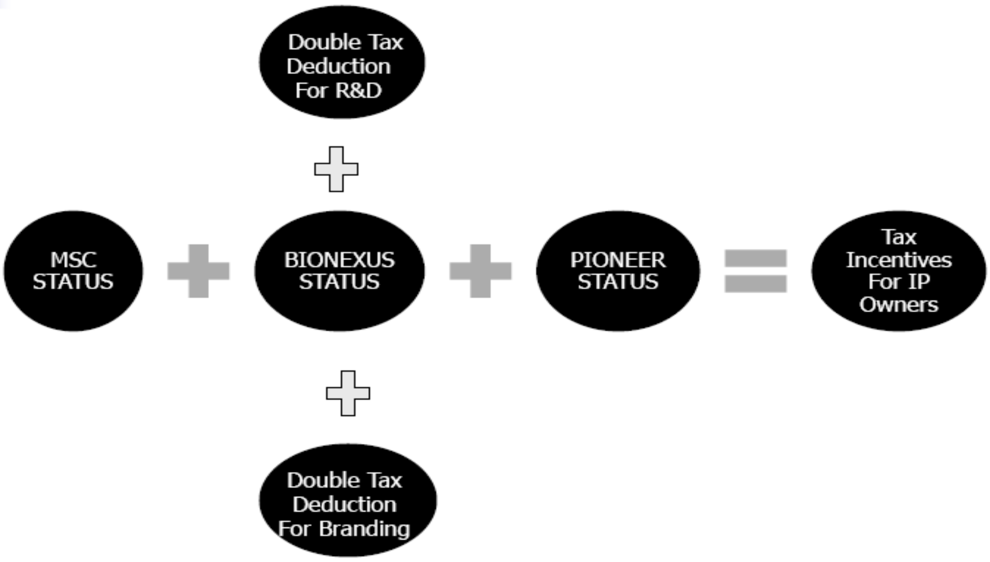
IP TAX

Due to the transferability of IP assets and various tax incentives accorded to IP related activities, IP assets have been increasingly used by IP owners as a tax planning tool.

Tax / Royalty Planning at 3 different situations

- New IP assets creation (development Stage)
- Acquisition of IP assets
- Existing IP assets owner in respect of revenue derived from IP Assets

A. Tax Incentives For Creation of IP Assets



A.1 Tax Holidays for Companies that create and commercialise new IPs

MSC Status	• ICT and Multimedia related IPs • Tax exemption for 5 years extended to 10 years, or • 100% ITA on qualifying Capital Allowances for 5 years
Bionexus Status	• Biotechnology Related IPs • An exemption from tax on 100% statutory income for 10 years (new) or 5 years (existing)
Pioneer Status	• Promoted activities or products • Tax exemption of 70% of Statutory income for 5 years

	• 100% for company located in promoted location
Investment Tax Allowance	• Promoted activities or products • Tax exemption of 70% of Statutory income for each YA computed at 60% on Qualifying Capital expenditure within 5 years from the date which the approval take effect. • 100% for company located in promoted location

A.2 Double tax deduction For IP Related Activities

1. Registration of patent, trademark and product licensing in Overseas

Cost of registration of patent, trademark and product licensing overseas

- For Malaysian **resident** company only
- Primarily and principally for the purpose of promoting the **export of goods.**

[Income Tax (Deduction for promotion of exports) Rules 2007. PU(A) 14/2007 Wef. YA2006]

2. Advertisement on Malaysia brand name goods

Advertising on **Malaysian Brand name goods locally**

– 70 % owned by Malaysian
– Brand name owned by the company or its related company
– Product must be export quality standardAdvertising on **Malaysian Brand name overseas**
– Expenses on advertising of Malaysia brand names registered overseas; and
– Professional fees paid to companies promoting malaysia brand names

[Income Tax (Deduction for promotion of exports) Rules 2007. PU(A) 62/2002 Wef. YA2002]

3. Research expenditure

Research Expenditure (s.32A)

– Approved by minister. Or
– Undertaken by person participating in industrial adjustment.
– Incurred within 10 years from the date of approval
– Approved research project undertaken by a company either in-house or contracted to external research companies or institute.
– Expenses for use of facilities or services provided by the approved research institute
– Contribution in cash to approved research institute

B. Tax Planning for Acquisition of IP Assets

Purchase an IP and put to use will have a benefit over a period of time (ie.general revenue) and are therefore considered of a capital nature for tax purposes

- **In general , cost of IP assets purchase is not subject to deduction or capital allowances!!** ***(capital expenditure with no capital allowances)***
- **In budget 2008, there are tax deduction, 20% of the cost of purchase :**

a) for locally incorporated company to acquire high tech assets
  - For production in Malaysia
  - To gain export market

b) For manufacturing Company to acquire IP "rights"
  - for the use in manufacturing process.

a) **For Locally owned Companies which acquire a foreign company to acquire high technology for production in Malaysia or to gain new export markets for local products**

- Deduction for an amount = 1/5 (20%) of the acquisition cost incurred for five years. , However, such acquisition must verified by MIDA
- Acquisition must be in the form of cash transaction and completed within 3 years
- Not allow for the second acquisition by same Company.
- Acquisition cost include value of the share, Professional fees, stamp duty, traveling and accommodation

[Income tax(Deduction for Cost of Acquisition of a foreign Owned Company) Rule 2003, Amended Rule 2008]

b) **The cost of acquisition of propriety rights** (IP) incurred by a manufacturing company for the use in manufacturing process**

- 20% of the cost as deduction in the YA of purchase and 4 following YA against business income includes
- Acquisition cost of the propriety rights, consultancy and legal fees, stamp duty.
- 70% owned by Malaysian.

*** Patent, industrial designs or trademarks*
[Income tax(Deduction for Cost of Acquisition of a foreign Owned Company) Rule 2003, Amended Rule 2008]

Tax Planning for Existing IP Owners

- Sell IP assets, or
- Generate income from IP assets (ie. Royalty Fee)

1. Outright Sale of IP assets

Outright sale of IP assets

- Capital Gain
- Not subject to Income Tax
- Under tax & Royalty planning scheme, to consider set up IPHC to in country of lower tax jurisdiction to acquire the IP assets

Outright sale of IP assets- Points to note:

- Willing seller willing buyer (supported by agreement)
- Lump sum payment. If periodic payments, may subject to income tax
- Valuation of IP assets – future income/ cash flow projection
- Timing of disposal to maximum the value.
- set up IPC since day one, this allows sale of Company instead of sale of IP assets within Malaysia!
- Set up MSC status company, Bionexus Company

2. Royalties Planning

Generating Guidelines for Tax on "royalty fee" from IP assets:

– Income (Royalty fee) received in Malaysia from resident is subject to normal income tax

– Scope of tax under S.4(d), Royalty is defined in S.2 of ITA

– Administration expenses to be deducted under normal business expenses. *(To show that the company running the business)*

– **Remit income back into Malaysia** - Foreign source of income received in Malaysia by a resident from outside Malaysia is exempted from tax (para 28, sch 6) inclusive of **dividend income** and **royalty income**

The Scope of royalty is defined in Section 2 of the ITA as follow:-

a) any sums paid as consideration for the use, or the right to use-

i) Copyrights, artistic or scientific works, patents, designs or models, plans, secret processes or formulae, trademarks*;*

ii) know-how or information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

iii) income derived from the alienation of any property, know-how or information mentioned in para (a) of this definition

Royalty Planning – Points to note:

– Income from IP is not like income from a regular business. It is highly mobile and can be easily moved to another tax jurisdiction.

– MOVE the income to countries with lower tax by setting up IPHC at countries (e.g Singapore/Hong Kong) with lower tax jurisdiction or tax free (eg) BVI and acquire the IP assets

– **Singapore Tax Rate**

effective 2010, corporate income tax rate will be further reduced from 18% to 17%. In order to make Singapore as an attractive investment destination, income tax rates in Singapore have been going down consistently as seen below.

1997-2000 – 26% , 2001-2001 -25.5% , 2002-2002- 24.5%, 2003-2004 -22%
2005-2006 -20% , 2007-2009 – 18% , 2010 17%

0% tax on S$100K taxable income for first <u>three tax filing years</u> for a newly incorporated company

8.5% tax on taxable income of upto S$300K

– Withholding tax 10% on royalty paid to non-residence – S109 /S15/S3/4(d) – final tax (as compared with 25% IT)

– **Remit income back into Malaysia -** Foreign source of income received in Malaysia by a resident from outside Malaysia is exempted from tax (para 28, sch 6) inclusive of **dividend income** and royalty income

The Tax/Royalties planning structure for an existing IP Owner can be summarised by Diagram 2.6.1 below.

Diagram 2.6.1