

## Incentive Guidelines

### Tax Exemption on Royalty Income from Patents

Issue Date: 18<sup>th</sup> January 2011

Version: 1.0

This document provides the additional guidelines in line with Legal Notice 429 of 2010, *Exemption on Royalties Derived from Patents Rules, 2010* issued under the *Income Tax Act*,

## **Contents**

1.	Introduction.....	3
2.	Eligibility .....	4
3.	Incentive Description .....	6
4.	Application Process and Approval .....	7
5.	Contact Details .....	9

# **1. Introduction**

---

## **1.1 Objectives**

Intellectual capital must be protected and nurtured to ensure that those members of our society that can contribute to our future development are motivated to support and seek the creation of new knowledge. Intellectual property is increasingly becoming a strategic asset that individuals and enterprise can exploit to generate wealth. The successful deployment of intellectual property rights leads to economic returns to the owner and also ensures that the knowledge is utilised and exploited.

The objectives are:

- To encourage researchers to exploit intellectual property through the licensing of patented knowledge;
- To encourage enterprises to invest in research and knowledge creation;
- To support the exploitation of intellectual property.

## **1.2 Scope**

The scope of these guidelines is to provide further details relevant to the Legal Notice entitled *Exemption on Royalties Derived from Patents Rules, 2010* issued under the *Income Tax Act*, provides the legal basis of this incentive.

## **1.3 Designated Authority**

This incentive is administered by Malta Enterprise and the Inland Revenue Department.

## 2. Eligibility

---

### 2.1 Eligible Applicants

This incentive is available to all persons<sup>1</sup> (individuals and enterprises) that own the rights to patented intellectual property and are receiving income in the form of royalties (or other similar income there from).

Malta Enterprise reserves the right not to consider application from applicants that are defaulting on VAT, Income Tax, Social Security and rent payments to Government.

### 2.2 Eligible Patents

A patent granted in Malta or overseas is considered as eligible as long as the same invention is considered patentable under Maltese Law<sup>2</sup> or is the result of Fundamental Research, Industrial Research or Experimental Development defined as follows:

**'Fundamental Research'** means experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundations of phenomena and observable facts, without any direct practical application or use in view;

**'Industrial Research'** means planned research or critical investigation aimed at the acquisition of new knowledge and skills for developing new products, processes or services or for bringing about a significant improvement in existing products, processes or services. It comprises the creation of components of complex systems, which is necessary for the industrial research, notably for generic technology validation, to the exclusion of prototypes as covered by 'experimental development' (see below);

**'Experimental Development'** means acquiring, combining, shaping and using of existing scientific, technological, business and other relevant knowledge and skills for the purpose of producing plans and arrangements or designs for new, altered or improved products, processes or services.

---

<sup>1</sup> As defined in Article 2(1) of the Income Tax Act (Chapter 123 of the Laws of Malta)

<sup>2</sup> Patents and Designs Act (Chapter 417 of the Laws of Malta)

These may also include, for example, other activities aiming at the conceptual definition, planning and documentation of new products, processes and services. The activities may comprise producing drafts, drawings, plans and other documentation, provided that they are not intended for commercial use.

The development of commercially usable prototypes and pilot projects is also included where the prototype is necessarily the final commercial product and where it is too expensive to produce for it to be used only for demonstration and validation purposes. In case of a subsequent commercial use of demonstration or pilot projects, any revenue generated from such use must be deducted from the eligible costs.

The experimental production and testing of products, processes and services are also eligible, provided that these cannot be used or transformed to be used in industrial applications or commercially.

Experimental development does not include the routine or periodic changes made to products, production lines, manufacturing processes, existing services and other operations in progress, even if such changes may represent improvements.

## **3. Incentive Description**

---

### **3.1 Details of Incentive**

Any person (individual or enterprise) receiving royalty payment or similar income for granting, through a licensing agreement or similar agreement, the exploitation of knowledge protected under a qualifying patent in terms of the Regulations, may opt to have any such income exempt from tax as long as all the following conditions are adhered to:

1. In the case where the owner of the patent is an individual; the individual must have been engaged in carrying out, solely or together with another persons, the research, planning, processing, experimenting, testing, devising, designing, developing or other similar activity leading to the invention which is the subject of the qualifying patent.
2. In any case the licence must be granting to an enterprise for using the patent in a productive economic activity, such as manufacturing, software development and data processing.

### **3.2 Additional Provisions**

The licensing of patented knowledge to linked enterprises<sup>3</sup> is allowable as long as:

1. the royalty paid does not exceed an amount that would have been paid at arm's length, that is the amount that would have been paid if the enterprises were not related.
2. the linked enterprise acquiring the licence must be directly involved in a productive economic activity, such as manufacturing, software development and data processing.

---

<sup>3</sup> Two or more enterprises are linked when they have any of the following relationships:

- One enterprise holds a majority of the shareholders' or members' voting rights in another.
- One enterprise is entitled to appoint or remove a majority of the administrative, management or supervisory body of another.
- A contract between the enterprises, or a provision in the memorandum or articles of association of one of the enterprises, enables one to exercise a dominant influence over the other.
- One enterprise is able, by agreement, to exercise sole control over a majority of shareholders' or members' voting rights in another.

## **4. Application Process and Approval**

---

### ***4.1 Application Process.***

Applicants are required to complete the official application form. This may be downloaded from the Corporation's website. The application should be supported with any additional documentation which may be requested by the Corporation.

An application will be required for each licensing agreement or similar agreement irrespective whether a previous approval has been granted to the patent holder.

The applicant will be required to submit declarations that the arms length principle has been respected in the transaction and that to his knowledge the patent will not be utilised in activities which conflict with public policy.

### ***4.2 Approval***

Malta Enterprise will review the application to corroborate that the applicant, the patent and the licensing agreement are aligned with the rules of the LN and these guidelines. If the application provides satisfactory evidence that these rules are being abided to, an Entitlement Certificate shall be issued, stipulating that from the evidence provided any royalty payments received by the patent holder from the licensee are to be treated in terms of LN 429 of 2010.

The Entitlement Certificate will have a validity of up to three years after which the applicant may resubmit an application for renewal.

### ***4.3 Tax Treatment***

The holder of the Entitlement Certificate may start benefiting from the provisions of LN 429 of 2010 on income gained from the patent licensing agreement from the year of assessment as stipulated in the Entitlement Certificate.

Annually, the applicant must submit to the Commissioner of Inland Revenue the following documentation:

1. A declaration that the documentation and information submitted to Malta Enterprise on the basis of which the Entitlement Certificate was issued are still valid and current.
2. A copy of the Entitlement Certificate.

## ***4.4 Monitoring and control***

Malta Enterprise and the Commissioner of Inland Revenue may:

1. require further evidence in relation to any royalty payment received;
2. revoke any incentive entitlement certificate if any evidence is found showing that the holder has abused from such entitlement.
3. revoke any incentive entitlement certificate if evidence is found showing that the licensee<sup>4</sup> is exploiting the knowledge gained through the agreement in activities prohibited by Article 4(5) of the Patents and Designs Act.

---

<sup>4</sup> This includes any other person or undertaking who through the licensing agreement between the patent holder and the licensee have gained the right to use and exploit the patented knowledge.

## 5. Contact Details

---

Further information on the scheme, as well as information and guidance on the filling in of the application form can be obtained by contacting Malta Enterprise on:

Postal Address: Malta Enterprise  
Enterprise Centre  
Industrial Estate  
San Ġwann SGN 3000  
Malta

Tel: +356 2542 2020  
Fax: +356 2542 3401

Websites: [www.maltaenterprise.com](http://www.maltaenterprise.com)

Email: [customer.relations@maltaenterprise.com](mailto:customer.relations@maltaenterprise.com)