Medical Technology and Intellectual Property Migration

Thursday, May 22, 2014
Expanding into the EU? Consider Ireland

U.S. Legal Issues

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Basic Legal Considerations

» Taxes (Foreign and Domestic)
» Investor Requirements and Interests
» Commercial Basis for EU Expansion
» Organizational Structure
» Employment Considerations
» Intellectual Property
» Disqualification from U.S. Investor Incentive Programs
» Exit Strategy
Examples

Start up company
» Easier to develop intellectual property offshore than to “move” it there
» No contracts or employees to move
» Straight-forward organizational structure
» Investors on board from the beginning
» Difficult to qualify for U.S. investment incentives

Expansion or Inversion Transaction
» Complex organizational structuring required
» Many contracts to convert
» Inability to transfer U.S. IP without significant tax penalties
» Strict procedures in the EU for transferring property and data
Summary

» Know what you hope to accomplish by either forming your company offshore or expanding into a foreign jurisdiction

» Understand the trade-offs for those benefits and legal considerations

» Engage both local country advisors and U.S. advisors before making the leap

» The benefits can outweigh the costs but long term planning is more critical than for domestic entities
US tax considerations
Foreign IP Migration / Cost Sharing

Benefits/Considerations

Benefits

• Move profits associated with foreign intangibles to cost sharing participants (e.g., non-U.S. entities)
• Cost sharing arrangement documentation
• Minimize audit exposure

Considerations

• Consider US income tax impact of buy-in payment
# Key Tax Considerations

## Benefits & Feasibility (Business Case)
- Cost benefit analysis based upon reliable forecasting

## Foreign and US business purposes for restructuring
- Globalization/Regionalization

## Substance
- Transactional Substance
- Physical Substance

## Impact on current relationships with tax authorities
- Audits and other current controversy
- Current tax rulings
Foreign IP Migration / Cost Sharing

Transfer Pricing Planning

- Profits follow functions, risks, and intangibles.
- Intangible property has value independent of the services of any individual, but personal services: (1) Add to the value of IP; and (2) Create additional IP.

Migration of Non-US IP

- Offshore income attributable to IP can be taxed at a lower rate, depending on where owned and exploited.
- Common migration methods: (1) Functional migration; (2) Cost sharing; (3) Licensing
- Offshore entity as economic owner of IP can earn a return on its exploitation.
- Taxpayer transfers Foreign IP offshore to a favorable tax jurisdiction. Taxpayer receives a buy-in payment for the value of existing intangibles and future benefits of those intangibles

Functional Migration

- Identify existing IP to be used offshore.
- Determine expected offshore useful life of IP.
- Identify functions that add value (will they be) offshore?
- Determine arm’s length royalty (straight line or declining amount)?

Cost Sharing Agreement

- Taxpayer enters into cost sharing agreement with Newco in a favorable tax jurisdiction.
- Taxpayer receives a buy-in payment for the value of existing intangibles and future benefits of those intangibles
Transfer Pricing Strategy

Transfer Pricing

- Foreign tax exposure on deemed disposition of intangible assets (patents, trademarks, goodwill, customer list, etc.) upon conversion
  - Risk managed through declining royalties or similar transfer pricing methods
  - Risk managed through phase down of leverage
Transfers of Intangibles – Section 367(d)

- U.S. person transferring an intangible to a foreign corporation in a tax-deferred exchange to which §367 applies is treated as having sold the property to the transferee in exchange for a “deemed royalty”:
  - The transferor is treated as receiving annual royalty payments on the last day of the transferor’s taxable year that are “commensurate with the income” attributable to the intangible.
  - The deemed royalty must be included for the property’s useful life.

- Notice 2012-39 – payments received by the US transferor will be treated as prepayments of the section 367(d) royalty, and thus currently includible in income, to the extent the payments are attributable to certain intangible property.

- IRS states that it is targeting transactions designed to repatriate earning without the “appropriate recognition of income.”
Globalization will have a profound impact on the medical technology supply chain.

The geographical expansion of the supply chain will make it much more difficult to manage.

Future supply chain will be responsible for commissioning services and ensuring that manufacturing specifications are met – a transition that will ultimately enable it to become a means of revenue generation and competitive differentiation, rather than a cost-center.
Tax Effective Supply Chain Management Objectives

- Optimize realignment of tax model with foreign sourcing and distribution configuration
- Minimize payments and compliance burdens for indirect and withholding tax purposes
- Maximize tax-efficient use of cash offshore within changed business model
- Minimize permanent establishment (PE) risk
- Comply with applicable transfer pricing rules
- Ensure structures are practical, achievable, and can be implemented from the operational, tax and legal perspectives
- Ensure structures support lines of business and are adaptable as the business evolves
Supply Chain Model

- **Legal title**
- **Physical flow**
- **Services**

- **Deliver materials**
- **Deliver products**
- **Sale of products**
- **Sale of finished goods**

- **R&D**
- **Shared Services & IT services**
- **Principal company = Hubco**

- **Supplier**
- **Deliver materials**

- **Consignment manufacturer**

- **Logistics - transport**
- **Manufacturing services**

- **Consignment manufacturer**

- **Logistics - warehousing**
- **Hospital**
- **LRD**

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Transfer Pricing

• **Documentation / Compliance**
  • Under the IRC code Section 482, the taxpayer should produce [contemporaneous] documentation in existence at the time the taxpayer file the tax return.
  • Transfer Pricing documentation must demonstrate that the taxpayer’s policies are in line with regulatory requirements for appropriate methodologies and with the “arms-length” standard.
  • As a result of enhanced enforcement efforts by many tax authorities, transfer pricing documentation has become a complex, multi-jurisdictional issue for most companies.

• **Affirmative use of Transfer Pricing by lowering the Effective Tax Rate**
  • Implement various tax planning techniques, e.g., structuring, financing and transfer pricing to achieve lower global ETR

• **The new model of doing business of Medtech will make transfer pricing procedures more complicated.**
Transfer Pricing: Sources of Profit

In tax-favored jurisdiction:
Valuable functions, risks, and IP

Transferable Profit
(valuable functions, risks & IP)

Base Profit
(basic functions)

Production

Transferable Production Profit

Transferable Marketing & Sales Profit

Transferable Profit
(valuable functions, risks & IP)

Base Profit
(basic functions)

Marketing & Sales
Holding Company/Finance Company Planning

Overall Considerations
- Business needs and direction
- Local substance
- Effective tax rate on intercompany financing income in Finco

Complexity
- Corporations v. partnerships / branches
- Number of tiers
- Necessity for interest withholding tax planning

Withholding Tax
- Reduce v. eliminate dividend withholding tax

Capital Duty
- Planning to avoid v. structuring going forward

Flexibility
- Exit strategy
- Longevity
Holding Company/Finance Company Planning

Creation of low taxed finance income:
- Contribution of existing loan portfolio into Finco
- Contribution of proceeds from third party loan taken up by Parent
- Capture dividends in Finco for financing foreign operations
- Transfer sub to local or foreign leveraged Holdco
Rulings –
Holding Company/Finance Company Planning

• Established ruling practice in most European countries (including Luxembourg, Netherlands, Switzerland)

• Rulings available for:
  - Holding structures (application of participation exemption, transparency of limited partnership)
  - Financing structures
  - Licensing structures
  - Principal structures
EU Tax Considerations
Expanding into the EU

- Single market of over 500 million people
- 28 sovereign member states
- Summary/Pricing of EU Law over National Law
Expanding into the EU

Four Key Freedoms

- Free movement of people
- Free movement of goods
- Free movement of services
- Free movement of capital
Expanding into the EU

Matters for Consideration

- Employment law
- Contractors and IP rights
- Currency consideration
- IP protection
- Data protection
Expanding into the EU

• One single market with underlying principles governing taxation policy, in theory
• Practice is different with each country adopting its own bespoke approach
• EU Directives on both Direct & Indirect Tax should be implemented but some derogations received and some non-compliance by certain countries
• But ECJ final arbitrator on taxation issues!
Expanding into the EU

International tax issues to the fore of the business debate at present

BEPS project being undertaken by the OECD with proposals to be on the table by end of 2015

The landscape for international tax structures will change over the coming months and years ahead

Certainty of structure becomes a valuable business asset
Expanding into the EU

- Use of Transfer Pricing principles to shift profits from a high tax jurisdiction to a lower tax jurisdiction
- Use of the definition of a Permanent Establishment to avoid payment of tax in a jurisdiction despite obvious activity there
- Double Non-Taxation through mis-match between residence rules of different jurisdictions
- Hybrid entities and hybrid instruments
Tax Planning for Global Business

**Tax challenge of a multi-jurisdictional business**

**Bottom line effect**

- Advance planning can lead to increased post tax for shareholders
- Additional source of working capital for expansion
- Poor planning can lead to additional unplanned for liabilities
- Potential for penalties and interest in circumstances where a liability arises in unforeseen circumstances
Tax Planning for Global Business

Matters to be considered

• Reputational damage from over aggressive tax planning
• Damage to business from overpaying tax by not understanding the rules of a new jurisdiction
• Cost in time and expense in retrospectively putting a ‘fit for purpose’ structure in place
• Tax structure must meet the commercial needs of the business – otherwise the structure will ultimately fail
Brief Overview of Key Highlights of these Jurisdictions

The Netherlands
Luxembourg
Switzerland
The United Kingdom
Ireland
The Netherlands

- Nominal corporate income tax rate of 25% (20% for first EUR 200,000)
- Various investment and R&D related incentives
- 100% participation Exemption on capital gains and dividends
- Full territorial approach (“object exemption”) for foreign branch results
- Tax Losses 9 years carry forward/1 year carry back
- No withholding tax on interest and royalties
- Extensive and attractive tax treaty network
- Advance Tax Ruling practice. Tried and tested & Flexible
- Numerous dividend withholding tax exemptions:
  - EU Parent –Subsidiary Directive
  - Dutch domestic law
  - Tax Treaties
  - Cooperatives
- No capital duty/transfer tax (shares)

Highlights of Dutch corporate income tax system
Switzerland

Highlights of Swiss corporate income tax system

- Low VAT rate of 8%
- Bi-Lateral agreement with the EU = De facto access to EU Parent Subsidiary and Interest/Royalty Directive
- Tax Ruling Culture 100% certainty for foreign companies/new investors
- Effective rate of between 12-24% depending on the canton
- No withholding tax on royalties
- Extensive tax treaty network
- Possibility to use a foreign functional currency
- Possibility of tax holidays for 10 years
- Specific attractive tax regimes: Holding company: 7.8% Auxiliary company: 9-12% Principal company: 5-10%
- Participation exemption on dividends and capital gains
- No CFC rules
- R&D grants: The Swiss Government supports applied research and development projects through special funds set up specifically for this purpose (CTI – Swiss Innovation Promotion Agency)
Highlights of the Luxembourg corporate income tax system

- Effective rate of 5.84% for royalties. 80% exemption available
- VAT – Standard rate of 15%
- Partial exemption on withholding taxes, subject to T&C
- Perception of light touch regulation on substitute rules
- Potential for participation exemption on dividends, capital gain sight to certain countries
- 80 double Tax Agreement
United Kingdom

Highlights of UK corporate income tax system

- Reduction in corporation tax rate to 20% (from 1/4/15)
- Generous interest deduction – subject to anti-avoidance
- No WHT on dividends
- R&D relief (225% tax relief for SME’s and 130% for Large companies on qualifying spend, plus the opportunity for a payable tax credit)
- Patent Box (10% tax rate on qualifying profits)
- Controlled Foreign Companies reform
- Foreign Branch Profits exemption
- Dividend exemption widely available
Irish Tax System Highlights

- 12.5% corporation tax rate on trading profits and dividends received from foreign trading subsidiaries
- Commitment from government to continue 12.5% rate of corporation tax
- Easiest country in Europe to pay business taxes (source: World Bank, IFC 2009)
- Government agencies welcoming, practical, pro-business and helpful (e.g. Industrial Development Agency, Revenue)
Securing 12.5% Corporation Tax Rate

- Need to demonstrate active trade taking place in Ireland
- Frequency of transactions and conduct of activity
- Employees working in Ireland
- Employees must have the necessary skills, knowledge and expertise to conduct the activities
- Company must clearly be “open for business” and seeking customers/contracts etc.
Securing 12.5% Corporation Tax Rate

The Irish tax authorities may make an advance determination on whether or a company is trading or not

• Is there a commercial rationale for this type of situation proposed?
• Is there any real value added in Ireland?
• Are there employees in Ireland with the sufficient skill levels to indicate that the trade in being actively carried on by the company?
Holding Company Regime

- Tax free disposal of shares in qualifying subsidiaries
  - Subsidiary must be trading
  - Minimum 5% holding
  - Must hold shares for 12 months
- Tax credits available for foreign dividends repatriated to Ireland
- No controlled foreign corporation ("CFC") legislation or thin capitalisation rules
- Relatively benign transfer pricing regime
- Interest free loans permitted
  - widely used as financing mechanisms
Foreign Dividend Income

Although foreign dividend income is technically liable to tax:
• usually possible to avoid this tax by using foreign credits

Manage or avoid withholding taxes through:
• Foreign tax credit pooling
• The EU Parent–Subsidiary Directive
• Double taxation agreements

2012 EU case – rethink of rules:
• Now credit given for overseas tax at nominal rate (as opposed to effective rate)
• Moves the Irish system even closer to a zero tax position on dividends
Other Tax Benefits for Irish Resident Companies

- No withholding tax on interest payments to EU/Treaty Countries
- Tax treaties with 70 countries, 68 of which are in effect
- No stamp duty on Intellectual Property
- Three year tax holiday for small start-up companies
- Foreign earnings deduction for employees developing markets in Brazil, Russia, India, China or South Africa and a number of African countries
Advantages for non-resident shareholders

No Irish capital gains tax for non resident, non domiciled persons on shares in Irish resident trading companies where the shares in the company do not derive their value from land and buildings in Ireland

No dividend withholding tax on dividend payments where shareholders are resident in a EU State or DTA country i.e. the US
The Change to Irish Corporation Tax

Payable by companies resident in the State and Irish branches of non-resident companies.

Trading profits are taxed at 12.5%.

Passive income e.g. rental profits, taxed at 25%.

Allowable expenses must be incurred wholly, exclusively for the purpose of the trade.

Accounting periods cannot exceed 12 months for tax purposes.
The Change to Irish Corporation Tax

How to avail of the 12.5% rate
- Irish resident company. Board meetings in Ireland
- Active trade in Ireland. Personnel and substance in Ireland

Irish Revenue will give prior approval for 12.5% rate

Irish Revenue will support companies in Ireland interacting with other tax authorities
Corporation Tax – Some key reliefs

- Research and Development tax credit
- Intellectual Property tax deduction
- Three year corporation tax holiday for small start-ups
R&D impetus

Legislation aims to encourage foreign & indigenous companies to undertake new and/or additional R&D activity in Ireland.

Coupled with the corporation tax regime it makes Ireland one of the prime locations in the world in which to undertake R&D activity.
Who can claim the relief?

Available to all companies who undertake R&D activities within the EU

For an Irish tax resident, the expenditure must not qualify for a tax deduction in another territory
Relief for the R&D tax credit

25% tax credit on qualifying incremental R&D spend
• over the amount spent in the base year which is set at 2003

First €300,000 of expenditure can be claimed even if
• Below 2003 base amount
• Outsourced

In addition to the accounts deduction at rate of corporation tax (12.5% + 25% = 37.5%)
Use of the R&D tax credit

Cumulative effective tax relief = 37.5% for R&D expenditure

Tax credit can be used to:

• Offset against company’s current or prior year corporation tax liability or;
• Carried forward against future tax liabilities or;
• Used to trigger a payroll tax refund, payable in three parts

In some cases company can surrender R&D credits to key R&D employees
Qualifying Activities – Rocket science not required!

**Examples**

- Developing and/or improving a new or existing products
- Improvements to plant efficiency i.e. energy efficiency, waste reduction, yield improvements, etc.
- Automation of manual processes / systems
- Plant and or/product trials, including pilot facilities
- Testing of new or modified raw materials
- Development of solutions to reduce product returns/technical failures
- Costs of R&D buildings can avail of the 25% credit
Tax relief available for expenditure on Intellectual Property

Irish IP Relief + Corp Tax + R&D Relief + legislation =
• prime location to exploit IP

Relief is capital allowances against trading income
The Relief

The tax deduction:

- Matches the annual accounts based depreciation/amortisation of the asset or;
- An election can be made to claim the allowances over 15 years

Available for offset against trading income generated from the exploitation of IP assets
What Intangible Assets come within the relief?

The scheme applies to intangible assets which:

- Are recognised as intangible assets under generally accepted accounting practice
- Which are listed as specified intangible assets in the legislation
What constitutes a “specified asset”? 

Legislation details a broad list of specified assets and includes the acquisition of or the license to use:

- Patents and registered trademarks
- Trademarks and brand names
- Know-how
- Domain names, copyrights, service marks and publishing titles
- Authorisation to sell medicines or a product of any design, formula, process or invention
- Goodwill, to the extent that it relates to the aforementioned assets
What constitutes a “specified asset”? 

IP tax relief will not be clawed back on the disposal of an IP asset if:
• the disposal takes place in 5 years following date asset was first acquired for use in the trade and;
• provided the asset is not disposed to a connected company

Irish legislation provides an exemption from stamp duty on the purchase of most IP assets
Corporation Tax – Other reliefs

Trading losses can be carried forward against future profits of the same trade indefinitely

Current year losses can be carried back against prior year income of any type

Current year losses can be set against other income in some cases

Employment Innovation Incentive Scheme

• tax relief offered to persons investing in a qualifying company can be a good method of raising finance

Tax exemption for start up companies

• 3 year exemption from CT where the total CT payable does not exceed €40k
• Gives up to €960K of exempt profits over the 3 years
• Valid at least until 2014
• If €960K has not been used up in 3 years, can be carried forward in some cases
Expanding into the EU

We have assisted many companies set up EU operations:

• Irish holding companies for pan-European groups
• Irish holding company of global group with treasury, R&D and IP functions in active holding company
• Irish R&D and IP subsidiaries of US group
• Irish incorporated, Bermudan resident company, which owns Irish resident trading company—double Irish
• Set up of Irish trading company to provide services to other group companies in higher tax jurisdictions
Examples

Presented by
Aidan Byrne and Jim Alajbegu
Double Irish Structure

US Co
IP
Double Irish Structure

- **US Co**
  - IP
  - IR Co (A)
    - Irish incorporated and Bermuda/Cayman tax resident
  - IR Co (B)
    - Irish incorporated and Irish resident
Double Irish Structure

- US Co
- IR Co (A)
- IR Co (B)

100% ownership relationships:
- US Co owns IR Co (A) 100%
- IR Co (A) owns IR Co (B) 100%

Financial transactions:
- Sale of non-US IP
- License of non-US IP
- Fee for IP license
Double Irish Structure with Dutch Sandwich

- **US Co**
  - **IR Co (A)**: 100%
  - **IR Co (B)**: 100%
- **Dutch BV**: Royalties (no WHT)
  - **US Co**: Royalties (no WHT)
Structure to reduce the Taxable Base in Home Countries without moving core functions

Co A (Non-Irish) high profits

Co B (Non-Irish) high profits
Structure to reduce the Taxable Base in Home Countries without moving core functions

Co A  
low profits

Co B  
low profits

Irish Co  
high profits

Services

Services

Services
Structure to reduce the Taxable Base in Home Countries without moving core functions

Leverage off Ireland’s mature financial services sector to place high value non core functions in Ireland, such as:

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<th>Functions</th>
<th>High Value</th>
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<td>Cash Pooling/ Treasury/ Intra group lending</td>
<td>High level expertise in Ireland</td>
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<tr>
<td>Factoring</td>
<td>Non recourse to Irish co – risk in Ireland</td>
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<tr>
<td>Reinsurance/ Captive Insurance</td>
<td>Maximise risk in Ireland</td>
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<td>IP Co</td>
<td>Accepted high value</td>
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<td>Internal leasing of equipment</td>
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