

Main provisions of Patent Box regime

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Introduction

At the end of 2014, the government presented the 2015 budget, which introduced a 'Patent Box' tax regime in line with similar schemes adopted in other European countries. It applies to corporate income tax and regional tax on productive activities. It aims to provide tax incentives to create, relocate and maintain intangible assets in Italy based on the Organisation for Economic Cooperation and Development's (OECD) 'nexus' approach.⁽¹⁾

The Ministry of Economics and Finance recently announced the approval of the decree, which sets out the Patent Box's application provisions. However, some application criteria are yet to be clarified.

Tax exemptions

The Patent Box will trigger an exemption – 30% in 2015, 40% in 2016 and 50% from 2017 – on income derived from the exploitation of eligible intangible assets.

Participation in the regime is optional, but applicants must sign up for five fiscal years. The tax incentives are equal to income derived from eligible intangible assets (50%) multiplied by the costs incurred to develop and maintain these assets. This sum is then divided by the overall costs incurred to develop and maintain the assets in question.

The Patent Box also provides a tax exemption for capital gains derived from the sale of intangible assets, provided that 90% of the considerations are reinvested in the maintenance, enhancement or development of other eligible intangible assets.

Eligibility

All entities that carry out business in Italy can apply for the exemption. Foreign companies are eligible only if their business income is earned through a permanent establishment in Italy and they are resident in a state that has a double tax treaty and an effective system for the exchange of information on tax matters with Italy.

Otherwise, the sole condition to qualify for the Patent Box regime is to carry out "eligible research activity which leads to the creation of an eligible intangible asset".

The new tax regime applies to a wide range of eligible intangible assets (Article 6 of the decree-law), including:

- software protected by copyright;

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- industrial patents;
- biotech inventions;
- utility models;
- patents for plant varieties;
- semiconductor topographies;
- registered or pending trademarks, including collective trademarks;
- legally protected designs and models; and
- confidential and legally protected business, commercial, industrial and scientific information and know-how.

Trademarks

The Patent Box regime applies to a wide range of intangible assets, including trademarks, which are considered fundamental to the worldwide success of Italian business, particularly in the luxury goods and food industries. The Italian approach in this regard appears to be consistent with the OECD approach outlined in its Action Plan on Base Erosion and Profit Shifting. However, at present, the OECD does not include trademarks under the scope of eligible intangible assets for the Patent Box regime.

In contrast, under the Italian Patent Box, trademarks will benefit from a five-year 'grandfather provision', under which the regime will apply until June 30 2021. The OECD is considering the introduction of a limitation of benefit clause for new entrants to the Patent Box regime from June 30 2016. The deadline will be more relevant in cases in which a ruling request is mandatory for the application.

Calculating tax benefits

The first factor to consider when calculating the tax benefits that the Patent Box offers is the portion of income earned through the exploitation of eligible intangible assets.

It is still uncertain how eligible income should be determined. However, if intangible assets are licensed to third parties, the calculation is based on royalty income earned by the beneficial owner of the assets minus the relevant costs incurred. Conversely, if the assets are exploited internally, the relevant income is calculated in line with generally accepted transfer pricing methods. In this context, the calculation of Patent Box income is often unpredictable and a compulsory advance ruling may be requested. The taxpayer must consider that the ruling request could be time consuming and that the Patent Box regime may be applied only after the ruling's formal release. The Patent Box regime provides that tax incentives can be retroactively applied to the fiscal year in which the ruling request is filed once all reporting requirements have been met.

The next step involves the application of a cost ratio to income derived from eligible intangible assets, which is determined as follows:

- The denominator comprises costs incurred for the purpose of acquiring, developing and maintaining the intangible assets considered; and
- The numerator comprises costs included in the denominator, although inter-company, purchasing and licensing costs are calculated only up to an amount that is equal to 30% of the qualifying costs.

Therefore, the only difference in costs considered under the denominator and the numerator are the relevant amounts (ie, if no inter-company, purchasing or licensing costs are borne or if they are less than 30% of the other qualifying costs, the ratio will be 100%). Under this scenario, the tax exemption will apply to all eligible income derived from the exploitation of relevant intangible assets.

In order to calculate the above ratio, a special system applies for the first four tax periods, determining a single ratio for all eligible intangible assets. Following the opt-in period, the taxpayer will apply a 'tracking and tracing' approach to costs incurred regarding each intangible asset in accordance with the OECD nexus approach.

An effective and analytic tracking and tracing system must therefore be implemented for each eligible intangible asset; if a single process is performed or a product made using various intangibles, they will be treated as a single asset in order to determine the eligible income and cost ratio.

Eligible costs

Article 8 of the decree-law provides for an exhaustive list of eligible costs, including:

- product design;
- market research; and
- communication, marketing and promotion activities that aim to increase the value and reputation of a commercial trademark.

For further information on this topic please contact [Marco Abramo Lanza](#) or [Franco Pozzi](#) at Studio Legale Tributario Biscozzi Nobili by telephone (+39 02 763 6931) or email (marco.lanza@slta.it or franco.pozzi@slta.it). The Studio Legale Tributario Biscozzi Nobili website can be accessed at www.slta.it.

Endnotes

(1) This approach is set out in Chapter 4 of Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance (Action 5/2014 Deliverable).

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