Tax implications of assigning and licensing intellectual property in Kenya in the context of IP holding companies

Innovation plays an important role in the growth of a business and is increasingly becoming a strategic pillar for any organisation that wants to be successful in today's global economy. At the heart of innovation is the development and use of intellectual property (**IP**) in both the input and output of an organisation. IP rights exist in different forms such as copyright, trademarks, patents, designs and trade secrets, and provide the proprietor with an exclusive monopoly over the utilisation and commercialisation of the IP.

IP can be a business' most valuable asset. Forbes' annual list of the World's Most Valuable Brands of 2020 had Apple (unsurprisingly) at the top of its list, calculating its brand value at USD 241.2 billion and brand revenue at USD 260.2 billion, but there were other notable contenders. These included Toyota, ranked 11th, at USD 41.5 billion (brand value) and USD 187 billion (brand revenue), PwC, ranked 70th, at USD 11 billion (brand value) and USD 42.4 billion (brand revenue), and Lego, ranked 92nd, at USD 8.6 billion (brand value) and USD 5.8b (brand revenue).

One way to capitalise on the value of your company's IP and to enjoy the financial benefits from the commercialisation of the IP is to earn revenue through licensing. For companies operating across multiple jurisdictions and/or where opportunities for considerable revenue generation can be earned through IP licensing, whether locally or in new markets, the incorporation and establishment of an IP holding company should be given due consideration.

A primary benefit of incorporating an IP holding company within your group structure is that it ring-fences the IP from the operations and liabilities of the other affiliated companies within the group.

Prior to any licensing, it is fundamental to undertake some form of tax planning. Below are some of the tax considerations to take into account in the establishment of an IP holding company, the assignment of existing IP to the IP holding company (to ensure that it owns the IP rights to be licensed) and in the licensing arrangements, whether intra-group or to unrelated third parties:

1. **Transfer pricing on the assignment:** Kenyan transfer pricing rules require transactions between a Kenyan entity and its related non-resident affiliates to be undertaken at arm's length. Thus, transfers of IP (i.e. when assigning the IP rights to the IP holding company) from a Kenyan entity to a non-resident related entity should be undertaken at the market value of the IP.
2. **Transfer pricing on the licence fee:** Licensing fees charged between related entities should be at market rates to avoid transfer pricing issues. This is aimed at ensuring that companies do not shift profits by way of setting up IP holding companies in low-tax jurisdictions and then charging high licensing fees to operating companies in other jurisdictions.
3. **Capital gains tax:** Where the value of the IP has appreciated since creation, the transfer of the IP will likely result in gains for the owner of the IP. Where the selling entity is in Kenya, such gains will be subject to capital gains tax at the current rate of 5%. It is therefore important to consider whether

or not the IP is sitting with the appropriate entity before the IP gains too much value. Note that the chargeable gain is determined by offsetting the transfer price/consideration against the initial acquisition cost of the IP, along with costs incurred in improving/defending the IP and any transaction expenses with respect to the transfer/assignment of the IP.

4. **Applicability of double tax treaties (DTTs):** Consider whether DTTs exist between the jurisdictions of a non-resident entity transferring IP and a Kenyan recipient entity, as these may provide for taxation of capital gains in the country of residence of the transferring entity (being the non-resident entity). In such circumstances, Kenyan capital gains tax will not apply. We can consider the structure of the proposed transfer in order to determine whether there are any treaty limitations that would prevent the parties relying on the applicable DTT.

5. **Value added tax (VAT):** The VAT implications of the transfer of the IP should be considered. Where a Kenyan entity transfers IP to a non-resident entity, the transfer of the IP will comprise an exported service which is currently zero-rated (i.e. subject to VAT at 0% for Kenyan VAT purposes). A transfer by a non-resident entity to a Kenyan entity will however constitute an imported service for which the Kenyan entity will be required to account for VAT (as if it has made a supply to itself), using the reverse charge mechanism. In addition, if a Kenyan VAT-registered business licenses out its IP or gives another person within Kenya a right to the use of its IP, any licence fees or royalties payable will be subject to VAT at the current rate of 16%.

6. **Stamp duty:** A transfer of IP will also trigger stamp duty implications depending on the nature of the document for the transfer. Where the IP is transferred by way of a deed of assignment, nominal stamp duty would apply. Where transferred by way of an instrument under the Movable Property Security Rights Act (MPSRA), the instrument of transfer will be exempt from stamp duty in Kenya. Licensing agreements under which the IP is licensed from one entity to another will also be subject to nominal stamp duty.

7. **Withholding tax:** Where a Kenyan entity is charged licensing fees by the IP rights holder, withholding tax will apply on such payments, which will constitute royalties under the Income Tax Act. The applicable withholding tax rate will depend on whether the payment is made to Kenyan resident persons, non-resident persons with a permanent establishment in Kenya or to non-resident persons without a permanent establishment in Kenya. Where the jurisdiction of the non-resident person has entered into a DTT with Kenya, a reduced rate of withholding tax may apply subject to the limitation of treaty benefit provisions as mentioned above.

Please contact Ariana Issaias, Denis Magonga, Alex Ndegwa or your relationship partner at Bowmans Kenya if you would like to discuss this further.