REPUBLIC OF SAN MARINO

DECREE LAW no. 123 of 25 September 2018
(Ratifying Decree -Law no. 76 of 28 June 2018)

We the Captains Regent
of the Most Serene Republic of San Marino

Having regard to Decree-Law no. 76 of 28 June 2018 - "Implementation of the regime for the remission of tax on income from intangible assets" - promulgated:

Having regard to the conditions of necessity and urgency referred to in Article 2, paragraph 2, letter b) of Constitutional Law no. 183 of 15 December 2005 and Article 12 of Qualified Law no. 184 of 15 December 2005, and namely:

- *the need to adjust national regulations on tax benefits for the exploitation of intangible assets to anti-avoidance measures developed by the OECD under the BEPS Project, which the Republic of San Marino joined in July 2016;*
- *the urgent need to adjust these regulations by 30 June 2018, in order to effectively combat harmful tax practices possibly deriving from elusive strategies, in compliance with the provisions of Action 5: 2015 Final Report - Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance);*

Having regard to Congress of State decision no. 12, adopted during its sitting of 25 June 2018;

Having regard to the amendments to the above-mentioned decree, which were introduced at the time of its ratification by the Great and General Council in its sitting of 24 September 2018;
Having regard to decision no. 12 adopted by the Great and General Council on 24 September 2018;
Having regard to Article 5, paragraph 2 of Constitutional Law no. 185/2005 and to Article 9, paragraph 5, and Article 10, paragraph 2 of Qualified Law no. 186/2005;
Hereby promulgate and order the publication of the final text of Decree-Law no. 76 of 28 June 2018, as amended following the approval of the Great and General Council when ratifying it:

IMPLEMENTATION OF THE REGIME FOR THE REMISSION OF TAX ON INCOME FROM INTANGIBLE ASSETS

TITLE I
GENERAL PROVISIONS

Art. 1
(Object and purpose)

1. The following rules shall be adopted in order to:

– Adjust San Marino tax system to the best international practices and, in particular, to the OECD's (Organisation for Economic Co-operation and Development) measures under Action 5 of the Action Plan on Base Erosion and Profit Shifting, especially as regards the Agreement on Modified Nexus Approach for IP Regimes, taking into account that the increasing globalization of the world economy renders the fundamental role of intangible assets for value creation all the more evident;

- Review the tax measures supporting the management and exploitation of the above intangible assets.

2. The provisions of this decree law concern introduce optional rules in the area of taxation with the following purposes:

- Favour the keeping of intangible assets in San Marino in order to avoid their transfer abroad;
- Encourage and protect investment in research and development activities.

Art. 2
(Definitions)

1. For the purposes of this Decree Law:

a) "territory" shall mean the territory of the Republic of San Marino;

b) "tax" shall mean the general income tax (IGR) in accordance with Law no. 166 of 16 December 2013 and subsequent amendments (hereinafter also referred to as Law no.166/2013);

c) "intangible assets" shall mean industrial patents, designs and models, legally protected and deriving from research and development activities, and software protected by copyright under Article 4 of this Decree Law;

d) "taxpayer" shall mean the party subject to the tax obligations under Law no. 166/2013 and subsequent amendments, or any party who, in the presence of a legal fact or act revealing the tax paying capacity provided for in the above law as prerequisite for taxation, is subject to such taxation;

e) "overall income" shall mean the overall net income deriving from the exploitation of intangible assets;

f) "qualified income" shall mean the portion of the overall income eligible for the benefits provided for in this Decree Law;

g) "nexus ratio" shall mean the ratio between the costs for research and development activities incurred for the maintenance, improvement and development of the intangible asset eligible under Article 8 of this Decree Law and the total expenditures incurred to produce it;

h) "enterprise", shall mean the taxpayer, specified in par. 1 of art. 3, which applied for the regime provided for by this Decree Law;

i) "final report on Action 5 BEPS" shall mean the Final Report issued by the OECD in 2015 entitled Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance.

TITLE II
OPTIONAL REGIME FOR THE REMISSION OF TAX ON INCOME FROM INTANGIBLE ASSETS

CHAPTER I
SUBJECTIVE AND OBJECTIVE SCOPE

Art. 3
(Subjective scope and qualifying subjects)

1. The special tax treatment is available to those receiving business income specified in Chapter V, Title II and Title III of Law no. 166/2013 and subsequent amendments.

2. The special tax treatment under this Decree Law shall not apply to companies subject to insolvency proceedings starting from the first accounting period during which the decree for the

initiation of judicial insolvency proceedings has been issued.

3. Companies or entities of any kind, including trusts, with or without legal personality, not resident in the territory, can exercise the option provided that they reside in countries with which exchange of information is effective.

4. The option of the special tax treatment regime of this Decree Law is available on the condition that the parties exercising the option engage in the research and development activities under Article 9 (including through agreements in the research and development field concluded by the enterprise, the State of San Marino or entities controlled by the latter with independent universities, entities, private enterprises of other Countries) aimed at producing intangible assets within the scope of the special tax treatment regime of this Decree Law.

5. The option can be exercised by the parties entitled to the economic exploitation of the intangible assets under Article 4 below.

Art. 4

(Objective scope – Qualifying intangible assets)

1. The special tax treatment of this Decree Law concerns income deriving from the use of the following intangible assets:

- Industrial patents, granted or in the course of being granted, which include patents for inventions, such as biotechnological inventions and relevant supplementary protection certificates, patents for utility models, as well as patents and certificates on plant varieties;
- designs and models legally protected and deriving from research and development activities;
- software protected by copyright.

2. The following uses fall in the scope of the option:

a) licensing of the right to indirectly use the intangible assets;

b) direct use of the intangible assets, meaning their use in the framework of any activity reserved to the holder of the rights on intangible assets.

3. In the case specified in paragraph 2, letter a) of this Article, the income qualifying for the special tax treatment shall be determined according to the nexus ratio and consists of the royalties deriving from the licensing of the right to use intangible assets, minus direct and indirect tax-related expenditures connected therewith, in observance of the accounting rules applicable in San Marino.

4. In the case specified in paragraph 2, letter b) of this Article, for each qualifying intangible asset, it is necessary to identify the economic contribution arising therefrom that has been taken into account algebraically to form the business income or loss according to the provisions of art. 6, Law no. 166/2013.

5. The option is also applicable to sums received as compensation or as refund for contractual or extra-contractual liabilities, due to breach of contract whose subject matter refers to the intangible assets or due to violation of rights on such assets.

5 bis. If the legal protection requirement is no longer met, or in the event that an industrial patent in the process of being granted pursuant to the first point of paragraph 1 of this Article is not granted, the taxpayer shall not obtain the benefit referred to in Article 5. In this case, the Tax Office shall carry out the tax assessment and collect the higher tax, as well as the interests and sanctions provided for by Law no. 166/2013.

CHAPTER II
SPECIAL TAX TREATMENT AND ACCESS TO THE REGIME

Art. 5

(Special tax treatment of income from intangible assets)

1. The qualified income of enterprises deriving from the use of intangible assets shall not be included in the overall income, being totally excluded, for their entire amount.

2. Capital gains from transfer of the intangible assets shall not be included in the overall income of the enterprise - being totally excluded from the formation of income - provided that at least 90% of the amount deriving from such transfer is re-invested in the maintenance and/or development of other intangible assets, before the closing of the second tax year following that in which the transfer occurred.

The provisions relative to the agreement with the Tax Office in paragraph 1 of article 7 below shall apply.

Art. 6

(Access to the special tax treatment)

1. The enterprises may be granted access to the special tax treatment specified in Article 5 of this Decree Law, both in case of direct and indirect use of intangible assets, on the condition that they expressly exercise the option through specific application.
2. The exercise of the option in paragraph 1 of this Article shall be irrevocable and binding for the tax year during which the option is exercised and for the following four tax years. The access to the option can be renewed for the following five-year periods without limitation.
3. The procedure and time-limits for the submission of the application to exercise the option shall be regulated in detail by an ad-hoc circular jointly issued by the Ministry of Finance and Budget and the Ministry of Industry, Handicraft and Trade, Labour, Cooperation and Telecommunications. Such circular shall include the explanatory provisions for the implementation of this Decree Law.

Art. 7

(Advance application)

1. In case of direct use of the intangible assets, their economic contribution to the overall income of the enterprises may benefit from the exclusion provided for in paragraph 1 of Article 5, on the condition that the economic contribution be determined in a specific agreement in accordance with paragraph 3 of Article 123 of Law no. 166/2013 and subsequent amendments. In this case, the subject matter of the advance application procedure shall be the advance determination through cross-examination with the Tax Office of the amount of implicit revenues and the criteria to identify the expenditures linked to such revenues.
2. In case the revenues are received in the context of transactions with companies directly or indirectly controlling the enterprise, controlled by the enterprise or controlled by the same company controlling the enterprise, the special tax treatment shall be available on the condition that such revenues have been determined in a specific agreement concluded according to paragraph 3 of Article 123 of Law no. 166/2013 and subsequent amendments.
3. Pending the conclusion of the advance agreement under this Article, the enterprises shall calculate business income in accordance with the general rules. In order to permit access to the special tax treatment from the tax year during which the application of paragraph 1 of this Article was submitted, the portion of the income qualifying for special tax treatment for the tax years between the date of submission of the application and the date of conclusion of the advance agreement can be indicated in the income tax return for the tax year during which the agreement was concluded.
4. The tax payer may submit an advance application, for the same purposes described in the preceding paragraphs of this Article, also in case of indirect use of intangible assets.

CHAPTER III
DETERMINATION

Art. 8
(Determination of the special tax treatment)

1. The portion of the income qualifying for the special tax treatment provided for in paragraph 1 of Article 5 of this Decree Law shall be calculated on the basis of the ratio of the expenditures for research and development activities incurred to maintain, improve and develop the intangible assets to the overall expenditures incurred for the production of such asset, according to the following formula:

QE : OE x OI = QI

Where:

QE: Qualifying expenditures incurred for the development of the intangible asset;

OE: Overall expenditures incurred for the development of the intangible asset;

OI: Net overall income from the use of the intangible asset;

QI: Qualified income eligible for the tax benefits.

2. The expenditures to be indicated in the numerator of the ratio of paragraph 1 of this Article (QE) are connected with the activities specified in Article 9 of this Decree Law, performed:

a) directly by the enterprise;
b) through agreements in the research and development field concluded by the enterprise, the State of San Marino or entities controlled by the latter, with independent universities, entities or private enterprises of other Countries, aimed at producing intangible assets;
c) by companies, including high tech start-ups under the provisions of Delegated Decree n. 116 of 24 July 2014, and subsequent amendments and integrations, which are not directly or indirectly controlling the enterprise, controlled by the enterprise or controlled by the same company controlling the Enterprise.

3. The amount specified in paragraph 2 of this Article is increased by:

a) the expenditures, without any margin, relative to the activities of Article 9 of this Decree Law carried out in San Marino arising from transactions undertaken with companies indicated in paragraph 1 of Article 3 of this Decree Law, directly or indirectly controlling the enterprise, controlled by the enterprise or controlled by the same company controlling the enterprise up to an amount equal to the re-charge of the expenditures incurred by the above companies vis-à-vis third parties and
b) the expenditures relative to the activities indicated in Article 9 incurred by the enterprise in the context of a cost contribution arrangement at least up to the amount of the proceeds for the re-charge of the expenditures specified in paragraph 2 of this Article to the parties to the cost contribution agreement.

4. The expenditures to be indicated in the denominator (OE) of the ratio of paragraph 1 shall be the expenditures in paragraphs 2 and 3, increased by:

a) the expenditures arising from transactions undertaken with companies directly or indirectly controlling the enterprise, controlled by the enterprise or controlled by the same company controlling the enterprise incurred for the development, maintenance and improvement of the asset related to the activities specified in Article 9 and
b) the cost of the acquisition - in anyway occurred - related to the intangible asset, incurred during the tax year.

5. The amount of the expenditures specified in paragraphs 2 and 3 shall be increased, through a procedure called uplift, by an amount equal to the difference between

a) the amount of the expenditures specified in paragraph 4 and
b) the amount of the expenditures specified in paragraphs 2 and 3.

Such amount shall not exceed 30% of the amount of the expenditures specified in paragraphs 2 and 3.

6. For the purpose of assessing the ratio of paragraph 1, the expenditures specified in such paragraph shall be the expenditures incurred from the start of the activity to which the present provisions apply and shall be calculated separately for each qualifying intangible asset.
7. The amount of the income qualifying for the special tax treatment shall be the income of paragraph 1 of this Article multiplied by the ratio specified in the preceding paragraphs of this Article.
8. For the purpose of determining the ratio of paragraph 1 the following shall not be taken into account:

- interest payments
- expenditures relative to real estate;
- any expense that cannot be directly connected with a specific intangible asset.

Art. 9

(Definition of research and development activities. Limitation of benefits)

1. The research and development activities in paragraph 4 of Article 3 of this Decree Law carried out in the territory of the Republic of San Marino include the following activities performed for the purpose of developing, maintaining and increasing the value of the intangible assets:

a) fundamental research, meaning experimental or theoretical works undertaken for the purpose of acquiring new knowledge, where it is subsequently used in applied research;
b) applied research, meaning research planned for the acquisition of new knowledge and abilities to be used for the development of new products, processes or services or to improve existing products, processes or services, in any sector of science and technology; experimental and competitive development, meaning the acquisition, combination, shaping and use of existing knowledge and abilities of scientific, technological, commercial or any other nature for the purpose of developing new or improved products, processes or services. The present definition includes also the other activities aimed at conceptually defining new products, procedures or services as well as the tests, verifications and experiments necessary to obtain authorizations for the marketing of products or for the use of processes and services. Experimental development includes construction of prototypes and samples, presentation, launch of pilot projects, testing and validation of new or improved products, processes or services, and the installation of necessary facilities and equipment;
c) development and implementation of software protected by copyright;
d) preventive research, testing and market research and other studies and interventions also for the purpose of adopting anti-counterfeiting systems, application, granting and maintenance of the relevant rights, their renewal upon expiry, their protection, even in associated form and in relation to activities for the prevention of counterfeiting, and management of disputes and relevant agreements.

2. The research and development activities provided by paragraph 1 of this Article shall include the research and development activities, as envisaged by letter b) paragraph 2 of Article 8 of this Decree Law, carried out through collaboration agreements in the research and development field concluded by the enterprise, the State of San Marino or entities controlled by the latter, with independent universities, entities or private enterprises of other Countries, aimed at producing intangible assets;
3. Amounts that were not actually expended or charged for commercial purposes pursued in good faith or are part of one or more schemes implemented by the taxpayer applying to access the regime of this Decree Law, whose main purpose or one of the main purposes is to evade/avoid taxes, shall not fall within the scope of this Decree Law and therefore shall not be taken into account as qualifying expenditures for the calculations in Article 8 of this Decree Law. Marketing expenditures related to Intangible assets can never qualify for tax benefits under this regime.

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Art. 10
(Traceability of expenditures and income)

1. The direct link between the research and development activities in Article 9 of this Decree Law and the intangible assets, as well as between the latter and the relevant income qualifying for the special tax treatment of this Decree Law arising from these assets, must result from an adequate accounting or non-accounting system.
2. In case a taxpayer has more than one intangible asset or incurs in expenditures for the outsourcing or acquisition of activities related to the development of several intangible assets, the accounting tracking system must also ensure that such a taxpayer has not manipulated the amount of overall expenditures to inflate the amount of income that may benefit from these tax incentives. Therefore, the tracking system shall be able to determine the link between expenditures and income referable to each intangible asset, and to provide relevant evidence to the tax administration.

Art. 11
(Extraordinary circumstances)

1. In case of merger, split or transfer of the company, the successor shall take over the position of the predecessor in the exercise of the option, including as regards expenditures incurred, provided that the latter has met all the requirements envisaged by this Decree Law to be entitled to the tax benefits.

Art. 12
(Treatment of tax losses generated in the economic exploitation of benefitted intangible assets)

1. If, after exercising the option, the enterprise verifies that the economic exploitation of the intangible asset generates a loss, such a loss will contribute to the formation of the income for the period.
2. This loss will therefore be calculated as a reduction of the qualified income equal to the surplus of revenues with respect to the costs relating to that intangible asset, until it is completely exhausted.

TITLE III FINAL PROVISIONS

Art. 13
(Special tax treatment already granted and grandfathering clause)

1. Any incentives or benefits shall not apply to intangible assets different from those specified in this Decree Law, nor exceed the limits envisaged by the latter. Any other rule providing any type of incentives or access to benefits concerning intangible assets shall be repealed as of the date this Decree Law enters into effect. In any case, no incentive for the exploitation of intangible assets that is inconsistent with the measures provided by the Final Report on Action 5 BEPS and the provisions of this Decree Law, shall be no longer granted after 30 June 2018.

2. Any tax provisions of San Marino taxation system providing for and regulating incentives or benefits concerning income deriving from or in any case related to the exploitation of intangible assets and granted before the entry into force of this Decree Law shall continue to apply until 30 June 2021.

3. The provisions under paragraphs 1 and 2 of this Article shall also apply to the incentives provided by:

- Article 73 of Law no. 166 of 16 December 2013;
- Article 21, paragraph 3 of Law no. 101 of 27 June 2013
- Article 14, Delegated Decree no. 116 of 24 July 2014.

Done at Our Residence, on 28 June 2018/1717 since the Foundation of the Republic

Stefano Palmieri – Matteo Ciacci

THE CAPTAINS REGENT

Guerrino Zanotti

MINISTER
OF INTERNAL AFFAIRS