Luxembourg government introduces a new IP tax regime

Introduction and background

On 4 August 2017, a bill of law proposing the introduction of a new Luxembourg intellectual property (IP) tax regime was published. In brief, Luxembourg taxpayers will, as from 1 January 2018, be able to benefit (under certain conditions) from an 80% (corporate) income tax exemption applicable to specific income derived from certain assets (such as patents and copyrighted software). In addition, the assets which qualify for the 80% exemption will be fully exempt from net wealth tax.

The new regime will replace the former IP regime which has been abolished as of 30 June 2016 since it was not in line with the so-called "modified nexus approach", as defined in the OECD Report on Action 5 of the BEPS Action plan.

Key features of the new IP regime

The income and gains qualifying for the 80% income tax exemption would equal the Net Eligible Income (subject to certain specific adjustments) from Eligible Assets multiplied by a specific ratio. The ratio equals the Eligible Costs (with an uplift of 30% but capped at the Total Costs) over the Total Costs, as further clarified below. According to the Luxembourg government, this ratio implements the modified nexus approach, as only the R&D activities having a nexus with the Luxembourg taxpayer benefit from the IP tax regime. The key elements of the IP tax regime are as follows.

Determination of the qualifying income for the 80% exemption

Eligible Assets:

i. patents,
ii. utility models,
iii. complementary protection certificates for patents for medicine and plant protection products,
iv. extensions of a complementary protection certificate for paediatric medicines,
v. plant variety certificates,
vi. orphan drug designations and
vii. software protected by copyrights.

Eligible Assets must have been constituted, developed or improved after 31 December 2007. The filing date for registration is decisive. Trademarks and domain can no longer qualify (where they could qualify under the former IP regime).

Net Eligible Income: royalties, income embedded in sold products or services, capital gains and certain indemnities, all in relation to *Eligible Assets*, minus all costs directly and indirectly linked to *Eligible Assets*.

Eligible Costs: the costs (excluding acquisition of Eligible Assets, financing and real estate costs) in direct relation to R&D for the constitution, development or improvement of an Eligible Asset conducted by the taxpayer (including its permanent establishment located in the EEA) or outsourced to third parties.

Total Costs: Eligible Costs plus acquisition costs of an Eligible Asset and costs of R&D outsourced to related parties in relation to an *Eligible Asset*.

The above results in the following formula to determine the income which is eligible for the 80% exemption:

Net Eligible Income X (Eligible Costs with 30% uplift/ Total Costs)

Considering this formula, companies which effectively want to benefit from the exemption will be encouraged to reduce their costs of R&D outsourced to related parties and/or increase their costs of R&D outsourced to third parties. Alternatively, it could be considered to convert related R&D centres to branches of the Luxembourg company owning the Eligible Asset as this will increase the ratio and hence, the income eligible for the 80% exemption. Furthermore, as the acquisition costs of the Eligible Asset are included in the Total Costs, passively held IP will no longer generate any income which could benefit from the 80% exemption.

The bill of law provides that the 80% tax exemption is in principle (subject to exceptions) to be applied on the basis of each IP-asset individually.

The bill must now follow the legislative process and will be voted on by the Luxembourg parliament, however, it is expected that it will apply as from January 1, 2018.

In case you have any questions regarding the new IP tax regime, feel free to contact us.

Joost van den Berg
j.vandenberg@hvkstevens.com
+31 (0) 20 763 09 16

Jeroen van Barneveld
j.vanbarneveld@hvkstevens.com
+31 (0) 20 210 51 36