



NEW IP REGIME

On the 22 March 2018, the Luxembourg parliament voted in favour of a new legal framework for the beneficial tax treatment of certain intellectual property (“IP”) rights. The new legal framework, which is adopted through the law dated 17 April 2018, is based on a draft law filed by the Minister of Finance on 4 August 2017 and is introducing the long-awaited new tax regime for IP rights (“the new IP Tax regime”).

The new IP Tax regime aims at replacing the beneficial tax regime that was in place for IP rights since the tax year 2008 (i.e. “the old IP Tax regime”). The old IP Tax regime will definitely end on 30 June 2021. However, already as of today no new IP rights are admitted to the old IP Tax regime.

The new IP Tax regime is intended to comply with the recommendations of action n° 5 “Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance” of the OECD Base Erosion and Profit Shifting (BEPS) Project. Thus, the amended IP regime continues to provide an 80% exemption for certain income derived from qualifying IP rights and an exemption of the qualifying IP rights from net worth tax. However, in order to align the IP regime to the requirements of BEPS action n° 5, the income benefitting from the 80% exemption is determined based on the nexus approach and the categories of IP rights qualifying for the IP regime have been narrowed down.

Main features of the new IP Tax regime are the following :

ADJUSTED SCOPE OF QUALIFYING IP

The new IP Tax regime is available to the owner of the following IP rights to the extent that these have been created, developed or improved after 31 December 2007 in the context of research and development (R&D) activities carried out by the owner:

- a. Inventions that are protected in accordance with national or international provisions by:

- A patent
- A utility model
- A supplementary protection certificate for medicine or for generic medicine
- An extension of a supplementary protection certificate for medicine for paediatric use
- A plant breeder’s certificate
- An orphan drug designation

- b. Software protected by an author right in accordance with national and international provisions.

The new IP Tax regime is not available anymore for domain names, trademarks and brand names, designs or models.

INCOME QUALIFYING FOR NEW IP TAX REGIME

Similar to the old IP Tax regime, income qualifying for the beneficial tax treatment of the new IP Tax regime includes:

- royalty income received for the use or the granting of the right to use an IP right qualifying for the new IP Tax regime, and
- capital gains realized upon the sale of IP rights qualifying for the new IP Tax regime.

Under the new IP Tax regime, the qualifying income also includes the portion of the sales revenues which directly relates to a qualifying IP right. The portion of the sales revenues directly relating to a qualifying IP right has to be determined based on the transfer pricing principles provided for by article 56bis LIR.

Finally, the new IP tax regime explicitly states that indemnities obtained in the context of a judicial procedure or of an arbitration in relation with a qualifying IP right are also included in the qualifying income.

DETERMINATION OF THE INCOME SUBJECT TO 80% EXEMPTION

The master piece of the new IP Tax regime is that the income from a qualifying IP right may only benefit from the 80% exemption if the owner of the qualifying IP rights has effectively carried out R&D activities for the creation, development, and improvement of the qualifying IP rights and consequently has incurred “qualifying expenses”.

Under the new IP Tax regime, the 80% exemption is only applicable to the portion of the positive “net qualifying income” corresponding to the ratio between:

- (i) the sum of the qualifying expenses incurred in relation to that IP right in the tax year considered and in previous tax years and
- (ii) the sum of the total expenses incurred for the creation, development or improvement of the particular IP right in the relevant tax year and in previous tax years.

Qualifying expenses include, in essence, the expenses that are required for the R&D carried out by the owner of the qualifying IP right or for R&D subcontracted from an unrelated party for the creation, development or improvement of an IP right qualifying for the new IP Tax regime. R&D expenses paid to a related party may also be included in the qualifying expenses to the extent, however, that the expenses merely correspond to expenses paid by the related party to an unrelated party and that the expenses have been recharged by the related party without a mark-up. The qualifying expenses may be increased by 30% without exceeding the sum of the total expenses incurred.

The “net qualifying income” corresponds to the difference between (i) the qualifying income derived from the IP right and (ii) the total expenses, as well as all expenses which are in indirect relation with that particular IP right.

Before the 80% exemption is applied, the net qualifying income derived from a

qualifying IP right has to be adjusted for certain items, such as:

- The offsetting with negative “net qualifying income” incurred in previous years in relation to that same qualifying IP right if that negative “net qualifying income” has not yet been offset with positive “net qualifying income” in those previous years;
- The neutralization of depreciations and value corrections booked in relation to the cost of the qualifying IP rights;
- The offsetting with negative “net qualifying income” incurred in relation to other qualifying IP right, if any.

Other adjustments may need to be considered if the IP right was acquired in the context of a business restructuring.

ADMINISTRATIVE FORMALITIES

The 80% exemption has to be applied for each qualifying IP right individually. As a consequence, the owner of IP rights qualifying for the new IP Tax regime needs to keep records for all the expenses and income which relate to the individual IP rights. The records would need to distinguish between the qualifying expenses, total expenses and qualifying income.

The new IP Tax regime also foresees that under certain conditions the expenses and income may be tracked per service or product or category of service or product.

The total expenses and qualifying expenses will need to be determined in accordance with the at arm's length principle.

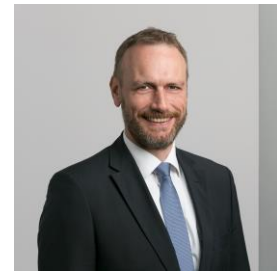
The owner must be able to provide the tax authorities with appropriate supporting documentation.

TRANSITION BETWEEN OLD AND NEW IP TAX REGIME

The new IP regime is available as of the tax year 2018.

Taxpayers who currently benefit from the old IP Tax regime may opt to apply the new IP Tax regime. Once exercised, the option is irrevocable.

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