Indian Business Chamber of Luxembourg

IP regime update

Frank Muntendam

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IP regime update
Agenda

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2. Luxembourg IP regime (Article 50bis LITL, §60bis BewG)
3. Administrative guidance (Circular of 5 March 2009)
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IP regime update

1. Overview of the Luxembourg IP regime

- **The Luxembourg tax regime related to income from IP rights entered into force on 1 January 2008**

- **The goal:**
- Promote research and development activities in Luxembourg and increase its attractiveness as a place for IP management

- **The legal framework:**
- Law of 21 December 2007 introducing Article 50bis to the Income Tax Law (LITL)
- Law of 19 December 2008 introducing the exemption of IP from Net Worth Tax (§60bis Valuation Law) and extending the scope of the IP regime to domain names
- Circular of 5 March 2009 issued by the Luxembourg tax authorities providing administrative guidance on how the IP regime should be applied in practice

- **The benefits of the IP regime:**
- Qualifying income taxed at a rate of 5.76% (overall income tax rate of 28.8% applied to 20% of the net income)
- Full exemption of qualifying IP rights from Net Worth Tax

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2. Luxembourg IP regime (Article 50bis LITL, §60bis BewG) (1/2)

How applicable?

- 80% exemption of net income (royalties) and capital gains derived from:
  - Copyrights on software
  - Patents
  - Trademarks
  - Domain names
  - Designs
  - Models

  acquired or constituted after 31 December 2007

- 100% exemption of qualifying IP rights from annual Net Worth Tax

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2. Luxembourg IP regime (Article 50bis LITL, §60bis BewG) (2/2)

The qualifying income (i.e., basis for the application of the 80% exemption)

- Net income arising from the use or the right to use IP rights
  - 'Net income' is the difference between gross revenue and any expenses directly connected with such revenue (incl. amortization and write-offs)
  - Negative IP income is in principle deductible, but a recapture rule applies
- Use of a self-developed patent by a company for its own activities
  - A taxpayer that develops a patent and uses it for its own activities, is entitled to a notional deduction equal to 80% of the net remuneration that a third party would have paid on an arm's length basis for the use of such patent
  - 'Net remuneration': Arm's length royalty reduced by expenses directly connected with such deemed income (incl. amortization and write-offs)
  - As from application for patent protection (claw-back applicable)
- Disposal of IP rights
  - Capital gains arising from the disposal of IP rights
  - Applicability of 'recapture' regime: The reduced basis for the computation of the capital gain is increased by 80% of the negative income incurred in the tax year of disposal or any previous year

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3. Administrative guidance (Circular of 5 March 2009)

The Circular issued by the Luxembourg tax authorities on 5 March 2009 provides guidelines on the application of the IP regime:

- Confirmed applicability of the IP regime to the situations where
  - Legal and economic ownership over the IP rights are not held by the same holder – the Circular confirms that economic ownership is sufficient
  - Sportsmen register name and/or image as a trademark and thereafter grant a license to a third party to exploit such a trademark
  - The owner of an IP right is not the inventor, creator or initial applicant
- Application of the partial exemption exclusively to the income considered as royalties, the necessity to exclude any other income (e.g., service fees)
- Certain transactions are not qualifying acquisitions for the purpose of the regime:
  - The conversion of a non-taxable entity into a taxable entity;
  - The allocation of assets to a Luxembourg permanent establishment of a non-resident entity; and,
  - The transfer of tax residence into Luxembourg of a non-resident entity.
- Acquisitions of IP rights via tax neutral reorganizations where assets are transferred at book value are excluded from the IP regime

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4. Recent developments in other jurisdictions (1/3)

- **<u>The Netherlands</u>: Innovation Box**
  - Replaces as from 1 January 2010 the Patent Box (which was introduced on 1 January 2007)
  - Applicable to self-developed or acquired intangible assets, covering income related to patents and/or income from R&D activities which do not lead to patents
  - 5% effective tax rate (10% in former Patent Box), losses fully deductible at 25% rate
  - No cap on the income that is allocated (4x development costs in former Patent Box)

- **<u>Ireland</u>: Depreciation regime of Intangible Assets**
  - Applies to a broad range of intangible assets acquired (from both third parties and related parties) or internally developed on or after 8 May 2009
  - Annual capital allowances and interest relief capped at 80% of taxable profit (before tax depreciation and associated expenses)
  - Effective tax rate of 2.5% possible (residual 20% profit taxed at a rate of 12.5%)
  - Claw back if the IP is disposed within 10 years

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4. Recent developments in other jurisdictions (2/3)

- **Belgium: Patent Income Deduction**
  - As from 1 January 2007, deduction from taxable base of an amount equal to 80% of the gross patent income generated by a Belgian entity, applicable to self developed and acquired IP
  - 0% - 6.8% effective tax rate (gross income approach)
  - Applicable with other deductions (notional interest deduction, R&D credit, etc.)

- **Spain: Patent Box**
  - As from 1 January 2008, 50% of gross income arising from licensing of certain qualifying IP rights is exempt, costs remain fully deductable
  - Ceases to be applicable in the tax year following to the one where the qualifying IP income exceeds 6 times its costs of development, IP must be self-developed
  - Applicable to a wide range of technological IP (including patents, designs or models, plans, secret formulae or processes)
  - Effective tax rate depends on the IP margin (gross income approach)

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4. Recent developments in other jurisdictions (3/3)

- **United Kingdom: Potential introduction of reduced tax rate on IP**
  - Patent Box regime to be introduced from 2013 (subject to parliamentary approval)
  - Net patent income (after associated costs) would be taxed at 10%
  - Optional regime applicable to patents which are granted / commercialized from 29 November 2010, and to profits arising from 1 April 2013

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5. Important developments relevant for the Luxembourg regime (1/4)

- **EFTA state aid decision on Liechtenstein's IP regime**
  - On 1 June 2011, the EFTA Surveillance Authority decided that the Liechtenstein tax rules for income from IP rights do not involve state aid within the meaning of the European Economic Area (EEA) Agreement
  - Similar to the Luxembourg IP tax regime, the new provisions introduced by Liechtenstein in December 2010 provide for an 80% exemption for income from qualifying IP
  - In analyzing whether the Liechtenstein regime constitutes illegal state aid, the EFTA Surveillance Authority concluded that the measure is **not selective** (but open to all taxpayers, i.e., general measure) and thus is not considered state aid that would be disallowed under the EEA Agreement
  - After the 2008 decision by the European Commission on the Spanish IP regime not constituting illegal state aid, the decision by the EFTA Surveillance Authority is already the second decision that confirms the compatibility of a European IP regime with European law

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5. Important developments relevant for the Luxembourg regime (2/4)

- **<u>Tax compliance update: New form issued by the Luxembourg tax authorities</u>**
  - New annex form (modèle 750) issued in September 2011
  - To be completed as from fiscal year 2010 for each IP right for which the taxpayer claims application of Article 50bis LITL
  - Information to be provided in this new form:
    - General information: Indication of the type of IP, in case of an acquisition: date and price of acquisition, relationship between the taxpayer and the transferor of the IP; or in case of self-developed IP: date of constitution of the right, development costs; way of financing of the IP
    - Information on the registration and protection of the IP
    - Additional information on domain names, designs or models
    - Determination of the amount to be capitalized in the taxpayer's balance sheet
    - Determination of the exempt income (net IP income of the year, summary of negative net IP income, capital gains realized upon disposal of the IP)

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5. Important developments relevant for the Luxembourg regime (3/4)

- **<u>Potential enhancements of the legislative framework ("IP White Paper")</u>**
  - In order to increase Luxembourg's attractiveness as a place for IP management and to remain competitive in this field, AmCham had launched a committee of experts (including tax specialists, lawyers and patent attorneys) to discuss potential enhancements of the Luxembourg IP regime, also involving government representatives
  - As a result of more than one year of work, the group prepared a "White Paper", which was submitted to the Ministry of Economy early September
  - This "White Paper" includes proposed changes to the Income Tax Law, the Net Worth Tax Law, the Circular of 5 March 2009 and further proposals

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5. Important developments relevant for the Luxembourg regime (4/4)

- **Potential enhancements of the legislative framework ("IP White Paper")**
  - Proposals for the improvement of the Luxembourg IP legislation include amongst others:
    - Inclusion of unregistered IP in the scope of the law, subject to the approval of a technical committee (similar to Dutch Innovation Box)
    - Inclusion of "auxiliary" IP in the scope of the law to overcome practical issues
    - Inclusion of Supplementary Protection Certificates (SPCs) in the scope of the law (currently only covered in a very restrictive manner)
    - Extension of the application of the IP tax regime to certain qualifying rights for self-developed IP, which are used in the taxpayer's own business (currently only for patents) as well as for acquired IP used in the taxpayer's own business
    - Elimination of the restriction that IP rights transferred upon migration, by allocation to a Luxembourg branch, by conversion to a taxable company or as a result of certain international merger operations do not lead to an acquisition in the sense of the IP regime
    - Clarification on inclusion of economic ownership in the scope of the law
    - Introduction of a safe harbor rule if income is derived from qualifying and non-qualifying IP rights
    - Inclusion of franchise agreements and distribution rights in the scope of the law
    - Tax incentives for taxpayers employing people in R&D (employer tax credit, employee tax concession)
    - Separate proposals will be prepared for a regime for copyrights (droits d'auteur)

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Thank you for your attention

For additional information please contact:

Frank Muntendam
Ernst & Young
+352 42 124 7258
Frank.Muntendam@lu.ey.com