

// IP in Luxembourg: beware of capital gains

In 2008, Luxembourg enhanced the tax treatment of intellectual property ("IP") by introducing a specific IP law. Luxembourg should thus be destined to become a major centre for managing a group's IP.



Paul Chambers



Gauthier Mary

The Luxembourg IP regime enables taxpayers to benefit from an 80% exemption on net royalty income and on capital gains derived from the sale of certain IP acquired after December 31st, 2007. As a result, the effective taxation of IP income is reduced down to 5.72%. For the purpose of this tax treatment the qualifying IP are patents, trademarks, designs and models, domain names and copyrights on software

// Typical structure

A typical IP structure would involve a Luxembourg company holding the IP of the group and granting a license for the use of this IP to

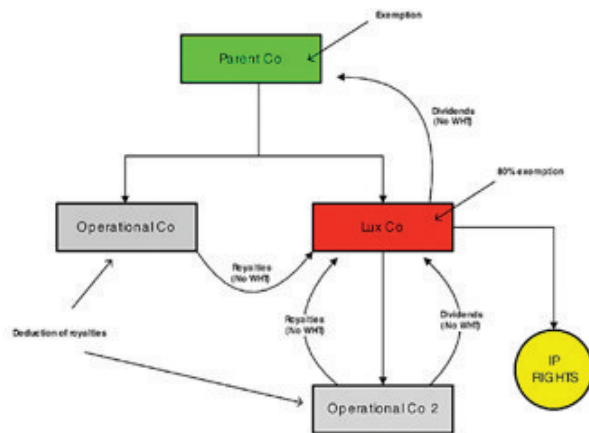
group and / or non-group companies (cf. chart). The advantage of such a structure is that on the one hand royalty payments are 100% deductible at the level of the operational companies, and on the other hand dividends and capital gains realised on the sale of shares would under certain conditions be exempt (cf. Operational Co 2 in the chart).

The IP regime is certainly attractive, however certain issues need to be addressed beforehand, especially when existing and valuable IP should be transferred to a Luxembourg company. The major issue here is the taxation in the jurisdiction from which the IP is transferred. In most jurisdictions, the disposal of IP (e.g. contribution, sale) must be operated at fair market value. The capital gain resulting from this transaction, i.e. the difference between the market value of the IP at the time of the transfer and its present book value, is generally fully taxable.

absorbed by tax savings overtime. Therefore, timing is of essence and it is obviously an advantage if IP can be transferred in its early stages of development, where the fair market value is relatively low.

In a particular case, capital gain arising from the transfer of IP could well be an opportunity. The situation is as follows: a non-resident company has accumulated operational losses in the last few years that can be offset against future positive results. While in Luxembourg these losses could be carried forward indefinitely, some jurisdictions limit the carry forward of losses in terms of timing (e.g. Switzerland), activity or ownership of the company (e.g. United Kingdom). In other terms, at a certain point, the tax losses accumulated could be lost if not offset against a taxable gain at the end of the financial year. In such a situation, transferring the IP to a Luxembourg company could be the right thing to do as the capital gain on the sale of the IP would trigger the use of its tax losses before they expire.

In today's knowledge based economies where IP is of increasing importance, focus is thus on IP (re)structuring. Combined with appropriate IP valuation tools, the Luxembourg IP regime allows companies and multinationals to improve the management of their IP and optimise their costs by centralising IP in Luxembourg.



Typical IP structures

// Tax savings outweigh

On a long term basis, the tax savings resulting from the favourable tax regime in Luxembourg should outweigh the costs resulting from the taxation of the capital gain realised. However, this is not efficient from a cash flow perspective as an immediate taxation is only

Gauthier Mary & Paul Chambers
director and partner at ATOZ

gauthier.mary@atoz.lu - +352 26 940 411
paul.chambers@atoz.lu - +352 26 940 364