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Luxembourg: New BEPS-compliant IP Regime in 2018



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A new BEPS-compliant IP regime will be introduced in Luxembourg in 2018, following the repeal of the former regime. The new regime should be beneficial for taxpayers and attract new R&D investment into Luxembourg: this article considers the potential changes.

On April 26, 2017, Prime Minister Bettel gave his annual speech on the state of the nation. During the speech, the introduction of a new intellectual property (“IP”) tax regime was announced. This announcement is welcome and has been much anticipated following the repeal of the former Luxembourg IP regime by the 2016 budget law.

Repeal of the Former Luxembourg IP Regime

The repeal followed the release of the report on Action 5 of the BEPS Action plan *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*. This report sets the conditions for an IP regime to be considered as not harmful and thus “BEPS-compliant.”

The report provides that countries that have IP regimes in place which are not consistent with the nexus

approach are required to amend their regimes. It provides further that there should be no new entrants to such IP regimes after June 30, 2016. Finally, taxpayers benefitting from regimes in place that do not comply with the nexus approach would no longer be able to receive any additional tax benefits from those regimes after June 30, 2021.

Given that the former Luxembourg IP regime, like several other foreign IP regimes, did not meet the requirements defined in the BEPS report on the modified nexus approach, it had to be amended. However, instead of amending the existing IP regime to make it BEPS-compliant, to act quickly, the Luxembourg government decided to abolish the existing regime in a first step and announced that a replacement regime would be subsequently introduced, in line with the requirements defined in the BEPS report.

Formerly, Luxembourg provided an IP regime which applied at two levels, one for income tax pur-

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poses and a second for net wealth tax (“NWT”) purposes, meaning that the regime had to be abolished at both levels:

- IP 80 percent income tax exemption regime

The 80 percent income tax exemption regime which applied to income arising from qualifying IP assets and capital gains on the sale of such assets was repealed from July 1, 2016. For IP rights created or acquired before July 1, 2016, a transitional period runs from July 1, 2016 until June 30, 2021, during which the exemption regime remains applicable. However, the regime no longer applies from December 31, 2016 if the IP was acquired from a related party after December 31, 2015, except if it was acquired from a party which already benefitted from the Luxembourg IP regime or a corresponding foreign IP regime at the time of the transfer.

- IP 100 percent NWT exemption regime

The 100 percent NWT exemption which applied to qualifying IP assets for NWT purposes was repealed as of January 1, 2017. For IP rights created or acquired before July 1, 2016, a transitional period runs until January 1, 2021 included, during which the NWT exemption remains applicable. However, the NWT exemption will no longer apply as from January 1, 2018 if the IP was acquired from a related party after December 31, 2015, except if the IP was acquired from a party which already benefitted from the Luxembourg IP regime or a corresponding foreign IP regime at the time of the transfer.

What Could the New Luxembourg IP Regime Look Like?

Following the announcement of April 26, 2017, is now clear that the Luxembourg Government intends to have its new IP regime in place as from 2018. How-

ever, no details were provided in the speech regarding the new regime, although a number of proposals have been circulated. It will be necessary to await the release of the draft legislation to know the approach taken.

What is clear is that the new regime will have to be in line with the so-called modified nexus approach defined in the BEPS Action 5 report.

IP Assets Covered

According to the nexus approach, the only IP assets that could qualify for tax benefits under an IP regime are patents and other IP assets that are considered as *functionally equivalent to patents if those IP assets are both legally protected and subject to similar approval and registration processes, where such processes are relevant*. Based on the BEPS report, IP assets that are functionally equivalent to patents are (i) patents defined broadly, (ii) copyrighted software, and (iii) in certain circumstances, other IP assets that are nonobvious, useful, and novel. Here, it remains to be seen how Luxembourg will interpret this definition and which assets will be considered as falling within the scope of this category.

Amount of IP Income Which can Benefit from an Exemption

The modified nexus approach aims to ensure that IP regimes, since they are intended to encourage R&D activity, only provide benefits to taxpayers that do in fact engage in such R&D activities. As a consequence, according to the nexus approach, a taxpayer will be able to benefit from an IP regime only to the extent that it can demonstrate that it did incur expenditures, such as R&D, which gave rise to the IP income.

The nexus approach which determines what income may receive tax benefits is as follows:

$$\frac{\text{Qualifying expenditures incurred to develop IP asset}}{\text{Overall expenditures incurred to develop IP asset}} \times \text{Overall income from IP asset} = \text{Income receiving tax benefits}$$

This means that if a company has only one single IP asset and incurs itself all of the expenditures to develop that asset, the nexus approach will allow all of the income from that IP asset to qualify for tax benefits.

When computing the amount of qualifying expenditures, jurisdictions may allow taxpayers to apply a 30 percent “uplift” to expenditures that are included in qualifying expenditures. This uplift may increase qualifying expenditures but only to the extent that the taxpayer has non-qualifying expenditures. It means that the increased amount of qualifying expenditures may not exceed the taxpayer’s overall expenditures.

Since the possibility to increase the amount of qualifying expenditures up to 30 percent is optional for states, it remains to be seen whether Luxembourg will make use of this option. However, since it can be expected that the Luxembourg Government will be

willing to make sure that the most competitive regime as possible is available for taxpayers, one can expect that this possibility will be provided by the new regime.

The report expands further on what is to be understood as qualifying expenditures, overall income from IP assets and overall expenditures incurred to develop IP assets when computing the income that may benefit from the regime. In addition, it explains what would occur in case of acquisition of an IP asset (as opposed to an IP asset developed in-house) and in case of outsourcing of R&D activities.

Next Steps

The announcement made by the Luxembourg Government on the upcoming introduction of a new IP regime is good news. The new regime will be positive

for both Luxembourg taxpayers and for Luxembourg itself, as the regime should attract new R&D activities to Luxembourg and strengthen existing activities. IP regimes in countries participating in the BEPS project will become more and more similar in the future given that they will all have to be in line with the modified nexus approach.

To remain competitive and make sure that its new regime is as attractive as possible, Luxembourg will have to make the right choices and exhaust all options provided in the BEPS report (e.g., broad definition of

qualifying IP income, 30 percent uplift on qualifying expenses, etc.). We will know more about the new regime as soon as the text of the draft legislation is released. To be continued. . .

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