New IP tax regime in Luxembourg – bill 7163 submitted

8 August 2017

In brief

On 4 August 2017, the Luxembourg Government, represented by its Finance Minister, Pierre Gramegna, introduced a bill on the proposed new Intellectual Property (IP) regime. The proposed regime is in line with the previous announcements made by the Minister and according to which a new beneficial tax regime based on the "modified nexus" approach would be released.

The proposal is meant to preserve Luxembourg's tax attractiveness while complying with the new EU and international tax standards and more particularly, as far as IP regimes are concerned, with the conclusions of OECD BEPS report on Action 5 in relation to the substantial activity requirement.

If enacted, the provisions of the bill will become effective as from tax year 2018 and will apply (non-cumulatively) in parallel with the former Luxembourg IP regime until expiry of the latter's grandfathering period (30 June 2021).

In detail

"Modified nexus" approach

Similarly to the previous regime, eligible net income from qualifying IP rights will benefit from a 80% tax exemption. The qualifying IP rights will also enjoy a full net wealth tax exemption.

As outlined in the Final BEPS Report of Action 5 (Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance), the nexus approach focuses on establishing a direct connection between expenditures, the IP assets and the income that can benefit from a beneficial regime. The main general features of the new regime may be summarised as follows:

Eligible assets

Two main groups of IP assets can benefit from the new regime, notably: (i) Inventions protected under patents, utility models and others IP rights that are functionally equivalent to patents and (ii) software protected by copyright under national or international norms.

Marketing-related IP such as trademarks are not eligible IP assets.

Furthermore, the eligible IP rights should have been constituted, developed or improved after 31 December 2007 within the framework of R&D activities of the taxpayer carried out by the taxpayer itself directly or through a foreign permanent establishment, to the extent that such permanent establishment is located within the European Economic Area (EEA) and does not benefit from a similar IP regime in its country of location.

Qualifying expenditures

The qualifying expenditures are the ones that are directly connected to the eligible IP rights.

This does not include acquisition costs as defined by the bill, interest and other financing costs as well as building costs. Any costs not directly linked to a specific IP asset are disregarded as well.

The costs must be incurred within the framework of a R&D activity undertaken by the taxpayer itself (directly or through a permanent establishment located in the EEA) or paid to unrelated outsourcing party.

Eligible income

Eligible income related to eligible IP rights mainly includes royalties, capital gains and embedded IP income from the sale of products and services as well as judicial indemnities related to an eligible IP.

The 80% exemption will then apply to the eligible “net” income meaning that IP expenditures allocable to the IP income and incurred in the year the IP income is earned should be deducted from the overall IP income, subject to the nexus ratio.

The nexus ratio

Under the nexus approach, a ratio applies in order to ensure that the proportion of income that may benefit from the exemption regime is the same as the one existing between qualifying expenditures and overall expenditures. A 30% “up-lift” will further apply to qualifying expenditures, up to the total amount of overall expenditures.

Others requirements

Additional requirements apply and notably:

- Taxpayers wanting to benefit from the IP regime should be able to track expenditures, IP assets and income in order to demonstrate the link between the costs and the income. Said link is in principle to be evidenced individually for each IP asset (with a product/family-based approach being allowed however in some circumstances).

- Overall expenditures and eligible income should be determined in accordance with the arm’s length principle.

Repeal of the previous IP regime and transitional rules

As a reminder, the previous Luxembourg IP regime (article 50bis LITL) (“the former IP regime”) granted an 80% exemption from tax on the net income derived, or deemed to be derived, from a wide variety of types of IP. In conformity with both decisions made by the EU’s Code of Conduct for Business Taxation Group in 2014, and the conclusions and timeline set out in the OECD/G20 BEPS Project Final Report on Countering Harmful Tax Practices, the regime was repealed by the law dated 18 December 2015 with effect as from 1 July 2016 for corporate income tax/municipal business tax, and as from 1 January 2017 for net wealth tax.

Taxpayers owning IP assets that benefited from the former IP regime continue however to be able to benefit from it during a transitional period lasting until 30 June 2021.

IP assets acquired after 1 January 2016 can also benefit from the former IP regime, until 30 June 2021, provided that:

- They have been developed, or acquired from unrelated parties, before 1 July 2016; or
- They were acquired from a related party before 1 July 2016 (including via a tax-neutral transaction), and had already been eligible for the IP regime or had benefited from a foreign country's IP regime that corresponded to the Luxembourg previous IP regime, prior to their acquisition.

In relation to IP income still benefiting from the transitional rules under the former IP regime and which may also qualify under the new one, the bill provides that it is up to the taxpayer to elect the regime it wants to benefit from, such election being non-cumulative and irrevocable.

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