

# GSK Newsletter

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# Luxembourg on its way to the new IP regime

A Bill aiming to implement the new BEPS-compliant IP regime has been published and is now under parliamentary scrutiny

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## Executive Summary

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On 7 August 2017, the Government submitted to the Parliament the Bill n° 7163 (the "**Bill**") on the new Intellectual Property regime to be adopted in Luxembourg.

Upon parliamentary approval of the Bill, the upcoming regime (the "**New Regime**") will replace its predecessor (the "**Former Regime**"), which had to be repealed since it did not conform with the the guidelines set forth by the OECD in its BEPS Action 5 report and was thus terminated on 30 June 2016 (subject to a 5 year-transitional period).

It is intended that the New Regime will come into effect from the 2018 fiscal year.

The main feature characterising the new framework however is the so-called "nexus approach", meaning that the benefit of the New Regime will depend on the actual level of R&D activities carried out by the taxpayer.

### Changes and continuities

The Bill seeks to introduce a new article 50-ter to the Luxembourg Income Tax Law that provides for some relevant changes to the Former Regime.

Subject to rather strict conditions, the 80 per cent exemption rate contained in the Former Regime remains unaffected by the New Regime.

In respect of Net Wealth Tax, as with the Former Regime, the New Regime provides for a full exemption through the introduction of a new article 60-ter in Net Wealth Tax Law.

The above-mentioned exemptions will apply to the net income derived from qualifying IP assets, according to some rules detailed hereinafter.

The conditions for the application of the proposed rules under the New Regime will change both on the side of the eligible IP assets and on the side of the eligible income to be exempt.

### Eligible IP assets

Only the following assets will be granted with beneficial tax rates:

- a) Patents;
- b) Functionally equivalent IP rights that are legally protected by utility models, supplementary protection certificates on patents for pharmaceutical and plant protection products, extensions of supplementary protection certificates for products intended for pediatric use, plant breeders' rights and orphan drug designations; and
- c) Copyrighted software.

Contrary to the Former Regime, trademarks, designs and domain names will no longer benefit from the exemption. This exclusion from the New Regime was expected, as the benefit from a favourable taxable regime to this kind of assets was rejected by the OECD in its Final Report on BEPS Action 5<sup>1</sup>.

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<sup>1</sup> Organisation for Economic Co-operation and Development (OECD), Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report, paragraph 38: "Under the nexus approach, marketing related IP assets such as trademarks can never qualify for tax benefits under an IP regime".

The above-mentioned qualifying IP assets, in order to be eligible for the tax exemption, have to be created, developed or improved after 31 December 2007.

### Eligible income benefitting from tax exemption

The New Regime intends to apply to IP income which results from a complex calculation foreseen by the Bill and broadly consists of three different and consecutive steps:

- (i) deduction of the so-called eligible expenditures and the total expenditures from the gross eligible income;
- (ii) adjustments and compensations of the net eligible income; and
- (iii) multiplication of the adjusted and compensated net eligible income by the so-called "nexus ratio".

The Bill provides specific definitions for each element of the above-mentioned calculation, such as "eligible income", "total expenditures", "eligible expenditures", and indicates two methods of adjustment of the net eligible income.

In this respect, only the net income exceeding the total amount of expenses related to the qualifying IP assets can benefit from the exemption. Thereafter, the Bill foresees that expenses and related losses are to be taken into account in the first year of a positive income.

### The nexus ratio

The nexus ratio can be expressed by the following formula:

$$IP\ EI = \frac{NEI \times \sum EE + \text{up to } 30\%^1 \times \sum EE}{TE}$$

Whereby:

*IP EI means eligible income benefitting from the 80 % IP tax exemption,*

*NEI means net eligible income, adjusted and compensated,*

*EE means eligible expenditures incurred to develop the IP asset, and*

*TE means total expenditures incurred to develop the IP asset.*

<sup>1</sup>The 30% uplift applies to eligible expenditures up to the amount of total expenditures (ie, the ratio cannot exceed 1).

The purpose of the nexus ratio is to grant the IP tax exemption proportionally to the net eligible income in a way that the portion of income that may benefit from the IP regime should be the same as between eligible expenditures and total expenditures.



Payments made by the taxpayer to an associated company for its R&D expenses under any contractual form (including sub-contracting) are not eligible expenses. These expenses are to be included in the total expenses calculation, so that a taxpayer having exposed R&D in house will have a 100 % ratio (ie, close or equal to 1), whereas a taxpayer having outsourced most of its R&D will have a significantly lower ratio.

It should also be noted that this ratio is recalculated each financial year, as the eligible expenses and total expenses of one taxable year and the previous years are taken into account on a cumulative basis<sup>2</sup>.

### Further requirements for taxpayers

In order to be eligible for the exemption, taxpayers must track all eligible expenditures, total expenditures and eligible income.

The Bill is silent on the manner in which this expense tracking should be carried out or which relevant documentation should be collected. Nevertheless, as a general rule, the above-

<sup>2</sup> Action 5 - 2015 Final Report, paragraph 45: "the nexus approach is an additive approach"

mentioned allocation and tracking must be performed on an IP-asset-per-IP-asset basis.

In case of multiple IP assets and complex R&D activities, taxpayers are permitted to adopt a product-based approach to provide any required evidence to Luxembourg authorities.

### **Interaction with former regime**

As mentioned above, the Former Regime – officially repealed on 30 June 2016 – applies (under certain conditions) until 30 June 2021, while the New Regime should be introduced in Luxembourg as from the 2018 fiscal year.

As a consequence of the foregoing, both regimes will co-exist for a limited time and the taxpayer has the option to be subject to the provisions of article 50-bis (and thus to the Former Regime) or of article 50-ter (and thus to the New Regime). This option will be made in the tax declaration and is irrevocable as from the tax year in which the chosen regime begins to apply.

### **What to expect?**

The Bill is currently under parliamentary scrutiny and potential amendments are expected to be proposed in the coming weeks within the work of Parliament. These amendments should be immaterial as the Bill reflects more or less the IP tax regime as proposed and outlined in the OECD Final Report.

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