

## Flash News

### Proposed new IP regime in Luxembourg

On 4 August 2017, the Luxembourg government introduced a draft law (projet de loi no. 7163), which provides for the introduction of a new intellectual property regime (IP regime) in Luxembourg. After several months of discussion, parliament has adopted the final version of the law on 17 April 2018. The provisions on the new IP regime will become effective for the first time for the tax year 2018.

As a reminder, based on the OECD report published on October 5, 2015 on action 5 of the Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan), the old IP regime was abolished with effect from 1 July 2016, respectively from 1 January 2017 for the determination of business assets (taxpayers who already applied the former IP regime could however continue to benefit from the IP Regime for a transitional period of 5 years starting on 1 July 2016 and ending on 30 June 2021).

As already earlier announced by the government, the new IP regime shall comply with the new international standards and the OECD recommendations by applying the so-called "Nexus Approach" which requires a direct link between expenses, the IP right and the respective income. Please bear in mind that the impact of the Nexus approach conducts to a low (or even no) tax benefit if either IP is acquired at a significant cost or R&D expenditure is relatively low.

Similar to the old rules, the new IP regime shall also provide for a tax exemption of up to 80% of the qualifying net income and capital gains generated by specific qualifying IP rights. These qualifying IP rights shall also benefit from a 100% exemption from net wealth taxes. In case a taxpayer qualifies for the transitional rules of the old IP regime and the new IP regime, he may irrevocably opt to apply the new system.

Compared to the old regime, the scope of qualifying IP will be more restricted in the new regime (**reduced scope**). Whereby e.g. protected patents, utility models and software protected by copyrights will still qualify for the new IP regime, trademarks, domain names and other marketing related rights will not qualify anymore.

Also, the basis for the exemption will be different (**distinct basis for 80% exemption**). In order to identify the tax exemption, the respective net income needs to be determined. Such income is then multiplied with an exemption rate. The exemption rate is function of the so-called eligible expenses compared to total expenses.

When determining the exemption rate, all expenses directly linked to the R&D, for the constitution, the development or the improvement on the qualifying IP assets and incurred by the taxpayer (including its permanent establishment located in the EEA) or outsourced to third parties, represent eligible expenses.

The eligible expenses will be set in a relation to the overall expenses, which include the eligible expenses, the acquisition cost of the IP and R&D expenses directly linked to the constitution, the development or the improvement of the IP.

Both – eligible expenses and total expenses - are cumulated over the years so that it will always be the cumulated amount of qualifying R&D expenses over the total expenses (also cumulated over the years), that will be considered for the calculation of the exemption ratio.

The so-determined exemption rate will also apply to a capital gain on the underlying IP.

To compensate for finance cost (acquired IP) and non-eligible R&D, the eligible expenses are increased by 30%, however, such increase is limited to the overall cost.

The following formula will be applied:

Exemption amount = Net eligible income \* Exemption rate

Exemption rate = Expense ratio \* 80%

Expense ratio =  $\frac{\text{eligible expenses } (\Sigma; \text{YearN}; \dots; \text{YearNx}) * 1,3}{\text{total expenses } (\Sigma; \text{YearN}; \dots; \text{YearNx})}$   
(max. = 1)

We today consider that the administrative cost of the company will not be considered in the “total expenses”.

In principle, the direct link needs to be evidenced per IP right (under certain circumstances a product based approach may be allowed). Positive and negative net income of qualifying IP rights have to be set-off against each other before applying the tax exemption. This applies also to negative net income (“carried forward” for the purposes of the IP exemption only) from prior years.

Qualifying IP income includes royalties, capital gains and IP income embedded in sold products and services as well as certain indemnities in relation to the qualifying IP.

IP rights to be registered may apply the tax exemption as from the year when filing the application. In case of a subsequent non-registration the exempt amounts have to be reintegrated in the result of the year in which the taxpayer is informed about the rejection of the registration.

**For further information, do not hesitate to contact one of our team members, who will be glad to assist you at any time:**

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