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An attractive new tax regime for income deriving from IP rights
Noble & Scheidecker

companies are entitled to a deduction of 80 per cent of the net consideration that a third party would have paid for the right to use the patent if it had been licensed to that third party. Here again, the new IP tax regime applies to both natural and legal persons. Parliament decided to limit the scope of application to patents because they are easily controllable thanks to their public nature and in order to promote the objectives of the new IP tax regime.

From a practical point of view, the exemption is granted from the date of application for protection of the qualifying IP rights. If the application is rejected (eg, if an invention is not considered patentable due to lack of novelty), the initial deduction must be reintegrated into the tax base for the fiscal year in which such decision is notified to the company.

Finally, net capital gains arising from the alienation of software copyrights, patents, trademarks, designs and models also benefit from an 80 per cent tax exemption.

The gain will remain taxable up to the extent of the expenses directly connected to the income, as well as depreciations and write-downs that reduced the tax base in the tax year of the disposal or in any previous tax year.

The new IP tax regime provides that the exemption will not apply if the IP rights are acquired by or from an 'associated company'. A company will be considered 'associated' in three cases:

- where the company directly owns at least 10 per cent of the share capital of the entity eligible for exemption;
- where the entity eligible for exemption directly owns at least 10 per cent of the share capital of such company; or
- where a third company, which directly holds at least 10 per cent of the share capital in the entity eligible for exemption, directly holds at least 10 per cent of the share capital of such company.

Conditions to benefit from the exemption

The new IP tax regime applies provided that the following additional requirements are met:

- Expenses that have a direct economic connection to the qualifying IP rights must be recorded as assets in the balance sheet of the company;
- The new IP tax regime is available only to Luxembourg taxpayers; and
- The IP rights must have been acquired (or created, as the case may be) after December 31 2007 independently from their geographical localisation.

Evaluating the IP rights

A taxpayer that wishes to benefit from the exemption must evaluate the qualifying IP rights. The new IP tax regime gives no accurate indication as to the determination of the income. If the IP rights are used by a third party (eg, through a licence), this determination raises no difficulties. Otherwise, the law provides that if no market value for the IP rights is available, the taxpayer should choose a method recognised by the administration or an internationally recognised method. In either case, the evaluation should preferably be carried out by IP professionals.

Furthermore, small and medium-sized businesses, as defined in the Decree of March 16 2005, are entitled to evaluate the qualifying IP rights which they assign at 110 per cent of the expenses that have reduced their tax base for the tax year of the disposal and of any previous tax year.

Areas of doubt

Some doubts remain, notably concerning the following issues:

- The scope of the new IP tax regime raises some doubts. Domain names are not expressly referred to in the law; however, a bill of October 1 2008 states that these will be expressly covered by the new IP tax regime.
- The law refers to "remuneration for use or the right to exploit". However, it is unclear whether sub-licensing of qualifying IP rights by Luxembourg companies is included within the scope of the new IP tax regime.
- The law does not specify what happens in the case of IP rights already owned by foreign branches of Luxembourg companies before December 31 2007 or where a Luxembourg company acquires IP rights via an indirectly affiliated entity.
- The new IP tax regime includes no provision regarding indirect intra-group acquisitions.

The tax administration is due to publish an administrative circular dealing with these issues. The circular will lay down some methods of implementation and specify the scope of the new IP tax regime – for example, to clarify whether other rights such as supplementary protection certificates for medicinal products are covered. The new IP tax regime should be completed by other similar regulations.

Conclusion

Further questions may be raised, notably regarding the EU rules on state aid as defined by the EC Treaty.

