The new BEPS compliant Luxembourg IP tax regime in Luxembourg

The draft bill n°7163 introducing an amended tax regime for intellectual property ("**IP**") assets was recently enacted into a law on 17 April 2018 (the "**Law**"). This new Law complies with the recommendations of the final report on Action 5 of the Base Erosion and Profit Shifting ("**BEPS**") plan released by the Organization for Economic Co-operation ("**OECD**") and it sets out the groundwork for improving the competitive position of Luxembourg as a center of excellence in research and developments since the repeal of the former tax regime. Under this new approach taxpayers are required to prove a nexus between qualifying expenditures, the IP assets and the income that can benefit from a beneficial regime.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.Please find below the most salient features of the Law: **1. Eligible IP assets**The qualifying assets to benefit from the new regime are:

- patents;
- utility models;
- supplementary protection certificates for patents on pharmaceutical and on phytopharmaceutical products;
- supplementary protection certificate extensions for pediatric medicine;
- plant breeders' rights (also known as plant variety rights); and
- orphan drug designations;
- software protected by copyright under national or international norms.

Trademarks and domain names are not eligible IP assets.To be eligible, IPs need to have been constituted, developed or improved after 31 December 2007, as part of the research and development 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.

2. Qualifying expenditures Research and development expenditures must be directly connected to the eligible IP assets. It excludes acquisition costs, interest and financing costs, building costs and all other costs that are not directly connected to an eligible asset.Qualifying expenditures include:

- Expenditures that are incurred in the context of research and development conducted by the taxpayer itself.
- Expenditures incurred by a foreign branch of the taxpayer, provided that the branch is (i) operational at the time the eligible IP income is generated, (ii) that it is situated in the European Economic Area and (iii) that it is not benefiting from a similar IP regime.
- Expenditures that result from outsourcing of research and development to unrelated parties (resident or non-resident). This outsourcing can also be routed through a related party, but only if no margin is realized by the related party on these costs paid to a third party.

Expenditures for general or speculative research and development or expenditures for unsuccessful research and developments.To ensure that the new regime does not penalize taxpayers excessively for acquiring IP or outsourcing R&D activities to related parties, the new regime provides for the opportunity to apply a 30% uplift to expenditure classified as qualifying expenditure. **3. Overall expenditures**The overall expenditure is the sum of all the expenditure that would count as qualifying expenditure if undertaken by the taxpayer itself (including acquisition costs and outsourcing costs for R&D activities carried out by related parties). **4. IP income**

The eligible income related to eligible IP rights includes:

- income received as a consideration for the use of, or the right to use eligible IP assets;
- capital gains realized on the sale of eligible IP assets;
- income in direct relation with the eligible IP assets which is incorporated in the sales price of a product or service (embedded royalties); and
- indemnities obtained in the frame of a legal or arbitration proceedings related to the eligible IP assets.

The 80% exemption applies to eligible net income meaning that qualifying expenditures related to the IP income and incurred in the year the IP income is realized should be deducted from the IP income subject to the following nexus ratio:

The eligible net IP income is exempted at 80

% from Luxembourg corporate income tax leading to an effective tax rate of approximately 5.2 % (based on the 26.01% aggregate corporate income tax rate for companies with a registered office in Luxembourg City). Lastly the Law grants to the taxpayer an irrevocable option to choose exclusively between either (i) the transitory provisions of the old IP tax regime applicable until 30 June 2021 and (ii) the new IP tax regime provided by the Law, for a given tax year in the event of an Eligible Income which could be subject simultaneously to both legal framework.Please do not hesitate to contact us should you have any queries.
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