Benelux tax competition to attract IP income is on again

Governments have identified policy supporting innovation as an important instrument to help the competitiveness of their economies. More and more countries are therefore introducing R&D/IP tax incentives and existing incentives are regularly improved. This is clearly an area that is very much in development and requires permanent review. The Benelux countries (Belgium, the Netherlands and Luxembourg) have all implemented favourable tax regimes for some type of intellectual property (IP) income.

Belgium

From tax year 2008 (in other words, accounting years ending on or after December 31 2007), the Belgian government introduced a patent income deduction (PID). The PID grants an 80% deduction for qualifying patent (improvement) income applied on a gross basis which allows the effective tax rate (ETR) on such income to be reduced to a maximum of 6.8% (20% multiplied with the Belgian corporate tax rate of 33.99%).

This 6.8% ETR can be further decreased with other deductions (such as tax-deductible business expenses, including R&D expenses) as well as by making use of other tax incentives such as R&D investment deductions or tax credits and the notional interest deduction.

The scope of the PID is limited to patents and extended patent certificates. Other IP rights, such as copyrights, know-how, designs, trade marks and marketing intangibles are not eligible for this regime. If licence agreements and fees do not exclusively relate to (qualifying) patents but also cover other IP rights such as know-how, trade marks or brands, a breakdown of the received payment must be made as only the portion relating to (qualifying) patents qualifies for the PID.

To be eligible for the PID, the patents must have been granted; PID is not available for pending patent applications. However, the Belgian tax authorities allow a retroactive application of the PID back to the first day of the tax year during which the patent was obtained. For example, for a company closing its accounting year on December 31 2009, a patent granted on December 20 2009 can qualify for the PID as of January 1 2009.

According to the position of the Belgian tax authorities, legal ownership of the patent in

---

1 Wim Eynatten and Patrick Brauns of Deloitte compare the IP tax regimes of the Benelux countries. Wim Eynatten (weynatten@deloitte.com) and Patrick Brauns, (pbrauns@deloitte.com), both are partners in Deloitte’s Brussels office. The authors are grateful to their colleagues in the Deloitte network for their assistance with this article, Karin Klein-Brinke (Deloitte Amsterdam) and Bernard David (Deloitte Luxembourg). This article was published in International Tax Review. IPEG is grateful that authors have consented to use this article for this blog.
hands of the Belgian taxpayer is required to be eligible for the PID. The PID regime applies to both self-developed patents and acquired patent rights including licenced patents. In case of acquired or licenced patents, the patents will have to be improved. However, it is not required that these improvements lead to additional patents.

Capital gains realised upon the disposal of patents are not covered by the PID. The PID will apply to all Belgian companies and Belgian branches of foreign companies for these types of income:

- Income derived from the licensing of patents or extended patent certificates by a Belgian company or branch; and,
- Income derived from the use of patents or extended patent certificates in the production process of patented products or delivery of services by a Belgian company or branch or on its behalf.

The second category requires a quantification of the relative portion relating to the use of the patented technology in the revenues generated by the commercialisation of these patented products or services. In a recent decision, the Belgian Ruling Commission accepted the use of three different transfer pricing techniques to compute this portion: the costs, income and market approaches.

Furthermore, the situation can become more complex when a single product requires several patented technologies, some of which qualify for the PID while others do not. In such a case, the question to be addressed is how to divide the income between the patents given there is only one global payment. The Belgian Ruling Commission has recently addressed this specific issue and ruled that the breakdown can be made in function of the relative contribution of research staff.

The deduction in respect of licensed patents will be equal to 80% of the arm’s-length royalties received. For self developed patents, the Belgian company (or branch) will be able to deduct from its taxable profits an amount equal to 80% of the qualifying income.

In case of patents licensed or acquired from third parties, the basis on which the 80% exemption is applied must be reduced with:

- any licence payments made to third parties; and,
- any amortisation charges on these patents.

Other costs (including improvement costs) remain fully deductible. In the case of patent improvements, the 80% exemption only applies to the added value created by the improvement. The amount of this added value should be supported by a valuation based on transfer pricing techniques.
These rules can be illustrated by the following example: Case 1: BelCo develops patent for an amount of €1 million ($1.38 million); and, Case 2: BelCo acquires patent for the same amount. Qualifying PID income amounts in both cases to €600,000; the patent is depreciated over 10 years; and, R&D/improvement expenses of €10,000.

The PID should be computed as shown in table 1.

<table>
<thead>
<tr>
<th>All amounts in €</th>
<th>Case 1</th>
<th>Case 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>PID Income</td>
<td>600,000</td>
<td>600,000</td>
</tr>
<tr>
<td>Less: Depreciation</td>
<td>(100,000)</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Less: R&amp;D/improvement expenses</td>
<td>(10,000)</td>
<td>(10,000)</td>
</tr>
<tr>
<td>PID Deduction</td>
<td>(480,000)</td>
<td>(400,000)</td>
</tr>
<tr>
<td>Taxable basis</td>
<td>10,000</td>
<td>90,000</td>
</tr>
<tr>
<td>Taxation at 33.99%</td>
<td>3,399</td>
<td>30,591</td>
</tr>
<tr>
<td>ETR (*)</td>
<td>0.5%</td>
<td>5%</td>
</tr>
</tbody>
</table>

(*) ETR can be further reduced by application of notional interest deduction.

Any excess PID will not be available for carry-forward to future years.

The law requires that the patented IP has been developed/further improved in a research centre that forms a branch of activity. A branch of activity is defined as "all assets which are invested in a division of the enterprise and which constitute, from a technical point of view, an independent business able to work autonomously".

The Belgian company (or branch) should have sufficient substance to perform or supervise R&D activities, but may use (related) subcontractors for developing its patents. The PID applies as from tax year 2008 to all new patent income, in other words, patent income that has not led to the sale of patented products or services by the Belgian company or branch, by a licensee or by a related company to unrelated parties before January 1 2007.

**The Netherlands**

The Netherlands was the first Benelux country to introduce a patent box tax regime. The Dutch patent box tax regime entered into force on January 1 2007. The benefit of this regime initially only covered income from IP protected through a patent. trade marks, designs and models were excluded.

To be eligible for the patent box regime, it was not necessary to have R&D premises located in the Netherlands. IP developed by third parties outside the Netherlands on behalf of Dutch companies can also qualify for the patent box tax regime. According to the Dutch patent box regime, net royalties derived from a self-developed patented intangible asset
developed after December 31, 2006 were subject to an effective (reduced) tax rate of 10% if this asset (to the extent of at least 30%) contributes to the profit derived from the use of the intangible asset. However, the 10% rate applied only to a maximum of four times the production costs of the intangible asset and the excess was taxed at the general Dutch corporate income rate (25.5%).

From January 1, 2008, the patent box tax regime was extended to non-patented intangible assets which result from R&D activities for which an R&D certificate was received. Since the R&D certificate provides an incentive of reduction of Dutch wage tax and social security premiums, the R&D certificate is mainly based on R&D activities performed in the Netherlands.

The maximum amount that could be allocated to the patent box for non-patented IP was set at €400,000. This second limit reduced the attractiveness of the patent box for innovative companies that cannot, or do not want to, protect their IP with a patent, such as software companies.

Provided the patent or the certified R&D project contributes to at least 30% of the total profits realised from the intangible asset, the total profits can be allocated to the patent box. Capital gains derived from the transfer of above-mentioned intangible assets are also subject to the 10% rate unless the capital gains are more than the maximum amount to which the patent box applies (in other words, four times the development costs for patent and €400,000 for other certified R&D activities). In the case of a transfer of the assets, the maximum amount is reduced with the gain derived on such a transfer.

The Dutch government realised that the patent box regime as introduced on January 1, 2007 and extended in 2008, was not competitive compared with the Belgian and Luxembourg regimes and therefore did not meet its objectives of attracting foreign investment.

To become more competitive and attract more foreign investment, the Dutch patent box has been renamed the innovation box from January 1, 2010. Furthermore, the tax regime itself has been improved on these two essential points:

- The ETR for the innovation box has been reduced from 10% to 5%; and,
- The cap on the amount of profits that can be allocated to the innovation box has been abolished (both patents and certified R&D activities).

With the changes described here, the Dutch innovation box has become an attractive regime for a wider range of profit-generating IP developed by Dutch taxpayers.
Luxembourg was the last of the Benelux countries to introduce an IP income tax incentive regime.

The law of December 21, 2007 introduced a favourable tax regime for income derived from intellectual property rights (IPR). The Luxembourg government introduced an 80% exemption on income derived from certain IPR, as well as capital gains realised on the sale of such IPR, resulting in a maximum ETR of 5.72% (20% multiplied with current Luxembourg corporate tax rate of 28.59%).

Foreign withholding tax suffered can be credited and will further reduce the ETR. The 80% exemption applies to qualifying IPR acquired or created after December 31, 2007 and is applicable for all Luxembourg taxpayers.

Eligible IPR are the following:

- Software copyrights
- Patents
- Trademarks or brands
- Designs or models
- Domain names

Taxpayers that develop and use patents for their own activities may benefit from a notional deduction that amounts to 80% of the income that they would have earned if they had licensed the right to use the patent to a third party.

In case of discrepancy between the legal and the economic ownership of these IPRs, the economic ownership will prevail.

IPR acquired from an associated company will not qualify. An associated company is defined as a company in which the company benefiting from the IPR income has at least a 10% direct participation or is its direct shareholder of at least 10%. Or where both companies have a common direct shareholder of at least 10%.

In the case of contribution, the existence of this relationship should be acknowledged before the contribution. The 80% exemption is calculated on the net positive income after deduction of all the related expenses. In case some expenses were incurred before claiming the benefit of this regime, those expenses must be activated during the year the company wants to apply the regime. The purpose is to ensure that all the related expenses incurred are actually taken into consideration for determining the IPR net positive income.
This rule can be illustrated by this example: IPR developed in 2007 and 2008 where the taxpayer incurred development costs of €50,000 in 2007 and €20,000 in 2008. These costs were accounted for in the profit and loss (P&L) statement of the company. In 2009, the company received a royalty of €25,000 on the IPR and wants to apply the new regime. In such a case the €70,000 taken into the P&L must first be activated and depreciated over a normal depreciation period (five years in this example).

In 2009 the taxable basis will be computed as follows:

<table>
<thead>
<tr>
<th>Costs activation</th>
<th>€70,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Royalties</td>
<td>€25,000</td>
</tr>
<tr>
<td>Depreciation annuity</td>
<td>€14,000</td>
</tr>
<tr>
<td>80% exemption ([25,000 – 14,000] \times 80%)</td>
<td>€8,800</td>
</tr>
<tr>
<td>Tax result</td>
<td>€72,200</td>
</tr>
<tr>
<td>Tax losses carried forward</td>
<td>€70,000</td>
</tr>
<tr>
<td>Taxable basis</td>
<td>€2,200</td>
</tr>
</tbody>
</table>

For the subsequent years, the taxable basis will also amount to €2,200 (calculated as 25,000 – 14,000 – 8,800).

Whereas determining the reference date for acquired IPR should not be a problem, this issue could be more sensitive for developed IPR and should be analysed for each type. For copyrights on software, the reference date is the date on which the computer software is ready for commercial use. For patents, this is the filing date of the patent application. As far as trade marks and brands are concerned, this is in principle their registration.

However, if it appears that the trademarks or brands were actually used before their registration, the prior use will prevail. The same rule also applies for designs and models. For domain names, the reference date is the one of the registration request with the competent office.

The Luxembourg regime presents some interesting features with limited constraints and conditions which makes it a success so far, such as the wide scope of IPR covered and the exemption of capital gains on disposal of IPR. Furthermore there is no need to continue to develop the IPR or to have a R&D centre in Luxembourg.
Comparing all three

The IP tax regimes of the Benelux countries are summarised and compared as in table 2.

<table>
<thead>
<tr>
<th>Tax Factors</th>
<th>Belgium</th>
<th>Netherlands</th>
<th>Luxembourg</th>
</tr>
</thead>
<tbody>
<tr>
<td>ETR</td>
<td>0% to max. 6.8%</td>
<td>5%</td>
<td>5.72%</td>
</tr>
<tr>
<td>Intellectual property</td>
<td>Patents and extended patent certificates</td>
<td>Self-developed patents, IP from innovation and plant breeder's rights</td>
<td>Software copyrights, patents, trademarks, domain names, designs and models</td>
</tr>
<tr>
<td>Type of income</td>
<td>Patent (improvement) income</td>
<td>Patent/innovation income and capital gains</td>
<td>IPR income and capital gains</td>
</tr>
<tr>
<td>Can work be performed outside the jurisdiction?</td>
<td>Yes: but some level of substance/activity required in Belgium</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Legal ownership of patent/IP right required?</td>
<td>Yes</td>
<td>Yes</td>
<td>No: economic ownership is sufficient</td>
</tr>
</tbody>
</table>

For qualifying patent (improvement) income, the Belgian regime still remains very attractive as it is applied on gross patent (improvement) income implying that the ETR may be further reduced by the costs for the development/improvement of the patents as well as by other tax incentives.

The combination of PID, a notional interest deduction and R&D tax credit may reduce the ETR on patents to 0%. The introduction of the PID can therefore be a catalyst for companies to:

- have their existing R&D centres in Belgium performing R&D activities for their own account and to take ownership of the patents; and,
- combine R&D (principal) activities with other functions to benefit from the PID by reducing the combined taxable basis.

Yet, the Belgian PID regime could still be improved to render the regime more effective, for example, these improvements could be considered:

- eligibility for PID as soon as the patent application is filed with the competent authorities;
- abolition of the R&D centre requirement; and,
- carry-forward of excess PID.
Furthermore, the PID has some disadvantages compared to the Dutch and Luxembourg regimes:

- the scope of the PID is limited to patents (and does not cover other IP rights);
- the PID is only available for granted patents (the PID is, in other words, not applicable in respect of pending patents);
- capital gains on patents are not covered under the PID; and,
- there is no carry-forward of excess PID.

The main advantage of both the Dutch and Luxembourg regimes is that they cover a broader range of IP including software development and also cover capital gains. On that basis, the Netherlands and Luxembourg are better positioned to attract a broader range of innovation and IP income.

An additional advantage of the Dutch regime is the so-called 30% threshold rule on the basis of which the total profits of an intangible asset can be allocated to the innovation box provided the patent or the certified R&D project contributes to at least 30% of the total profits realised from said intangible asset.

Under the Belgian PID regime on the other hand, only the portion relating to qualifying patent (improvement) income is eligible for the 80% exemption.

After the introduction of the Dutch innovation box, January 1 2010, the competition between the Benelux countries to attract IP income is on again. Other countries are also planning to introduce patent box type of tax regimes to attract IP income and R&D activities (for example, the UK is introducing a patent box tax regime from April 2013). It can be expected that Belgium and/or Luxembourg will react to reinforce the competitiveness of their regimes. However, budgetary shortfalls may render a quick reaction difficult.

There is no easy answer as to which of the Benelux countries offers the optimal conditions for locating a central IP company. The ultimate decision requires a detailed analysis taking into account the types of intellectual property as well as the particular needs of the group. Finally, changes to the IP company tax regimes in Europe have become frequent and numerous, so that there is need for permanent review if all possible benefits are to be claimed and tax pitfalls avoided.

ipeg, March 18, 2010