

LUXEMBOURG IP TAX REGIME WILL FOLLOW THE “NEXUS APPROACH”

Pierre Gramegna, current Luxembourg Minister of Finance, has recently announced, in his reply to a parliamentary question raised by the deputy Laurent Mosar regarding “patent boxes” that Luxembourg will amend the strongly anchored “Article 50bis Regime”, i.e. the favourable IP Tax Regime, in line with the so-called “modified Nexus approach”.

Luxembourg has established a business-friendly tax regime encouraging the exploitation of intellectual property rights. On 1 January 2008, with the Law of 31 December 2007 adding Article 50bis to the Income Tax Act 1967, Luxembourg introduced a favourable tax regime for incomes derived from certain Intellectual Property rights.

Article 50bis provides that Luxembourg companies and Luxembourg-based branches of foreign companies can benefit from an 80% exemption on net income (royalties) derived from certain IP rights and on capital gains resulting from the disposal of such IP rights, including copyrights on software, patents, trademarks, domain names, designs and models, acquired or constituted after 31 December 2007.

Yet both at the European level and at the Organisation for Economic Co-operation and Development (“OECD”) level, discussions regarding the criteria which must be satisfied to avoid classification as a harmful tax regime, were on-going. A progress report was published in September 2014 on “Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance” under the OECD’s project “Base Erosion and Profit Shifting” (BEPS) Action Plan.

A key part of the report focuses on strengthening the substantial activity requirement used to assess preferential regimes. One of the considered approaches was the “nexus approach”, which only allows a taxpayer to benefit from an IP regime to the extent that it can be shown that the taxpayer incurred expenditures such as research and development.

A joint proposal, based on the “nexus approach”, was put forward by Germany and the United Kingdom. A final consensus, built on that joint proposal, was agreed by all OECD and G20 countries, with the adoption of the “Action 5: Agreement on Modified Nexus Approach for IP Regimes”.

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Provisions of this agreement include the following:

An uplift of qualifying expenditure: the expenditures that a taxpayer incurs on IP and which can be taken into account in the nexus approach calculation can, in limited circumstances, be increased by 30%;

Closure to new entrants: the current regimes will be closed to new entrants as from 30 June 2016;

A grandfathering period: the phasing out of current existing IP tax regimes may last until 30 June 2021.

On 26 February 2015, the Luxembourg Minister of Finance, replying to a parliamentary question, said that the Article 50bis Regime will be amended in order to be in line with the agreed nexus approach. The legislative procedure replacing the current regime should start sometime in 2015.

