

Intellectual property enters new tax era

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More options are open for Luxembourg to make its IP box regime more attractive, says Deloitte's Thierry Bovier.
Photo: Deloitte Luxembourg

Changes to the taxation of intellectual property enter their final phase on 1 July 1, bringing a five-year transitional phase to an end. But what is really changing for businesses? Thierry Bovier, partner at Deloitte Luxembourg, takes stock.

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In Luxembourg, where certain intellectual property rights can lead to an exemption of 80% of the income derived from these rights, the regime was modified by narrowing the spectrum. The law was published in December 2015 and entered into force in July 2016.

However, it provided for a transitional phase of five years, until 1 July 2021, on intellectual property rights constituted or acquired before July 2016. Partner International Tax at Deloitte Luxembourg, Thierry Bovier, analyses the scope of the change.

On 1 July, the old IP box regime will be permanently buried. Are there big changes on the horizon?

Thierry Bovier: Since 2018, the two regimes have coexisted, and companies have had the opportunity to slide from the old to the new. I think a lot of companies have already made their arrangements and the 1 July date isn't going to change much.

Why did Luxembourg have to modify its intellectual property regime?

This is not just the case for Luxembourg. It wasn't targeted in particular. In the European Union alone, 13 out of 27 countries have implemented an IP box regime.

The measure was implemented by the OECD as part of its Beps plan. Action 5 provides for the review of preferential intellectual property regimes. The OECD considers this an attractive incentive for business, but it should be subject to substantial activity. Overall, the taxpayer can still benefit from a tax advantage as long as they themselves are involved in the development of intellectual property. It didn't exist before.

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therefore now limited to patents and copyright in software.

Second, the tax benefit is subject to the condition that the taxpayer is involved in the creation, development or improvement of intellectual property. It is a mathematical formula that calculates this percentage of involvement, based on the development costs incurred by the taxpayer.

Finally, you can get a tax exemption on the use of your own intellectual property. Before, this was only possible on patents made by the taxpayer themselves, but not on software.

What was the initial goal of the IP box regime?

The scheme dates back to 2008. It is just one tool among many to attract new businesses. On its own, it is not enough. In Luxembourg, it comes into play in the exploitation phase of an asset, internally or by licensing it to other players. What is missing, however, is a tax incentive for the research and development phase.

But with the new regime, which insists on the notion of substantial activity, research and development become essential...

Yes indeed. From now on, the exemptions are conditional based on research and development costs. Hence, in my opinion, the need to think quickly about what can be done to support companies in the R&D phase to create intellectual property which, itself, can benefit from the IP box regime. We must work on this phase in advance.

By reducing the spectrum, is there a risk of limiting the number of companies interested in the Luxembourg regime?

Yes. of course. Now. as the new regime widens the scope in terms of revenues

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But I would also like to point out that alongside patents and copyright on software, Beps action 5 provided a measure for a third category of beneficiaries. It is aimed at smaller companies that develop innovations but cannot afford to protect them with patents or copyright. With independent control over the character of the novelty, they may also benefit from exemptions.

Luxembourg has chosen not to retain this category, but it would be useful to redo an assessment on this subject to increase the attractiveness of the country. Why deprive yourself of it?

Must these new developments, which lead to exemptions, be carried out in the taxpayer's country?

No, they must be carried out by the taxpayer himself or subcontracted by a third party--an unrelated company. But the Luxembourg regime limits the geographical area of development to the territory of the European Union and to the three countries of the European Economic Area (Iceland, Norway and Liechtenstein). One can therefore wonder why Luxembourg does not extend it to all the countries with which it has a tax agreement. It would also increase attractiveness. Other European countries have gone as far as this.

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