

## **Luxembourg – A favourable tax reform for 2008**

**dated 21 December 2007**

The Luxembourg parliament has enacted the budget for 2008, as well as various tax measures provided for by a separate bill.

Broadly speaking, this tax reform for 2008 will prove to be favourable for companies as it offers:

- a reduction in the rate of capital duty to 0.5%, effective from 1 January 2008;
- an increase up to 12% of the tax credit for complementary investment;
- an 80% exemption for income and gains from intellectual property (“IP”).

A VAT measure has also been introduced, regarding the application of the super-reduced rate of 3% to the reception of radio and TV broadcasting services. This rate applies to the transmission of the content and to the mere transmission itself whatever the technical means used. Therefore, services provided by teledistributors will also benefit from this super-reduced rate even for pure transmission services.

In addition, a negative measure relating to polluting vehicles has not been implemented.

This Flash News only focuses on taxation of business entities, individual income tax issues will be dealt with separately. More specifically, the new regime for IP is outlined.

### **A new key centre for managing IP**

As part of the implementation of the EU's Lisbon strategy, Luxembourg has introduced a partial exemption of income and gains from intellectual property rights. The objectives of this tax provision are to enhance the visibility of Luxembourg as a key centre for managing intellectual property rights, as well as to increase technical innovation through research and development. This initiative follows the implementation of tax incentives for IP in Ireland, the Netherlands and Belgium. The Luxembourg tax measure is broad in its scope, mainly because it applies to IP other than patents and is not restricted to IP (further) developed in specific research structures.

### **Qualifying intellectual property rights**

The partial IP tax exemption would apply to software copyrights, patents, trade marks (including domain names according to the official comments), designs or models.

This scope has a partial link to the royalties' article in the OECD's model tax convention. However, the new regime does not cover copyrights of literary or artistic works, or plans, secret formulae or processes.

## 80% exemption for net IP income

The partial exemption is included in the provisions for the determination of commercial income. Hence, it can apply to any taxpayer realising a commercial profit that is subject to Luxembourg income tax. The tax exemption will be equal to 80% of the net positive income received in consideration for the use of, or the right to use, any qualifying IP. This partial exemption applies with regards to corporate and municipal business tax, leading to an effective taxation rate of 5.9% on the net IP income (i.e. 20% \* 29.63% for Luxembourg city). As no partial exemption is provided for net wealth tax, specific attention will have to be drawn on that point.

The net income is determined by reducing the gross income on IP by the expenses directly connected to such IP, including write-downs and yearly amortizations.

Taxpayers who have created a patent and use it for their own business purposes can apply a corresponding 80% deduction as soon as the registration of such patent has been affected. This notional deduction is computed by reference to the arm's length income that the taxpayer would have received had it licensed this patent to an unrelated party, after deduction of expenses directly connected to such IP, including write-downs and yearly amortizations.

## 80% exemption for capital gains on IP

The 80% exemption would also apply to a capital gain realised on the disposal of IP subject to the regime. A recapture rule is, however, foreseen to avoid exempting a gain, where losses have been fully deducted due to related expenses and amortisation of the IP.

According to this recapture rule, the exempt amount of the gain is reduced by the algebraic sum of 80% of the negative net income of IP derived during the year of disposal or previous years, as long as such negative income has not been previously utilised.

Last, the above-mentioned exemption is not applicable to the extent a capital gain has been rolled over into the IP (article 53 and 54 LITL).

## Valuation of qualifying IP

Upon disposal, the fair market value of IP is to be determined according to any commonly accepted valuation method. In any case, the arm's length principle must be respected.

To minimise valuation costs, a lump sum valuation rule can be applied by small and medium sized companies, i.e. 110% of the expenses that have reduced the taxable basis of the taxpayer during the year of disposal and any previous years. Small and medium sized companies are currently defined as those with less than 250 employees, and either yearly turnover not exceeding EUR 50 million or a total balance sheet not exceeding EUR 43 million.

## Conditions for exemption

The application of the IP partial exemption regime is subject to the following conditions:

- (i) The IP has been created or acquired after 31 December 2007;
- (ii) During the first fiscal year in which the IP partial exemption regime is requested, taxpayers are obliged to capitalize in their tax balance sheet all the previous expenses, amortisations and deductions connected with the IP and include in their taxable basis for that year the corresponding credit;
- (iii) The IP must not have been acquired from a related company. Related companies are specifically (and narrowly) defined as: parent companies that directly own at least 10% of the share capital of the taxpayer, subsidiaries in which the taxpayer holds directly at least 10% of the share capital and sister companies as long as at least 10% of their share capital is directly owned by the same parent company. The aim of this clause is to avoid the application of the partial exemption regime several times in a same group.

## Contact

For further information, please contact the PricewaterhouseCoopers Luxembourg Investment Tax expert:

Sami Douénias

Partner

+352 49 48 48-3206

sami.douenias@lu.pwc.com

Valéry Civilio

Partner

+ 352 49 48 48-3170

valery.civilio@lu.pwc.com

### PricewaterhouseCoopers

400, route d'Esch, B.P. 1443

L-1014 Luxembourg

Telephone +352 49 48 48-1

Facsimile +352 49 48 48-2900

PricewaterhouseCoopers cannot be held liable for mistakes, omissions, or for possible results obtained further to the use of this document, which is issued for information purposes only. No reader should act on or refrain from acting on the basis of any matter contained in this publication without considering and, if necessary, taking appropriate advice upon their own particular circumstances.

© 2007 PricewaterhouseCoopers. All rights reserved. PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.