

New Belgian Innovation Profits Deduction (“IPD”)

After the abolishment of the patent income deduction, Belgian government announced on 2 December 2016 a new tax deduction for innovation profits. In line with the recommendations made by the OECD in the BEPS action plan, Belgium wants to create a tax friendly environment for innovative research and development activities. Enterprises making their own R&D efforts may benefit from a tax deduction of up to 85% on the future profits generated by intellectual property rights (resulting in an effective tax rate of 5.1% on qualifying profits). It may be well worth the effort for enterprises and SMEs with substantial R&D activity to examine whether they can benefit from this new tax incentive.

SCOPE EXTENDED TO PLANT VARIETY RIGHTS AND PROTECTED INNOVATIVE SOFTWARE

The IPD applies on profits resulting from the exploitation of following intellectual property rights:

- ▶ Patents and additional protection certificates
- ▶ Plant variety rights applies for after 1 July 2016 or acquired after 30 June 2016
- ▶ Orphan medicinal products (limited to the first 10 year after registration) applied for or acquired after 1 July 2016
- ▶ Data or market exclusivity rights granted by a competent authority on crop protection chemicals protected under applicable EU law or similar rules of national or international law during the first 10 years of protection
- ▶ Copyright protected software providing that this software is created in the context of an R&D project or programme

The company applying for the deduction has to be the full owner, co-owner, usufructuary, licensee or rights owner (“rechtenhouder”).

As compared to the previous patent income deduction, the scope of the IPD has been substantially extended.



PROFIT FROM INTELLECTUAL PROPERTY RIGHTS

The new deduction is applicable on royalty income or on “deemed royalties”, i.e. royalties that a company would have to pay under arm’s length conditions for the use of the protected technology, rights or software.

It has now been clarified that the new deduction also applies on process patents, indemnities and capital gains. Special conditions apply for capital gains to qualify:

- ▶ it is required that the intellectual property right has been created during the previous tax year or, in case of an acquired right, that the acquisition has taken place in the previous 24 months;
- ▶ the deduction only applies if the realised capital gain is reinvested within 5 years (or before stopping professional activities) in R&D projects in view of obtaining other intellectual property rights

CALCULATION OF NET PROFITS

The IPD is calculated on the net profit generated by qualifying intellectual property rights. The calculation is made for each single right as follows:

- ▶ gross revenue is all revenue (e.g. royalty fees or deemed royalties included in the price charged for products) received in consideration for the use of the rights;
- ▶ net profits equal gross revenue reduced by the following amounts:
 - expenses for R&D directly related to qualifying intellectual property rights. Overhead expenses (expenses not directly linked to the R&D functions) and costs relating to buildings or financing do not have to be deducted
 - costs for the acquisition of intellectual property rights
 - fees paid to other parties (related or unrelated) in consideration for R&D services

It commonly occurs that, shortly after completion of R&D, expenses relating to R&D exceed the generated revenues. In such case, the excess balance has to be carried forward to future tax years. A company can also opt to depreciate the R&D expense (for purposes of application of the IPD) over maximum 7 years. Specific “recapture” rules apply in case the intellectual property rights are transferred and/or if the company does no longer apply the IPD during the depreciation term.

LIMITATION TO QUALIFYING PROFIT FOR OWN R&D EFFORTS

As recommended by the OECD (“modified nexus approach”), the IPD only applies to the extent that the taxpayer demonstrates that the qualifying intellectual property right is the result of own R&D efforts or R&D work performed by unrelated parties (e.g. universities, independent research offices, ...). Qualifying profit will be reduced to the extent that R&D work is outsourced to related entities or that qualifying rights are acquired.

Following formula will be used to calculate qualifying profits:

$$\frac{(A + B) * 1.3}{A + B + C + D}$$

A equals direct expenses for the taxpayer’s own R&D efforts. B equals expenses for R&D work outsourced to unrelated parties (or to related parties recharging such expenses without mark-up). C is the amount of expenses for R&D work outsourced to related parties while D equals the expenses for the acquisition of intellectual property rights.

The numerator is then increased by 30% (the result of the fraction is however capped at 1). The new IPD will apply to a maximum extent if a company is performing all R&D work itself (or is only subcontracting R&D work to unrelated parties. The IPD will be reduced to the extent that more R&D efforts are outsourced to related entities and/or rights have been acquired.

If, despite the fact that a corporate taxpayer is performing substantial R&D activities, the fraction results in a low deduction, it is possible to apply for a specific ruling allowing a higher IPD. Since these rulings have to be shared with other EU members states and the EU Commission, we expect that this exception will only be granted in very exceptional circumstances.

85% DEDUCTION THAT CAN BE CARRIED FORWARD

The Innovation Profit Deduction then equals 85% of qualifying profit. The percentage of this deduction can be changed by Belgian government without any intervention of parliament being required. It is expected that the amount of the deduction may be adjusted upward.

Unclaimed IPD (e.g. in absence of sufficient taxable income) can be carried forward during an unlimited period of time.

CLAIM OF THE IPD PENDING THE APPLICATION FOR AN INTELLECTUAL PROPERTY RIGHT

The IPD can already be claimed pending the decision on whether the intellectual property right will be granted or not. From a tax technical point of view, this conditional exemption constitutes a “tax exempt reserve” in the corporate income tax return. This reserve is tax exempt if the right is finally granted. In case the application for the right is no longer pending or if the right would not be granted, the exempted reserve will be subject to corporate income tax.

SPECIAL DOCUMENTATION REQUIREMENTS

The IPD has to be claimed by using a specific tax form to be filed together with the corporate income tax return.

Taxpayers need to document all elements used for the calculation of the IPD (e.g. amount of gross revenue, nature of R&D expenses for each IP right, ...). The documentation file has to comprise

- ▶ real (market) value of intellectual property rights acquired from a related entity
- ▶ calculation of gross revenue
- ▶ calculation of net profit
- ▶ calculation of the fraction for qualifying profits

In case it would not be possible to make all calculations for each single intellectual property rights, calculations may be aggregated by product/service based on a set of intellectual property rights.

APPLICATION FOR SME

As opposed to the patent income deduction, the IPD does no longer contain specific exemptions for small and medium sized enterprises (SME). This should not be an obstacle for these organisations to benefit from the IPD. Our office has extensive experience in assisting SMEs in these matters and will make available a documentation set allowing also innovative small companies to claim IPD on the profits generated by their R&D work.