

## REMINDER - Transitional period of Luxembourg's former IP regime coming to an end



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Luxembourg has an attractive IP regime offering an 80% tax exemption of net income and gains from qualifying IP assets. The IP regime was first introduced in Luxembourg in 2008 but abolished with effect from 1 July 2016 due to pressure of the EU following the outcome of the OECD BEPS project. Taxpayers owning IP assets that benefitted from the former IP regime were allowed to apply it for a transitional period ending on 30 June 2021 (1 January 2021 for net wealth tax purposes).

Luxembourg's current IP regime is applicable since 2018 and is fully in line with the outcome of the OECD BEPS Project. The main differences between the two regimes are the following:

- **Qualifying IP assets:** Marketing related IP assets such as trademarks, tradenames and domain names qualified under the former IP regime. Under the current IP regime, such IP assets do not qualify.
- **Acquired IP assets:** Acquired IP assets could benefit from the former IP regime (save for certain exceptions). Under the current IP regime, IP that is acquired and not self-developed does not qualify.
- **Modified nexus approach:** Under the former IP regime, the net income from qualifying IP assets could fully benefit from the 80% exemption. Luxembourg's current IP regime is in line with the so-called "modified nexus approach," as established by the OECD in its BEPS Action 5 Report. Pursuant to the modified nexus approach, net income derived from qualifying IP assets must be adjusted with the nexus ratio (the more R&D activities carried out by the taxpayer itself, the higher the nexus ratio). The net adjusted income benefits from the 80% exemption under the current IP regime.

Taxpayers that still apply the former IP regime to their IP assets should verify if their IP assets can benefit from the current IP regime. If not, they will no longer be able to benefit from the 80%

exemption after the end of the transitional period on 30 June 2021. Any gains realised upon the disposal of their IP assets after 30 June 2021 will thus be fully subject to Luxembourg income tax including the portion of the value increase which occurred during the period where the former IP regime was still applicable (i.e., no compartmentalisation).

The current IP regime will notably not be available when the IP assets concern marketing related IP assets, the IP has been acquired or if a taxpayer has outsourced all of the R&D activities to related parties. In such case, taxpayers should consider restructuring those IP assets prior to the end of the transitional period (e.g., by way of an intra-group transfer of such IP assets) so that any latent gains will still benefit from the 80% exemption. For any reorganisation or restructuring, any potential DAC 6 obligation should be considered (for example under Hallmarks E2 and E3).

In anticipation to any future challenges from the Luxembourg tax authorities, taxpayers should consider preparing a transfer pricing report to support the transfer price of the intra-group transfer of their IP assets. However, taxpayers that employ less than 250 people and whose annual turnover does not exceed EUR 50 million or whose total annual balance sheet does not exceed EUR 43 million do not have to prepare a valuation report to determine the intra-group sales price. They can instead value the IP assets at the moment of transfer using a lump sum valuation equal to 110% of the sum of the expenses in direct economic relation with the constitution of the IP assets and which expenses reduced the tax base of the transferor for the tax year of alienation and previous tax years. This lump sum valuation is especially tax beneficial if the fair market value of the IP assets is higher than the lump sum valuation and the recipient can value the acquired IP assets at fair market value. Use of the lump sum valuation may be subject to DAC6 reporting (for example under Hallmark E1).