As a result of the BEPS action plan Belgium had to assess its existing patent box against the principles contained in the OECD recommendations and introduce any required changes by 30 June 2016. The result was that the existing patent income deduction was abolished and replaced by a new deduction for innovation revenue.

A brief history

The summer of 2016 saw the end of the Belgian tax-friendly regime for income from intellectual property (IP) rights as we had known it. Thanks to this preferential regime – the so-called ‘patent box’ – companies were able to deduct 80% of their gross revenue from patents from their profits for the taxable period. So tax for this patent income amounted to 33.99% of 20% of the revenue, which boiled down to actual taxation of a mere 6.80%.

The OECD’s BEPS plan (action 5) meant that member states were required to review, no later than by 30 June 2016, their preferential regimes for income from intellectual property obtained through research and development activities. As of 1 July 2016 the OECD member states were expected to have reformed their IP regimes so that they complied with the principles set out in the OECD recommendations.

During the cabinet meeting on 2 December 2016 the governing parties reached an agreement on the new IP regime that will henceforth be named the ‘deduction for innovation revenue’, which is applicable as of 1 July 2016. Income derived from patents that are applied for as of 1 July 2016 as well as adjusted patents and licences obtained after 1 July 2016 will consequently no longer be subject to the old patent box. For taxpayers whose income from intellectual property benefitted from the old patent box before 1 July 2016, a transitional scheme of 5 years (until 30 June 2021) has been introduced.

The draft bill was passed by parliament on 2 February. On 20 February the law introducing the deduction for innovation revenue was published in the Belgian Official Journal, and it was effective as of 1 July 2016.

The most significant characteristics of the new deduction for innovation revenue are as follows:

1. Qualifying beneficiaries

The new deduction for innovation revenue applies to Belgian companies or permanent Belgian establishments of foreign companies that are the full owner, co-owner, usufructuary or licence or (exclusive) rights holder thereof.

2. Qualifying intellectual property rights

The new deduction for innovation revenue has a wider scope than the old patent box (which was limited to patents and supplementary rights alone, which ostensibly excluded the entire software industry from the deduction).
The deduction for innovation revenue is applicable to the following intellectual property rights:

- patents or supplementary protection certificates;
- plant variety rights;
- orphan medicinal products;
- data or market exclusivity;
- copyright-protected software: as long as it is the result of a research & development project or programme as defined in the facility for the partial exemption of the payment of withholding tax for scientific research or as long as binding advice is received from BELSPO (Belgian Science Policy). The software cannot have generated any income prior to 1 July 2016. Any changes or upgrades to software that existed prior to 1 July 2016 that result in income after 1 July 2016 is eligible, but only for that income that is due to the change or upgrade.

The new deduction can be applied to income from intellectual property rights irrespective of the country in which the product, service or method receives protection.

This new regime is applicable (with the exception of patents that could already benefit from the patent box) insofar as the above-mentioned rights were obtained or applied for after 1 July 2016.

It is important to also note that a part of the profits can already be exempted as of the time that an application for an intellectual property right is submitted, while the patent box could only be employed for a recognised patent. In this event a temporary exemption shall be awarded by means of an exempted reserve, in anticipation of the final approval of the intellectual right (subject to the repayment thereof if the intellectual property right is not awarded).

3. Qualifying income

The deduction for innovation revenue is applicable to income from qualifying intellectual property rights. When compared to the previous patent box, the new version includes a much wider range when it comes to qualifying incomes: licensing payments, royalties included in the price of (protected) goods or services, royalties for (protected) products or methods included in the 'production process' of commercialised goods or services, income from the sale of intellectual property rights and compensation resulting from an intellectual property right infringement.

4. Calculating the deduction for innovation revenue

Rate

The deduction for innovation revenue allows for 85% (compared to 80% under the patent box) of the net income (compared to the gross income under the patent box) derived from intellectual property to be deducted from the tax base of the company or permanent establishment for its corporation tax.

Deduction of net income

The deduction for innovation income is calculated using the net sum of the income from intellectual property rights. This means that the expenses incurred by the company or permanent establishment for research & development for the year concerned are deducted from the revenue from intellectual rights. Moreover, the historical expenses incurred for research & development in previous taxable periods (insofar as those periods end after 30 June 2016) must also be deducted. When it comes to historical costs, the law allows for them to be spread across a maximum of seven tax years, which means that taxpayers who have incurred significant costs and investments in the start-up phase can still benefit from the favourable tax-environment in respect of the revenue generated by their intellectual property rights. The choice of spreading the historical costs and the number of years over which they are depreciated are irrevocable. Should the deduction of the aforementioned research & development costs from the revenue lead to a negative balance, then this balance is carried forward to following years.

The Nexus approach

The biggest change introduced by the new tax regime for deductions for innovation revenue is that the calculation of the new deduction is linked to the so-called Nexus fraction, an amendment that legislators were compelled to introduce on the basis of the directives released by the OECD within the scope of the BEPS plan. The goal of this directive is to retain tax-friendly regimes for companies that have sufficient economic substance at a local level.

In concrete terms this means that the calculation of the deduction will be subjected to a fraction that represents the ratio between the costs for the research & development activities the company has performed itself (the numerator) and the total research & development costs (the denominator). The expenditure on research & development activities performed by the company itself also includes those costs paid to unaffiliated companies, or paid to an affiliated company if it pays the received remuneration to an unaffiliated company without deducting a margin. The numerator of the Nexus ratio will be automatically increased by 30% (called 'up-lift'), but can never exceed the total sum of the costs incurred for research & development in the denominator. In order to compile this Nexus fraction, all expenditure for research & development in preceding taxable periods must be included and retained without restriction.

Finally, it must be noted that the Nexus approach is considered as a rebuttable presumption. If a taxpayer can demonstrate that the fraction will lead to a lower deduction for innovation revenue on the basis of actual elements, then one can apply for a deviation from the Nexus fraction. Such a deviation will only be permissible by means of a Advance Ruling.

5. Administrative obligations

The new deduction for innovation revenue entails administrative compliance and a documentation obligation that must not be underestimated by taxpayers who wish to employ the regime. Innovation revenue as well as the expenditure directly related thereto (for determining the Nexus fraction) must be determined separately for each intellectual property right. Exceptionally, it can be permitted that the obligation in respect of documentation is kept updated for each type of product or service developed. In order to comply with these administrative obligations a specific form shall have to be added to the corporation tax return, both for SMEs and for larger companies.

6. Processing the deduction for innovation revenue

The deduction for innovation revenue in the corporation tax return shall be processed after the processing of the definitively taxed income deduction and prior to the processing of the notional interest deduction.

The unused balance of the deduction for innovation revenue can (as opposed to the patent box) be wholly carried forward to following tax years.

Neither will the deduction be henceforth lost in the event of a company restructuring (merger, demerger, etc.) on the part of the taxpayer concerned.

In conclusion, we also note that the application of the deduction for innovation revenue does not threaten the application of the investment deduction with respect to the same intellectual property right.

7. Choosing between the old and new regimes for revenue from intellectual property rights

Some taxpayers shall be able to opt for the transitional scheme of the former patent box or for the new deduction for innovation revenue for certain intellectual property rights. Depending on the specific characteristics of each case and, more specifically, the structure of certain corporate groups, it could in some cases be more advantageous to opt for the former patent box. When a taxpayer settles on the transitional scheme of the old patent box, this is an irrevocable choice and the taxpayer will be unable to switch to the deduction for innovation revenue regime before 30 June 2021.

Finally, it is handy to know that some taxpayers will have to apply both the ‘old’ patent box and the ‘new’ deduction for innovation revenue in the same tax return, which is possible as long as this is not done for the same property rights.

A summary of the major differences between the old and the new regimes:

	Patent box	Deduction for innovation revenue
Qualifying intellectual property rights	Patents and supplementary protection certificates	Innovation revenues
Deduction rate	80%	85%
Qualifying income	Gross income	Net income
Nexus limitation	Not applicable	Nexus limitation for purchased intellectual property rights and the payment of remuneration for R&D activities to affiliated companies
When is the regime applied?	As of the patent approval	As of the application for the intellectual property right
Processing in the tax return	Taxable profits after the definitively taxed income deduction	Taxable profits after the definitively taxed income deduction
Can unused deductions be carried forward?	No	Yes
What happens in the event of a merger or demerger?	Unclear	Applicable
Research centre required	Yes, but not for SMEs	Substantiation is required by means of applying the Nexus fraction
How is it processed in the tax return?	Specific annexe	Specific annexe
Documentation obligation	Only for revenues	Revenues and costs per intellectual property right and, where this is impossible, per product or group of products. All costs from previous taxable periods that conclude after 30 June 2016

Authors: An Lettens & Anne-Sophie Van den Bosch

More information on www.moorestephens.be

MOORE STEPHENS