Executive summary

On 2 December 2016, the Belgian Government formally announced the innovation deduction as the successor of the Belgian patent income deduction. The new regime is intended to increase the competitiveness of the Belgian economy while complying with the requirements of Action 5 of the Organisation for Economic Co-operation and Development’s (OECD’s) Base Erosion and Profit Shifting (BEPS) Action Plan.

There are significant improvements compared to Belgium’s previous intellectual property (IP) regime. The scope of the new innovation deduction is not limited to patents, but will be extended to other IP rights, including copyright protected software. According to the proposal, the income qualifying for the incentive will also include capital gains. The incentive can be applied as of the year in which the IP right is requested. The deduction rate is increased to 85% of the net qualifying IP income. This results in an effective tax rate of 5.10%.

The innovation deduction will retroactively apply as of 1 July 2016. It replaces the patent income deduction which was previously abolished as of 1 July 2016 with a five-year grandfathering period until 2021.
Detailed discussion

Qualifying IP assets: extension to copyright protected software and other IP rights

The new innovation deduction will apply to the following IP rights:

- Patents and supplementary protection certificates (SPCs)
- Copyright protected software, provided that the software results from a research and development (R&D) project or program, as defined in the rules on the partial payroll tax exemption for researchers
- Orphan drug designations, requested or acquired as of 1 July 2016 (for the first 10 years)
- Data and marketing exclusivity granted by the authorities, notably for medicinal products (also limited to the first 10 years)
- Plant breeders’ rights requested or acquired as of 1 July 2016

The deduction applies to self-developed IP rights as well as IP rights acquired or licensed from related or unrelated third parties. Marketing intangibles, such as trademarks, are excluded.

Qualifying IP income

In addition to at arm’s length license fees and IP income included in the sales price of products and services (so-called embedded royalties), the new innovation deduction also applies to damages received further to IP infringements, IP income derived from process innovation, as well as capital gains.

Capital gains only qualify as IP income, provided that they relate to a fixed asset that was created in the previous taxable period or acquired 24 months in advance. The sales price received should be re-invested in qualifying expenditures, within five years (see below).

Determination of net income

The innovation deduction applies to the net IP income, i.e., the gross IP income after deduction of current-year expenditures for the development of the IP asset, including expenditures for the acquisition of IP rights, expenditures in relation to the R&D conducted by the company, as well as R&D outsourced to related or unrelated parties. Prior-year expenditures incurred in financial years ending after 30 June 2016 should also be deducted. However, taxpayers may choose to spread the recapture of prior-year expenses over a maximum period of seven years.

Calculation

The requirement of development or improvement of the IP assets in a qualifying R&D center is abolished and replaced by the so-called “nexus ratio” in the following formula, to calculate the innovation deduction:

\[
\text{Qualifying expenditures} \times 130\% \times \text{Net qualifying IP income} \times 85\% = \text{Innovation deduction}
\]

The purpose of the nexus ratio is to ensure that the innovation deduction is only available to the extent that qualifying expenditures were incurred by the taxpayer. Qualifying expenditures are defined as expenditures for R&D that are incurred in the context of R&D conducted by the taxpayer or that result from outsourcing of R&D to unrelated parties. Expenditures for outsourcing to related parties and acquisition costs are excluded from the qualifying expenditures. Consequently, a taxpayer who did not acquire the IP and did not outsource the development to a related party, will have a ratio of 100% and the net IP income will fully qualify for the 85% innovation deduction.

A 30% uplift applies to the qualifying expenditures in order not to penalize taxpayers excessively for acquiring IP or for related-party outsourcing. The nexus ratio is capped at 100%.

The nexus ratio only serves as a rebuttable presumption. Subject to conditions, taxpayers can prove that due to exceptional circumstances the nexus ratio does not correctly reflect the share of their own R&D activities in the overall R&D activities. In order to deviate from the nexus ratio, taxpayers will be required to obtain an advance tax ruling.
Carryforward of unused deduction

The innovation deduction is deducted from the corporate tax base. Unused innovation deduction can be carried forward indefinitely.

Exemption for IP rights which were requested, but not yet granted

For IP rights which require a request procedure, taxpayers will be entitled to a conditional exemption which is equivalent to the innovation deduction pending the request. The amount of the exemption should be recorded on an unavailable reserve account. The exemption will become final, provided that the request is granted. If the request is not granted, but rejected or withdrawn, the amount will be included in the corporate tax base. In such case, late payment interest will become due.

Other features

In principle, the calculation should be performed for each IP asset separately. Taxpayers should allocate expenditures and IP income to the various IP assets. However, if such allocation is not practical, the allocation can be done by type of product or service, or by group of products or services. Taxpayers will be required to claim the innovation deduction in a special form to be added to the corporate income tax return. Furthermore, the fair market value of the IP, the gross IP income and the qualifying and overall expenditures should be documented (tracking and tracing).

Interaction with patent income deduction

The patent income deduction was abolished as of 1 July 2016. A five-year grandfathering period is optionally available for patent income earned up to 30 June 2021 in respect of: (i) self-developed patents requested before 1 July 2016; and (ii) improved patents and patent licenses acquired before 1 July 2016.

If the taxpayer opts for the patent income deduction during the grandfathering period, the taxpayer will not be able to apply the innovation deduction in relation to the relevant patent for the taxable periods ending prior to 1 July 2021.

For additional information with respect to this Alert, please contact the following:

Ernst & Young Tax Consultants SCCRL/BCVBA, Brussels

- Herwig Joosten +32 2 774 93 49 herwig.joosten@be.ey.com
- Kurt Van der Voorde +32 2 774 92 81 kurt.van.dervoorde@be.ey.com
- Jan Bode +32 2 774 92 93 jan.bode@be.ey.com
- Arne Smeets +32 2 774 63 63 arne.smeets@be.ey.com
- Peter Moreau +32 2 774 91 87 peter.moreau@be.ey.com
- Pierre Legros +32 2 774 96 77 pierre.legros@be.ey.com

Ernst & Young Tax Consultants SCCRL/BCVBA, Antwerp

- Pieter Van Den Berghe +32 3 270 12 42 pieter.van.den.berghe@be.ey.com

Ernst & Young LLP, Belgium-Netherlands Tax Desk, New York

- Max Van den Bergh +1 212 773 5586 max.vandenbergh@ey.com
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients.
For more information about our organization, please visit ey.com.

© 2016 EYGM Limited.
All Rights Reserved.

EYG no. 04225-161Gbl
1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com