

Overall benefit

The introduction of the PID makes Belgium even more attractive as a preferred location for R&D activities, as a group IPCo or as a principal company, and serves as a major incentive for R&D intensive industries in Belgium.

How can Ernst & Young assist you?

Ernst & Young consults on a day-to-day basis on the application of this relatively new measure. We are constantly updating our knowledge and can fill in the gaps. Furthermore, Ernst & Young can assist you in monitoring and in tax-optimizing your PID position.

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Patent income deduction

Attractive tax regime confirms and strengthens Belgium as a prime location for IP and R&D

Patent income deduction - concept

The patent income deduction (PID) regime is a tax incentive which allows a deduction of 80% of the qualifying (adjusted) gross patent income from the taxable income, effectively reducing the related maximum effective tax rate (ETR) to 6.8% (i.e. 20% of the Belgian statutory rate of 33.99%).

The main purpose of this tax incentive is to support investments in technical innovation through research and development. It applies irrespective of the industry in which the entity is active (e.g., pharmaceutical, automotive, (green) energy sector, etc.). Specifically, the PID aims at encouraging companies to perform R&D activities resulting in patents, stimulate ownership of patents and promote the production of goods or delivery of services based on these patents.

The regime contains many features which make it very attractive, also when compared with other European IP regimes. First of all, the regime applies both to self-developed patents and to acquired or licensed patents which are further developed. Secondly, there is no cap on the amount of the PID. Thirdly, the regime can also be used in combination with e.g. contract R&D and contract manufacturing activities. Finally, the regime is straightforward, automatically applicable and does not require a special ruling or election. The Belgian tax authorities issued guidance on the practical application and interpretation of the PID regime through publishing frequently asked questions. This FAQ list is regularly updated. Recent topics added to the list relate to patent related know-how, income from multiple patents and geographical application field.

Field of application

Eligible companies

All companies (Belgian or foreign) which are subject to (i) Belgian corporate income tax, or (ii) Belgian non-resident corporate income tax (i.e. Belgian permanent establishment) can benefit from the PID regime.


Quality In Everything We Do



PID makes Belgium even more attractive for R&D activities

Eligible income

The 80% deduction from taxable income is available (a) for qualifying income generated through the licensing of qualifying patents to a related or unrelated party; and (b) for the qualifying notional patent income embedded in a sales price of a product or service. The incentive will apply to variable income streams, fixed income streams, as well as upfront fees, milestones, etc. on qualifying patents. Capital gains on the transfer of qualifying patents do currently not qualify for the PID. Production of a product can either be done by the Belgian company or a branch (i.e. full fledged manufacturing) or on its behalf (i.e. contract or consignment manufacturing, e.g. in a principal company context).

The FAQ document issued by the Belgian tax authorities provides guidance on the determination of the qualifying income and deals in particular with products for which multiple qualifying and un-qualifying patents and/or associated know how are used in the production. It also deals with the question in which country(ies) the patent should be protected to generate qualifying income (e.g. country of commercialization and/or country of production). These are important aspects to consider in analyzing the application of the PID.

Should the amount of the PID deduction exceed the qualifying (notional) net patent income, then the excess can be used against all other types of income.

Qualified patents

Four types of (extended) patents (certificates) are eligible for the new measure:

- ▶ Patents self-developed by Belgian companies (or branches), either developed in qualifying R&D centers in Belgium or abroad; or
- ▶ Patents acquired by Belgian companies (or branches) from related or unrelated parties provided they are being further developed in qualifying R&D centers in Belgium or abroad (independent of whether or not such developments lead to additional patents).
- ▶ Patents licensed from related or unrelated parties by Belgian companies (or branches), provided they are being further developed in R&D centers in Belgium or abroad (independent of whether or not such developments lead to additional patents).
- ▶ Additional protective certificates

A R&D center must constitute a branch of activity in order to qualify.

According to the Belgian definition, a patent represents the exclusive and temporary rights of exploitation granted for any invention that is new, is based on an inventive activity, applies to an industrial application and is not contrary to public order or morality. The PID is not restricted to Belgian or European patents that are valid in Belgium. Patents valid in other jurisdictions also qualify. Other intellectual property rights – such as copyrights, trademarks, designs, models, plans, secret formulas or processes, currently do not qualify for the PID.

How does it work?

Self-developed patents

For patents that are licensed to related or unrelated parties the deduction will be equal to 80% of the gross arm's length patent income received, resulting in a maximum effective tax rate of 6.8%.

For patents that are used in the production process or delivery of services by or on behalf of Belgian companies, a deduction will be applied on the profits of the Belgian company equal to 80% of a deemed arm's length royalty (i.e. equivalent to a royalty the Belgian company would have received had it licensed the patents used in the production process to unrelated parties), which can be supported through a transfer pricing analysis.

The PID is calculated on the gross patent income, but is deducted from the net patent income (e.g. after amortization, interest expenses, license fees paid, etc.). Therefore, the PID generally results in an ETR below 6.8% on the patent income or even in excess PID (i.e. PID exceeding the patent income), which may offset any other taxable income.

The PID is not recorded in the annual accounts (i.e. off balance) however it is deducted from the taxable base remaining after the participation exemption on dividends and prior to the Notional Interest Deduction (carried forward for 7 years) and the deduction of tax losses carried forward (carried forward unlimited in time). The remainder of the excess PID, i.e. exceeding the total taxable profits, can not be carried forward.

Given the recent change in law allowing the carry forward of excess participation exemption on certain dividends, this order of deduction could change in the future and put the PID before the participation exemption.

Acquired patents

Amortization expenses on acquired patents as well as payments made for licensed patents need to be deducted from the gross qualifying patent income before calculating the 80% PID. Note that interest expenses incurred for such an acquisition would not need to be deducted from the gross qualifying income and are fully tax deductible.

The PID cannot be increased by entering into non-arm's length intercompany transactions as specific tax clauses are introduced to adjust for such non-arm's length transactions.

Examples

Example illustrating the effect of the PID on a Belgian company with self developed patents for a book value of 100,000,000 (amortized over 5 years)

| P&L | Before PID | After PID |
|-----------------|-------------|--------------|
| Royalty income | 125,000,000 | 125,000,000 |
| IP amortization | -20,000,000 | -20,000,000 |
| PID | - | -100,000,000 |
| Taxable profits | 105,000,000 | 5,000,000 |
| Tax (33.99%) | 35,689,500 | 1,700,000 |
| ETR | 33.99% | 1.62% |

Example illustrating the effect of the PID on a Belgian company with a licensed patent for which an annual license fee equal to 20% of the royalties received is paid

| P&L | Before PID | After PID |
|-----------------|-------------|-------------|
| Royalty income | 125,000,000 | 125,000,000 |
| Royalty expense | -25,000,000 | -25,000,000 |
| PID | - | -80,000,000 |
| Taxable profits | 100,000,000 | 20,000,000 |
| Tax (33.99%) | 33,990,000 | 6,798,000 |
| ETR | 33.99% | 6.79% |

Formalities

- ▶ The PID is automatically applicable. However, a form has to be filed with the tax return calculating the claimed PID

- ▶ The application of the PID is not subject to any investment or employment obligation or approval by the Belgian tax authorities through a formal or informal ruling (apart from further development in a qualifying R&D center)
- ▶ Under certain circumstances a transfer pricing analysis, potentially supported by a formal ruling may be recommended for obtaining upfront certainty on the qualifying patent income

Entry into force

The PID regime is applicable as from tax year 2008 (i.e. financial years ending on or after 31 December 2007) to income from patents which have not been commercialized by the company, a licence holder or group affiliates prior to 1 January 2007.

Factors increasing the benefit of the PID

- ▶ No capital duties allowing increases in share capital in cash or in kind without tax leakage
- ▶ Domestic exemption of withholding tax on dividends to Qualifying Parent Companies located in treaty countries allowing tax-efficient profit repatriation
- ▶ Introduction of the Notional Income Deduction as from tax year 2007 allowing a tax-free return on qualifying equity for the NID rate (3.8% for tax year 2011)
- ▶ Broad and strong treaty network (98 treaties signed), in particular the very beneficial treaty with the US to reduce/eliminate withholding tax
- ▶ Access to the EU Interest Royalty Directive eliminating foreign withholding taxes on certain EU inbound royalties
- ▶ The availability of a foreign tax credit to compensate for foreign withholding taxes on inbound royalties
- ▶ The absence of real thin capitalization provisions for debt-financed operations
- ▶ The availability of numerous grants, subsidies and R&D incentives
- ▶ An excellent tax regime for expatriates (e.g. specialized researchers)
- ▶ Business minded ruling practice