



## Gi<sup>3</sup> alert

# Patent income deduction definitively replaced by innovation income deduction

The transitional period for claiming Belgium's patent income deduction (PID) with respect to certain qualifying intellectual property (IP) rights expired on 30 June 2021 and, as from 1 July 2021, only the innovation income deduction (IID) applies. The PID broadly allowed companies to deduct 80% of their gross patent income from taxable profits. The PID was abolished as from 1 July 2016 with a five-year transitional regime. To replace the PID and align Belgian legislation with the OECD recommendations under BEPS action 5 (countering harmful tax practices) the IID was introduced.

### **Expanded qualifying IP rights and innovation income**

The IID is more broadly applicable than the PID, offering additional possibilities for relief. The scope of the IID includes, for example, copyright-protected software and breeders' rights, while eligible income is expanded to include, among other sources, licence fees, IP income embedded in products or services, IP income embedded in the application of production processes, and damages for IP infringement.

### **Modified nexus approach**

The IID is based on the OECD's "modified nexus" approach that broadly requires a link between income eligible for tax benefits and the activity generating that income, while also allowing related party outsourced expenditure and IP acquisition costs to be taken into account. Applying the IID requires a thorough prior analysis and calculation. Appropriate structuring of the R&D activities, correct valuation of gross innovation income, and efficient monitoring and documentation of the R&D costs are essential.

Unlimited outsourcing to related parties or acquisition of IP would not provide many opportunities for taxpayers to receive benefits without themselves engaging in substantial R&D activities, e.g., improvements.

Reflecting this, the IID is determined by multiplying the net innovation income by a fraction with the numerator of the “qualifying R&D expenditure” and the denominator of the “global R&D expenditure” of the enterprise. The aim of the nexus is to consider (i) the ratio between the R&D activities performed by the enterprise itself and those outsourced to unrelated undertakings and (ii) the R&D activities outsourced to related entities and those reflected by the costs of acquiring the IP right. The IID granted will be limited according to this ratio. The qualifying R&D expenditure in the numerator of the nexus may be increased by 30% but cannot exceed the total expenditure in the denominator.

Where the company has itself carried out all the R&D directly related to a qualifying IP right and/or has outsourced the work to an unrelated company, the nexus ratio will be 100%; using intragroup outsourced R&D activities or acquiring IP would reduce this percentage.

The taxable result of a Belgian company or branch will be reduced by 85% of the total net innovation income calculated after applying the nexus fraction.

### **Tracking and tracing**

Since the modified nexus approach depends on there being a nexus between expenditure and income, taxpayers must carefully monitor and document expenditure, qualifying IP, and income. Supporting documentation must be retained and available to the tax authorities, such as the gross amount of income, an overview of expenditure, and the link between costs and income.

### **Rulings**

Owing to the complexity of the subject and the high level of audit activity from the tax authorities in this area, taxpayers may wish to apply for a ruling from the Ruling Commission to obtain certainty of tax treatment.

### **Don't forget the PID!**

Although the PID can no longer be claimed as from 1 July 2021, it is possible to apply it to income generated early in 2021 in the corporate income tax return to be submitted in September 2022 (related to fiscal year 2021). Where the qualifying conditions are met, this presents the opportunity to “clear” all the historical R&D costs related to a patent.

### **Our support**

This “clearing effect” also offers a unique opportunity to substantially improve the future IID on the same patent. This scenario can be taken into consideration during a feasibility analysis.

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### **Contacts**

If you have any questions concerning the items in this alert, please contact your usual tax consultant at our Deloitte office in Belgium or:

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