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R&D tax alert
Belgium

IID closer to reality

Innovation Income Deduction legislation update

Previous R&D tax alerts (12 July, 29 August and 20 October 2016) covered the Government's objective to adopt a new innovation income deduction ("IID") legislation before year-end. As the Council of Ministers approved the pre-draft IID legislation in first reading last Friday, 2 December 2016, this may finally become reality. Subject to a positive outcome from the State Council review, the approval in second reading by the Council of Ministers and discussions and votes in the Chamber, the adoption of the law may be expected as a "new year's present".

The below outline highlights the main changes and updates the previous R&D tax alerts. This summary may of course still be subject to possible changes until adoption.

Qualifying IP rights

In the last version of the pre-draft legislation, data or market exclusivity obtained from public authorities has been added to the list of qualifying IP rights. The data or market exclusivity focuses primarily on medicinal products for human and veterinary use and orphan drugs according to European Regulations and Directives, but also refer to similar provisions in national and international law.

The list of qualifying IP rights for the application of the IID is as follows:

- Patents
- Supplementary protection certificates (SPC’s)
- Plant Breeders' Rights (1)
- Orphan Drugs (1),(2)
- Data or market exclusivity granted by a public body (3)
- Computer programs protected by copyright (3)

(1) Applied as of 1 July 2016 or acquired after 30 June 2016
(2) Limited to the first 10 years of registration in the European Register of orphan drugs
(3) No threshold application or acquisition date appears to be applicable

Regarding computer programs protected by copyright, a link should be established with R&D projects or programs as defined in the legislation related to the wage tax exemption for R&D personnel. An advice may be obtained regarding the existence of an R&D project or program from the Belgian Science Policy Office.

The company should be owner, co-owner, licensee (exclusive or non-exclusive) or rights holder of the intellectual property.

Qualifying IP income

Regarding qualifying IP income, as indicated in previous R&D tax alerts, amounts obtained upon alienation of qualifying IP rights may, under certain conditions, also benefit from the IID regime.

The following income streams may qualify for the application of the IID:

- Revenues from licenses
- IP income embedded in products or services
- IP income embedded in the application of production processes
- Damages from IP infringement
- Income consequent to IP rights’ alienation, subject to a re-investment condition

Income generated after filing, but before obtaining the qualifying IP right, qualifies as an exempt innovation income, provided specific provisions are applied.

Net income approach

With respect to the net income approach, the basic provisions remain unchanged. Some changes have been made with respect to the recapture provisions and the treatment of negative innovation income.

The IID regime only applies to the net amount of qualifying IP income that exclusively relates to a qualifying IP right, i.e.:

- the gross qualifying IP income related to the qualifying IP right of the taxable period; less
- the overall expenditure (see below for definition) taken as an expense and borne in the taxable period.

Specific provisions are foreseen:

- to apply innovation income for the first year, where the company needs to “recapture” relevant expenses made in taxable periods ending after 30 June 2016;
- to deduct negative innovation income for the IP right (or product /service type or group of products/services) from innovation income calculated in subsequent taxable periods; and
- to carry forward unused innovation income

Modified nexus fraction

Specific transitional provisions have now been added for expenditure until tax year 2019.

The amount of net qualifying IP income should subsequently be multiplied by the following “modified nexus fraction”, which is also to be determined separately for each qualifying IP right (or type or group of products or services):

$$\frac{\text{Qualifying expenditure (A+B+C) x (max) 1,3}}{\text{Overall expenditure (A+B+C+D+E)}}$$

Qualifying expenditure is, as a general rule, defined as consisting of the following expenses:

- expenses made by the taxpayer (A);
- expenses made by the taxpayer in the context of outsourcing to an unrelated party (B); and
- expenses made by the taxpayer in the context of outsourcing to a related party, as far as that related person outsources the R&D and invoices, without mark-up, his outsourcing cost to the taxpayer (C).

Qualifying expenditure must directly relate to a qualifying IP right, and does not include (e.g.) interest payments and costs related to real property.

Overall expenditure, as a rule, comprises the same expenses as qualifying expenditure, with the addition of:

- expenses made by the taxpayer for acquiring the qualifying IP right (D); this expense is therefore not included in item A mentioned above;
- expenses made by the taxpayer in the context of outsourcing to a related party (E), with the exception of expenses listed under item C.

Within the “modified nexus fraction” framework, qualifying and overall expenditure are in principle calculated on a cumulative basis. Qualifying expenditure may be raised by 30%, but the amount of overall expenditure constitutes the maximum.

Subject to certain conditions, taxpayers can request permission from the Ruling Commission to deviate from the modified nexus fraction.

IID rate

The resulting amount after calculating net income and applying the "modified nexus fraction" would be eligible for a 85% deduction (compared to 80% under the old PID regime and 95% under the previous version of the pre-draft IID legislation).

Entry into force

Based on the current draft version of the legislation, the new IID regime will apply (retroactively) from 1 July 2016.

Taxpayers that are eligible to continue applying the PID regime until 30 June 2021, under the grandfathering rule, would need to choose irrevocably between claiming the PID or IID regime (for the period running until 30 June 2021). Hence, taxpayers that have opted to apply the PID regime under the grandfathering rule would not be able to "switch back" to the IID regime, and vice versa.

Tax authorities will require documentation to verify the taxpayers' correct application of the IID. A royal decree is expected to provide terms, conditions and deadlines to be met. A specific form will also be foreseen for the tax return.

Next steps

The expectation is that the new regime will still be adopted before year-end.

In view of the upcoming IID legislation, companies may have to rethink their organisation, processes, intellectual property strategy and implementation to take advantage of the IID regime.

Are you ready for the IID?

Contacts

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