Belgium Abolishes Patent Box, Introduces Innovation Box

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Apart from the correction of a piece of legislation introduced at the end of last year (following *Tate & Lyle*, prior coverage), Belgium's recently published Act of August 3, 2016, deals mainly with the abolition of the patent box, which provides an 80 percent deduction of patent income related to the development or enhancement of patents.

Tate & Lyle Adapted

The Act of December 18, 2015, implemented the judgment of the Court of Justice of the European Union in *Tate & Lyle Investments* (C-384/11) by introducing a new withholding tax rate equal to 5 percent of the current company income tax rate (that is, 5 percent of 33.99 percent, or 1.6995 percent) on dividends paid to qualifying parent companies that hold a participation of less than 10 percent. Those companies were not entitled to the tax exemption under the EU parent-subsidiary directive and, unlike Belgian companies, they were not entitled to a refund of withholding tax. (Prior coverage .)
The reduced withholding tax rate is subject to the following conditions:

- the parent company must be established in the European Economic Area or in a country with which Belgium has concluded an income tax treaty with an exchange of information provision;
- the parent company must have the legal form of one of the companies listed in the EU parent-subsidiary directive (see Annex I, part A, of Council Directive 2011/96/EU of November 30, 2011); if the parent company is established in a treaty country, it must have a comparable legal form to one of the companies there;
- when the dividend is granted or is made payable, the parent company must have full ownership of a participation of under 10 percent but with an acquisition value of at least €2.5 million; and
- the parent company must hold the participation for an uninterrupted period of one year.

What was forgotten is the condition that the parent company had to be subject to company income tax or a similar income tax that does not deviate from the common regime.

Patent Income Deduction

The Current System

A Belgian company or permanent establishment can deduct 80 percent of qualifying patent income if it is involved in the development or improvement of patents in an in-house research and development center. This R&D center must be a division of an entity that can operate autonomously. It must have sufficient substance to perform and supervise R&D activities, but it may use subcontractors in its development of the patents or extended patent certificates. The R&D center can be located outside Belgium as long as it is owned by a Belgian legal entity; however, this condition applies only to large enterprises.

The company must either be the owner, be the licensee, or have the usufruct of the patents or extended patent certificates as a result of its own patent development activities in its R&D center in Belgium or abroad. Small and medium-size enterprises can also benefit from the patent income deduction even if the patents are not developed or improved within an R&D center that forms a branch of activity. The deduction can also be claimed for patents or extended patent certificates that the company has acquired from a related or unrelated party, in full ownership, joint ownership, usufruct, or via licensing agreement, provided that the company has improved the patented products or processes in the company's R&D center.

The deduction is calculated at 80 percent of the relevant (gross) patent income for patents licensed by the Belgian company or a PE to any party, related or not, to the extent that the income does not exceed an arm's-length price. Consequently, only 20 percent of gross patent income will be taxable at the normal CIT rate (33.99 percent), which means that the effective tax rate is 6.8 percent.

A recently introduced draft bill on urgent tax measures aims to, among other things, abolish the Belgian patent income deduction regime with effect from July 1, 2016.

Action 5 of the BEPS Action Plan

In conjunction with its base erosion and profit-shifting program, the OECD investigated Belgium's patent income deduction together with similar intellectual property box regimes in 15 other OECD jurisdictions. The conclusion of the OECD's final report on BEPS action 5 (countering harmful tax practices) was that these regimes constitute harmful tax practices and must be adapted.

The Act of August 3, 2016, abolishes the Belgian Income Tax Code articles 2051 to 2054, which relate to the patent income deduction, with effect from July 1, 2016. However, at the same time, it introduces an optional transitional regime that allows Belgian companies and Belgian PEs to continue to apply the patent income deduction until June 30, 2021, with regard to patent income received until that date for patents applied for before July 1, 2016, or for patents and licensing rights acquired until June 30, 2016.

Patents obtained after June 30, 2016, or improved patents that were acquired after that date are ineligible for the patent income deduction.

Further, patents acquired from an associated company after January 1, 2016, are excluded from this transitional regime unless they qualified for the patent income deduction or a similar intellectual property regime in another jurisdiction.

Deduction for Innovation Income

The government also intends to institute a new tax incentive for innovation income, effective July 1, 2016, that would comply with BEPS action 5 and the modified nexus approach introduced by the OECD.
This means that a company that is entitled to the deduction for innovation income must have sufficient substance with regard to R&D activities to create qualifying intellectual property rights. Moreover, the deduction would apply only to the net amount of qualifying intellectual property income. That means a Belgian company would have to monitor expenses, patents, and patent income.

There are no texts available yet, but it is intended that the scope of the innovation box would be broader than that of the patent box, which was limited to patents. The new box would include other intellectual property rights (for example, copyrights for software, plant breeders' rights, etc). The rate of the deduction may also be raised from 80 percent to 90 or 100 percent.

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