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EXPERTBRIEFING December 2018

The Netherlands' preferential IP regime for software companies

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The Netherlands government is promoting engagement in research and development (R&D) activities through a preferential corporate income tax regime, as well as specific R&D tax incentives granted to employers with regard to salaries paid to employees who perform qualifying R&D activities and related capital expenditures.

Following international scrutiny, most preferential intellectual property (IP) regimes have been amended in line with base erosion and profit shifting (BEPS) Action 5. The new Dutch innovation box also follows the internationally approved standards under BEPS Action 5.

Briefly, the new rules require companies that apply the new innovation box to have performed substantial R&D activities, and that eligible R&D profits are related to patents or other IP rights that are capable of being registered and to which the profit allocation is sufficiently documented. Moreover, the extended application of the Netherlands innovation box has been welcomed by most Netherlands companies that typically have to rely on R&D declarations, but may now also rely on copyrights to support their innovation box position.

Software companies

Interestingly, the new rules may, however, provide benefits to software companies. The definition of qualifying intangible assets includes software programmes that are capable of being protected via copyright legislation. This provision confirms that copyrighted software shares the fundamental characteristics of patents, since such software is novel, non-obvious and useful and it is unlikely that core software developments will be outsourced to unrelated parties.

The Netherlands has used the term 'programmatuur' to define software in the revised legislation. At first glance, and based on the wording, this definition seems to limit the software definition. This is, however, somewhat unclear. Nevertheless, this is an important remark taking into consideration the fact that this term is mentioned in the R&D wage tax credit (which also functions as a starting point for the innovation box) that is granted by the Ministry of Economic Affairs. We expect that we will see some discussion

with the Dutch tax authorities, which may want to limit the definition of software.

In respect of R&D profit calculation, the revised Netherlands innovation box regime provides that qualifying income is determined per qualifying intangible asset or per coherent group of qualifying intangible assets (tracking-and-tracing). In the case of software companies, we typically identify templates or particular groups of programmes.

If it is not possible to apply the tracking-and-tracing method, the method for determining the qualifying income will be established by taking into account the nature of the business enterprise and the R&D activities of the taxpayer. Observing the difference with the main methods used under the current innovation box regime to determine qualifying income – which commonly uses the residual profit split method – we expect an increase in the administrative burden for software companies, as well as the Netherlands tax authorities.

Relocation in accordance with ATAD1

As mentioned above, most preferential IP regimes have been amended in line with BEPS Action 5, in particular by implementing the 'nexus approach'. Under the 'nexus approach' a taxpayer that utilises the IP regime is obliged to ensure that, in order for a significant proportion of IP income to qualify for benefits, a significant proportion of the actual R&D activities must have been undertaken by the qualifying taxpayer itself.

We observe that a number of (software) companies that utilise an IP regime do not comply with the aforementioned requirement of the nexus approach and, therefore, are at risk of being rejected to utilise a preferential IP regime. For such companies it could be feasible to relocate IP assets to the country with sufficient 'nexus' in terms of developing IT personnel. The Netherlands could be an attractive alternative because of its relatively accessible IP regime. Relocation of (IP) assets and activities, however, would normally trigger exit charges on realised and unrealised profits (hidden reserves and goodwill), especially with the new EU exit taxation rules as part of the first Anti-Tax Avoidance Directive (ATAD 1).

ATAD1 contains five legally-binding anti-abuse measures, which all EU Member States should apply against common forms of aggressive tax planning. One of the measures the directive contains is new exit taxation rules to provide for a payment of tax in instalments over five years. Many countries, for instance Luxembourg and the Netherlands, were providing for deferral of exit taxation for 10 years, provided certain requirements were met.

EU Member States are obliged to implement these new exit taxation provisions for tax years starting after 1 January 2020. For (software) companies considering relocation of (IP) assets and activities, it could therefore be worthwhile to consider any relocation of R&D assets and activities before this date as in most Member States (such as Luxembourg) deferrals granted for periods ending before 1 January 2020 may ultimately not lead to effective exit taxation. Following year-end 2019 ATAD1 will apply which should result in exit taxation in, for instance, Luxembourg.

In terms of the Netherlands, upon migration a step-up in basis is granted for IP, which could be depreciated. In addition, any R&D activities that result in new IP assets and newly attributable income should provisionally lead to the application of the Netherlands innovation box whereby an effective tax rate of 7 percent is imposed on income generated by qualifying intangibles. ■