This insight aims at providing a general overview of the implementation of action 5 of BEPS (Base Erosion and Profit Shifting) in order to counter harmful practices that arise through national R&D tax incentives, and notably how the Modified Nexus Approach ("MNA") is impacting the European "IP Box" favourable tax regimes.

In a nutshell, the BEPS measures aim at preventing tax evasion internationally, notably by shifting profit from one jurisdiction to another, taking advantage of the effective tax rate differences and sometimes using companies which lack substance. The Actions set out by BEPS are progressively entering into effect within the OECD countries, including the aforementioned Action 5 which targets specifically the so-called IP Box structures, i.e. IP Holding companies deriving royalties from license and sales of IP assets and which are subject to specific, low tax rates. One way to align where the R&D is performed with where the IP Box benefits are claimed, and thus to avoid abusive or unsubstantiated transfer of IP profit, is by using the so-called "MNA" concept.

The focus of this insight will be on EU countries, notably the Netherlands, Belgium, the UK and Ireland.

The MNA is not yet introduced in France, where informal discussions have taken place with respect to possible amendment to the current French IP Box system. The existing regime may evolve but there are no details available at this time.

In Luxembourg, the previous IP box regime was cancelled on 1 July 2016, and a draft including the MNA is expected to be presented soon.

The modified nexus approach conditions

According to the OECD: “the very conceptual basis of the Modified Nexus Approach is intended 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”.

Accordingly, a ratio must be applied on the IP income:

- The qualifying expenditure includes: R&D expenditure incurred by the taxpayer itself and subcontracting expenses to unrelated parties;
- Overall expenditure includes: the qualifying expenditure, acquisition costs and subcontracting expenses to related parties.

The MNA approach intends to reallocate the R&D tax benefit where R&D activity is undertaken. However, the definition of eligible expense remains to be decided by the countries involved. Under this approach, the R&D Tax Credit analysis and the IP Box analysis become tightly linked, and the need to provide evidence to IP companies via transfer pricing analyses is even more important.
An uplift of the qualifying expenses is allowed. It may only be granted to the extent that expenditure in the context of outsourcing and acquisitions has actually taken place, and it is in any case limited to a certain percentage (30%) of the qualifying expenses of the respective company.

The OECD provided the following examples:

**Example (1):**
- Parent company incurred qualified expenses of **100**
- Parent company incurred costs for acquisition of IP assets of **10**
- Subsidiary company incurred R&D expenses of **40**
- Maximum uplift amount = 100 x 30% = 30

Overall qualifying expenses including a limited percentage of outsourcing and acquisition costs = **130**

**Example (2):**
- Parent company incurred qualified expenses of **100**
- Parent company incurred costs for acquisition of IP assets of **5**
- Subsidiary company incurred R&D expenses of **20**
- Maximum uplift amount = 100 x 30% = 30

Overall qualifying expenses including a limited percentage of outsourcing and acquisition costs = **125**

**The uplift expenditure is the lower of:**
1. 30% of the qualifying expenditure; or
2. the aggregate of the acquisition costs and group outsourcing costs.

**Other things to consider include:**

**Timing:** New entrants cannot use the existing regime / new regimes consistent with the modified nexus approach, which takes effect no later than 30 June 2016.

**Grandfathering:** In order to give protection for taxpayers benefiting from existing regimes, countries are allowed to introduce grandfathering rules. The abolition date should not exceed five years (no later than 30 June 2021).

**Reporting:** An approach to the tracking and tracing of R&D expenditure, that is practical for tax authorities and companies to implement, needs to be developed in order to implement the Modified Nexus Approach.

I. Implementation in the Netherlands

The MNA ratio must be applied on the qualifying income.

The qualifying assets, in addition to having obtained R&D wage tax certificates, must have one of the following:

- Patents or plant breeders' rights;
- Intangible assets in respect of which a patent or plant breeders' right is applied for;
- Software program(s);
- Intangible assets for which EU marketing authorizations for medicinal products were granted;
- Intangible assets in respect of which a supplementary protection certificate was granted by the competent Dutch government agency; or
- Intangible assets in respect of which a registered utility model for the protection of innovation was granted.

The uplift of 30% can be applied under the following conditions:

**Timing:** Yes. The old regime applies until 30 June 2016;

**Grandfathering:** Yes. Grandfathering rule applies until 1 July 2021;

**Reporting:** Tracking and tracing process is implemented.

II. Implementation in Belgium

The MNA ratio must be applied on the qualifying income.
Compared to the PID (old regime), the scope of the regime is enlarged to include the following categories of intellectual property:

**The Uplift of 30 % can be applied under the following conditions:**

**Timing:** Yes. The old regime applies until 30 January 2016, but the new one came into force on 1 July 2016;

**Grandfathering:** Yes. Grandfathering rule applies until 1 July 2021 and a combined use of both regimes is possible;

**Reporting:** Tracking and tracing process is implemented.

### III. Implementation in the United Kingdom

The MNA ratio must be applied on the qualifying income.

The qualifying expenditure depends on:

**The Uplift of 30 % can be applied on the following conditions:**

**Timing:** Yes. The old regime applies until 30 June 2016;

**Grandfathering:** Yes. Grandfathering rules apply until 1 July 2021;

**Reporting:** Each profit stream from each patent must generally be calculated separately, to meet transparency requirements.

### IV. Implementation in Ireland

The MNA ratio must be applied on the qualifying income:

**Qualifying assets**

Small and Medium Enterprises (SMEs) benefit from an expansion of the definition of Intellectual Property (IP) to include inventions that are certified by the Controller of Patents, Designs and Trademarks as being novel, non-obvious and useful.

**The Uplift of 30 % can be applied if:**

**Timing:** The relief is available to companies for accounting periods beginning on or after 1 January 2016 and before 31 December 2020;

**Grandfathering:** None (no previous IP Box regime);

**Reporting:**

The company must also show how such expenditures and income are linked to the qualifying asset.

How we can help:

1. Patents and supplementary protection certificates;
2. Copyrighted software resulting from the taxpayer’s recognised research or development projects;
3. Breeders’ rights acquired after 30 June 2016 or for which the application is filed on or after 1 July 2016;
4. Governmental data or market exclusivity regarding crop protection, medicines for humans and animals and orphan drugs; and
5. Orphan drugs registered with the European Medicines Agency and acquired after 30 June 2016 or for which the application is filed on or after 1 July 2016.
   - Basic staffing costs, such as salaries, wages, Employers Class 1 NICs and payments to pension funds;
   - Payments made to qualifying entities such as universities or independent R&D establishments;
   - Materials and equipment used in the R&D process which do not necessarily form part of the patented product/process; and
   - Subcontracted R&D payments, which can be claimed, usually for 65% of the cost.
   - Copyrighted software;
   - Certain patented inventions;
   - Plant breeders’ rights;
   - Protection certificates for medicinal products and plant protection certificates.
A company must have records available which track:
- Overall income from the qualifying asset;
- Qualifying expenditure on qualifying assets; and
- Overall expenditure on the qualifying asset.

Our tax team can assist you in reviewing, structuring and possibly amending your current R&D and licensing operations to test and meet the MNA approach;

Using our worldwide and renowned IP team, we can assess the patentability of your IP assets, including software, to determine an IP Box perimeter; we can also assist any legal restructuring required to carve out and relocate these IP assets;

We have strong credentials in both IP Box and transfer pricing areas, notably within the EU zone;

We have a team of transfer pricing and economics specialists who can assist in defining the arm’s length royalty rates and/or IP valuation;

We have best friend firms for any engineering / technical documentation matters in relation with these projects (patentability / scope of the R&D Tax credit etc…).