

Holding Companies in Luxembourg

How Luxembourg treats Licensing Holding companies; they enjoy tax advantages, but are regulated

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Luxembourg holding companies are to be defined as corporate entities the object of which is limited to holding equity interests in, and securities of, other corporate entities. The corporate structure of a holding company is the same as that of other commercial companies except that holding status can only be granted to companies with limited liability. The relevant difference between holding companies and commercial companies is the special tax treatment as set forth by the law of July 31, 1929.

The main purpose of that law had been to create companies sponsoring and controlling industrial activities of their subsidiaries. As the activity of holding companies should consist in the control of and the assistance to subsidiaries, their object is limited by law to the holding of "participations". "Participations" normally means equity interest in the form of shares of other limited companies, but this concept has been enlarged by interpretation so as to include various forms and possibilities of holding interests in other companies, such as the holding of bonds, notes, patents or trademarks. The activity being limited as aforesaid, the holding company cannot carry out any industrial or commercial activity.

As on the one hand holding companies have considerable tax advantages, there is on the other hand a need for rules and regulations to restrict the possibilities of abuse. As stated above, the holding company is not entitled to exercise any activity which goes beyond the limits set by law. In fact a certain number of other limits have been set forth by administrative practice. Thus a holding company is not entitled to have more real property than strictly necessary for the carrying out of its own business; it can only have equity interests in other limited companies and is not allowed to hold interest in partnerships.

Additional Rules

Additional rules have been generated by administrative practice with respect to the limits of indebtedness of holding companies, as well as to their right of granting loans to other companies. With respect to the latter possibility, it has been restricted so that a holding company can extend loans or guarantees only to its subsidiaries. When a com-

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pany is to be considered as a subsidiary, is a matter of appraisal in each case. As a rule, a subsidiary means a company in which the holding company holds a substantial interest, i.e., generally, an interest of around 25 percent. However, other criteria may be taken into consideration, such as the respective sizes of the holding company and the beneficiary of the loan.

As to the possibility of receiving loans, criteria of

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capital-loan ratio have been set forth by administrative practice: a holding company is entitled to receive ordinary loans, i.e. without issuing any bonds or notes, from shareholders or banks, only to the extent of three times its subscribed capital. In addition it may launch loans by way of bond issues in a total amount of 10 times the paid in capital. With respect to this latter rule, reference is made to the provision of corporate law which allows a company to have paid-in capital of only 20 percent of the subscribed capital.

TAXATION OF HOLDING COMPANIES

1. The interest of Luxembourg holding companies lies in the fact that such companies are not subject to taxation of income or capital gains. The fundamental idea was to treat holding companies so as to avoid double taxation which would necessarily arise from their being subject to general tax, while the income deriving from subsidiaries would have been taxed previously in whole or in part.

However, not being considered as taxpayers, holding companies are excluded from the benefit of all the double taxation avoidance treaties which Luxembourg has concluded with other countries. Therefore, withholding tax at full rate is levied by such other countries on the income which the holding company receives by way of dividends, interest or royalties.

2. The taxes incurred by the holding company itself are the following:

A capital duty (*droit d'apport*) is payable at incorporation and at increase of capital. Such capital duty is levied at a rate of 1 percent on the value of the assets contributed to the company at incorporation or increase of capital. This tax, which had been initially at the rate of 32 percent now corresponds to the normal capital duty as introduced in the EEC.

An annual tax, (*taxe d'abonnement*) or subscription tax is due at a rate of 16 percent per annum on the value of the securities issued by the company. The value of such securities is calculated by reference to the average value of the securities during the preceding calendar year; such average value is calculated according to stock exchange quotations; if the securities are not quoted on a stock ex-

change, the calculation should, at least theoretically, be based on the balance sheet or the amount of realized profits during the 10 preceding years, or the value of the net assets.

In practice for most of the holding companies the basis for the valuation of the shares is the paid-in capital. If capital does not correspond to shareholders' equity, for instance if issue premiums have been allocated to extraordinary reserves, the whole of the shareholders' equity has to be considered for the purpose of the valuation.

In order to provide for a correct valuation of the shares, the authorities make reference to the distribution of dividends when it appears that the dividends distributed are not in an acceptable relation with the amount of the capital. As a rule, if the annual amount of dividends exceeds 10 percent of the corporate capital, the administration does not accept the figure of the capital as a basis for the valuation of the shares, and multiplies by 10 the figure of the dividends distributed.

As mentioned above, the basis of taxation is constituted by the value of the securities issued by the company: the word securities includes shares, bonds, notes and other types of securities issued by the company. Therefore, if a loan is made by the company by way of a bond issue, the value of such bonds has to be included as well. The value of bonds is determined either by their nominal amount, or if the bonds are listed, by the average quotation on the stock exchange during the preceding calendar year.

3. Dividends paid by a holding company are free of any withholding tax, and the same rules apply to interest paid on bonds issued.

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PARTICULAR ASPECTS OF PATENT HOLDING COMPANIES

Holding of patents

Although the law of 31st July 1929 on holding companies does not make any special provision for the possibility of holding patents and for receiving royalties, such possibility has been recognized very generally since the origins of the law. Indeed, the preparatory documents which led to the law of July 31, 1929 specifically assimilate patents to the broad concept of *valeurs mobilières*, which, in this connection, implies any movable assets embodied in a transferable title. On the ground of the opinion so expressed during the development process of the law of 1929, the Administration de l'Enregistrement, in its interpretation work, has constantly admitted that a holding company can hold patents and that such holding of patents and granting licenses thereon is assimilated to taking a "participation" in the companies to which licenses are granted.

Obviously, a holding company can acquire such patents by purchasing a finished patent; however, it is also authorized to purchase the right of depositing the patent, provided such purchase is indeed made with the intention of depositing the patent and not simply with the intention to resell the right to the patent. Needless to say that in the process of acquisition of patents, the holding company must obey to the various laws governing the rights to patents and patents themselves.

It should be understood that the "patent holding com-

pany" is not a special or specialized type of holding company: thus, a holding company, the main purpose of which is to hold securities can, in addition, hold one or more patents and inversely, a holding company which is essentially meant for the holding of patents, may also hold a portfolio of securities or equity interests.

Obviously, the general rules on holding companies, as described above, apply to patent holding companies as well: thus, it is essential for those companies not in any way to be involved in a commercial or industrial activity. Accordingly, the acquisition of patents should essentially be made for the purpose of holding such patents and for granting licenses, and not for the purpose of trading actively and making a market in such patents.

In a similar field, the question has come up whether a holding company, for the purpose of developing its patents, can itself organize and run technical facilities. To the extent that these technical facilities are justified within the legitimate scope of the patent holding company's activity and are in no way made available, or serve the purpose of, outside customers, the question can be answered affirmatively.

Licenses by a patent holding company

There is no doubt that a patent holding company can legitimately grant licenses on such patents and receive royalties thereon, this, indeed, being its basic purpose.

Questions come up, however, as to the scope of the beneficiaries of such licenses.

To the extent that, during the preparatory period of the law of 31st July 1929, the patent itself was assimilated to a *valeur mobilière* in the broad sense defined above, it was logical for the administrative practice, to assimilate the licenses granted by the holding company on the basis of such a patent, to a "participation" in the company which is granted the license.

This involves two consequences:

The patent holding company may give financial assistance to its licensees, much in the same way as a general holding company may make loans to its subsidiaries. Obviously, the same limitations apply: thus, there must be a reasonable relation between the license and the loan so that it can be said that the loan is justified by the interest which the patent holding company has in the company to which it grants the license. Whereas, in an ordinary company, this interest lies in the good prospects of development of the subsidiary and the increased possibility of drawing dividends and liquidation proceeds from it, the interest here lies in the fact that the financial assistance may increase the value of the patent and the prospects for collecting royalties.

As the license is itself assimilated to a "participation", it is not necessary that a holding company has otherwise an equity interest in the licensee company. In other words, patent holding companies can grant licenses not only to their subsidiaries or companies affiliated with their group, but to any company.

A holding company is not permitted to be itself a licensee even if the purpose of obtaining such a license is to sublicense to others. The reason for this constant administrative practice is to be found on one hand in the idea that a license is by itself the right to commercially and in-

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tiveness of such work in certain fields.

Maximum Profitability

It is nonetheless essential to have these studies made since they provide a picture of the characteristic features of competitive R and D, showing the directions that are taken and those that are abandoned and also, in the light of the geographic coverage of the patents applied for, the economic importance attached to these R and D directions.

If collected at a sufficiently early date and carefully analyzed and synthesized, information of this kind has considerable value in view of its direct or indirect implications for the firm's own R and D program in which the projects to be chosen and, as mentioned above, the avenues to be explored or abandoned will be decided with this information in mind.

Such a policy seems to us essential if maximum profitability is to be obtained from the capital invested in R and D, since it will prevent the exploration of blind alleys and the investigation of problems whose solutions have already been found. It will save the company from being outdistanced and help it to steer its R and D program so as to ward off the danger that competitive R and D results might present, or else to come to agreement with the competition in order to ensure profitability from results already required.

Once the market research has been done and therefore the potential markets clearly defined, it is clear from the outset that the choice among these three alternatives is predetermined by the firm's size; in other words, the extent to which it is represented in other countries in terms of production units or marketing networks.

A highly pragmatic attitude is essential in taking this decision based upon a strictly objective analysis of the direct or indirect implications of each option.

Forward-looking comparative figures must be calculated extremely carefully taking into account not only the expenditures which are necessary in each case and the expected return on investment but also the various forecast increments in the firm's short-, medium-, and long-term cash flow.

It is also obvious that not only competitive but also political situations in relation to each of the possible alternatives must be taken into account, since it is clear that they will often affect and even, in many cases, eliminate certain options.

The possibilities in countries with a liberal and capitalist economy, for example, are not all the same as those in the socialist economies. They are also dependent on the level of economic and technical development in the country concerned, their range often being very different in countries with a high technical and economic potential as compared with the developing countries.

To conclude, this question needs to be tackled with imagination, bearing in mind that brain is one of Europe's most valuable raw materials that is often inadequately exploited and turned to too little account.

When Should Innovation Be Licensed?

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therefore embraces a wide scope. Innovation does not simply refer to invention, patent and know-how, but includes all kinds of new technical information that may become available in the course of R&D. This information may be the object of licensing.

"When can a new technology be licensed profitably?"

A study should be made to determine the best time for licensing by considering the content of the new technology, the licensing policy of the party who owns the technology, and his capability to package the technology for licensing. The licensing formula must be organized so that it is of practical use to the licensee.

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industrially use the patent, which obviously is not permitted to a holding company, even through sublicensees, and on the other hand the fact that, according to the traditional interpretation of the law on this matter, a patent is only acceptable as an investment of a holding company for the reason that it constitutes a *valeur mobilière* in the broad sense, i.e. a right embodied in a transferable title.

In the practical field, this may lead to the question whether instead of granting a license, the parties may use other legal forms of temporary or conditional transfer, for example whether it is permitted for the holding company to purchase the patent itself from another company under the proviso that the holding company has an option to resell the patent to the vendor after a given time and under the further proviso that such other company has the option to repurchase the patent from the holding company after expiration of that same time. If any one of the options is exercised, this will have resulted, from a purely economic point of view, in temporary transfer of the patent to the holding company and this may achieve the purposes which the parties would have otherwise tried to achieve through a license obtained by the holding company, depending on the way the repurchase price is set up. It would seem that such a construction is acceptable as long as the retransfer is not automatic but depends on the actual exercise of the option by at least one of the two parties.

Trademarks

Traditionally, and on the basis of the spirit of the law and of its preparatory documents, the administration admits the holding of trademarks by holding companies, subject however to the condition that the relevant trademark, under its original legislation, can be validly transferred without the business of the vendor being transferred at the same time. It should be recalled that a certain number of legislations, including Luxembourg law

prior to the Benelux uniform law, prohibit transfers of trademarks if such transfer is not done together with the business of which it forms part. Obviously, as a holding company is not authorized to own a business organization, it cannot own such trademarks as can be held only within a *fonds de commerce*.

Even if this condition is fulfilled, the administrative practice does not completely assimilate trademarks to patents. Specifically, rulings of the Administration de l'Enregistrement have set forth that licenses on trademarks can only be granted to subsidiaries of the holding company or at least companies which form part of the general group of companies to which the holding company belongs, and for all of which the relevant trademark is a valid commercial sign.

In other words, by comparison to the solutions prevailing on patents, a trademark is not completely assimilated to a *valeur mobilière* in the broad sense defined above. However, as the license of a patent is itself considered as a "participation", there would be no objection to grant a license on the trademark held by the holding company to any company to which a license of a patent, held by the same company, is also granted.

Although these solutions appear as somewhat complex, the difference between the treatment of patents and the treatment of holding companies can easily be justified by the different nature of these rights the patent being a title confirming the right to a new creation whereas the trademark is only a distinctive sign for the purpose of attracting and conserving clients to a product. In other words the attitude of the administration which treats the trademark to a lesser degree as a "participation" is justified by the fact that the patent is indeed by its nature a more complete type of industrial property.

Other forms of industrial property

On the ground of the interpretations referred to above, the Administration de l'Enregistrement has repeatedly, in its rulings, rejected the possibility for holding companies to hold any types of industrial rights other than patents or trademarks. Specifically, all attempts to include in the portfolio of a holding company industrial know-how, design rights, offership rights, exclusive sales rights, etc. have been rejected.

The Licensing Package

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plant construction and production start-up. If the plant has a certain size it will be essential to obtain a net plan from the planning department in order to keep up with all the problems.

Economics of a Licensing Operation

All the above-mentioned requirements for successful negotiation and licensing are only a sort of checklist which must be adapted to each case. One of the main purposes of the exercise we went through is to show that licensing is not cheap. Most licensors simply consider licensing income to be net additional return without considering the cost of the operation. And we have to understand: there is no licensing without cost except in very rare cases where

licensing is just a means to avoid patent litigation. It is therefore recommended to closely watch this side of the job. In one of my last seminars on licensing we have tried to calculate the cost of the preparation of the full licensing documentation and of the training for a high quality machine tool and we ended up with at least Sfr. 100,000! Beforehand one of the groups had proposed more or less offhand to collect a down payment of Sfr. 50,000—and a 5 percent royalty. This would have meant the loss of at least the royalty of the first production year just for failure to calculate the real cost of the transfer of know-how.

It was also amazing to hear from large-size companies who used to license quite a lot and who did not even have a separate licensing account on the cost side. It is so nice to show a high royalty income in a balance sheet: the cost thereof is simply hidden in the general overheads!

CONCLUSION:

As a conclusion I would say:

1. Licensing can only be successful if it is properly prepared as well for the negotiation stage as for later stages.
2. Licensing should always be backed by a proper system of documentation adapted to the transfer of technology to third parties. Otherwise it will be a failure which may have heavy commercial and legal consequences. Such documentation should be kept up-to-date at regular intervals.
3. Licensing can and should of course be a source of additional income. However successful licensing is linked to high cost already at the negotiation stage, but in particular at the stage of transfer of know-how. The cost is no doubt justified at the negotiation stage because it ensures a much higher return: a well prepared licensing documentation is attractive for the future licensee. The cost of the transfer of know-how stage which is much higher should be taken into consideration when fixing the licensing conditions. Such cost should be covered by the down payment at the signature of the agreement.
4. Licensing based on industrial property rights is easier and safer than know-how licensing. The possibility of filing patents and designs should therefore be carefully considered.

Case History: Licensing to China

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from their licensees which, in turn, are distributed free to all other licensees. Despite the fact that the Chinese would benefit very substantially because of the technical sophistication of our other licensees, they could not on political grounds agree to commit the Chinese Government to transmit improvements outside of China.

Somehow the Chinese found that I was at the time the immediate Past-President of LES and requested that I give some lectures in my spare time to less experienced members of their staff. Naturally, I accepted this invitation and one of the questions we discussed during the seminar related to the Chinese attitude with respect to improvements. I was able to confirm that their view on this was essentially ideological. They did not want to be obli-