# The Inward Investment and International Taxation Review

Twelfth Edition

**Editor**
Tim Sanders

The LawReviews

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# PREFACE

In January 2021, the 11th edition identified and described two material global tax trends that emerged in 2020: the response of economies to the covid-19 pandemic and the taxation of the digital economy. These two trends evolved through 2021 and can be expected to occupy centre stage in 2022 and beyond.

In 2020 and 2021, governments sought to bolster economies hit by the pandemic through a series of measures ranging from furlough schemes, postponing tax deadlines and deferring tax payments to relaxing residence rules. In 2021 and into 2022, governments will face the difficult balancing act of continuing to support their economies and encourage growth on the one hand, while needing to raise money from damaged economies to pay for such support and reduce the size of large deficits on the other, without such tax raising stifling any recovery. Precisely how each jurisdiction will deal with this balance remains uncertain and is a key area to observe in 2022. At this stage it appears that, while we may see some limited tax rises, more rigorous tax enforcement is likely to play a material role.

On 1 July 2021, a statement was made by the G20 Finance Ministers that on 8 October 2021 resulted in the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS 2) that contains details of how Pillars 1 and 2, which seek to address the issues raised by the digital economy, will be applied in practice. Pillar 1 deals with the reallocation of certain profits from very large multinational enterprises to market jurisdictions, while Pillar 2 deals with a global minimum tax. Among significant points to note is that under Pillar 1 it is intended that a new multilateral convention will be drafted and available for signature in 2022 that will remove unilateral digital services taxes and similar measures. Some jurisdictions that have applied a unilateral solution, notably the United Kingdom, Austria, France, Italy and Spain, have committed to transition from existing digital services taxes to the new multilateral approach solution. Under Pillar 2, the minimum tax rate is set at 15 per cent rather than the previously proposed rate of 'at least 15 per cent'. This has already had an impact, with Ireland announcing an increase in its minimum corporate rate to 15 per cent. While a remarkable amount of progress has been made in a short time, there are still important technical issues to be addressed quickly if the timetable, which proposes implementation in 2023, is to be adhered to. However, there is sufficient detail in the proposals for businesses likely to be affected to consider starting the process of reviewing their internal procedures and processes to ensure they can be compliant.

It is hoped that this volume will prove to be a useful guide to the tax rules in the jurisdictions where clients conduct their businesses. Each chapter aims to provide topical and current insights from leading experts on the tax issues and opportunities in their respective jurisdictions. While specific tax advice is always essential, it is also necessary to have a broad understanding of the nature of the potential issues and advantages.

The views expressed in this book are those of the authors and not of their firms, the editor or the publishers. Every endeavour has been made to ensure that what you read is the latest intelligence.

**Tim Sanders**
London
January 2022

**Chapter 17**

# LUXEMBOURG

*Pieter Stalman and Delphine Martel*[1]

## I INTRODUCTION

Situated in the heart of Europe, Luxembourg has built its position as a major European financial centre on its political stability, good communication with the market, and its actors and powerful service sector. This as well as Luxembourg's limited dimensions have allowed it to maintain a certain degree of flexibility in its legal system and to cope easily with an ever-increasing volume of inward investments.

## II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

There are several forms of entity with separate legal personality through which business can be carried out in Luxembourg:

*a* corporate entities:
- public limited company (SA);
- private limited company (SARL); and
- public company with both limited and unlimited liability shareholders (SCA); and

*b* non-corporate entities:
- general partnership (SNC);
- limited partnership (SCS); and
- special limited partnership (SLP).

The above-mentioned corporate entities (listed under (a)) are fully subject to corporate income tax, municipal business tax and net wealth tax, and can therefore be considered as opaque for Luxembourg tax purposes.

The SARL is the most frequently used corporate form owing to the favourable combination of its limited liability, the flexibility of its by-laws and corporate legal rules, and the limited minimum capitalisation requirements (i.e., €12,000 or its foreign currency equivalent).

Although the above-mentioned partnerships (listed under (b)) have legal personality (with the exception of the SLP), from a Luxembourg corporate income tax perspective they are not separate from their partners and are therefore transparent. The partnership is considered

1 Pieter Stalman is a partner and Delphine Martel is an associate at Loyens & Loeff. The authors wish to thank Olivier Coulon and Bastien Nowobilski , associates at Loyens & Loeff, for their contribution to this chapter.

as a mere collection of the partners' individual businesses for corporate income tax purposes: even though the taxable commercial income is determined at the level of the partnership, it is attributed and taxed *pro quota* directly at the level of the partners. Municipal business tax is instead levied directly from the partnerships that carry on a commercial activity or that are deemed to do so by virtue of the commercial nature of the majority of their partners (SNC) or of some partners holding a minimum interest in the partnerships (SCS and SLP). An SNC is deemed to carry on a commercial activity when the majority of its interests are held by a capital company, whereas an SCS or SLP is deemed to carry on a commercial activity when its general partner is a company whose capital is divided into shares holding at least a 5 per cent interest in the SCS or SLP. For the purpose of determining the nature of the activity carried out by a partnership whose interests are (fully or partially) held by another partnership, the latter is considered as a capital company when it carries out a commercial activity or is deemed to do so.

The SCS and the SLP are particularly suitable for the structuring of unregulated funds and frequently used in such context.

## III DIRECT TAXATION OF BUSINESSES

### i Tax on profits

Business income is subject to corporate income tax and to municipal business tax. Because the taxable basis of the municipal business tax is to a very large extent derived from the corporate income tax basis, the rules for their determination are examined together, and the main differences are highlighted where relevant.

#### *Determination of taxable profit*

Resident taxpayers are taxed on their worldwide income on a yearly basis, whereas non-resident taxpayers are taxed in Luxembourg only on certain categories of income sourced therein. In principle, income is determined and taxed separately for each category of income, but all of the income[2] derived by corporate entities and deemed commercial partnerships is considered to be of a business nature. In general, the business profit of an entity is defined as the increase in value of its net assets over the fiscal year, adjusted for capital contributions, capital repayments and profits distributed. The determination of the net asset value is based on the annual accounts of the entity. Therefore, the taxable profit in principle coincides with the financial result and is determined on an accrual basis, unless specific tax rules expressly deviate from the accounting rules or a special tax regime is in place. For this purpose, a 'fiscal balance sheet' is prepared, where the accounting values of the assets and liabilities are replaced by the values of the same that should be used for tax purposes where different.

In broad terms, all the expenses derived by a company that carries on a commercial activity that are related to its business are deductible unless they relate to exempt income.[3] Some expenses are explicitly classified as deductible (e.g., non-creditable foreign taxes and value added tax (VAT), real estate tax and capital duty, and depreciation and amortisation),

2 See, however, Section V for a description of the exemption regimes applicable to income derived from qualifying participations and intellectual property rights.

3 See Section V for a more detailed discussion of the deductibility of expenses related to exempt participations and to partially exempt income from intellectual property rights.

whereas some expenses are explicitly classified as non-deductible (e.g., corporate income tax, municipal business tax, net wealth tax, directors' fees referred to supervisory services, fines, non-qualifying gifts, profits distributions).

For municipal business tax purposes, profits and losses derived through a foreign permanent establishment (PE) are not taken into account and nor are profits and losses that have already been taxed at the level of a (deemed) commercial partnership of which the taxpayer is a member.

### ***Capital and income***

Capital gains are included in the taxable basis for corporate income tax and municipal business tax, and taxed at the ordinary rates, subject to the Luxembourg participation exemption or a treaty reduction or exemption applying.[4]

### ***Losses***

Losses can be carried forward and offset against the taxable income of the same taxpayer that generated them (on the condition that they result from acceptable accounts) for 17 consecutive years. Losses generated before 2017 can be carried forward indefinitely. No carry-back of losses is allowed.

When a corporate reorganisation takes place (e.g., merger), the losses generated by an entity that disappears as a consequence of the reorganisation (e.g., the merged company) cannot be carried forward by the company resulting from it (e.g., the merging company).

According to case law from 2013,[5] a change in the 'economic owner' of the losses (e.g., change in the ownership of the loss-making company) is of no prejudice to the carry-forward of losses unless the abusive intent of the reorganisation that led to a major change in the ownership of the company is demonstrated (in particular when the company's activities change after the change in ownership). Following the aforementioned case law, an administrative circular was issued by the Luxembourg tax authorities confirming this analysis.[6]

### ***Rates***

#### *Corporate income tax*

The fiscal reform of 2018 reduced the corporate income tax rates. For the fiscal year 2021, the rates are: (1) 15 per cent for income not exceeding €175,000; (2) €26,250 plus 31 per cent for income exceeding €175,000 but lower than €200,001; and (3) 17 per cent for income exceeding €200,000. For 2022, these rates are expected to stay the same.

A 7 per cent solidarity surcharge applies to the aforementioned rates, leading to an aggregate corporate income tax rate of 18.19 per cent (2021).

#### *Municipal business tax*

The tax rate is determined every year by each municipality and varies between 6.75 per cent and 10.5 per cent. For Luxembourg City, the rate for 2021 is equal to 6.75 per cent, resulting in a combined corporate income tax and municipal business tax rate of 24.94 per cent.

4 See Section V for a description of the exemption regime applicable to capital gains on qualifying participations and intellectual property rights.

5 Administrative Court (Luxembourg), 7 February 2013, No. 31320C.

6 Circular No. 114/2, 2 September 2010, 'Loss carry-forward in the context of the Mantelkauf'.

### *Administration*

As a general rule, the fiscal year coincides with the calendar year. In such a case, companies have to electronically file the annual corporate income tax, municipal business tax and net wealth tax returns, along with the commercial and fiscal balance sheets, by 31 May of the next year. This means that 2021 annual corporate income tax, municipal business tax and net wealth tax returns have to be filed by 31 May 2023 ultimately, but it is recommended to have these filed before 2022 year end. Under certain conditions and at the request of the taxpayer, this deadline can be postponed.

After a preliminary review of the tax returns, the Luxembourg tax authorities can request further documents and information or invite the taxpayer to discuss potential adjustments of the tax returns submitted. A final assessment is then issued: the amounts due, net of the quarterly advance payments made, have to be paid within one month. Alternatively, and at the option of the Luxembourg tax authorities, a self-assessment procedure can apply, whereby an assessment is issued by the Luxembourg tax authorities based on the tax returns submitted by the taxpayer requesting the immediate payment of the corporate taxes computed on such a basis. The assessment can be reviewed later by the Luxembourg tax authorities before the ordinary statute of limitations[7] expires, potentially giving rise to a higher corporate tax liability.

The taxpayer can file an appeal against the final assessment within three months of its receipt, provided that such assessment leads to an actual claim from the tax administration (i.e., following the assessment, the taxpayer is not in a loss position). The taxpayer can lodge an appeal against the decision of the head of the tax authorities with the Administrative Tribunal within three months, while the decision of the Administrative Tribunal can be appealed before the Administrative Court.

The risk of a litigation procedure can be limited by asking for clarification by the tax authorities where there is uncertainty as to a correct interpretation of the tax law applied to specific circumstances (see Section IX.iv).

### *Tax grouping*

If a joint written request is submitted before the end of the financial year for which the application of the fiscal unity is solicited, the fiscal unity regime enables certain group companies to opt, under certain conditions, to consolidate their results for corporate income tax and municipal business tax purposes. The fiscal unity regime allows for horizontal and vertical integration, or a combination of both.[8] The vertical fiscal unity regime is available to a Luxembourg parent company or to a Luxembourg PE of a foreign company fully subject to a tax comparable to the domestic corporate tax (group parent), as well as to qualified subsidiaries. As of 2016,[9] the horizontal fiscal unity regime is also available to the Luxembourg subsidiaries of a non-integrating parent company. A non-integrating parent

7 The statute of limitations for the assessment and the collection of income tax is generally five years following the end of the calendar year in which the tax liability arose. However, a 10-year limitation period applies in the case of additional taxation owing to failure to file a return, or for an incomplete or incorrect return (with or without fraudulent intent).

8 ECLI:EU:C-749/18, Administrative Court (Luxembourg), 15 October 2020, No. 40632Ca.

9 The possibility to constitute a horizontal fiscal unity was introduced into domestic law with the law of 18 December 2015, driven by ECLI:EU: C-40/13 (joined with cases C-39/13 and C-41/13), ECLI:EU:C:2014:1758. This case continues a series of other cases that resulted in an extension of the scope of the fiscal unity regime, among which case C-418/07, Papillon [2008], ECLI:EU:C:2008:659.

may be a Luxembourg parent company or to a Luxembourg PE of a foreign company fully subject to a tax comparable to the domestic corporate tax, or a capital company that is resident in a European Economic Area (EEA) country fully subject to a tax comparable to the domestic corporate tax, or to a PE of such a corporation in the EEA. The non-integrating parent is not, itself, part of the fiscal unity. The consolidation takes place at the level of the integrating subsidiary. The qualified subsidiaries as well as the integrating subsidiary must be either a Luxembourg-resident fully taxable company or a local PE of a non-resident capital company fully subject to a tax comparable to the domestic tax. Luxembourg subsidiaries can be included when they are controlled, directly or indirectly, by the group parent or the non-integrating parent company for at least 95 per cent of their capital since the beginning of the fiscal year for which the option is exercised. The book year must be coinciding for all companies that are included in the fiscal unity.

With effect as from fiscal year 2020, the budget law for 2020 introduced a transitory provision to allow the formation of a horizontal fiscal unity with companies that are already vertically integrated without such vertical fiscal unity being considered dissolved. Groups wishing to benefit from this special rule have until the end of the 2022 tax year to replace the vertical fiscal unity with a horizontal fiscal unity without any tax impact at the level of the exiting consolidated group.

Taxable income and losses of each company pertaining to the fiscal unity are determined on a stand-alone basis (as if it were not integrated) and then aggregated at the level of the group parent or the integrating subsidiary (as the case may be), and adjusted to eliminate double taxation and double deduction of the same items of income. The tax due on such aggregated result is then levied from the group parent or the integrating subsidiary. As the requirements for the application of the participation exemption regime are less strict than the requirements for the application of the fiscal unity regime, inter-corporate dividends paid within the fiscal unity regime are already fully exempt and do not need to be adjusted when determining the profit of the group. Losses generated prior to the fiscal unity can be used to offset the income of the group up to the taxable income of the integrated subsidiary that generated them. Once the regime ends, losses generated during the tax unity have to be left at the level of the group parent or the integrating subsidiary.

On 21 December 2018, Luxembourg implemented the EU Anti-Tax Avoidance Directive 2016/1164/EU of 12 July 2016 (ATAD 1) into domestic law and introduced, inter alia, the interest deduction limitation rule (IDLR), further described in Section VII. These rules cap the deductibility of 'exceeding borrowing costs' at the higher of 30 per cent of the earnings before interest, taxes, depreciation and amortisation (EBITDA) or €3 million. Within a fiscal unity, the IDLR automatically applies at the level of the integrating company (while the application at individual entity level requires the timely filing of a request). The definitions, options and limitations included in the IDRL are correspondingly applied and determined at the level of the fiscal unity. In practice, the application of the IDLR at the level of the fiscal unity requires first to determine the interest expenses (and equivalent) and the interest income (and equivalent) for each entity part of the fiscal unity separately, before determining the exceeding borrowing costs of the fiscal unity at the level of the integrating company by aggregating the interest income and interest expenses of each entity that is part of the fiscal unity.

The tax unity regime lasts for at least five years; termination prior to this five-year period ending leads to a full retroactive denial of the fiscal unity regime. If after the five-year period the requirements for the application of the fiscal unity regime are no longer met, the benefits obtained during the fiscal unity are recaptured and the tax liability of each company participating in the consolidation is assessed on a stand-alone basis from the beginning of the fiscal year in which the termination took place.

## ii Other relevant taxes

### *Net wealth tax*

Net wealth tax is levied at a 0.5 per cent rate on the estimated net realisable value (unitary value) of the assets of businesses as of the beginning of the fiscal year. A reduced rate of 0.05 per cent applies to taxable net wealth in excess of €500 million. An independent expert's appraisal is not required for the determination of the unitary value, which is generally determined using the accounting book values, adjusted where necessary. With regard to real estate located in Luxembourg, the unitary value is determined on the basis of cadastral values assessed in 1941, which derives from a law of 1934.[10]

Assets giving rise to exempt or partially exempt income (i.e., exempt participations and qualifying intellectual property rights) are generally also exempt for net wealth tax purposes, and assets allocated to a foreign PE and foreign real estate are generally exempt by virtue of tax treaties signed by Luxembourg. Liabilities are generally deductible if they do not relate to exempt assets. Provisions for liabilities, the existence of which is not certain (e.g., provisions for risks), are not deductible.

Net wealth tax is not deductible for income tax purposes and is generally not creditable in foreign jurisdictions. Net wealth tax is not due for the first year of existence of the company (as the assets as of 1 January are deemed to be nil).

A minimum net wealth tax applies, which can be fixed (€4,815) if the financial assets of the resident corporate taxpayer in a given year exceed (1) 90 per cent of the total balance sheet and (2) €350,000, which is the case for most holding and financing companies. In all other cases, the minimum tax is contingent on the balance sheet total of the resident corporate taxpayer and varies from €535 to €32,100 (for a balance sheet total exceeding €30 million).

### *Capital duty or registration tax*

A €75 fixed duty applies to newly incorporated companies, or upon transfer of the legal seat or of the effective management of a foreign company to Luxembourg or upon the setup of a local branch of a foreign company.[11]

Other *ad valorem* or fixed registration duties may apply depending on the assets or documents registered.

### *Real estate taxation*

A real estate tax is levied annually on the unitary value of real estate properties located in Luxembourg at a rate that depends on the classification and on the location of the property. The unitary value is, as described above, determined by the Luxembourg tax authorities, and generally does not exceed 10 per cent of the market value of the property.

10 Bewertungsgesetz, Memorial 902, 3 January 1934, page 9002.

11 Memorial A No. 207, 24 September 2008.

***VAT***

Being an EU Member State, Luxembourg applies EU VAT Directive 2006/112/EC. Luxembourg's standard VAT rate is the lowest in the EU (17 per cent). Luxembourg also applies reduced rates (3, 8 and 14 per cent) to various goods and services.

Contrary to other Member States, Luxembourg has not implemented the 'use and enjoyment' rule that obliges non-registered holding companies to pay the VAT on services received from non-EU suppliers without being allowed to recover it.

Following decisions of the Court of Justice of the European Union (CJEU), Luxembourg strictly limited the use of the VAT exemption for 'independent group of persons' (cost-sharing) to taxable persons performing activities of public interest. As a counterpart to the virtual disappearance of the cost-sharing exemption for the financial, fund and insurance sectors, Luxembourg implemented the VAT grouping mechanism, relying on Article 11 of EU VAT Directive 2006/112/EC.

Luxembourg also has an extensive definition of regulated funds qualifying for the VAT exemption on the management of regulated funds.

## IV TAX RESIDENCE AND FISCAL DOMICILE

### i Corporate residence

Collective entities are considered resident in Luxembourg for tax purposes if they have their legal seat or their central administration therein. Therefore, for domestic tax law purposes, both collective entities incorporated in Luxembourg, and collective entities incorporated abroad but having their central administration in Luxembourg or having their registered office in Luxembourg are considered resident therein for tax purposes.

The central administration of an entity is deemed to be located in Luxembourg if the direction of the entity's affairs is therein concentrated. The central administration should be determined on the basis of facts through a substance-over-form analysis; in this respect, the place where the central accounting and archives of an entity, as well as the place where the shareholders' and board meetings are held, are generally considered relevant.

### ii Branch or permanent establishment

A definition of PE is provided by domestic law to determine the minimum threshold of business activity a foreign taxpayer must reach in Luxembourg to be taxed therein on the income 'directly or indirectly realised' by the PE. The domestic definition of PE is broader than the Organisation for Economic Co-operation and Development (OECD) Model Convention definition, last updated in 2017, as it generally includes a 'place which serves for the operation of an established business' and therefore does not require that the business is realised 'through' such place. Further, the domestic definition includes places of purchase and sale of goods.

As of financial years beginning on or after 1 January 2019, a new provision governs the Luxembourg recognition of a foreign PE. Additional guidance on this changed PE definition was also provided in an administrative circular.[12] The new provision impacts the recognition of a PE where a tax treaty is in force between Luxembourg and a foreign country, and provides that the verification of the existence of a PE has to be based on the criteria set out in the

12 Circular No. 19, 22 February 2019.

relevant tax treaty in place. According to the OECD Model Convention, the identification of a PE requires: (1) a business being carried on; (2) being through a fixed place that must be at the disposal of the enterprise carrying on the business; and (3) a certain degree of permanency. However, the Luxembourg law provision further states that a resident taxpayer is considered to be carrying on a business in whole or in part through a PE in the other contracting state if that activity in isolation (1) is an independent activity and (2) represents a participation in the general economic life in that state, unless an explicit provision contained in the tax treaty between Luxembourg and the other contracting state precludes this interpretation.

Furthermore, the Luxembourg tax authorities are entitled to request proof that the source country recognises a PE (tax returns, ruling, etc.). Such proof is to be mandatorily provided in the event that the relevant tax treaty does not contain a certain specific anti-abuse rule[13] and only upon request of the Luxembourg tax authorities in other cases. If a taxpayer is not capable of providing proof that the activity is considered a PE in the other state, the above-mentioned administrative circular clarifies that the Luxembourg tax authorities will consider that there is no PE.

In the absence of specific provisions in domestic law regarding the allocation of profit to a PE (and thus the determination of taxable basis in Luxembourg), a PE should be considered as an entity separate from the foreign head office. OECD guidelines may serve as a source of interpretation there, such that, in a nutshell, the profits attributable to the PE are the profits that the PE would have derived if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the PE and through other parts of the enterprise.

Tax treaties signed by Luxembourg mainly follow the OECD Model Convention and limit the Luxembourg taxing rights of business income derived in Luxembourg by foreign taxpayers to income derived through a local PE. The income taxable in Luxembourg is only the income that is attributable to the PE (i.e., no force of attraction applies) net of the expenses that are thereto allocable. The majority of tax treaties signed by Luxembourg provide for the prohibition of discrimination in the tax treatment of local PEs of foreign taxpayers as compared with domestic companies.

## V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

### i Holding company regimes

There is no specific holding company regime in Luxembourg. The participation exemption regime is available to both Luxembourg resident companies and PEs of non-resident companies holding qualifying participations.

Dividends (including constructive dividends and interest on profit-sharing bonds), liquidation proceeds and capital gains are fully exempt when the participation they refer to:

13 That is, a provision similar to Article 23A(4) of the OECD Model Convention, which reads as follows: 'The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of the Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income'.

*a* is held, directly or through a transparent entity, in a fully taxable resident company, in a European company meeting the requirements listed in Article 2 of the EU Parent–Subsidiary Directive or in a non-resident company subject to a tax that is comparable (in terms of rate and taxable basis) to the Luxembourg corporate income tax[14] (subsidiary);

*b* is held by a fully taxable resident company or by a domestic PE of an EU company meeting the requirements listed in Article 2 of the EU Parent–Subsidiary Directive, or by a domestic PE of a company resident in a treaty country or in an EEA country (parent); and

*c* represents at least 10 per cent of the capital of the subsidiary (or, alternatively, has a purchase price of at least €1.2 million (for the exemption of dividends and liquidation proceeds) or €6 million (for the exemption of capital gains)) and was held without interruption over the previous 12 months (or, alternatively, the parent commits to hold such participation for at least 12 months).

Pursuant to the amendment of the EU Parent–Subsidiary Directive, with the introduction of an anti-hybrid provision (EU Directive 2014/86/EU) and a minimum common general anti-abuse rule (EU Directive 2015/121/EU), as of 1 January 2016 profit distributions covered by the EU Parent–Subsidiary Directive received by a Luxembourg company do not benefit from the participation exemption regime to the extent that the same payments were deductible in the country of the payor, or were paid in the framework of an arrangement or a series of arrangements that, having been put in place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purposes of the EU Parent–Subsidiary Directive, are not genuine. The CJEU recently issued several judgments[15] dealing with the concepts of beneficial owner and abuse under the EU Parent–Subsidiary Directive and the EU Directive 2003/49/EC (the Interest and Royalty Directive). In the cases at hand, the targeted groups were using intermediate holding companies to benefit from the withholding tax exemption on interest payments or dividends on the basis of the above-mentioned directives. However, the CJEU denied the benefit from the Interest and Royalty Directive considering that the recipient companies of the interest payments were not the ultimate beneficial owners. The CJEU identified the beneficial owner as the entity that actually benefits from that interest economically and, accordingly has the power to freely determine the use to which it is put. In addition, the judgments provide useful indicators on how to apply the abuse concept. It remains to be seen how these judgments will impact EU Member States' tax authorities' positions.

If the above-mentioned minimum holding requirement is not met, an exemption of 50 per cent is available for dividends (including constructive dividends and interest on profit-sharing bonds, and excluding liquidation proceeds) distributed by a resident fully taxable capital company, a company covered by Article 2 of the EU Parent–Subsidiary Directive, or a capital company resident in a state with which Luxembourg has concluded a tax treaty and that is subject in its country of residence to income tax comparable with that

14 The Luxembourg tax authorities generally consider that a foreign tax is comparable with the Luxembourg corporate income tax if the rate of the foreign tax is at least 8.5 per cent (i.e., half of the current corporate income tax rate) and the taxable base is computed on the basis of criteria that are comparable to the Luxembourg criteria.

15 CJEU, 26 February 2019, joined cases C-116/16 and C-117/16 and CJEU, 26 February 2019, joined cases C-115/16, C-118/16, C-119/16 and C-299/16.

of Luxembourg. The exemption applies to the net dividend income (i.e., the dividend income minus directly related costs and write-offs on the participation in connection with a dividend distribution of the same year).

Costs (typically, financing costs), capital losses and write-offs relating to exempt participations are deductible provided that they exceed the exempt dividends received in the same year. Losses resulting from this deduction can also be carried forward for 17 consecutive years. Losses generated before 2017 can be carried forward indefinitely. However, such deductions are recaptured when a capital gain is realised on the disposal of the same participation (i.e., the capital gain is exempt only to the extent it exceeds the amount of the recaptured deductions).

### ii IP regimes

On 22 March 2018, Luxembourg adopted a new IP regime applying to any Luxembourg tax resident carrying out a business activity in Luxembourg and owning qualifying IP.

Eligible net income from qualifying IP assets can benefit from an exemption of up to 80 per cent from income taxes and a full exemption from net wealth tax. The eligible assets must have been constituted, developed or improved after 31 December 2007 and are limited to patents, utility models, supplementary protection certificates granted for a patent on medicine and plant protection, plant variety certificates, extensions of a complementary protection certificate for pediatric use, orphan drug designations, and software protected by copyrights.

The portion of the IP income benefiting from the advantageous tax treatment is calculated based on a ratio taking into account the R&D costs. The ratio corresponds to the eligible R&D costs divided by the overall R&D expenses. Luxembourg allows the eligible R&D costs to be uplifted by 30 per cent insofar as the resulting ratio does not exceed the total amount of expenditure. Expenses must be incurred within the framework of an R&D activity to be eligible but can be undertaken either by the taxpayer itself or outsourced.

The new IP regime is in line with the recommendations made by the OECD in its base erosion and profit shifting (BEPS) Action Plan 5 by adopting a nexus approach to ensure that only the R&D activities having a nexus with the Luxembourg taxpayer itself benefit from the new IP regime.

Unlike the previous regime, IP assets of a marketing nature (e.g., trademarks) are excluded from the scope of the proposed regime.

The former IP regime was abolished in 2016 but continued to be applicable to qualifying IP that was created or acquired before 1 July 2016. This grandfathering period started on 1 July 2016 and ended on 30 June 2021. Where the taxpayer was eligible under both regimes, the taxpayer was allowed to elect the IP regime to be applied during the grandfathering period. The choice for either option was irrevocable for the entire transitional period.

### iii Tax subsidies

The main subsidies and incentives are mentioned in this chapter. Business investments, professional development and employment are, however, further supported through specific tax credits granted for new investments in qualifying business assets located in Luxembourg and put to use in Luxembourg or in the EEA (with the exception of ships, which benefit from the credit even if operated abroad);[16] 'sustained employees' training expenses; and hiring employees previously registered as unemployed.

The above-mentioned subsidies are available to all businesses and do not refer to any specific sector of activity.

## VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

### i Withholding on outward-bound payments (domestic law)

Distributions paid by a resident company to non-resident shareholders are generally subject to a 15 per cent withholding tax. This includes repayments of previously contributed capital, unless such a repayment is motivated by sound business reasons.

As a general rule, there is no withholding tax on outbound royalties and interest; however, outbound payments to related parties exceeding the arm's-length measure can be requalified as hidden dividend distributions and be subject to a 15 per cent withholding tax. Furthermore, profit-sharing interest received by a 'money provider' as payments on loans represented by securities that, in addition to a fixed coupon, are entitled to a variable coupon that depends on the company's profit distributions, are subject to a 15 per cent withholding tax.

### ii Domestic law exclusions or exemptions from withholding on outward-bound payments

A dividend withholding tax exemption is granted provided that a participation of at least 10 per cent (or alternatively a participation, the purchase price of which is at least equal to €1.2 million) was held for an uninterrupted period of at least 12 months, when dividends are paid to:

*a* a European company meeting the requirements listed in Article 2 of the EU Parent–Subsidiary Directive or a Luxembourg PE thereof; pursuant to the amendment of the EU Parent–Subsidiary Directive with the introduction of a minimum common general anti-abuse rule (EU Directive 2015/121/EU), as of 1 January 2016 profit distributions covered by the EU Parent–Subsidiary Directive paid by a Luxembourg company do not benefit from the participation exemption regime to the extent they were paid in the framework of an arrangement or a series of arrangements that, having been put in place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purposes of the EU Parent–Subsidiary Directive, are not genuine;

*b* a non-resident company resident in a treaty country and subject therein to a tax that is comparable (in terms of rate and taxable basis)[17] to the Luxembourg corporate income tax;

16 Following the *Tankreederei I SA* decision by the CJEU (C-287/10 of 22 December 2010), which ruled that the scope of application of the incentive is contrary to the freedom of movement of capital, a circular issued by the tax authorities (Circular 152-bis/3 of 31 March 2011) and an update of the law clarify that the tax credit is also applicable to new investments in qualifying business assets located in Luxembourg put to use in a state that forms part of the EEA.

17 The Luxembourg tax authorities generally consider that a foreign tax is comparable with the Luxembourg corporate income tax if the rate of the foreign tax is at least 8.5 per cent (i.e., half of the current corporate

*c* a company resident and fully taxable in Switzerland not benefiting from any exemption; or

*d* a fully taxable company resident in an EEA country, or a Luxembourg PE thereof.

### iii Double tax treaties

As at the date of writing, Luxembourg has 83 tax treaties currently in force, which are mainly in accordance with the OECD Model Convention, and further treaties are being negotiated. The table in Appendix I at the end of the chapter shows for each double tax treaty in force the potential reductions of withholding tax rates applicable to outbound payments of dividends, interest and royalties according to such treaties.

### iv Taxation on receipt

Economic and juridical double taxation of foreign profits is generally avoided through a full or partial exemption system. The general conditions for the participation exemption regime are described in Section V.i. When a certain participation threshold is reached in a foreign company, tax treaties signed by Luxembourg generally provide for the exemption of foreign profits as a system to relieve double taxation. When foreign dividends are not exempt, taxes levied by the foreign authority to the Luxembourg recipient can at least be partially recovered, if certain conditions are met, through the domestic foreign tax credit system. Domestic law does not provide for an indirect tax credit system of taxes levied by the foreign authority at the level of the foreign entity.

## VII TAXATION OF FUNDING STRUCTURES

Entities are commonly funded with a mix of equity and debt. Whether an instrument should be considered as debt or equity for Luxembourg tax purposes has to be evaluated on the basis of a 'substance over form' approach (i.e., taking into account the economic rather than the legal features of an instrument). This prevalence of economic characterisation over legal appearances has been confirmed by both parliamentary history[18] and case law as a principle underlying Luxembourg tax law.[19] The parliamentary history stated that the absence of typical loan features, such as, inter alia, a fixed term and interest, may lead to a presumption that a loan qualifies as hidden capital. Recent cases law provide for further guidance on the relevant criteria. In the case law,[20] the Administrative Court ruled, on the basis of the overall picture, that the instruments had to be qualified as equity for tax purposes.

The equity investment can, in principle, be represented by different classes of shares that track different income or investments of the same company (or both).

Several financing tools can be created that combine features of debt and equity according to the projected profitability of the investments and are tailored to the needs of the investors (base reduction in Luxembourg, withholding tax planning, repatriation of profits, flexibility upon exit).

income tax rate) and the taxable base is computed on the basis of criteria that are comparable to the Luxembourg criteria.

18 Parliamentary document 571/4, commentary to Article 114 (p. 294).

19 Administrative Court, 26 June 2008, No. 24061C.

20 By way of example: Administrative Court, 26 July 2017, No. 38357C, Administrative Court, 13 December 2018, Nos. 40704 and 40705.

Under certain conditions, hybrid debt instruments may be issued by a Luxembourg company. These hybrid debt instruments (e.g., convertible preferred equity certificates) may be treated as debt for Luxembourg legal, accounting and tax purposes (to the extent that the instrument has a majority of debt features) but may be treated as equity for tax purposes in the country of residence of the holder of the instrument (e.g., the United States). The expression 'CPECs' is often used as a general abbreviation. However, the precise terms and conditions may differ on a case-by-case basis. In addition, the above-referenced case law has made the debt qualification of instruments from a Luxembourg tax perspective a bit more of an attention point; such case law has so far not led to additional or different enquiries from the Luxembourg tax authorities.

The use of hybrid instruments will be affected by the anti-hybrid rules, described in Section X.

### i Thin capitalisation

There are no specific thin capitalisation rules under Luxembourg law. However, when a loan is granted or guaranteed by related parties and such loan finances assets different from receivables (e.g., participations, real estate, intellectual property rights), the Luxembourg tax authorities typically observe a debt-to-equity ratio of at least 85:15.[21] The interest payments related to the debt exceeding this ratio may be treated, for tax purposes, as dividends, and, therefore, considered non-deductible for corporate income tax purposes and subject to the 15 per cent dividend withholding tax.

In addition, the Luxembourg transfer pricing rules require intra-group financing companies to avail of an appropriate amount of equity, such that they have the financial capacity to assume the risks they run. This amount is to be determined on a case-by-case basis.

### ii Deduction of finance costs

As a general rule, any arm's-length costs incurred for the purposes of the business activity are deductible to the extent they are not related to exempt income. See also Section V.i.

The Luxembourg law implementing ATAD 1 into domestic law (the ATAD 1 Law) introduced, inter alia, the IDLR, effective as of 1 January 2019. The main elements of the IDLR as contained in the ATAD 1 Law are summarised here below.

The concept of 'exceeding borrowing costs' is introduced. It means the excess, if any, of a Luxembourg taxpayer's deductible interest (and economically equivalent) expenses over that taxpayer's taxable interest (and economically equivalent) income. As a general rule, the deductibility of a taxpayer's exceeding borrowing costs in a given fiscal year is capped at the higher of 30 per cent of such taxpayer's EBITDA in such fiscal year or €3 million. 'EBITDA' is defined as the taxpayer's net income (1) increased by its exceeding borrowing costs, depreciation and amortisation, and (2) decreased by tax-exempt income and the expenses attributable to such exempt income.

The ATAD 1 Law contains a grandfathering provision, pursuant to which interest (and economically equivalent) expenses incurred in respect of loans that were concluded prior

21 Pursuant to the OECD (2020), Transfer Pricing Guidance on Financial Transactions: Inclusive Framework on BEPS Actions 4, 8-10, OECD, Paris, published in February 2020, the taxpayers have to compute their profits in compliance with arm's-length conditions, so that the ability to attract debt in a certain amount and under certain conditions should not be off market.

to 17 June 2016 and that were not subsequently modified are not subject to the IDLR. In addition, the following three categories of Luxembourg taxpayers are, inter alia, excluded altogether from the application of the IDLR:

*a* a taxpayer that constitutes a 'financial undertaking', which is, inter alia, the case if the taxpayer is an alternative investment fund managed by an alternative investment fund manager as defined in point (b) of Article 4(1) of Directive 2011/61/EU;
*b* a taxpayer that qualifies as a 'stand-alone entity', which means a taxpayer that is not part of a consolidated group for financial accounting purposes, and has no associated enterprise and has no PE in another jurisdiction; and
*c* a taxpayer that is a member of a consolidated group for financial accounting purposes and, in short, the ratio of equity over total assets of the consolidated group does not exceed the same ratio of the taxpayer by more than 2 percentage points.

On 28 July 2021, the Luxembourg tax authorities issued an administrative circular[22] on the interpretation of the IDLR. Most notably, the guidance clarifies the concepts of borrowing costs, exceeding borrowing costs and their carry-forward, the notions of fiscal EBITDA and unused interest capacity, the application of the grandfathering rule and the specific exemption applicable to long-term infrastructure projects.

### iii Restrictions on payments

Distributions can be made up to the amount of freely distributable reserves as shown in approved financial statements after the accruals to the legal reserve required by the law are thereto allocated. Under certain conditions, interim dividends can be distributed.

### iv Return of capital

In principle, repayments of share capital contributions are subject to a 15 per cent withholding tax. However, such contributions can be repaid to the shareholders without triggering any taxation to the extent that the share capital repaid was not formed by allocations of profit reserves to the share capital (which are deemed to be distributed first) and the share capital reduction is supported by valid economic reasons. Repayments that correspond to profit reserves allocations to the share capital or that are not supported by valid economic reasons are considered, from the perspective of the shareholders, as income from capital.

The formal repayment of capital (i.e., share capital decrease by way of cancellation of shares) is, however, subject to limits and procedures set by corporate law: the share capital resulting from the repayment cannot be lower than the minimum share capital required by the law (i.e., €12,000 for a SARL and €30,000 for an SA). A higher degree of flexibility can be obtained through the provision of a share premium reserve.

From a tax perspective, the concepts of hidden capital contribution and of hidden capital repayment are applied, under certain conditions. Both hidden capital contributions and hidden capital repayments benefit from the tax treatment of formal contributions and repayments irrespective of their different accounting treatment. As a typical example, a shareholders' debt waiver could be considered exempt from corporate income taxes if certain features, typical of hidden capital contributions, are present.

22 Circular LIR, No. 168 *bis*/1, 28 July 2021.

## VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

### i Acquisition

See Section VII for a general comment on funding structures.

### ii Reorganisation

As a general rule, the assets of a resident company merged into (or demerged in favour of) another resident company or into a foreign company are deemed realised at market value, and are, therefore, fully taxable in Luxembourg.

Domestic and European reorganisations can be performed tax-neutrally to the extent that, broadly speaking, Luxembourg's future taxing right on latent gains is not lost because of the reorganisation (e.g., a PE is maintained in Luxembourg to which part or all of the assets incorporating a latent gain are allocated). The taxation can, therefore, be deferred to the future actual realisation of latent gains.

For domestic mergers, tax neutrality is granted if the cash payment does not exceed 10 per cent of the face value of the share capital of the absorbed company and the merger allows the future taxation in Luxembourg of latent capital gains.

For domestic demergers, tax neutrality is granted if, in addition to the conditions set out above for mergers, the shareholders of the divided company receive, in exchange for their participation, a proportional participation in each beneficiary company (i.e., 'proportional demerger') and the assets transferred include at least an autonomous business unit.

If the beneficiary of the merger or of the demerger maintains the book values of the assets and liabilities acquired, the historical acquisition dates can be maintained. This rule is relevant for the application of the participation exemption regime (e.g., the date of acquisition of the participation can be maintained by the company acquiring it by way of a merger or demerger).

The same neutrality regimes apply to mergers whereby a fully taxable resident company is absorbed by a company resident in a Member State, and to demergers whereby a fully taxable resident company is demerged into companies resident in other Member States.

### iii Exit

As a general rule, when a domestic business (in an incorporated or unincorporated form) leaves Luxembourg's tax jurisdiction, exit taxation applies. Under the current law provisions, a deferral for transfers to an EU or EEA jurisdiction is under certain conditions available for a five-year period.

When a resident company transfers its legal seat and its central administration abroad, the company is deemed liquidated, and capital gains accrued on its assets and liabilities are subject to tax. The migration can, however, be performed at book values, thereby deferring the capital gain taxation, when the assets of the migrating company are attributed to a domestic PE.

When a non-resident company disposes of or transfers abroad a domestic PE, the capital gains accrued on its assets and liabilities are subject to tax. A tax deferral can be obtained if the PE is transferred to a company resident in a Member State by way of a going concern contribution, merger or demerger and the book values of the PE transferred are maintained by the acquiring company.

When the foreign PE of a domestic company is disposed of, the accrued capital gains on the assets and liabilities of such PE are subject to tax unless a tax treaty providing for the exemption of foreign PEs is in force with the country where the PE is located.

When an asset is attributed to a foreign (exempt) PE, it is debatable whether the Luxembourg head office is taxable on the deemed capital gain realised. The main position of the doctrine is that, even if the attribution of the asset should be booked at fair market value according to the 'separate entity approach', the resulting capital gain is taxable only once the asset is actually disposed of by the company and to the extent a capital gain is actually realised.

## IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

### i General anti-avoidance

The taxpayer is free to choose the structure or the transaction that allows the most tax-efficient results. Nonetheless, the law provides that the tax benefits deriving from the use of forms and constructions that, even though formally permitted, are aimed at mitigating or evading taxes and lack further economic reasons, cannot be recognised. In such cases, taxes will be levied that correspond to the form or to the construction that would be reasonable and appropriate in consideration of the economic reality.

The above-described general anti-abuse rule was amended effective 1 January 2019, following the implementation into Luxembourg law of the ATAD 1. Following this amendment, it is in principle sufficient for a tax advantage to be one of the main purposes of the arrangement to be caught under the general anti-abuse rule. The wording of the new rule remains, however, close to the existing wording and will require case law to further refine its interpretation.

The civil law concept of simulation can also be used by the tax authorities to deny the tax benefits deriving from a certain transaction if it can be proved that the intention of the parties is to put in place a different, hidden transaction. In such a case, the tax effects of the latter will be applicable.

In an international setting, the applicability of some tax regimes (e.g., participation exemption) is conditional to the proof of a minimum level of effective taxation of the foreign entity involved.

### ii Controlled foreign corporations

The ATAD 1 Law includes controlled foreign corporation (CFC) rules, which provide that where a CFC has been put in place essentially for the purpose of obtaining a tax advantage, Luxembourg corporate taxpayers are taxed on the undistributed net income of a CFC, pro rata to their ownership or control of the foreign branch or the (directly and indirectly held) subsidiary, but only to the extent such income is related to significant functions carried out by the Luxembourg corporate taxpayer. The Luxembourg tax authorities published administrative guidance whereby Luxembourg taxpayers must yearly document the functions and risks performed by the foreign entities in relation to any CFC income. To the extent that a Luxembourg company can establish, on the basis of adequate documentation of its activities or functions, or both, that it does not perform significant functions related to the CFC's activities, the CFC rules should not have an adverse tax impact. Certain exceptions apply, notably if the foreign entities' accounting profits are lower than €750,000 or their accounting profits amount to less than 10 per cent of their operating costs for a given year.

The above-mentioned CFC rules only apply for corporate income tax purposes and not for purposes of the municipal business tax.

### iii Hybrid mismatch rules

Luxembourg implemented into domestic law the Council Directive (EU) 2017/952 (ATAD 2) extending the scope of ATAD 1 to hybrid mismatches situations arising between EU Member States and third states (the ATAD 2 Law).[23] The ATAD 2 Law is effective to book years commencing on or after 1 January 2020 (except with respect for the reverse hybrid rules, which becomes effective 1 January 2022). When assessing whether a payment made by a Luxembourg company could give rise to a hybrid mismatch, the final OECD report on BEPS Action 2 may be taken as an additional source of interpretation.

The ATAD 2 Law contains hybrid instrument mismatch rules that target the situation where a payment between associated enterprises made under a financial instrument gives rise to a deduction without inclusion, with such outcome being attributable to differences in the characterisation of the instrument or the payment made under it. As a result, if such a mismatch occurs, the EU Member State that is the payer jurisdiction will deny the tax deduction of the payment.

Next to the hybrid instrument mismatch rules, the ATAD 2 Law contains hybrid entity mismatch rules. A hybrid entity mismatch involves a payment made between associated enterprises to a hybrid entity that gives rise to a deduction without corresponding inclusion, with such outcome being attributable to differences in the allocation of payments made to the hybrid entity under the laws of Luxembourg and the jurisdiction of any person with a participation in that hybrid entity. In case such a mismatch occurs, the EU Member State that is the payer jurisdiction will deny the tax deduction of the payment.

The ATAD 2 Law also contains reverse hybrid rules. The reverse hybrid rules may come into play where one or more associated non-resident entities see a Luxembourg entity as non-transparent while this entity is regarded as transparent for Luxembourg tax purposes. Reverse hybrid rules, if applicable, could result in the partnership becoming subject to corporate income tax on all or part of its income to the extent allocable to the investors that see the Luxembourg entity as opaque.

Finally, the ATAD 2 Law contains imported mismatch rules. The imported mismatch rules target payments made on a non-hybrid instrument that (directly or indirectly) fund deductible payments giving rise to a hybrid mismatch arrangement (i.e., at a different level in the group), unless one of the other states involved has made an equivalent adjustment in respect of the hybrid mismatch.

### iv Transfer pricing

In 2015, the arm's-length principle, already applied in practice, was codified in Luxembourg tax law[24] and, in 2016, a new article dealing with the main principles on which a transfer pricing functional analysis should be based (i.e., the commercial and financial relations between affiliated companies and the economically significant circumstances of these relations) was introduced.[25]

23 An extensive description of the ATAD 2 rules would be beyond the scope of this publication.

24 Article 56 LIR.

25 Article 56 *bis* LIR.

In addition, an obligation was included in the law for taxpayers to be able to present transfer pricing documentation upon request of the tax authorities, substantiating the arm's-length character of related-party transactions.[26] The burden of proof therefore lies with the taxpayer in that respect.

A circular letter issued on 27 December 2016 (the Circular) by the Luxembourg tax authorities officially clarifies the criteria to be followed for the determination of arm's-length remuneration on intra-group financing transactions. The Circular applies to group companies whose principal activity other than holding activities consists of intra-group financing transactions, which are defined as the granting of loans or advances to associated companies financed by any financial means. While the Circular does not address other intra-group situations, such as borrowing from an affiliate to acquire receivables in the market, the principles set out in it should also be largely relevant to those transactions.

Inter alia, the Circular highlights the main substantive requirements that a group financing company established in Luxembourg is required to meet to be able to enter into an advance pricing agreement (APA) with the tax authorities. In this respect, and among other substance requirements, the financing company should be adequately capitalised to face the functions performed and the risks assumed in connection to its financing activity. As such, the amount of equity that a financing company needs should be benchmarked.

Pursuant to the Circular, it is specified that the APA procedure will only be available for intra-group financing companies that have sufficient substance in Luxembourg and bear the risks linked to the financing activities. A Luxembourg company will be considered as having sufficient substance if, broadly summarised:

*a* the majority of its directors or managers are Luxembourg residents and have the capacity to make binding decisions for the company;
*b* personnel should have the understanding of risk management in relation to the transactions carried out;
*c* the key decisions regarding its management are taken in Luxembourg, and at least one shareholders' meeting a year takes place there;
*d* it has a bank account in Luxembourg;
*e* it is not considered as a tax resident in another country;
*f* its equity should be sufficient for the functions it performs, the assets used and the risks it assumes; and
*g* the financing company should have fulfilled its obligations regarding the filing of tax returns at the time when it requests an APA.

Over the last few years, the European Commission has opened several investigations with respect to EU Member States. Those investigations notably focus on the existence of illegal state aid by way of an advance decision regarding the application of the Luxembourg tax laws to certain operations described by the taxpayer (ATA) or APA (as defined below). Under the Treaty on the Functioning of the European Union, illegal state aid is defined as (1) a measure granted through state resources; (2) that distorts competition or threatens to do so; and (3) affects intra-group EU trade favouring certain undertakings or the production of certain goods. Regarding Luxembourg, the European Commission has, inter alia, taken the position that the transfer pricing analysis performed by a Luxembourg company part of

26 Article 171(3) General Tax Act (22 May 1931).

the Fiat group amounts to illegal state aid.[27] Luxembourg and Fiat appealed against decision with the EU General Court. On 24 September 2019, the EU General Court upheld the European Commission's decision stating that Luxembourg granted selective tax advantages to Fiat.[28] The judgment is important as it explicitly confirms the possibility for the European Commission to verify the arm's-length nature of transactions between related parties. At the same time, the judgment still acknowledges that taxpayers and Member States have a margin of appreciation, considering that transfer pricing inherently entails a degree of inaccuracy, so that an advantage only arises when the variation between two comparables exceeds the inaccuracy inherent to the chosen transfer pricing method. The outcome of the *Fiat* case may potentially impact the transfer pricing practice in Luxembourg, especially where Luxembourg entities carrying on both holding and financing activities are concerned.

### v Tax clearances and rulings

On the basis of a written and motivated request by any taxpayer, the competent tax office will issue an ATA. This decision would bind the tax office, albeit only with respect to the requesting taxpayer and limited to the concrete case described by the latter. The decision of the tax office will be made on the basis of a uniform interpretation of the tax laws and the principle of equality. An administrative fee applies, ranging between €3,000 and €10,000, determined by the Luxembourg tax authorities on the basis of the complexity of the case concerned.

On 13 July 2016, a law on the mandatory automatic exchange of information in the field of taxation, implementing EU Council Directive 2015/2376 extending the scope of mandatory exchange of information on cross-border ATA and APA, was approved. As a consequence, the Luxembourg tax authorities will, from 1 January 2017, exchange information on ATA and APA with other EU Member States with retroactive effect (the exchange applies to ATA and APA amended or renewed from 1 January 2012, provided that they were still valid on 1 January 2014). ATAs and APAs that involve only individuals or taxpayers with a low turnover (i.e., less than €40 million in the year preceding the issuance of the ATA or APA) are excluded. As of the end of the 2019 fiscal year, all pre-2015 ATAs are no longer binding on the Luxembourg tax authorities. Taxpayers affected by this measure have the possibility to file new ATA requests in accordance with the procedure introduced in 2015.

## X YEAR IN REVIEW

A relatively small number of changes were made to the Luxembourg tax laws in 2021 or are expected to still be adopted before year end. To the extent not mentioned above, these changes include, for instance, those listed below.

With effect from 1 January 2021, the budget law for 2021 introduced a new real estate levy applicable to certain investment vehicles owning real estate located in Luxembourg. The tax would apply to investment vehicles that are regulated either under the Specialized Investment Funds regime, the Reserved Alternative Investment Funds regime or the 'Part II' of the Undertakings for Collective Investment regime, provided that they are not a tax transparent partnership or a collective investment fund (FCP). The real estate levy applies at an annual rate of 20 per cent on gross rental income (excluding VAT), capital gains resulting

27 Case SA.38375.

28 EU General Court judgments of 24 September 2019 in cases T-760/15 and T-636/16.

from the alienation of the real estate assets, and capital gains resulting from the alienation of units in certain tax transparent entities and FCPs, to the extent the value of these 'shares' reflects the value of real estate located in Luxembourg, including when these transfers do not lead to cash generation (e.g., intra-group restructuring). This levy is not deductible from the overall taxable real estate revenue nor creditable by any corporate or individual investor. This measure targets very specific cases while maintaining the current tax regime for Luxembourg investment vehicles and should only impact a very limited number of players.

Effective from 1 March 2021, some expenses incurred by corporate taxpayers towards recipients resident in non-cooperative jurisdictions are deemed to be non-tax deductible. Only interest and royalties' expenses paid or due to 'associated enterprises', as defined for the purposes of applying the Luxembourg's transfer pricing regime, are in the scope of this provision. This measure does not apply to operations that satisfy the 'valid commercial reasons that reflect economic reality' requirement (which shall be assessed on a case-by-case basis). The jurisdictions concerned are those listed in the most recent version of the 'Annex 1' list published in the Official Journal of the European Union.

On 12 May 2021, Amazon succeeded in its appeal against the European Commission's *State Aid* accusations. The case deals with the arm's-length nature of royalties paid by a Luxembourg operating company to a Luxembourg SCS (which is transparent for tax purposes) for the use of valuable IT rights related to technology, trademarks and customer lists. These royalty payments caused a large portion of Amazon's European-related profits to be outside of Luxembourg taxation because of the transparent nature of the Luxembourg SCS. In a 2003 tax ruling, the Luxembourg tax authorities confirmed the arm's-length nature of the deductible royalty payments. The EU General Court ruled in favour of Amazon considering that the European Commission had failed to prove that Amazon was granted a selective advantage deriving from the non-arm's-length character of the intragroup transactions.

## XI OUTLOOK AND CONCLUSIONS

Luxembourg is committed to continuing and extending its role as a major European financial centre, ensuring at the same time the transparency and, in general, compatibility with EU laws and principles of its own tax law. Outside the taxation arena, major initiatives are being undertaken in other fields, notably that of investment funds, one of the other main drivers in the financial area.

**Appendix I: Domestic and treaty rates for dividend, interest and royalty payments**

| | **Dividends** | | **Interest** | **Royalties** |
|---|---|---|---|---|
| | **Individuals, companies** | **Qualifying companies** | | |
| **Domestic rates %** | | | | |
| Companies | 15 | 0 | 0/15 | 0 |
| Individuals | 15 | N/A | 0/15 | 0 |
| **Treaty country %** | | | | |
| Andorra | 15 | 0/5 | 0 | 0 |
| Armenia | 15 | 5 | 0/10 | 5 |
| Austria | 15 | 5 | 0 | 10 |
| Azerbaijan | 10 | 5 | 10 | 5/10 |
| Bahrain | 10 | 0 | 0 | 0 |

| | Dividends | | Interest | Royalties |
|---|---|---|---|---|
| | Individuals, companies | Qualifying companies | | |
| **Treaty country %** | | | | |
| Barbados | 15 | 0 | 0 | 0 |
| Belgium | 15 | 10 | 0/15 | 0 |
| Brazil | 25 | 15 | 0/10/15 | 15/25 |
| Brunei | 10 | 0 | 0/10 | 10 |
| Bulgaria | 15 | 5 | 0/10 | 5 |
| Canada | 15 | 0/5/10 | 0/10 | 0/10 |
| China | 10 | 5 | 0 / 10 | 6/10 |
| Croatia | 15 | 5 | 0/10 | 5 |
| Cyprus | 5 | 0 | 0 | 0 |
| Czech Republic | 10 | 0 | 0 | 10 |
| Denmark | 15 | 5 | 0 | 0 |
| Estonia | 10 | 0 | 0 | 0 |
| Finland | 15 | 5 | 0 | 0/5 |
| France | 0 | 0 | 0 | 0 |
| Georgia | 10 | 0/5 | 0 | 0 |
| Germany | 15 | 5 | 0 | 5 |
| Greece | 7.5 | 7.5 | 8 | 5/7 |
| Guernsey | 15 | 5 | 0 | 0 |
| Hong Kong | 10 | 0 | 0 | 3 |
| Hungary | 10 | 0 | 0 | 0 |
| Iceland | 15 | 5 | 0 | 0 |
| India | 10 | 10 | 10 | 10 |
| Indonesia | 15 | 10 | 10 | 10/12.5 |
| Ireland | 15 | 5 | 0 | 0 |
| Isle of Man | 15 | 5 | 0 | 0 |
| Israel | 15 | 5 | 0/5/10 | 5 |
| Italy | 15 | 15 | 10 | 10 |
| Japan | 15 | 5 | 0/10 | 10 |
| Jersey | 15 | 5 | 0 | 0 |
| Kazakhstan | 15 | 5 | 0/10 | 10 |
| Laos | 15 | 0/5 | 0/10 | 5 |
| Latvia | 10 | 5 | 0/10 | 0/5/10 |
| Liechtenstein | 15 | 0/5 | 0 | 0 |
| Lithuania | 15 | 5 | 0/10 | 0/5/10 |
| Macedonia | 15 | 5 | 0 | 5 |
| Malaysia | 10 | 0/5 | 10 | 8 |
| Malta | 15 | 5 | 0 | 10 |
| Mauritius | 10 | 5 | 0 | 0 |
| Mexico | 15 | 5 | 0/10 | 10 |
| Moldova | 10 | 5 | 0/5 | 5 |
| Monaco | 15 | 5 | 0 | 0 |
| Morocco | 15 | 10 | 10 | 10 |

| | Dividends | | Interest | Royalties |
|---|---|---|---|---|
| | Individuals, companies | Qualifying companies | | |
| **Treaty country %** | | | | |
| Netherlands | 15 | 2.5 | 0 | 0 |
| Norway | 15 | 5 | 0 | 0 |
| Panama | 15 | 5 | 0/5 | 5 |
| Poland | 15 | 0 | 0/5 | 5 |
| Portugal | 15 | 15 | 10/15 | 10 |
| Qatar | 5/10 | 0 | 0 | 5 |
| Romania | 15 | 5 | 0/10 | 10 |
| Russia | 15 | 5 | 0 | 0 |
| San Marino | 15 | 0 | 0 | 0 |
| Senegal | 15 | 5 | 10 | 6/10 |
| Saudi Arabia | 5 | 5 | 0 | 5/7 |
| Serbia | 10 | 5 | 10 | 5/10 |
| Seychelles | 10 | 0 | 0/5 | 5 |
| Singapore | 0 | 0 | 0 | 7 |
| Slovakia | 15 | 5 | 0 | 10 |
| Slovenia | 15 | 5 | 5 | 5 |
| South Africa | 15 | 5 | 0 | 0 |
| South Korea | 15 | 10 | 5/10 | 5/10 |
| Spain | 15 | 5 | 10 | 10 |
| Sri Lanka | 10 | 7.5 | 10 | 10 |
| Sweden | 15 | 0 | 0 | 0 |
| Switzerland | 15 | 0/5 | 0/10 | 0 |
| Taiwan | 10/15 | 10/15 | 10/15 | 10 |
| Tajikistan | 15 | 0 | 0/12 | 10 |
| Thailand | 15 | 5 | 10/15 | 15 |
| Trinidad and Tobago | 10 | 5 | 0/7.5/10 | 10 |
| Tunisia | 10 | 10 | 7.5/10 | 12 |
| Turkey | 20 | 5 | 10/15 | 10 |
| Ukraine | 15 | 5 | 5/10 | 5/10 |
| United Arab Emirates | 10 | 0/5 | 0 | 0 |
| United Kingdom | 15 | 5 | 0 | 5 |
| United States | 15 | 0/5 | 0 | 0 |
| Uruguay | 15 | 5 | 0/10 | 5/10 |
| Uzbekistan | 15 | 5 | 0/10 | 5 |
| Vietnam | 10/15 | 5/10 | 5/7/10 | 5/10 |
| Source: IBFD, Amsterdam, based on information available on 2 November 2021 | | | | |

It is not uncommon for a tax treaty to establish more than one highest withholding tax rate applicable to the same item of income (e.g., dividends, interest or royalties). For instance, dividend withholding rates generally decrease when certain participation thresholds are reached. At the same time, interest paid by or to the government of one contracting state is frequently exempt from withholding tax. However, because each treaty is the result of the negotiation between Luxembourg and the relevant contracting state, it is not possible to define a common rule on the application of treaty rates. For more information, reference should be made to the specific tax treaty.[29]

On 7 June 2017, Luxembourg (together with 67 other jurisdictions) signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI). On 14 February 2019, Luxembourg's parliament adopted the law ratifying the MLI, which was then notified to the OECD on 9 April 2019. The entry into force of the MLI with respect to Luxembourg occurred on 1 August 2019. In terms of timing, however, owing to the required national ratification procedure in both jurisdictions that are party to a matching treaty, as well as the timetable provided in the MLI, large-scale effects were variable. However, for many Luxembourg's treaties, the new 'Principal Purpose Test' took effect on 1 January 2020.

The purpose of the MLI is to introduce the BEPS principles in double tax treaties. Luxembourg declared that all the signed tax treaties currently in force will be seen as covered tax treaties for the purpose of the MLI. However, a large number of treaty partners have not signed yet the MLI (including the United States). Even though Luxembourg has made several reservations about the application of the MLI, which in most instances will be applied only as far as the 'minimum standards' are concerned, certain MLI provisions (e.g., the principal purpose test) will affect the application of the current double tax treaties.

29 See https://impotsdirects.public.lu/fr/conventions/luxembourg.html.

**Appendix 1**

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