LOYENS & LOEFF

Luxembourg investment climate
Main tax features

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Main Tax Features

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Preface

When you close your eyes and think of Luxembourg, the Moselle river with its vineyards on either side will almost certainly come to mind. Maybe even the beautifully preserved castles of Vianden, Beaufort or Bourscheid to mention just a few. Typical Luxembourg scenery like this attracts vast amounts of visitors. Among them international investors, although they will probably be more interested in another attraction: the Luxembourg investment climate.

This booklet is meant for investors and their advisers. To inform them about the main features of the investment climate in Luxembourg – what makes an investment in Luxembourg worthwhile? We do so in general, by setting out the main benefits of operating your business from Luxembourg. And, being a firm of lawyers and tax advisers, we specifically focus on the main tax aspects of investing in Luxembourg. Not by giving a (theoretical) overview of Luxembourg tax law, but by explaining in practical terms what other investors have done. In other words, we describe Luxembourg tax in its applied form – how it works in action. Having read this booklet, also gives you sufficient background to help you talk with confidence to Luxembourg tax counsel (presumably, Loyens & Loeff).

Our home markets are in Luxembourg, Belgium, the Netherlands and Switzerland. Which is why we have similar publications for our other home markets, the Netherlands, Belgium and Switzerland. We present each country without a bias for one particular country. If you want to compare specific countries, we recommend you get them. That allows you to take an informed decision on which country best fits your business and market.

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Enjoy the read!

Willem Jarigsma
Managing Partner, Loyens & Loeff

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Introduction

A tax guide to the broad spectrum of issues related to doing business in Luxembourg is bound to be incomplete: what has been attempted is to provide a condensed inventory of the most commonly encountered issues.

The purpose of the guide is to respond to the increased need for instant information on various tax aspects of doing business and making investments in Luxembourg. It is a product of the firm's continued effort to invest in knowledge and to share this result with its clients. The present information should allow the reader to more easily identify detailed issues as well as assist in raising focused questions. It is our belief that a law firm should, in the first place, create added value and this starts with making sure the basics are readily available.

The law changes constantly. We have taken account of the law, as it stands at 31 August 2015. Readers are, therefore, well advised to always seek up to date or more detailed specialised advice.

Doing business in Luxembourg

Luxembourg is a small country located in the heart of Europe with an international and multilingual workforce. The country's three official languages include French, German and Luxembourgish, although English is the language of the financial sector. Luxembourg is one of the founding members of the European Union, and Luxembourg City is the seat of several European Union institutions. The country has a strong and stable economy, and its GDP per capita consistently ranks among the highest in the world. Luxembourg is widely known for its major international financial centre, but it should also be pointed out that it boasts a strong industrial sector. Moreover, Luxembourg offers an extraordinarily high standard of living. The following paragraphs touch on these and more elements in slightly more detail.

1 Ease of doing business

For decades, international businesses have chosen Luxembourg to base their operations. The pro-business environment and supporting policies implemented by the Luxembourg government have greatly benefited the international popularity of Luxembourg as an investment location.

2 Solid workforce

Luxembourg features a highly skilled, flexible and productive workforce. Luxembourg professionals are also among the most multilingual in the world, enabling them to successfully operate within a vast range of industries that are engaged in cross-border trade and services.

3 Stable political climate

Luxembourg has a stable political climate. This is strongly evidenced by the fact that the previous prime minister was in function from 1995 until 2013, and that strikes are rarely regarded as the primary means to settle labor disputes (and as such have been very rare over time).

4 Transparent and firm regulatory framework

Specific markets, industries, consumer rights, and competition behaviour of individual firms, are firmly regulated by national and European institutions. Financial markets are supervised by the national regulators, the Luxembourg Central Bank and the Luxembourg Financial Sector Supervisory.

5 Flexible, reliable and enforceable legal framework

The Luxembourg legal framework is very flexible and user-orientated. To a considerable extent, it is possible to shape the Luxembourg entity and its surrounding contractual agreements in a manner which caters to the requirements and frameworks preferred by parties from different jurisdictions. Of great importance is a court system that has a reputation for reliability and transparency.

6 Exceptional quality of life

The Luxembourg standard of living, though very high, remains affordable. The cost of living, housing, education and cultural activities are lower than in most Western European countries, and there is a great selection of these cultural highlights available to both residents and visitors alike. The openness of Luxembourg society and its wide variety of leisure activities make the country a welcoming home to new expatriates.

Tax feature 1: Holding activities

As a result of Luxembourg's efficient holding regime, extensive tax-treaty network and approachable tax authorities, Luxembourg is internationally accepted and widely used as a jurisdiction for establishing holding companies.

1 Introduction

"Soparfi" (*Société de Participations Financières*) is the term used for a company incorporated under Luxembourg law whose corporate object is the holding of participations in other companies. A Soparfi is fully subject to corporate income tax and net wealth tax and may benefit from the participation exemption regime, which generally provides for a CIT exemption on income and capital gains derived from shares, and an NWT exemption on net wealth allocable to these shares. Shareholders of a Soparfi may benefit from a wide range of withholding tax exemptions for dividends distributed by the Soparfi.

2 The participation exemption

Dividends (including liquidation proceeds) received and capital gains (including foreign exchange rate gains) derived from participations in the nominal paid-up capital of a subsidiary held by a Soparfi are fully exempt from CIT, provided that the following requirements are met:

a. the subsidiary is (i) an entity covered by article 2 of the Parent-Subsidiary Directive, (ii) a fully taxable resident company, or (iii) a company subject to an income tax comparable with Luxembourg corporate income tax (in practice, a minimum rate of 10.5% levied on a basis determined in accordance with Luxembourg standards, is required); and

b. at the time the dividend or the capital gain is realised, the Soparfi must have held for an uninterrupted period of at least 12 months (or undertake to continue to hold for an uninterrupted period of at least 12 months) a participation of at least 10% in the subsidiary's nominal paid-up capital; or alternatively, a direct participation with an acquisition price of at least €1.2 million for dividends, or €6 million for capital gains.

The 10% threshold should be assessed on the overall nominal paid-up capital and not on a share class per share class basis. The acquisition price is an off-balance sheet item and only recorded in the tax return of the shareholder. The acquisition price includes the expenses attributable to the acquisition (e.g. lawyer fees). A bill of law is currently pending targeting abuse of the participation exemption for dividends in relations covered by the EU Parent-Subsidiary Directive. This will typically target the interposition under a Luxembourg company of EU holding companies for the purpose or one of the main purposes to convert taxable dividends into tax exempt dividends.

Even if the above conditions are met, the participation exemption on the dividends and capital gains can, however, be denied for a period of five years following acquisition if a non-qualifying participation was exchanged in a tax neutral manner for a qualifying participation. The conditions for the participation exemption for dividends (not capital gains) are generally relaxed under the tax treaties Luxembourg has concluded with other countries (see Tax feature 9).

Capital losses on alienation or liquidation derived from a participation are tax deductible.

3 Deduction of costs and recapture rule and loss carryforward

If a dividend is tax exempt, costs directly and economically related thereto (typically interest costs on loans that finance the participation but also impairments on loans granted to the participation) are tax deductible in a given year, but only insofar as they exceed the exempt dividends from the participation in the same year. An impairment of a participation in the tax books is tax deductible. An impairment of a participation triggered by a distribution of exempt dividends is, however, not tax deductible. A latter revaluation should, thus, not be taxable. Luxembourg tax law provides that a latter revaluation of the participation is assimilated to a dividend up to the amount of the impairment triggered by the distribution of exempt dividends and is, therefore, tax exempt.

The aforementioned deductible costs and impairments may be offset against other income such as income from financing or commercial activities, or may result in tax losses that can be carried forward indefinitely. At the time when an exempt capital gain is realised on the relevant participation, the net negative revenues derived from the participation and loans granted to the participation in the year of realisation and previous years reduce the exempt part of the capital gain (recapture rule). There

should, in fact, be no effective taxation on the non-exempt part of the capital gain due to the available losses and unlimited loss carryforwards, provided the costs or losses were not offset against income from other activities.

Loss carryforward can be denied in case of abuse – so when the purpose of a transaction is to secure Luxembourg tax savings. Abuse may lead to the denial of loss carryforward when the transfer of shares in a company that avails of losses is made to new shareholders whose sole aim is to avail of the losses. The relevant circumstances that support abuse are the termination of the loss-generating activities by the old shareholder, the termination of these activities coinciding with the share transfer, and when at the moment of the transfer the company does not avail of any meaningful assets.

4 Debt-to-equity ratios

Luxembourg's income tax act (ITA) legislation does not provide for debt-to-equity ratios. As a matter of policy, the Luxembourg direct tax authorities may, however, apply a debt-to-equity ratio of 85/15 for holding activities. Return paid on excessive debt financing is re-qualified as a dividend distribution and is subject to 15% withholding tax unless a withholding tax exemption applies. The excessive interest, which is re-qualified as a distribution, is also considered as non-deductible. The latter should not trigger adverse tax effects if the Soparfi only has tax exempt income under the participation exemption regime and has a shareholder entitled to a dividend withholding tax exemption.

5 Net wealth tax aspects

NWT is levied at a rate of 0.5% on January 1 of each year on the net wealth of a company (generally the fair market value of the assets minus the liabilities). The value of the participations meeting the requirements as set out under II (except the minimum holding period), net of allocable liabilities, is exempt from NWT. The conditions for the participation exemption for net wealth tax purposes are generally relaxed under the tax treaties Luxembourg has concluded with other countries (see Tax feature 9). A reduction for NWT purposes can be claimed provided (i) an amount equal to five times the requested NWT deduction is allocated to a net wealth tax reserve as recorded in the commercial accounts, (ii) the reserve is formed no later than the closing of the financial year following the year for which the reduction is claimed, (iii) the reserve is maintained for five years, and (iv) the reserve is formed of commercial profits of the relevant year and, in case there is not sufficient profit

for the relevant year, it can be formed of freely distributable reserves of prior years. The amount of the NWT reduction is capped at the corporate income tax (calculated prior to any tax credits) for the previous year and is reduced by the amount of the minimum tax (see VI) that is due for the previous year.

6 Minimum taxation

A company with its statutory seat or central administration in Luxembourg is subject to an annual minimum CIT levy. A Luxembourg permanent establishment of a foreign company is, therefore, not subject to this minimum CIT levy. This minimum CIT levy (including the 7% surcharge for the unemployment fund) is €3,210 for a company of which the assets are, for more than 90%, composed of fixed financial assets, receivables on related parties, cash and cash equivalents as referred to in account 23, 41, 50 and 51 of the Luxembourg standard set of accounts (*plan comptable normalisé*) at the end of the relevant taxable year, and the aggregated value of such assets exceeds €350,000. Interest in Luxembourg and foreign partnerships are considered to qualify under account 23. Considering the activities of a Soparfi, it should normally be subject to this minimum tax. Companies that do not meet the latter asset test are subject to a progressive minimum tax contingent on the balance sheet total. The lower minimum tax bracket amounts to €535 for a balance sheet total of up to €350,000, and the higher bracket amounts to €21,400 for a balance sheet total exceeding €20,000,000. Assets which generate revenues that are exclusively taxable in a treaty state (e.g. real estate situated in a treaty country) are excluded when assessing the 90% threshold. Tax credits cannot reduce the minimum tax. The minimum tax itself reduces the CIT tax charge in a latter year to the extent it exceeds the tax charge due for the tax year. The minimum tax is not reimbursable. In case of a fiscal unity, the minimum tax liability levied from the head of the fiscal unity is determined on a company-by-company basis, but the aggregate amount cannot exceed €20,000. Minimum tax also applies to SICARs and SVs (see Tax feature 5 and 7 respectively).

7 Taxation of a Soparfi’s shareholders

Dividends

Dividends paid by a company with its statutory seat or central administration in Luxembourg are subject to 15% withholding tax, unless a lower treaty rate applies. An exemption, however, applies if the distributor is a Luxembourg company which is fully subject to tax in Luxembourg with either a Luxembourg legal form, or a legal

form of a member state or a fully taxable capital company which has a legal form of a non-member state and the recipient is:

(i) a company covered by article 2 of the Parent-Subsidiary Directive or a permanent establishment thereof;
(ii) a fully taxable resident capital company with a legal form of a non-member state or a permanent establishment thereof;
(iii) a company resident in a treaty state and subject to a tax comparable to the Luxembourg corporate income tax, or a domestic permanent establishment thereof;
(iv) a Swiss company subject to tax in Switzerland and not benefiting from a tax exemption; and
(v) a capital company or a cooperative company resident in an EEA country other than a member state and fully subject to a tax comparable to the Luxembourg corporate income tax regime, or a permanent establishment thereof

provided the parent company has held shares in the Soparfi which represent at least 10% of the nominal paid-up capital or shares in the Soparfi, having an acquisition cost price of €1.2 million for an uninterrupted period of at least 12 months (or undertakes to continue to hold them for an uninterrupted period of at least 12 months). A bill of law is currently pending targeting abuse of the withholding tax exemption in relations covered by the EU Parent-Subsidiary Directive. This will typically target the interposition on top of a Luxembourg company of an EU holding company for the purpose or one of the main purposes to convert dividends subject to withholding tax in tax exempt dividends.

Liquidation distributions and capital repayments

Liquidation distributions are not subject to withholding tax. Partial liquidation distributions (buyback and cancellation of all the shares held by a specific shareholder or an entire class of shares held by a specific shareholder) are also not subject to withholding tax. Repayments of nominal paid-up capital, not being capitalised retained earnings, should not be subject to withholding unless sound economic reasons for the repayment can be demonstrated. If the nominal paid-up capital repayment is subject to withholding tax, the aforementioned exemptions can be applied, provided the relevant conditions are met. Share premium and capital contributions under private seal are, in practice, considered to benefit from the same treatment; although they formally do not qualify as nominal paid-up capital.

Capital gains and liquidation proceeds realised by non-resident shareholders

Non-resident shareholders (those without a Luxembourg permanent establishment to which the shares in a company are allocable) are only taxable on the realisation

of a capital gain (or liquidation gains) in respect of shareholdings of more than 10% in a company with its statutory seat or central administration in Luxembourg if they realise that capital gain within six months after acquisition, or if they became non-resident taxpayers less than five years before the realisation took place and have been Luxembourg resident taxpayers for more than 15 years. However, shareholders resident in a country with which Luxembourg has concluded a treaty are generally not taxable on such capital gains in Luxembourg.

8 Debt forgiveness

The Luxembourg ITA provides for a specific provision to avoid direct adverse tax effects of (partial) debt forgiveness. If a debt is fully or partially waived with a view on the financial recovery of the company, such waiver profit is eliminated from the profits of the debtor to the extent that it results in a net profit for the company in the relevant year (prior to loss carryforward). The eliminated amount, however, reduces the available loss carryforwards of the company. If the debt waiver is motivated by shareholder reasons (non-business reasons), the waiver should qualify as an informal capital for an amount equal to the fair market value of the receivable. Hence, for that amount the waiver should not be subject to taxation at debtor's level.

9 Treaty entitlement

Soparfi should be entitled to benefit from treaties (see Tax feature 9).

Tax feature 2: Intra-group financing activities

As a result of its efficient legal framework, extensive tax treaty network and approachable tax authorities as well as the absence of interest withholding tax, Luxembourg is internationally accepted and widely used as a jurisdiction for establishing financing companies.

1 Introduction

Luxembourg is an attractive jurisdiction for (intragroup) financing companies as it provides for an efficient legal framework, generally does not levy withholding tax on interest or impose a debt-to-equity ratio for financing activities. It also has an extensive treaty network (see Tax feature 9) and gives access to the EU Interest and Royalty Directive, which generally provides for reduced withholding taxes on foreign source interest and for an absence of withholding taxes on certain intragroup interest respectively.

2 The Financing Circulars

Financing companies may obtain advance confirmation on the arm's length character of the remuneration they report for their financing activities. In 2011, the Luxembourg tax authorities issued Financing Circulars specifying their new policy for providing such confirmation to intragroup financing companies, i.e. financing companies which principally lend money to related parties refinanced by any financial means and instruments, whether related or not (FinCos). A company is considered to be related to the lender if one participates (in)directly in the other's management, control, or the same person participates (in)directly in two other companies (e.g. sister companies). Unfortunately, the Financing Circulars do not provide any guidance on the required level of the participation. In practice, more and more financing companies that lend money to non-related entities and aim to seek confirmation on the arm's length character of the remunerations they earn also tend to be compliant with the requirements imposed by the Financing Circulars.

3 Requirements imposed by the Financing Circulars

The Financing Circulars impose certain substance, risk and transfer pricing requirements on FinCos seeking advance confirmation of the arm's length nature of the remuneration they report on their financing transactions.

Substance requirement

On the substance side, the Financing Circulars require the FinCo to be effectively managed in Luxembourg. This means, in particular, that a majority (half plus one) of its directors must be Luxembourg (professional) residents. Corporate directors are permitted provided they have their statutory seat and central administration in Luxembourg. The directors must have the necessary professional knowledge to perform their functions. Key decisions should be taken in Luxembourg. The Financing Circulars do not clarify when a decision qualifies as a key decision, but decisions on seeking and granting financing should qualify as such. 'Taking decisions' should mean that a decision should not merely be ratified in Luxembourg yet actually made elsewhere. It can generally be held that a decision is taken 'in' Luxembourg if it is passed during a board meeting organised in Luxembourg. The Financing Circulars do not impose a minimum number of annual board meetings but requires that the FinCo disposes of a Luxembourg bank account, that it has met its Luxembourg tax filing obligations and that it is not considered a tax resident of another country. The Financing Circulars do not impose that the FinCo's books are kept in Luxembourg. From a general substance perspective, however, it is recommended that one complies with that as well.

Risk requirement

The Financing Circulars also require a minimum amount of the FinCo's equity to be at risk in relation to its financing activities (1% of on-lent funds or €2 million, whichever is lower). A FinCo solely engaged in financing activities (its only asset is the loan granted) with an actual amount of equity in accordance with the aforementioned equity cap meets such a risk profile by definition. Such a FinCo can, however, become insolvent if the loan granted defaults for an amount in excess of the equity. To avoid insolvency of FinCos the Luxembourg direct tax authorities require, in practice, that the loan obtained contains a limited recourse clause. Such a clause provides that the loan obtained is automatically waived for an amount equal to the defaulted amount under the loan granted to the extent this defaulted amount exceeds the required equity at risk. If a FinCo has more equity than the required equity at risk, a limited recourse clause may limit the potential erosion of the equity in accordance with the above-mentioned minimum equity at-risk requirement. The latter would entail a reduced-risk profile and a lower taxable remuneration as a consequence. In case of a third-part lender, a limited recourse clause is normally unacceptable;

in such a case a keep-well agreement can, for example, be concluded with the parent of the FinCo which limits the FinCo's risk profile to the minimum equity at-risk requirement. Alternatively one may demonstrate that the lender will take control of the borrower (e.g. via a share pledge) and will restructure the financing arrangement without triggering the bankruptcy of the company.

Transfer pricing requirement
The interest margin reported by a FinCo must be substantiated in a transfer pricing report. The report will define and analyse the functions and risks of the FinCo to calculate the relevant remuneration which follows from a specific transfer pricing software program.

Failure to comply with the Financing Circulars requirements may entail that the Luxembourg tax authorities may not endorse the FinCo's position as the beneficial owner of the interest it receives. It should be well understood that the latter does not mean that the FinCo's claim of beneficial ownership is only endorsed if advance tax confirmation is obtained. If the Luxembourg tax authorities do not endorse a beneficial ownership claim this might result in the refusal of treaty or EU Interest and Royalty Directive benefits by the country where the FinCo's debtor is situated (e.g. refusal to grant reduced interest withholding tax rates). In practice, the requirements imposed by the Financing Circulars is not considered as burdensome, and they further improve Luxembourg's image as a leading international financing centre.

Tax feature 3: Fiscal unity regime

Group companies can be consolidated for Luxembourg CIT purposes, thus potentially leading to tax savings and administrative relief.

1 Introduction

Luxembourg provides for a fiscal unity regime which allows Luxembourg groups to assess their CIT charge on an integrated basis. The fiscal unity regime does not apply for NWT purposes. A bill of law is currently pending which introduces the possibility of horizontal integration, meaning a fiscal unity with a parent company that is not in the scope of the Luxembourg tax framework. The changes proposed by this bill of law are reflected in this section.

2 Eligibility criteria

The following requirements must be met to form a fiscal unity:

(i) the head of the fiscal unity must be (i) a fully taxable Luxembourg resident capital company, or (ii) a permanent establishment of a non-resident capital company which is subject to a tax corresponding to the CIT (referred to as Parent);
(ii) the subsidiaries must be fully taxable Luxembourg resident capital companies;
(iii) the Parent must at least hold directly or indirectly 95% (75% in very specific cases being subject to approval of the Minister of Finance) of the capital of the subsidiaries. The percentage held in the capital of subsidiaries which are held via tax transparent Luxembourg entities are considered as directly held by the Parent proportionally to the fraction it holds in the net invested assets of the tax transparent Luxembourg entity;
(iv) if the Parent holds the subsidiary indirectly, the foreign intermediate company must be a fully taxable capital company subject to a tax that corresponds to the CIT; and
(v) the companies must open and close their accounting period on the same date.

The functional currency of the entities which form part of the fiscal unity must be equal. Although they qualify as fully taxable Luxembourg resident capital companies, a SICAR and a securitisation company cannot form part of a fiscal unity. The threshold of 95% must be maintained without any interruptions, from the beginning of the first accounting year for which the fiscal unity is requested. The latter requirement entails that the integration of a subsidiary in the fiscal unity during a financial year is, in principle, not possible. The fiscal unity regime does not impose any requirements on economic and organizational integration.

3 Fiscal unity request

The Parent and the subsidiaries can, on written request, form a fiscal unity. The written request must be filed with the Luxembourg tax authority (LTA) in the name of the Parent and all the subsidiaries. The request must be filed before the end of the first book year for which the fiscal unity is requested. The fiscal unity should be maintained for at least five book years.

4 Effects of the fiscal unity

The Luxembourg fiscal unity regime does not work as a tax consolidation. All companies (Parent and subsidiaries) in the fiscal unity determine their taxable result on a standalone basis, and each files a separate tax return. The companies forming part of the fiscal unity have to file separate tax returns and respect the at-arm's-length principle in dealings with each other. The profits and losses of the Parent and its subsidiaries in the fiscal unity are subsequently added up (apart from some small adjustments to avoid double (non-) taxation), and the Parent entity will file an extra tax return on the basis of which the tax charge for the fiscal unity is determined. Tax assessments will only be issued to the head of the fiscal unity. The Parent is held responsible for paying the CIT for the members of the group. Luxembourg tax legislation does not foresee whether the fiscal unity members can be held jointly or severally liable for the taxes due by the Parent of the fiscal unity.

The ITA only provides for loss carryforward rules (loss carryback is impossible) without limitation. Only the company that suffered the losses can deduct them from its future profits. Pre-fiscal unity losses can, therefore, only be carried forward on taxable profits of the member of the fiscal unity that incurred them. This principle is, in practice, not only applied to subsidiaries but also to the pre-fiscal unity losses of the Parent of the fiscal unity. Fiscal unity losses deemed to be suffered by the Parent can only be carried forward to the fiscal unity profits which are also deemed to be

generated by the Parent of future years. This entails that if a company is demerged from the fiscal unity (without retroactive effect) it will not avail of its standalone losses for the fiscal unity period. The fiscal unity may further have effect on the possibility to reduce the net wealth tax burden. A reduction is granted if certain conditions are met, but a cap applies which equals the annual corporate income tax due. If the company that applies for the credit is merged in a fiscal unity, the cap is assessed on the basis of the total corporate income tax due of the fiscal unity.

5 The term and termination of the fiscal unity

The fiscal unity applies for a period of at least five book years. If this is interrupted before the end of this five-year period, the advantages enjoyed under the fiscal unity regime are wound back with retroactive effect. The fiscal unity is automatically extended after the lapse of the five-year period, provided the relevant conditions remain or are still intended to be met. If such conditions are not met, the fiscal unity is interrupted with effect as per the beginning of the book year during which the conditions were not met. Based on the current practice, absorptions or liquidations of entities within the fiscal unity should not terminate the fiscal unity. If the Parent of the fiscal unity were to change, however, the fiscal unity would be considered as interrupted.

Tax feature 4: Intellectual property regime

As a result of its intellectual property (IP) regime, extensive tax treaty network, approachable tax authorities and the absence of withholding tax on royalties, Luxembourg is internationally accepted and widely used as a jurisdiction to establish intellectual property companies.

1 Introduction

Luxembourg's IP regime provides for an 80% exemption from CIT for net positive income and capital gains derived from IP acquired or created after 31 December 2007. Thus the effective tax rate in the IP regime is reduced from the general combined rate of 29.22% to 5.84% for 2015 in Luxembourg City. Luxembourg provides for a tax credit/deduction for royalty withholding tax imposed by source countries. Net wealth allocable to qualifying IP is not subject to NWT. The Luxembourg government has indicated that the IP regime will be aligned with the modified nexus approach as proposed in the context of the BEPS project. In essence, this approach requires that the benefits of the IP regime are only granted in relation to patents and only in proportion to the research and development (R&D) costs incurred by the taxpayer in relation to that patent.

2 Ownership requirement

The IP regime may only be applied by the IP's owner. In the case of a discrepancy between legal and economic ownership, the latter prevails. The economic owner is the party who generally exercises effective control over the IP and can exclude the legal owner from his economic influence during the IP's expected lifetime. The fact that the economic owner can apply the IP regime is a very welcome feature as it may avoid burdensome re-registration of the IP rights needed to transfer the legal ownership.

3 Qualifying IP requirement

To benefit from the IP regime, the net positive income and capital gains must be attributable to the following categories of IP:

(i) software copyrights
(ii) patents
(iii) trademarks
(iv) service marks
(v) designs
(vi) models
(vii) top-level and lower-level domain names

The concept of a patent also covers utility models and pharmaceutical supplementary protection certificates. The circular to the IP regime also stipulates that name and image rights which are registered as a trademark may benefit from the IP regime, provided that they are used to commercialise products or services.

4 Qualifying revenue requirement

Net positive income and capital gains related to the IP benefit from the IP regime. Net positive income is defined as gross income less costs in a direct economic relationship to that income, including depreciation and amortization. To qualify for the IP regime, the income must have the form of a royalty for the use of or entitlement to use the IP. A royalty is a payment for the use or the entitlement to use the IP that would infringe the protection right if no license agreement were to be in place. Compensation payments for the infringement of IP rights qualify as well. The form of the payment (e.g. lump sum, instalment, or contingency payment) is not relevant. Capital gains on the alienation of IP are 80% exempt in the year of alienation. The exempt amount is reduced by the sum of 80% of the net negative revenues stemming from the alienated IP in the year of alienation and previous years, but only insofar as these net negative revenues have not been capitalised under the capitalisation requirement explained in section VI below. Losses from prior years may be carried forward for their full amount and offset against the non-exempt part of the capital gain.

5 Creation and acquisition date requirement

To qualify for the IP regime, the IP must be acquired or self-developed after 31 December 2007. In case of a discrepancy between the legal and economic ownership, the time when the economic ownership is acquired should be decisive. For an acquisition of the ownership of IP, determining the date on which the ownership

passes should not pose a problem. No new acquisition date is recognised when, inter alia, a permanent establishment (not a legal distinct entity) to which the IP is allocated is created in Luxembourg, or a company owning IP is migrated to Luxembourg.

6 Capitalisation requirement

Before the IP regime can be applied, all costs, including depreciation and amortisation costs attributable to the IP, must be capitalised and will be integrated in the taxable result for the first year in which the regime applies. The capitalised cost may be amortised for tax purposes over the IP's useful lifetime. The profit realised as a result of this capitalisation does not benefit from the IP regime. However, losses from prior years may be carried forward and will offset the profit originating from the capitalisation.

7 Anti-abuse requirement

To avoid possible abuse, IP acquired from related companies as opposed to individuals does not qualify for the IP regime. Related companies are defined as entities:

(i) which directly own at least 10% of the Luxembourg taxpayer's capital;
(ii) at least 10% of whose capital is directly owned by the Luxembourg taxpayer; or
(iii) at least 10% of whose capital is directly owned by a company which also directly holds at least 10% of the Luxembourg taxpayer's capital.

The related party test is to be applied immediately before the transfer of the IP takes place. This means that a company which contributes its IP on the incorporation of its Luxembourg subsidiary would not be considered as related to that subsidiary because the subsidiary did not yet exist immediately prior to the contribution. The related party test does not prevent the taxpayer from applying the IP regime to royalty income received from related parties. Since the anti-abuse requirement only has an effect in the case of direct relationships, it should not, in practice, substantially hinder intragroup transfers of IP.

8 Tax credit/deduction for royalty withholding tax

A royalty withholding tax credit may, under certain conditions, be granted against Luxembourg CIT, including the surcharge for the unemployment fund, but not against municipal business tax due. Withholding taxes that cannot be credited can

be deducted from the Luxembourg company's CIT base. The credit is equal to the relevant net foreign income (after foreign withholding tax), grossed up against the Luxembourg CIT rate multiplied by the Luxembourg CIT rate but cannot exceed the foreign taxes paid. Royalty withholding taxes can only be credited under the 'per country' method, meaning the credit is limited to the Luxembourg tax calculated on the basis of the net income derived from the relevant state. The Luxembourg tax authorities apply the following formula to calculate the credit if income benefits from the IP regime, which in essence provides for a gross-up at the effective tax rate under the IP regime: IP regime tax credit = R * T / 1 - T, where R = foreign income net of foreign taxes, and T = CIT rate.

9 Self-developed (pending) patents used in a taxpayer's own business

In the case where a self-developed (pending) patent is used in the taxpayer's own business, a deduction is granted which equals 80% of the net positive income which would be generated if the patent was licensed to a third party. The net positive income equals the fictitious gross income, which would be generated under a license to a third party, minus allocable expenses. The deduction is granted from the moment the patent is filed. If the patent is refused, the tax benefits obtained as a result of the deduction are recouped in the year of refusal.

Tax feature 5: SIF and SICAR regime

An attractive regulatory and tax framework for alternative investment funds is provided in Luxembourg in the form of the SIF regime and the SICAR regime. Both regimes are reserved for well-informed investors.

1 Introduction

Luxembourg provides an attractive tax and regulatory framework for alternative investment funds which are reserved for well-informed investors, i.e. the SIF (*fonds d'investissement specialisé*) and the SICAR (*société d'investissement en capital à risque*) regimes. Well-informed investors are institutional investors, professional investors and certain other investors with a confirmed status as 'well-informed investors' who either invest at least €125,000 or have been the subject of a positive assessment by a credit institution, investment firm or management company. A SIF may invest in any type of asset, but the principle of risk remunerationing applies. In general, the CSSF considers that the risk-remunerationing principle is complied with if the SIF does not invest more than 30% of its assets in securities of the same type issued by the same issuer. In addition, SIFs often benefit from a ramp-up period, which allows them to meet the diversification requirement over a period of time. SICARs can only make investments in risk capital (investments in companies in view of their launch, development or listing) and no risk-remunerationing requirements apply to them.

A SIF may be organised as a tax-opaque company in one of the various forms available in Luxembourg, as a tax-transparent partnership or contractual arrangement (*fonds commun de placement*) managed by a Luxembourg management company. A SIF organised as a contractual arrangement is, in practice, referred to as an FCP-SIF; a SIF organised as a company with variable capital as a SICAV-SIF; and a SIF organised as a company with fixed capital as a SICAF-SIF. A SICAR may be organised as a tax-opaque company or a tax-transparent limited partnership.

2 Taxation of the SIF and its non-resident investors

SIFs organised as companies are exempt from CIT and NWT. As a result of their tax transparency, SIFs organised as contractual arrangements or partnerships are not subject to CIT and NWT. SIFs are subject to an annual subscription tax levied at a rate of 0.01% on their total net assets; however, certain exemptions apply.

SIFs are also subject to annual charges and regulatory application charges levied by the CSSF. Distributions and capital gains realised in respect of SIFs by non-residents are not subject to Luxembourg taxation. Management services provided to a SIF benefit from a VAT exemption.

3 Taxation of a SICAR and its non-resident investors

SICARs organised as companies are subject to CIT but exempt from NWT. SICARs benefit from a CIT exemption for income and capital gains derived from securities (*valeurs mobilières*). Distributions and capital gains realised in respect of a SICAR by non-residents are not subject to Luxembourg taxation. Management services provided to a SICAR benefit from a VAT exemption.

4 Treaty entitlement

As an SIF organised as a company is tax-exempt, it may not be considered as a tax-liable person and, therefore, not as a treaty resident – meaning that it is not eligible for treaty benefits. An SIF organised as a partnership or in contractual arrangement is, in principle, not eligible for treaty benefits either; their investors may, however, be eligible for such benefits. A SICAR organised as a company is a fully taxable resident company, and hence should be eligible for treaty benefits. A SICAR organised as a partnership is, in principle, not eligible for treaty benefits; their investors may, however, be eligible for such benefits. Whether a treaty is actually applied will ultimately depend on the source state's view of the taxation of the SIF or SICAR, its status as beneficial owner and its Luxembourg substance in general. The availability of treaty benefits for investment funds is also considered in the context of the BEPS project. Developments in that field should be closely monitored.

Tax feature 6: SPF regime

The SPF regime provides for a beneficial tax regime for private asset management.

1 Introduction

The Luxembourg *Société de gestion de patrimoine familial* (SPF) is a specific type of company that can be set up for private asset management. A Luxembourg company may adopt the SPF regime if:

i. it adopts the legal form of an SA, S.à r.l., SCA or Coop SA;
ii. its sole object is the acquisition, holding, management and disposal of financial assets, excluding any commercial activity in the sense of the Luxembourg ITA;
iii. its shares are held by (a) one or more private individuals acting in the context of their private wealth management, (b) private wealth entities (trusts, foundations) acting solely for one or more private individuals, or (c) intermediaries acting on behalf of either (a) or (b); and
iv. its articles of association state that the company is subject to the SPF law.

The concept of ‘financial asset’ must be interpreted in the sense of the law of 5 August 2005 on financial guarantees for which the law provides a broad definition. It also covers cash deposits or deposits of any other nature (precious metals) held with a financial institution, and sophisticated products including derivatives, options and exchange rates. An SPF can hold participations and even a majority of the voting rights or share capital in such participations, provided it does not interfere in the management of the participation (it can thus not exercise any function in the governing bodies of the subsidiaries or render any services thereto). The SPF can therefore only exercise its voting rights in the subsidiaries it holds. An SPF cannot grant any loans, not even to its participations, but on an accessory basis and without remuneration the SPF may grant advances or guarantee the obligations of the company in which it holds a participation. An SPF cannot conduct a commercial activity, which is defined as an independent activity conducted on an ongoing basis that constitutes a participation in economic life and is conducted with the aim of making a profit. Examples are trading financial assets or the supply of (financial) services.

2 Taxation of an SPF

A company that has adopted the SPF regime is fully exempt from CIT and NWT. An SPF is subject to an annual subscription tax of 0.25%, levied quarterly, on the sum of (a) its share capital, (b) its premium, and (c) its outstanding debt when that debt exceeds eight times the sum of the share capital and premium. Retained earnings are not included in the subscription tax basis. The minimum annual amount of subscription tax is €100 and the maximum amount is €125,000.

3 Termination of the SPF status

When the SPF no longer fulfils all of the legal conditions of the SPF regime, the SPF can be denied the benefits of the SPF regime. In such a case, the SPF will be notified of the decision through a registered letter by the authorised authority in Luxembourg. After the termination of the SPF regime the Luxembourg company will no longer be subject to the subscription tax, but will become subject to CIT and NWT.

4 Taxation of non-resident foreign investors

Distributions and capital gains realised in respect of an SPF by non-residents are not subject to Luxembourg taxation.

5 Treaty entitlement

Due to its tax-exempt status, an SPF is generally not entitled to treaty benefits and it cannot benefit from the EU Parent-Subsidiary Directive.

Tax feature 7: Securitisation regime

Luxembourg has an attractive tax and legal framework for securitisation entities. Securitisation companies are generally tax neutral, but should be eligible for Treaty benefits.

1 Introduction

A Luxembourg securitisation entity may be set up in the form of a company, or as a contractual arrangement (*fonds de titrisation*) managed by a Luxembourg management company. As Luxembourg securitisation entities are seldom set up as contractual arrangements, we will not focus further on such entities here. To qualify as a securitisation company, the entity must carry out a full or partial securitisation, and its articles of association, management regulations or issuance documents must provide that it is subject to the securitisation law of 22 March 2004. The concept of securitisation is broad, covering every transaction by which a risk relating to any type of asset is acquired, and where securities are issued whose value or yield depend on that risk. Securitisation companies are often used for the acquisition of (distressed) debt. Only securitisation companies that issue securities to the public on a continuous basis, i.e. more than three times a year, are subject to authorisation by the *Commission de Surveillance du Secteur Financier* (CSSF). The guidance issued by the CSSF on permissible activities for a securitisation company may generally also be considered relevant for securitisation companies not subject to authorisation. According to the CSSF, a securitisation company should limit its activities to the passive administration of financial flows linked to the securitisation transaction itself and the prudent-man management of the securitised risks. It may not act as an entrepreneur.

2 Taxation of a securitisation entity

A securitisation company is fully subject to CIT in Luxembourg. A Luxembourg securitisation company benefits from a deduction right that aims to achieve tax neutrality. Under this right, commitments to pay a yield to investors and any other creditors are tax deductible – also if they arise in respect of equity capital. A securitisation company is not subject to NWT. Management services provided to a securitisation entity benefit from a VAT exemption.

3 Taxation of non-resident foreign investors

Distributions and capital gains realised by non-residents in respect of a securitisation entity are not subject to Luxembourg withholding tax. Non-resident shareholders (those without a Luxembourg permanent establishment to which the shares of a securitisation company are allocable) are not usually taxable, unless they realise a capital gain in respect of at least a 10% shareholding in the securitisation company within six months after acquisition, or became non-resident taxpayers less than five years before the disposal took place, after being Luxembourg resident taxpayers for more than 15 years. However, shareholders resident in a country with which Luxembourg has a treaty in force should generally not be taxable on such capital gains.

4 Treaty entitlement

As securitisation companies are fully taxable resident companies, they should in principle be eligible for treaty benefits. Whether a treaty is actually applied will ultimately depend on the source state's view of the taxation of the securitisation entity, its status as beneficial owner and its Luxembourg substance in general.

Tax feature 8: Unregulated funds structured as limited partnerships

The modernised Luxembourg limited partnership legislation offers a highly sophisticated and flexible contractual and efficient tax regime. The modernised legislation assists the establishment of vehicles suitable for structuring funds, most notably unregulated funds.

1 Introduction

The limited partnership legislation in Luxembourg was modernised in the summer of 2013 in ways that assisted the establishment of fund vehicles, most notably unregulated funds. As the investment platform which such vehicles use is often already based in Luxembourg, the whole fund structure can now be efficiently set up in Luxembourg, i.e. in a single jurisdiction. This should result in operational, tax substance and cost advantages.

2 Main legal characteristics

The legislation modernised the legal framework of the existing Luxembourg limited partnership (*société en commandite simple*), which has legal personality and introduced the new special limited partnership (*société en commandite spéciale*) without legal personality. The modernised provisions for the limited partnership (LP) are substantially applicable to the special limited partnership as well, unless indicated otherwise. The key characteristics, changes and implications are described below.

Establishment – a simple formality
An LP is established by contract (notarised or under private seal) between at least one partner who is jointly liable for the LP's obligations on an unlimited basis and usually has control over its management (i.e. the general partner, (GP)) and one or more partners who have limited liability, being the limited partners. The identity of limited partners is not publicly available.

Management of the LP
The legislation enables the governance of an LP to be organised flexibly. Managers of an LP may be appointed and removed under the rules established by the LP agreement. The management of an LP may be entrusted to one or more GPs, or to individuals who are not partners. Only GPs are liable without limitation; the other

managers will be liable only in cases of negligence. GPs and other managers do not have to be individuals but may be any Luxembourg legal entity. An LP is bound by any of its managers' acts towards third parties; even, in principle, if those acts exceed the LP's objects.

Participation by limited partners in management

Limited partners are prohibited from carrying out any acts of management other than internal management acts. They may be held jointly and individually liable to third parties for any commitments made by the LP in which they have participated contrary to this prohibition. There is a non-exhaustive list of acts which constitute internal management acts: (i) exercising partners' rights; (ii) providing advice to the LP, its affiliated entities or their respective managers; (iii) performing acts of control and supervision; (iv) granting loans, guarantees, securities or any other type of assistance to the LP or its affiliated entities; (v) granting authorisations to the managers as provided for in the LP agreement for acts exceeding the manager's powers; and (vi) any other act, unless that act misleads a third party on the limited partner's limited commitment. In addition, it is possible for a limited partner to act as manager of a legal entity, which in turn acts as manager of the LP.

Voting rights

It is allowed to derogate in the LP agreement from the traditional one-share-one-vote principle. In the absence of specific provisions in the LP agreement, each partner's voting rights are in proportion to his interest. In other words, flexibility is created to allow restrictions on (or increase) limited partners' voting rights, or grant veto rights to GPs.

Distributions

Distributions may be freely arranged in the LP agreement; they are not restricted by the company law applicable to partnerships. Distributed capital may only be clawed back if the LP agreement so provides. Creditors will not be able to force limited partners to repay dividends which GPs/managers distribute to them incorrectly.

Fewer transfer restrictions for partnership interests

Transfer restrictions with respect to both GP and limited partner interests may be freely defined in the LP agreement. If the LP agreement does not contain any restrictions, the transfers of limited partners' interests are subject to the majority requirements applicable to amendments to the LP agreement. For GP interests, the consent of any other GPs would be required.

3 What the modernisation entails in tax terms

LPs are tax-transparent for Luxembourg corporate income tax purposes. LPs which conduct a real or a deemed business through a Luxembourg permanent establishment are subject to Luxembourg municipal business tax levied at a rate of 6.75% in Luxembourg City. A real business is present if the LP conducts an independent activity conducted on an ongoing basis which constitutes a participation in the economic sphere and is conducted with the aim of making a profit. Where the LP is an AIF, the LTA has confirmed in a circular that it is not considered to be a real business. It may be deemed a business if the GP is a capital company owning an interest of at least 5% in the LP. In other respects, a Luxembourg LP remains tax-neutral; its distributions are not taxed in Luxembourg and non-resident investors receiving distributions are not taxed in Luxembourg either. Management services provided to an LP benefit from a VAT exemption if it is an AIF.

Tax feature 9: Tax-treaty network

The Luxembourg tax-treaty network is comprised of 76 high quality tax treaties that aim to avoid double taxation by, among other things, providing for beneficial allocation of capital gains taxing rights and reduced withholding tax rates. Luxembourg continuously expands and improves its tax-treaty network.

1 Introduction

Luxembourg values the importance of its treaty network for companies doing business in Luxembourg and is therefore continuously broadening and improving its scope and contents. The treaties generally provide for reduced withholding tax rates on payment of interest, dividends and royalties to Luxembourg entities and protect Luxembourg entities from foreign taxation on capital gains on foreign shares and business income allocable to a foreign permanent establishment.

Over the past few years, Luxembourg has sought to conclude or update treaties with emerging markets such as India, Hong Kong, Qatar, Mexico, Russia, Poland and Turkey. Luxembourg has also begun efforts to update the exchange of information clauses in its treaty network in order to underline its commitment to transparency as a sustainable financial centre. Luxembourg will exchange information on request with each of its treaty partners, even if such information is held by Luxembourg banks or financial institutions.

2 Overview of treaties

Luxembourg currently has 76 treaties in force. We refer to *www.impotsdirects.public.lu/conventions/conv_vig/index.html* for an actualised overview of the relevant treaties in force and in negotiation. It is noted that most tax treaties concluded by Luxembourg contain a participation exemption for dividends (not for capital gains) and also for net worth tax under conditions which may be more favourable than the Luxembourg participation exemption regime (see Tax feature 1).

Tax feature 10: APA/ATR practice

Luxembourg companies engaged in both national and international business can obtain advance certainty from the Luxembourg tax authorities by requesting a tax ruling (ATR/APA), a written interpretation on how a provision applies to a specific taxpayer and a proposed arrangement. The Luxembourg process is of a mature and transparent nature and generally very efficient by international standards.

1 Introduction

As the predictability of the tax burden is crucial when making investment decisions, the possibility to obtain certainty in advance by means of an ATR/APA is important.

2 Legal basis

Prior to 1 January 2015, the basis of the Luxembourg ATR/APA practice was found in administrative circulars and general principles. Luxembourg has since then codified the ATR/APA practice. The competent tax inspector (*préposé*) has to decide based on written and motivated requests filed by taxpayers. A decision to be issued by the tax inspector cannot result (by itself) in a tax exemption or reduction of tax and will only be valid for a maximum period of five years. The decision will bind the LTA unless (i) the description of facts and circumstances is inaccurate, (ii) the relevant facts and circumstances have changed since the request was filed, or (iii) the decision is no longer in line with national, European Union or international law. Finally, for requests filed by enterprises, an administrative fee has been introduced in order to have the ATRs/APAs addressed. The fee will be payable by the applicant and will vary between €3,000 and €10,000 depending on the complexity of the request.

3 Procedural rules

Procedural rules for the ATR/APA practice are also codified as of 1 January 2015.

- Written ATR/APA requests can be filed by taxpayers (companies and individuals) and must be sent to the competent tax inspector (*préposé*) of the competent tax office, or, in case the competence cannot be determined, to the head of the tax directorate (*directeur des contributions*).

- ATR/APA requests should at least include the following information:
  (i) a precise designation of the applicant (name, residence and fiscal number, if any), of the parties and of other third parties involved and a description of their respective activities;
  (ii) a detailed description of the activities and/or contemplated activities which have not yet generated their effects;
  (iii) a detailed analysis of legal issues, together with a detailed description of the legal position of the applicant relating thereto; and
  (iv) confirmation that the request provides all relevant information, and that the facts and circumstances as described in the request are accurate.
- APA/ATR requests filed by companies will be submitted by the tax inspector to an advisory body, the *Commission des Décisions Anticipées*.
- The decision on the request will be made by the competent tax inspector (the *Commission des Décisions Anticipées* will only advise the tax inspector to ensure a uniform and equal treatment of taxpayers).
- Upon receipt of the ATR/APA request, the level of the administrative fee for each request will be determined and will be payable by the applicant (also in the case where it involves multiple taxpayers) within one month after determination. The ATR/APA request will not be considered as long as the administrative fee has not been paid. The administrative fee will not be refunded if the request is withdrawn, is refused, or if the decision on the request is negative.
- The decisions made by the tax inspectors will be summarised and published on a 'no-name' basis in the annual report of the tax authorities. In the decree, it is mentioned that the activities for which the request is filed should not yet have generated their effects. In practice, the LTA requires that the request is filed in advance within a reasonable period of time (generally up to three months) – after implementation of the transaction and prior to the moment the tax return of the first relevant year is filed. The LTA demonstrates an open and communicative thorough approach when analysing APA/ATR requests. There are no statutory deadlines for issuing ATRs/APAs.

Abbreviations and Definitions

AIF	Alternative investment fund in the sense of the AIFMD.
AIFMD	Alternative Investment Fund Managers Directive 2011/61/EU.
APA	Advance pricing agreement.
ATR	Advance tax agreement.
CIT	Corporate income tax, levied at a general combined rate of 29.22% and composed of income tax at a rate of 21% (but 20% for taxable income not exceeding €15,000), a 7% surcharge on the income tax rate and municipal business tax levied at a rate of 6.75% for Luxembourg City in 2015.
ITA	The Luxembourg income tax act of 1967 (*Loi du 4 décembre 1967 concernant l'impôt sur le revenu*).
COOP SA	A Luxembourg cooperative organised as a public limited liability company, *Société Coopérative organisée sous forme d'une société anonyme*.
CSSF	*Commission de Surveillance du Secteur Financier*, Luxembourg's supervisory commission for the financial sector.
EU	The European Union, which currently compromises the following 28 member states: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom.

Financing Circulars	The circulars issued by the director of the Luxembourg direct tax authorities on 28 January 2011 (#164/2) and 8 April 2011 (#164/2) on intragroup financing companies.
IP	Intellectual property.
EU Interest and Royalty Directive	Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different member states.
LTA	The Luxembourg direct tax authorities (*administration des contributions directes*).
Member state	A country belonging to the EU.
NWT	Net wealth tax, levied at a rate of 0.5% on a Luxembourg company's net wealth on 1 January of each year.
EU Parent-Subsidiary Directive	Directive 90/435 EEC on the common system of taxation applicable in the case of Parent companies and subsidiaries of different member states, as amended.
SCA	Public partnership limited by shares, *Société en Commandite par Actions*.
SA	A Luxembourg public limited liability company, *Société Anonyme*.
SARL	A Luxembourg private limited liability company, *Société à Responsabilité Limitée*.
Treaty	A treaty for the avoidance of double taxation concluded between Luxembourg and another state.

Annex – General overview of Luxembourg tax and legal forms of doing business

Please find below a high-level overview of certain aspects of the Luxembourg corporate tax system and some of the legal forms of business most commonly used in Luxembourg. Although the following provides a brief general overview, it is by no means an exhaustive list.

1 Corporate income tax

General
CIT is levied from entities that are resident in Luxembourg and from foreign resident entities on certain types of Luxembourg source income. CIT has two tax brackets: the first €15,000 of annual taxable profit is taxed at a combined rate of 28.15%, with the annual profit exceeding this amount then taxed at a combined rate of 29.22%.

Subject to tax
CIT is levied from, among others, SARLs, SAs, SCAs and Coop SAs. Luxembourg limited partnerships are considered to be tax transparent and are, therefore, not subject to Luxembourg CIT.

Taxable profits
CIT is levied over the net amount of worldwide taxable profits. The starting point for determining the taxable profit is the reported profit in the commercial accounts. This commercial profit is then adjusted for CIT purposes with the necessary tax corrections included in Luxembourg law.

Deductible costs for CIT purposes include interest on loans and annual depreciations on assets used in the business enterprise of the taxpayer. Although Luxembourg law does not contain thin-capitalisation rules, the Luxembourg tax authorities apply, in practice, a debt-to-equity ratio of 85/15% in case a loan is attracted to finance a participation qualifying for the participation exemption regime in Luxembourg.

Various systems of depreciation are allowed, provided that they are used consistently. The annual amount of depreciation depends on the historic cost price, the economic life of the asset and the residual value. Accelerated depreciation is allowed under certain conditions.

Functional currency

Luxembourg companies are allowed to file their tax returns in a foreign currency other than the Euro. The conditions to be met by a Luxembourg taxpayer to be able to use functional currency as well as the exchange rates to be applied are set forth in an administrative circular published by the Luxembourg tax authorities (*Circulaire du directeur des contributions L.G.-A nr 60 du 16 juin 2014*).

Conditions for use of functional currency are as follows:

i) A request must be filed with the Luxembourg tax authorities no later than three months before the first financial year for which it is intended that the functional currency will be applied. For newly established taxpayers the request must be filed prior to the end of the intended first financial year. The request should include certain details.

ii) The Luxembourg taxpayer must have its capital denominated in a functional currency and prepare financial statements in such currency.

iii) Any currency of which the exchange rate is determined and published by the European Central Bank can be used as functional currency. These include all the main currencies.

iv) The functional currency will remain applicable as long as the taxpayer has its capital denominated in such a functional currency.

v) All taxpayers that are part of a fiscal unity (*intégration fiscale*) must use the same functional currency as of the first financial year in which the fiscal unity starts.

Losses

Losses may be carried forward indefinitely. Loss carryback is not allowed under Luxembourg law. According to Luxembourg case law (*CA du 15 juillet 2010, numéro 25957*), the trading of tax losses (*Mantelkauf*) may under certain circumstances give rise to abuse of the law. As a consequence, loss carryforwards will be denied. The Luxembourg tax authorities have specified in an administrative circular (*Circulaire du directeur des contributions L.I.R. nr 114/2 du 2 septembre 2010*) certain situations that, in their view, give rise to abuse of law and thus the denial of loss carryforward.

2 Dividend withholding tax

Dividends distributed by a Luxembourg company (i.e. SARLs, SAs, SCAs and Coop SAs) are subject to 15% Luxembourg dividend withholding tax (*retenue à la source*). Dividend withholding tax can also be due if a Luxembourg company repurchases its own shares or reimburses paid-in share capital and share premium in the case where there are no justifiable economic reasons. Luxembourg dividend withholding tax

may be reduced under an applicable tax treaty or eliminated pursuant to a domestic exemption.

The domestic exemption applies where dividends are paid by to either (i) a fully taxable Luxembourg entity; or (ii) an entity falling within the scope of article 2 of the EU parent-Subsidiary Directive or to a permanent establishment thereof; or (iii) a Swiss resident capital company that is subject to corporation tax in Switzerland without benefiting from an exemption; or (iv) a company resident in a treaty country (or to its Luxembourg permanent establishment) that is subject to a tax comparable to the Luxembourg CIT (i.e. a minimum tax rate of 10.5% and a comparable basis) and provided the Parent company holds (or commits itself to holding) a shareholding of at least 10% or more of the nominal paid-up capital of the Luxembourg company paying the dividend or a shareholding in the Luxembourg company with an acquisition cost price of €1.2 million, for an uninterrupted period of at least 12 months.

Proceeds distributed upon the full or partial liquidation of a Luxembourg company are not subject to Luxembourg dividend withholding. There is a full liquidation in the event a Luxembourg company is dissolved. Luxembourg law states that in the case of a repurchase of a participation by a Luxembourg company that results in a reduction of the share capital of the company, the company is deemed to be partially liquidated for the fraction corresponding to the repurchase.

3 Withholding tax on interest / royalties, stamp duties, net wealth tax, lump-sum tax

Luxembourg does not levy withholding tax on interest (unless interest is reclassified into dividends and in certain specific cases dealing with profit sharing interest) and royalty payments. Furthermore, there is no capital duty. Stamp duty in the amount of €75 is due for incorporation of a Luxembourg company, amendments of the articles of association of a Luxembourg company or the migration of a company to Luxembourg.

4 VAT

Value added tax (*taxe sur la valeur ajoutée*) is levied at each stage in the chain of production and distribution of goods and services. The tax base is the total amount charged for the transaction excluding VAT, with certain exceptions. Luxembourg applies a standard VAT rate of 17% and reduced rates of 3%, 8% and 14% for certain specified goods and services which are the lowest rates in the EU. The

taxable person can deduct the VAT on its costs insofar these costs relate to goods or services used for VAT taxed purposes. On balance, due to the deductions in the previous stages of the chain, VAT should in principle not be cumulative, implying that the end consumer ultimately pays the VAT.

5 Legal frameworks for doing business

One subject to consider when establishing a business in Luxembourg is the legal framework. It is possible (e.g. for cost reasons) to carry out the contemplated business activities through a branch office of an existing legal entity. Most foreign investors, however, prefer to establish a separate legal entity or to enter into a partnership. Although there are a wide variety of legal forms available under Luxembourg law, the following are by far the most commonly used:

i) the public limited liability company (*Société Anonyme* or *SA*), shares of which can be listed on a stock exchange;
ii) the private limited liability company (*Société à responsabilité limitée* or *SARL*), frequently used for financing, tax structuring and for setting up joint ventures and group holdings;
iii) the partnership limited by shares (*Société en commandite par actions* or *SCA*), which combines the characteristics of a limited partnership and a public limited liability company; and
iv) the common limited partnership (*société en commandite simple* or *SCS*) and special limited partnership (*société en commandite spéciale* or *SCSp*) i.e. a partnership between one or more managing partners (with unlimited liability) and one or more limited partners (liability limited to the amount of their capital contribution).

A company is incorporated by means of execution of a notarial deed of incorporation by a civil law notary. This deed of incorporation contains the articles of association. The incorporation procedure, including registration with the Trade Register of the Luxembourg Chamber of Commerce, can be completed within a few days.

A Luxembourg partnership is formed by an agreement between two or more partners, each of which may be an individual or a corporation, either for a limited or unlimited period of time. A partnership agreement must be entered into in writing. No additional formal requirements (such as notarial deed, government approval or minimum paid-in capital) apply with respect to the formation of a Luxembourg limited partnership. As such, the timespan of formation can be very limited.

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