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Tax Controversy 2025

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Trends and Developments

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Loyens & Loeff is an independent European full-service business law firm providing integrated legal and tax advice with specialists in Dutch, Belgian, Luxembourg and Swiss law. The Luxembourg tax controversy team helps clients navigate an increasingly complex EU and Luxembourg tax environment and represents taxpayers in pre-litigation discussions with tax authorities and before the courts. The firm's services include developing litigation strategies, engaging in settlement negotiations, assisting with arbitration or mutual agreement procedures (MAPs), assisting with information requests from tax authorities, managing tax audits and investigations, filing appeals and representing clients in proceedings at all levels, including at the Court of Justice of the European Union. The team is part of a fully integrated firm with home markets in the Benelux and Switzerland, and representative offices in all major financial centres such as London, New York and Paris.

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In 2024, the number of judgments issued by the administrative tribunal (the court of first instance competent for litigation on direct taxes) and the administrative court (appeal court) saw a significant drop compared to prior years, accentuating a reversal of the trend already observed in 2023. The total number of judgments slightly exceeded 100, whereas in 2022 it had exceeded 200.

This new situation must also be interpreted in light of the change in parliamentary majority after the October 2023 elections, the entry into function of a new government in early 2024 and the appointment of a new director of the tax authorities. A priority of the government and tax authorities is to increase legal certainty for taxpayers and the business climate in general, which should reduce the number of cases going to court. Moreover, in 2024, there have been various (non-public) instances in which the tax authorities decided to drop a case before the hearing, in line with their intention to focus resources on the cases where they stand a good chance of winning.

In this submission, the authors first look at some statistics on Luxembourg tax litigation, and then turn to an analysis of the key topics before finally commenting on some developments in respect of the litigation strategy and procedure.

Overview of the Volume of Litigation

In 2024, the administrative tribunal issued close to 80 judgments and the administrative court nearly 40. The numbers in Q1 2025 suggest there might be even fewer judgments issued in 2025.

Compared to the prior year, the number of inadmissible cases significantly dropped, representing about 5% of the tribunal cases (versus 25% in 2023). The year was, however, not very successful for taxpayers in court: they won only about 20% of cases in the first instance, with the Luxembourg tax authorities winning two-thirds and the remaining close to 10% providing for a divided outcome. On appeal, taxpayers managed to overturn about a third of the losses in the first instance; close to 60% of the cases were won by the Luxembourg tax authorities.

These statistics can be explained in part by the sometimes excessive deference of the tribunal's judges to the tax authorities' argumentation, including allocation of the burden of proof. Hopefully, this will be progressively mitigated by the creation of the fifth chamber within the tribunal, which is predominantly dedicated to tax matters. In part, the statistics are also explained by the insufficiently strong cases brought by taxpayers. Whilst the predictability of an outcome is very subjective, it nevertheless seems fair to state that in close to 60% of the lost cases the outcome was predictable.

The Key Topics in Luxembourg Tax Controversy

Setting aside certain topics more relevant for individuals (including guarantee call assessments and discretionary waivers of the tax liability), the following topics have dominated Luxembourg tax case law in 2024: (i) the recognition of foreign permanent establishments (PEs), (ii) the application of the general anti-abuse rule (GAAR), (iii) transfer pricing and hidden distributions, and (iv) valuation for net wealth tax (NWT) purposes.

Recognition of foreign permanent establishments

Following the introduction in 2019 of new legislation to tighten the recognition of a foreign PE, in an attempt to prevent double non-taxation mismatch outcomes (where Luxembourg would recognise a foreign PE and exempt its income but the foreign jurisdiction would not recognise a PE and allocate the taxing rights to Luxembourg), the Luxembourg tax authorities have started raising questions about the substance and activities of certain foreign branches and their recognition for local tax purposes. Whilst in a number of instances doubts are satisfactorily addressed prior to the issuance of a tax assessment, there have been several high-profile cases dealing with US branches, as well as a Malaysian branch of a Luxembourg subsidiary of a Malaysian group.

In case 47267, the existence of a Malaysian branch was only based on a service level agreement. The address of the branch was not clearly defined, and the taxpayer failed to substantiate the activities alleged to have been conducted through the branch. The branch also did not avail of its own staff, nor of a bank account, for years. The tribunal ruled that the mere board resolution deciding on the opening of the branch was not sufficient either. Interestingly, the taxpayer submitted a letter from the Malaysian authorities, but that letter was considered insufficiently clear and, in any case, not binding on the Luxembourg tax authorities, instead being just a factual element amongst others that could be taken into account.

In case 46975, the tax authorities taxed dividends from a Cayman subsidiary that were supposed to be held through a US branch. The US branch was managed by an employee seconded part-time by the group headquarters but, contrary to the agreement between the branch and the group headquarters, no invoice was issued, and no fees were paid in remuneration for the support received. The head office of the Luxembourg company also provided support to the US branch and received a small remuneration for these functions, but the tax authorities considered the transfer pricing report insufficient evidence. The taxpayer seems to have provided (or been able to provide) very few proofs of decision-making at the US branch level. As to the UK bank account of the US branch, it could be managed by the US branch manager but also by three Luxembourg resident managers. Taken together, all these factors led the tax authorities to conclude that there was not enough activity in the US branch for it to qualify as a PE. Interestingly, the tribunal recognised the existence of a fixed place of business but considered that the taxpayer had not proven that activities were effectively conducted through that fixed place: sufficient proofs of the work of the branch manager were lacking and, as raised by the tax authorities, no payment was made to the group headquarters for the secondment of the employee.

At the court level, the court confirmed the non-recognition of another US branch in a case where there were insufficient proofs of the branch's substance. The mere decision to open a branch and the signature of an office-sharing agreement (which failed to clarify the address and for which there was no rent) were not enough to show the daily activities allegedly conducted through the branch. Furthermore, there were no details of meetings with counterparties or minutes showing decisions of the branch manager. It is worth noting that in this case, a ruling request had been rejected.

From these various cases, some lessons can probably be learned as to what is important for the recognition of foreign branches, such as:

- clear separation between activities of the branch and activities of the head office; and
- the need for proper legal documentation that is backed up by the facts.

Application of the GAAR

In 2024, case law has shown that the GAAR continues to be invoked by the Luxembourg tax authorities in increasingly sophisticated cases.

One of the main cases concerned a Luxembourg company that had granted a profit participating loan (PPL) to its Belgian subsidiary. The latter repaid the PPL in kind by transferring receivables on a US group company at nominal (book) value (instead of the fair market value); the Luxembourg company then sold these receivables at fair market value on the same day to a Swiss resident company and claimed that there was no gain for tax purposes, as it should be seen as having received an exempt hidden dividend from the Belgian subsidiary (for the difference between the book value and the fair market value).

The tax authorities claimed that, taken together, the steps constituted an abuse of law because the Belgian company could have sold the receivables at fair market value directly to the Swiss company, which would have generated a profit tracked by interest under the PPL. Such interest would have been deductible in Belgium and therefore non-exempt in Luxembourg under the implementation of the EU parent-subsidiary directive's anti-hybrid rule.

The court acknowledged that simplifying treasury and financing structures in the group is a priori a legitimate goal. However, the chosen path, involving successive transfers of the notes, was found to be a non-authentic arrangement mainly aimed at circumventing the anti-hybrid rule and benefitting from the exemption under the parent-subsidiary directive. In particular, the court observed that a third party would not have accepted transfer of the notes at nominal value to the Luxembourg company, so that the chosen path was indeed inadequate and aimed at saving tax.

Two other noteworthy cases dealt with the carry-forward of tax losses.

- The first one concerned a Luxembourg company that, after terminating a loss-making activity, had remained dormant for some years before being used for purchasing and reselling a real estate asset within a few months at a significant gain. The tax authorities claimed the losses carried forward could not be used to offset the gain. The court, reversing the tribunal's judgment, noted that in the absence of a change of shareholder (for which there appeared to be no evidence), the company could use losses of a prior activity against profits of a newly started activity launched with the hope that it will be more

profitable. This is a very helpful statement, which better frames the abuse doctrine in the context of the carry-forward of tax losses (the so-called *Mantelkauf* doctrine).
- In the second case, the taxpayer was unsuccessful. Following a prior court case confirming that there was abuse after a change of shareholder combined with a change of activity, the taxpayer thought it would be able to remedy the issue by reinstating the prior activity. However, the court ruled that such a change of circumstances did not *"un-freeze"* the losses: an abuse of law conclusion is definitive. As such, it is key for taxpayers that may be at risk under the *Mantelkauf* doctrine (ie, in cases where a company with tax losses is being transferred to a new shareholder) to maintain the prior activity (with a sufficient degree of materiality) rather than terminating it and immediately starting a new one.

Transfer pricing and hidden distributions

Similar to the situation in 2023, this type of case is linked to transfer pricing considerations and sometimes to claims of irregular accounting. Most of the transfer pricing challenges so far have arisen in situations where a company has given benefits to a shareholder or an interested party that it would not have granted without the beneficiary having such status.

The types of undue benefits can be quite varied, including:

- expenses borne by the company that are not in the interest of the company's business but rather incurred (in a more or less hidden manner) on behalf of the shareholder(s) and the family thereof;
- insufficient interest charged on a shareholder's current account; and
- use of a company car by the shareholder(s) for private purposes.

The majority of these cases are lost by the taxpayer because it fails to rebut the body of evidence submitted by the tax authorities. This failure can in particular arise from a lack of regular accounting and of supporting accounting documentation, a lack of justification of the commercial rationale of a transaction or a lack of a proper transfer pricing study.

Importantly, however, the tribunal expects the tax authorities to show sufficient evidence that the shareholder or interested party did obtain a benefit as a result of the operation. In some cases, the tax authorities failed to explain why, for example, a waiver of a receivable on a subsidiary made the shareholder richer.

Another important lesson is that the tax authorities do not need to provide detailed figures about the volume of the hidden distribution for it to be recognised: in one of the cases, a lack of regular accounting, insufficient profit margins (compared to other market players) and the fact that there was only one shareholder was enough to constitute a body of evidence suggesting a hidden distribution. The burden of proof then shifted to the taxpayer to demonstrate that there was none.

Valuation for net wealth tax purposes

One of the court cases dealing with this topic concerned stock lending and the treatment of lent shares. The case was not ideal, as there was some missing documentation, but based on the available evidence, the court first found that there had been a transfer of legal ownership of the shares, so that the loan was akin to a *prêt de consommation*. The lender could furthermore not claim economic ownership of the lent shares, as it did not meet the cumulative criteria for dissociation of economic and legal ownership. As such, it had to recognise a receivable, which is a taxable asset for NWT purposes. As special valuation provisions did not apply, the receivable had to be valued at the *gemeine Wert*. The tax authorities used the underlying listed share price as an approximation of the fair market value of receivables but had not clearly substantiated the source of valuation for all receivables, such that the case was sent back to the director of the tax authorities.

Another significant case concerned a taxpayer that claimed that the fair market value of convertible debt increased together with the fair market value of the (non-exempt) participation tracked by that debt. The tax authorities and the court disagreed, observing that the law explicitly requires the valuation of convertible bonds (when these are a debt) at nominal value, unless particular circumstances require otherwise. In the present case, the court noted that the conversion is not mandatory (bonds could also be repurchased by the issuer or sold to a third party), and there was no intention to convert around the relevant NWT assessment dates. There was also no contractual obligation for the issuer of the bonds to repurchase them at fair market value. As such, the taxpayer ended up with a mismatch between the (higher) fair market value of its asset and the nominal value of the debt, triggering an NWT liability.

Topics for 2025

It is likely that many of the above-mentioned topics will continue appearing in case law in 2025. Some elements worth highlighting from the case law in Q1 2025 include:

- the fact that the tax authorities do not have to precisely identify the recipient of a hidden distribution in order to validly claim the existence of such a distribution;
- some questionable statements in a tribunal case in which the judges found that (i) the benefit received from a sister company did not constitute a hidden contribution because the sister company was not a direct or indirect shareholder of the taxpayer and (ii) a loan that is taken to fund an outstanding profit distribution is not linked to the operations of the company, such that interest is not deductible; and
- a renewed confirmation that the tax authorities are not bound by their positions taken in prior years (except in case of a tax ruling).

Strategic Considerations and Trends

To pay or not to pay?

The first question often asked is whether the tax must really be paid while an assessment is being litigated. An objection and a subsequent appeal before the administrative jurisdictions is not suspensive. As such, the legal obligation to pay the tax due remains fully in force unless the taxpayer has obtained a payment suspension or payment deferral from the tax office, both of which are very unlikely.

When appealing before the tribunal, the taxpayer can also request in parallel a stay order from the president of the tribunal. Such an order is difficult to obtain as the taxpayer must show that its arguments present a reasonable chance of success and that enforcing the payment obligation would cause severe and irreparable damage to the taxpayer.

The president of the tribunal is often strict in appraising these criteria, though a stay order is occasionally successfully claimed.

In case the taxpayer has not obtained any suspension of the payment obligation, late payment interest will accrue at a rate of 0.6% per month. This cost needs to be balanced against (i) the (significantly increasing) cost of borrowing, in case the taxpayer does not avail of sufficient cash and (ii) the risk of the tax authorities seeking to enforce the payment obligation by seizing (in principle Luxembourg-situated) assets.

Waiting for a director's decision?

The mandatory first step to challenge a corporate tax assessment is filing an objection with the director of the tax authorities. When a decision that rejects the objection is issued, the taxpayer has three months to appeal such decision before the administrative tribunal. If no decision is issued within six months of filing the objection, the taxpayer is free to directly appeal the assessments before the tribunal without a time limit, as long as no decision has been adopted.

Due to the growing backlog at the level of the director, more and more taxpayers choose to directly appeal after six to eight months without waiting for a director's decision. This avoids losing more time, especially as the procedure before the tribunal is itself increasingly lengthy: nowadays, it is not rare that after the written phase (five months from the filing of the appeal), a taxpayer needs to wait for 15–18 months for the oral hearing, and thereafter for three to nine months (sometimes more) for a judgment.

There can be one downside of not waiting for the director's decision: if at any time the director does adopt a decision ruling on the objection, the appeal before the administrative tribunal becomes moot and, if the decision goes against the taxpayer, a whole new procedure needs to be started.

On the other hand, however, it seems filing an appeal can also spur the director to take a decision in favour of the taxpayer in cases that are likely to be lost by the tax authorities. In such situation, the tribunal procedure can then be withdrawn further to the receipt of the decision and, normally, of revised tax assessments.

Taking insurance

More litigation means more risks and also a new market for insurers and taxpayers wishing to reduce their exposure to potentially large tax bills. Brokers and insurers do look with increasing interest at Luxembourg, in view of the increasing volume and complexity of (potential) tax controversy cases. This trend can be expected to continue.

Conclusion

On the one hand, the numerous legislative changes in recent years and further changes due to be implemented (eg, Pillar Two rules) may pave the way for more litigation, as the number of tax rulings has dwindled. On the other hand, the reduction in the number of judgments may foreshadow a new era of greater legal certainty under the administrative guidance of the tax authorities and more detailed parliamentary documents.

In parallel to domestic tax litigation, some EU cases were fought by Luxembourg resident taxpayers and/or Luxembourg. Tax controversy in Luxembourg thus goes beyond the borders of the Grand Duchy and can also have an impact across the EU.

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