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Q&A Chapters

Luxembourg


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1 Tax Treaties and Residence

1.1 How many income tax treaties are currently in force in your jurisdiction?

As at September 2022, Luxembourg has 88 tax treaties currently in force and an additional five under negotiation. Six treaties are signed but yet to be ratified.

1.2 Do they generally follow the OECD Model Convention or another model?

Tax treaties concluded by Luxembourg are usually based on the OECD Model Tax Convention (the "**OECD MC**"). Luxembourg has agreed with most of the treaty countries to implement a provision on the exchange of information in line with Article 26 OECD MC. The new tax treaty signed with France on 20 March 2018, which entered into force in January 2020, reflects all the post-base erosion and profit shifting ("**BEPS**") changes and the 2017 version of the OECD MC; *inter alia*, the treaty changes the definition of a permanent establishment to include commissionaire arrangements and restricts the scope of the "preparatory and auxiliary" activities. It further changes the distributive rules for payments of dividends, interest and royalties in line with the 2017 OECD MC.

A few treaties signed by Luxembourg deviate from the OECD MC. A notable example is the treaty concluded with the USA, which follows the US Model Income Tax Convention. A more recent example is the treaty with Ghana, signed in December 2021, which more closely resembles the UN model.

1.3 Has your jurisdiction signed the tax treaty MLI and deposited its instrument of ratification with the OECD?

Luxembourg has signed and ratified the MLI. For Luxembourg purposes, the MLI entered into force on 1 August 2019. Hence, each tax treaty signed with Luxembourg has to be interpreted in conjunction with the MLI provisions in case the countersigning country has also ratified the MLI.

In this context, almost half of the treaties entered into by Luxembourg have recently been supplemented with a synthesised text adding the relevant provisions of the MLI. The provisions of the MLI as they relate to the provisions of the OECD MC are included in boxes throughout the text of the document.

1.4 Do they generally incorporate anti-abuse rules?

As a general rule, tax treaties concluded by Luxembourg do not include anti-treaty shopping rules. However, a limitation on benefits ("**LOB**") clause is used in the treaties signed with, *inter alia*, Hong Kong, Poland, Senegal, Singapore, Trinidad and Tobago, and the USA. Interestingly, the new treaty signed with France contains a specific anti-treaty shopping rule in its new Article 28 (Denial of benefits under the Convention).

The MLI signed by Luxembourg contains a general anti-abuse provision in the preamble to all of its tax treaties, which includes the express statement to eliminate double taxation without creating opportunities for reduced taxation or non-taxation. Such provision is a minimum standard and cannot be opted out of by any of the signatories to the MLI. In the context of Article 7 (prevention of treaty abuse), countries may choose to apply either the Principal Purpose Test ("**PPT**") or the detailed LOB provisions. Like most of the signatories to the MLI, Luxembourg chose to apply the PPT.

Depending on whether the tax treaty is subject to the MLI provisions, the MLI anti-abuse provisions would override any other diverging provision under the existing treaty. Indeed, the previously mentioned synthesised texts do cover anti-abuse rules. Therefore, they expressly refer to the overriding status of Article 7 on the provisions of the treaty. This is well illustrated in the synthesised text dated February 2021 for the treaty signed with Japan.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Luxembourg applies the hierarchy of norms. The constitution is the highest source of law, followed by laws and regulations. It is worth noting that the relationship between international law and domestic law is governed entirely by case law. Such established case law states that tax treaties incorporated into internal legislation by a ratification law should constitute a superior law. Therefore, if a conflict between the provisions of an international treaty and those of a national law occurs, international law should take precedence over the national law.

Further to the above and under the general principles of Luxembourg public law, treaties are considered a "*lex specialis*" and therefore take precedence over the national provisions.

1.6 What is the test in domestic law for determining the residence of a company? Has the application of the test been modified in response to COVID-19?

According to Article 159 of the Luxembourg income tax law ("**LITL**"), an entity is treated as a resident of Luxembourg for direct tax purposes if it has (i) its registered office (*siège statutaire*) in Luxembourg, or (ii) its central administration (*administration centrale*, i.e. the place of effective management) located in Luxembourg.

In response to COVID-19, the Luxembourg parliament introduced measures enabling companies to hold meetings remotely until 31 December 2020. As the LITL applies both the "place of effective management" and "place of incorporation" concepts to assess tax residency of a company, the temporary COVID-19 measures have not affected the residency of Luxembourg companies from a Luxembourg tax point of view.

This is also in line with the analysis of the OECD issued on 3 April 2020 regarding the impact of the pandemic on double tax treaties ("**DTTs**"), which referred to the "usual" and "ordinary" place of effective management to determine one's residency.

The Directive Proposal of the Anti-tax Avoidance Directive ("**ATAD 3**"), laying down rules to prevent the misuse of shell entities for tax purposes, is expected to enhance substance requirements. ATAD 3 foresees, for instance, that factors such as domiciliation and/or management outsourcing would need to be considered when assessing the tax residence of entities. An entity not meeting the minimum substance requirements would be deemed to a shell entity and qualify as a so-called "conduit company". As a result, it would no longer be able to benefit from DTTs, the EU Parent-Subsidiary Directive ("**PSD**"), or the Interest and Royalties Directive. The Directive Proposal is currently aimed to be transposed into domestic law by 30 June 2023 and entering into force as of 1 January 2024.

1.7 Is your jurisdiction's tax authority expected to revisit the status of dual resident companies in cases where the MLI changes the treaty "tiebreaker"?

Luxembourg opted out of the MLI's new tiebreaker rules on dual-resident companies. Therefore, the old tiebreaker rules for dual-resident companies under Luxembourg's bilateral tax treaties will continue to apply. Accordingly, it is unlikely that Luxembourg will revisit the status of dual-resident companies.

2 Transaction Taxes

2.1 Are there any documentary taxes in your jurisdiction?

Under Luxembourg law, certain acts, such as official acts, acts of estate agents and transfer of ownership of certain goods, are required to be registered with the Luxembourg *Administration de l'Enregistrement, des Domaines et de la TVA*. Registration duties are fixed or proportional, depending on the nature of the acts and transfers that are subject to them. A fixed fee of €12 is levied on all acts that do not contain a movement of securities, while a proportional duty (ranging from 0.01% to 14.4% depending on the transaction and the nature of the underlying asset) is levied on acts and conventions involving a movement of securities.

For instance, payment obligations are subject to a proportional 0.24% registration duty (which tax is calculated on the principal or highest amount stated in the document), if stated in a loan agreement physically attached to a deed subject to mandatory registration (such as a notarial deed).

2.2 Do you have Value-Added Tax (VAT), or a similar tax? If so, at what rate or rates? Please note any rate reduction in response to COVID-19.

Luxembourg applies VAT pursuant to the law of 12 February 1979 as amended. Currently, four rates are applicable: a standard rate of 17%; an intermediary rate of 14%; a reduced rate of 8%; and a super-reduced rate of 3%. Annexes A, B and C provide for a detailed list of goods and services that are subject to the reduced rates. Such Annexes are to be interpreted strictly.

There has been no rate reduction of the Luxembourg VAT in response to COVID-19. However, the 2023 anti-inflation package contains measures including, *inter alia*, a temporary reduction of the VAT standard rate, intermediary rate and reduced rates by 1%. It should be noted that the 3% super-reduced rate remains untouched. This package should be released in October 2022, and will be applicable as of 2023.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Luxembourg, as an EU Member State, follows the partially harmonised VAT system and applies exemptions as prescribed for by Council Directive 2006/112/EC, as amended (the "**VAT Directive**"). Such exemptions are granted, *inter alia*, in the context of financial services, fund management or medical services. Recent EU case law has confirmed that the exemption for fund management is to be applied on a case-by-case basis when it comes to third-party suppliers. An important point to highlight is that Luxembourg does not allow for an "opt-in/opt-out" mechanism for activities that are exempt, with the exception of rent, in which case the taxable person can choose to either apply VAT or not.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

In accordance with EU VAT rules, companies registered for VAT can deduct input VAT to the extent that it is linked with their output VATable economic activity. In the past, a *pro rata* deduction was used based on the percentage of VATable and non-VATable activities. However, after the judgment of the Court of Justice of the European Union (the "**CJEU**") in *BLC Baumarkt GmbH & Co. KG* (C-511/10), the VAT Directive must be interpreted as allowing Member States to use a more accurate method than that of the general *pro rata*. In Circular n° 765 of 15 May 2013, the Luxembourg VAT authorities referred to a direct allocation or another key allocation method. The general *pro rata* deduction should not be used if a more precise allocation method can be applied.

As per Circular n° 765-1 of 11 June 2018, the VAT tax administration extended the regime applicable in Circular n° 765 to persons carrying out both economic and non-economic activities for VAT purposes. The former Circular referred only to persons carrying out an economic activity partially exempt for VAT purposes.

A recent EU case law, the "*Titanium Case*" (3 June 2021, C-931/19), may have a primary impact on recoverability of input VAT via VAT refund claims for companies exploiting properties in certain foreign Member States. According to the CJEU, the mere ownership and exploitation of properties without any local human resources shall not be considered a fixed establishment.

Indeed, this may be relevant for a great number of Luxembourg companies investing in real estate abroad. The German tax authorities have not yet provided clarification on how to recover input VAT.

2.5 Does your jurisdiction permit VAT grouping? If so, how does this apply where a company in one jurisdiction has an establishment in another?

In its judgment of 4 May 2017, the CJEU ruled that the Luxembourg implementation of the VAT group regime was not compatible with the VAT Directive, as it extended the benefits of the exemption to taxable activities that were not directly necessary for the exempt or out-of-scope activities of the VAT group. In light of the above decision, Luxembourg has repealed its old regime and implemented a new VAT group regime as per the law of 6 August 2018 (in line with the *Skandia* case (C-7/13)).

The new VAT group regime treats all of the transactions between its members as "out of the scope" of VAT. One of the major differences between the new and former regimes is that the VAT group regime is restricted to persons established in Luxembourg and Luxembourg branches of foreign companies, whereas the former regime allowed for grouping with other EU Member States. Therefore, an establishment in another Member State should not be considered part of a VAT group together with a Luxembourg parent company according to Luxembourg law.

Companies wishing to benefit from the VAT group regime must generally meet three requirements proving their bond; there must be (i) an economic link, (ii) a financial link, and (iii) an organisational link with the other company(-ies).

2.6 Are there any other noteworthy transaction taxes or indirect taxes that are payable by companies?

A fixed registration fee of €75 is due in some specific cases determined by law, such as, but not limited to, upon incorporation or subsequent capital increase and migration of a company to Luxembourg.

2.7 Are there any other indirect taxes of which we should be aware?

There are custom and excise duties applicable for certain goods.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Dividends paid to residents as well as non-residents are, in principle, subject to a 15% withholding tax ("**WHT**") in Luxembourg. It is possible, however, to benefit either from a reduced rate or an exemption under a DTT or from the domestic participation exemption regime.

Domestic participation exemption is granted if, at the time of the dividend distribution:

- the parent company is a Luxembourg fully taxable company, or a resident company of an EU Member State as defined in Article 2 of the EU PSD 2011/96, as amended, or a Swiss resident capital company that is subject to an income tax in Switzerland without being exempt from tax, or a foreign joint-stock company that is subject in its country of residence to an income tax regime corresponding to the Luxembourg corporate income tax ("**CIT**");
- said company holds or commits to hold a participation of at least 10% (or with an acquisition price of at least €1.2 million) in the nominal share capital of the distributing company; and
- such qualifying participation has been held for an uninterrupted period of at least 12 months.

If the shareholder is an EU company within the scope of the PSD, the exemption applies subject to the additional general anti-abuse rule ("**GAAR**") below:

- the EU parent company is not used for the main purpose or as one of the main purposes of obtaining a tax advantage that defeats the object of the PSD.

Liquidation proceeds are not subject to dividend WHT. If properly structured, a partial liquidation may as well not be subject to WHT.

In addition, dividend payments made by certain types of vehicles, e.g. SPFs (*sociétés de gestion de patrimoine familial*), SICAVs (*sociétés d'investissement à capital variable*), SICARs (*sociétés d'investissement en capital à risque*) and securitisation vehicles are not subject to WHT.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

There has been no WHT on royalties in Luxembourg since 1 January 2004.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

There is no WHT on arm's-length interest payments in Luxembourg. However, interest paid under certain hybrid instruments or not at arm's length may be subject to a 15% WHT if reclassified as dividend payments by the tax authorities.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

There is currently no legislation specifically concerning the thin capitalisation ratio; however, in practice, the tax administration uses a debt-to-equity ratio of 85:15 for the intra-group financing of participations. According to the OECD guidance on financial transactions released on 11 February 2020, the debt-to-equity ratio of a company should be determined on the basis of a debt capacity analysis performed on a case-by-case basis. Consequently, the informal debt-to-equity ratio of 85:15 may, in principle, no longer not be applied as such without an appropriate assessment of the debt and equity levels. The Luxembourg tax authorities have not release any guidelines or circular on this matter until now, refraining from the 85:15 debt-to-equity ratio. In case a taxpayer fails to comply with this ratio, the surplus of interest may be requalified as a hidden dividend distribution. Such requalification would result in a lack of deductibility for those payments and possible application of a 15% WHT (subject to an applicable tax treaty or participation exemption if applicable). Back-to-back financing is not subject to the abovementioned ratio.

As of 1 January 2019, however, due to the transposition into Luxembourg tax law of the interest deduction limitation rule (Article 168*bis* LITL), deduction of interest qualifying as "exceeding borrowing costs" is limited to the higher of:

(i) 30% of the company's EBITDA (defined as the total net income increased by the exceeding borrowing costs, depreciation and amortisation); or
(ii) €3 million.

The €3 million threshold is to be calculated at the company level and not at the compartment level.

Exceeding borrowing costs are defined as the amount by which the deductible borrowing costs of a taxpayer exceed

taxable interest revenues and other economically equivalent taxable income of the taxpayer.

Interestingly, although borrowing costs are defined, the LITL does not provide for a definition of "interest revenues and other equivalent taxable income". According to the Luxembourg tax administration circular dated 25 March 2022 (the "**Circular**"), the term "interest income and other equivalent taxable income" should be interpreted by analogy to the definition of "excess borrowing costs" and should include the items listed under the latter definition accordingly (e.g.: payments under profit participating loans; imputed interest on instruments such as convertible bonds and zero coupon bonds; amounts paid under alternative financing arrangements, such as Islamic finance; the financial cost element of finance lease payments; capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest; amounts measured by reference to a financing return under transfer pricing rules; notional interest under derivative instruments or hedging arrangements related to an entity's borrowings; certain foreign exchange gains and losses on borrowings and instruments related to the raising of financial guarantee fees for financing arrangements; and agency fees and similar costs related to the borrowing of funds). The position of the Luxembourg tax administration hence follows the recommendations of the Luxembourg Chamber of Commerce on the corresponding draft law implementing the interest deduction limitation rule.

Another suitable source of interpretation of the term "interest income and other equivalent taxable income" is the accounting treatment of the income in accordance with the generally accepted accounting principles in Luxembourg ("**Lux GAAP**"), although this is not binding and does not replace the "substance over form principle" as defined in the LITL.

Exceeding borrowing costs not deductible in a tax period can be carried forward indefinitely. The same applies to the excess interest capacity that cannot be used in a given tax period (however, for a maximum period of five years).

Exemptions to the interest deduction limitation rule have been introduced, as follows:

- Grandfathering: debt instruments concluded before 17 June 2016 shall not fall within the scope of the interest limitation rule to the extent that they have not been amended. The amount of exceeding borrowing costs shall be computed as if no amendments have taken place. The Circular confirms that in case of a subsequent modification, the grandfathering only applies to the original terms of the loan.
  The Circular provides for a non-exhaustive list of the amendments that would qualify as a subsequent modification of a loan, namely:
  - Modification of the term of the loan as of 17 June 2016, when such modification was not contractually foreseen before 17 June 2016.
  - Modification of the interest rate or the calculation of the interest as of 17 June 2016, when such modification was not contractually foreseen before 17 June 2016.
  - Change in the amount borrowed as of 17 June 2016.
  - Modification of one or more of the parties involved as of 17 June 2016, when such a change was not contractually foreseen before that date (restructurings such as mergers or spin-offs do not impact the benefit of the grandfathering clause, as these transactions, as such, do not result in a change in the initial terms of the loan).

  The Circular also includes a non-exhaustive list of changes not to be considered a subsequent modification of a loan. *Inter alia*, and probably most importantly, draw-down of funds made after 17 June 2016 under a facility agreement concluded prior to that date and within the initial terms and conditions of such agreement should not be considered subsequent modifications of a loan.
- Stand-alone entity: stand-alone entities are exempt from the scope of application of the interest deduction limitation rule. A stand-alone entity is defined as a taxpayer that is not part of a consolidated group for financial accounting purposes and had no associated enterprise. The Circular specifies the term "stand-alone entity" as a taxpayer that cumulatively meets the following three conditions: (i) it is not part of a consolidated group for financial accounting purposes; (ii) it has no associated enterprise (i.e. any entity or individual that is recognised as being an associated enterprise as per the definition used for purposes of applying the Controlled Foreign Company ("**CFC**") rules); and (iii) it has no permanent establishment located in a jurisdiction other than Luxembourg. The legal definition of "associated enterprise" as per Article 168*ter* LITL encompasses any entity – and not company – in which the taxpayer holds, directly or indirectly, 50% or more of voting, capital or profit interests, or an individual or entity that holds, directly or indirectly, 50% or more of voting, capital or profit interest in the taxpayer. In case of hybrid mismatches involving a financial instrument, the 50% threshold is replaced by a 25% threshold. Furthermore, included in the category of associated enterprises are entities that are part of the same consolidated group for financial accounting purposes as the taxpayer, enterprises in which the taxpayer has significant managerial influence or enterprises that have a significant managerial influence over the taxpayer.
  The Circular further clarifies that "associated enterprise" is not limited to entities in which the taxpayer holds a participation. The existence of an associated link must be analysed from an economic point of view. As a result, a securitisation company held by a trust, foundation or *stichting* should not be considered a stand-alone entity under the interest deduction limitation rule. As per the Luxembourg law of 20 December 2019, implementing Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries ("**ATAD 2**") into Luxembourg domestic law (the "**ATAD 2 Law**"), the so-called "acting together" concept was introduced in the framework of associated enterprises to circumvent the abusive splitting of the holding of participations in third parties into several persons or entities. Following this concept, an individual or entity who acts together with another individual or entity, in respect of the voting rights or capital ownership in another entity, shall be treated as holding the other individual or entity's participation.
- Financial undertaking: any entity that falls within the definition of a "financial undertaking" (under Article 168*bis* LITL) is outside the scope of the interest deduction limitation rule. This definition includes, *inter alia*, (i) alternative investment funds in the meaning of Alternative Investment Fund Managers Directive 2011/61/EU, and (ii) EU securitisation vehicles that fall within the scope of Article 2(2) of EU Regulation 2017/2402. With regard to the latter exemption, its current wording only covers Simple, Transparent and Standardised securitisations. On 14 May 2020, Luxembourg and Portugal received formal letters from the EU Commission criticising the transposition of Directive (EU) 2016/1164 ("**ATAD 1**") into their national laws. As per the formal letter, Luxembourg is requested to transpose the interest deduction limitation rule in a manner that is fully compliant with ATAD 1. Following this, there is a likelihood that Article 168*bis* (7) LITL will be amended to remove the carve-out concerning

certain securitisation vehicles from the scope of the definition of "financial undertakings". It is, however, unclear whether such amendment will apply with retroactive effect or with effect from the current financial year. In addition, the Circular does not refer to this EU Commission letter nor to a potential amendment to Article 168*bis* (7) LITL in order to rectify this non-compliance.

- Equity escape clause: under Article 168*bis* (6) LITL, entities that are part of a consolidated group for financial accounting purposes may, upon request, deduct the entirety of their exceeding borrowing costs incurred if they can demonstrate that the ratio of its equity to its total assets is to be considered greater than or equal to the equivalent ratio of the group to which it belongs.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

The only safe harbour rule is set out in Circular n° 56/1-56*bis*/1 in relation to transfer pricing rules. The rule stipulates that for entities providing financial services to group companies and acting as a simple intermediary, a minimum return of 2% after tax is considered a transaction performed at arm's length. It should be noted that the safe harbour rule applies only at the level of the Luxembourg tax administration and other tax administrations may consider the transaction as not at arm's length.

Additionally, in the framework of the ATAD 2 Law, the abovementioned limitation to deduct exceeding borrowing costs up to €3 million is considered a *de minimis* rule.

3.6 Would any such rules extend to debt advanced by a third party but guaranteed by a parent company?

Debts guaranteed by a parent company (other than pledging the shares of the Luxembourg debtor to the creditor) are treated as a shareholder loan and, as a result, in the absence of a transfer pricing report, the 85:15 debt-to-equity ratio (as far as still applicable, see question 3.4 above) will most likely be used.

3.7 Are there any other restrictions on tax relief for interest payments by a local company to a non-resident?

If the interest payments are not made at arm's length or are paid under a profit participating debt instrument, there is a risk of reclassification of the interest payments as a dividend payment, with the tax consequences set out above under question 3.4.

In that regard, the Luxembourg Administrative Tribunal recently ruled out the reclassification of interest payments on the basis that they exceed the ratio of debt participation. The Tribunal confirmed that the OECD-compliant methodology for PPLs is sufficient to evidence an arm's-length interest payment rate without any reference to a proportional relationship to the debt participation.

Therefore, as per this case law, the interest rate under a debt instrument is not capped at 85% in order to meet proportional remuneration regarding the debt/equity participation.

See also question 3.4 for further developments with regard to the interest deduction limitation rule as introduced under Luxembourg law as of 1 January 2019. In addition, rules providing for the limitation of the deductibility of interest and royalties paid to entities located in non-cooperative jurisdictions have been implemented as of 1 March 2021.

3.8 Is there any withholding tax on property rental payments made to non-residents?

Luxembourg does not levy any WHT on property rental payments made to non-residents nor residents.

3.9 Does your jurisdiction have transfer pricing rules?

Luxembourg transfer pricing rules are embedded in the revised Article 56 and Article 56*bis* LITL, which incorporate the concept of the arm's-length principle based on Article 9 OECD MC. The amended provision, however, goes further and reflects the spirit set out in BEPS Actions 8–10, such as the concept of comparability analysis and a GAAR that allows the disregarding of a transaction that has been made without any valid commercial or business justification.

On 27 December 2016, the Luxembourg tax authorities issued Circular n° 56/1-56*bis*/1, which has reshaped the transfer pricing framework for companies carrying out intra-group financing activities in Luxembourg. The Circular provided additional guidance in terms of substance and transfer pricing requirements in line with the OECD Guidelines. In particular, it provided substantial details on how to conduct the comparability and functional analyses in a way that is consistent with the OECD principles. Furthermore, the Circular requires the performance of a comprehensive risk analysis in order to determine the adequate level of equity capital.

In the financial sector, most transfer pricing studies are based on a benchmark. In case the comparable data is affected, it is likely that it will be reflected in the pricing.

3.10 Can companies in your jurisdiction obtain unilateral, bilateral or multilateral advance pricing agreements?

As provided for in the MLI (Article 25 §3 OECD MC 2014) and introduced in Luxembourg law as of 29 December 2014, advanced pricing agreements ("**APAs**") can be filed with the Luxembourg direct tax administration.

Although most APAs are unilateral in order to deal with specific intra-group transactions, bilateral and multilateral APAs are also available to prevent and/or resolve transfer pricing disputes. Indeed, the transaction to be covered must be compliant with the abovementioned rules regarding transfer pricing principles.

According to §29a of the Luxembourg General Tax Code (*Abgabenordnung*), APAs are binding on the Luxembourg tax authorities for a maximum of five years. The filing fees for APAs depend on the complexity of the situation and can reach up to €10,000.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

As from the tax year 2019, income exceeding €200,000 is taxed at a rate of 17%. In addition, a 7% solidarity surcharge for the employment fund and a 6.75% municipal business tax ("**MBT**") for companies registered in Luxembourg City are levied. For companies located outside of Luxembourg City, a different rate of MBT may apply.

The above amounts to an aggregate tax rate of 24.94% for Luxembourg City domiciled companies.

As of 1 January 2019, two intermediary CIT rates have been introduced:

- 15% for taxable income up to €175,000; and
- €26,250 plus 31% of the tax base above €175,000, for taxable income between €175,000 and €200,000.

It is worth noting that in the past (from 1 January 2011 until 31 December 2015), companies were subject to a minimum CIT of €3,210. However, since that provision was rendered incompatible with the PSD, Luxembourg abolished the minimum CIT and introduced a minimum net wealth tax ("**NWT**") as of 1 January 2016, which amounts to €4,815.

4.2 Is the tax base accounting profit subject to adjustments, or something else?

As a general rule, companies in Luxembourg follow the Lux GAAP under which both upward and downward adjustments are allowed.

4.3 If the tax base is accounting profit subject to adjustments, what are the main adjustments?

Profits in commercial accounts differ from taxable profits mainly for the following reasons:

- tax-exempt profits (e.g. as per the participation exemption regime applicable for dividends and capital gains);
- add-back expenses (e.g. interest expenses on assets generating tax-exempt income);
- adjustment to the tax results from the transactions that were not at arm's length (e.g. the interest rate set was not at market conditions, or interest payments were reclassified as hidden dividend distribution and hence no longer tax deductible); and
- discrepancies between the application of different valuation rules in accounting and in tax (e.g. amortisation, roll-over relief).

Under certain conditions, a tax balance sheet may be prepared in a way that deviates from the statutory accounts.

4.4 Are there any tax grouping rules? Do these allow for relief in your jurisdiction for losses of overseas subsidiaries?

Luxembourg allows a group of companies to apply a fiscal unity (or tax consolidation). Under such regime, the respective taxable profits of each company in the consolidated group are pooled or offset to be taxed on the aggregate amount, which means that the group is effectively treated as a single taxpayer.

Generally, the conditions to qualify for a fiscal unity are as follows:

- each company that is part of the tax unity is a Luxembourg fully taxable resident company (the top entity may be a Luxembourg permanent establishment of a fully taxable non-resident company) ("**Eligible Company**");
- at least 95% of each subsidiary's capital is, directly or indirectly, held by an Eligible Company;
- each company's fiscal year starts and ends on the same date; and
- the fiscal unity is applied for at least five financial years.

The taxable income/loss of the fiscal unity is calculated as the sum of the taxable income/loss of each constitutive entity. The vertical fiscal unity regime has been extended since 1 January 2016 in accordance with CJEU case law in particular to allow horizontal integrations. Eligible Companies (at least two Luxembourg companies) that are held by a common parent established in any EEA country and subject to tax comparable to Luxembourg's CIT in its country of residence are now also permitted to form a fiscal unity. Companies consolidated for CIT are also automatically consolidated for MBT. However, there is no tax consolidation for NWT purposes.

Securitisation entities and venture capital companies are excluded from the possibility of forming a fiscal unity in order to prevent tax evasion schemes.

4.5 Do tax losses survive a change of ownership?

Companies resident in Luxembourg can carry forward their losses for 17 years for financial losses realised from the financial year closing after 31 December 2016 (before that, tax losses could be carried forward indefinitely; losses incurred between 1 January 1991 and 31 December 2016 are, however, grandfathered in) and offset them against any future profits if the following conditions are met cumulatively:

- the losses have not already been offset;
- the company has maintained proper accounting in the loss-making period; and
- the losses are offset by the company that incurred them.

Based on Luxembourg case law, companies should have a right to carry forward tax losses in case of change of ownership, unless an abuse of law has been established. Such condition should be interpreted in the meaning of corporate law and not solely on economic rationale. The right to offset the losses based on the above conditions should only be interpreted in light of the definition of a company based on corporate law. As a consequence, amendments to articles of association relating to the sale of shares of the company do not lead to the creation of a new legal entity and hence do not prohibit that entity from the carrying forward of losses.

However, application of the tax carry forward may be denied if the transaction occurred purely for tax reasons; the so-called "*Mantelkauf*" theory.

It should be noted that tax losses may be offset against CIT and MBT but not against NWT.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Luxembourg taxes retain and distribute profits in the same manner. However, distributed profits may be subject to WHT unless a domestic or treaty exemption applies. It should also be noted that undistributed profits might also be subject to NWT.

4.7 Are companies subject to any significant taxes not covered elsewhere in this chapter – e.g. tax on the occupation of property?

Yes, Luxembourg levies NWT on Luxembourg corporate tax residents. NWT is assessed on 1 January of each year on the basis of the estimated realisable value of the company's net operating assets (total assets minus total liabilities, the so-called "unitary value"). There is a possibility of reduction of the NWT up to the CIT paid for the previous fiscal year. NWT of 0.5% is levied on the unitary value of up to €500 million (inclusive) and 0.05% for the unitary value exceeding this threshold.

A minimum NWT of €4,815 is due by Luxembourg corporate taxpayers holding financial assets representing at least 90% of their total assets and having a balance sheet exceeding €350,000.

Exemptions are available for securitisation vehicles, SICARs, SEPCAVs (*sociétés d'épargne pension à capital variable*), ASSEPs (*association d'épargne pension*), and reserved alternative investment funds ("**RAIFs**") that invest exclusively in risk capital-related securities – which only pay the minimum flat NWT rate of €4,815. A Luxembourg resident company can also benefit from an NWT exemption on qualifying participations under the same conditions applicable for the participation exemption on dividend income, except that no minimum holding period is required.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

In principle, capital gains arising from the sale of assets are treated as ordinary income and taxed as such, unless participation exemption as specified in question 5.2 below applies.

5.2 Is there a participation exemption for capital gains?

Capital gains exemption is available provided that, at the time the capital gains are realised:

- the Luxembourg company has held a direct participation representing at least 10% of the nominal paid-up share capital of its subsidiary (or, if below 10%, a direct participation having an acquisition price of at least €6 million);
- it has held such qualifying participation for an uninterrupted period of at least 12 months; and
- the subsidiary entity is (i) a Luxembourg resident entity fully subject to Luxembourg income taxes, (ii) a non-resident capital company liable for an income tax in its country of residence comparable to the Luxembourg CIT, or (iii) an entity resident in an EU Member State (as defined in Article 2 PSD).

It is important to note that the GAAR does not apply to capital gains deriving from qualifying subsidiaries that benefit from the Luxembourg participation exemption, regardless of their location.

5.3 Is there any special relief for reinvestment?

Yes, Article 54 LITL provides for a reinvestment relief if fixed assets consisting of a building or non-depreciable assets are disposed of during the course of operations, provided that certain conditions are met. The purpose of this Article is that the profit on the disposal of assets should not be taxed if the funds released are retained in the business and will be used to invest in other capital assets.

5.4 Does your jurisdiction impose withholding tax on the proceeds of selling a direct or indirect interest in local assets/shares?

Luxembourg does not impose WHT on the sale of a direct or indirect interest in local assets/shares as such profits are taxed as capital gains.

6 Local Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

A €75 registration duty is due upon formation of a subsidiary; the same duty is paid in case its articles of association are amended.

6.2 Is there a difference between the taxation of a local subsidiary and a local branch of a non-resident company (for example, a branch profits tax)?

"Branch" is a corporate law term; therefore, the classification of an entity/activities as a branch is not imperative for the determination of its tax treatment. Instead, tax law uses the term "permanent establishment" to determine whether an entity is taxable in Luxembourg.

Branches and subsidiaries fall under the same tax regime. In addition, all transactions between the head office and the branch are disregarded for tax purposes, e.g. there is no WHT on any payments.

6.3 How would the taxable profits of a local branch be determined in its jurisdiction?

In principle, Luxembourg branches of foreign companies should be taxed the same way as resident companies (subject to the provisions of a relevant tax treaty), with the exception that transactions between a branch and a head office are disregarded.

6.4 Would a branch benefit from double tax relief in its jurisdiction?

It depends on the domestic law of the jurisdiction where the head office is located and the applicable DTT. However, as a general rule, a permanent establishment is not considered a resident under a tax treaty and cannot claim the benefits of such treaty on its own.

6.5 Would any withholding tax or other similar tax be imposed as the result of a remittance of profits by the branch?

No, transactions between the branch and the head office are not subject to WHT or any similar tax.

7 Overseas Profits

7.1 Does your jurisdiction tax profits earned in overseas branches?

As a general rule, in the absence of a DTT, profits realised by an overseas branch would be included in the taxable basis of the Luxembourg head office (as it is taxed on its worldwide income). However, within the framework of DTTs, Luxembourg generally exempts profits of a permanent establishment that are taxed in the other Contracting State.

It should be noted that profits of an overseas branch would not be subject to MBT, as this tax is applicable only to commercial activities carried on in Luxembourg.

7.2 Is tax imposed on the receipt of dividends by a local company from a non-resident company?

Yes, all dividends received from abroad are calculated in the taxable profits of a company.

Such income might be exempt under the applicable tax treaty or the domestic participation exemption.

Under the domestic participation exemption, dividend income (and liquidation proceeds) is exempt if, at the time the income is put at the disposal of the taxpayer:

- the subsidiary entity is (i) a Luxembourg resident entity fully subject to Luxembourg income taxes, (ii) an entity resident in an EU Member State (as defined in Article 2 PSD), or (iii) a non-resident capital company liable to an income tax in its country of residence comparable to the Luxembourg CIT;
- the Luxembourg company holds a direct participation representing at least 10% of the nominal paid-up share capital of its subsidiary (or, if below 10%, a direct participation having an acquisition price of at least €1.2 million); and
- it has held (or commits itself to hold) such qualifying participation for an uninterrupted period of at least 12 months.

If the dividends are distributed by an EU subsidiary that is listed in Article 2 PSD, the exemption applies subject to the two additional conditions below:

- the EU subsidiary is not used for the main purpose or as one of the main purposes of obtaining a tax advantage that defeats the object of the PSD (GAAR); and
- the dividend/profit distribution from the EU subsidiary has not been deducted from its taxable base (anti-hybrid rule).

7.3 Does your jurisdiction have "controlled foreign company" rules and, if so, when do these apply?

CFC rules have been introduced into Luxembourg law as of January 2019 upon the implementation of ATAD 1 and were detailed by a circular issued by the Luxembourg tax administration on 4 March 2020. Under Article 164*ter* LITL, entities may qualify as CFCs if they are permanent establishments or companies that are not subject to Luxembourg taxes, or if their income is tax exempt in Luxembourg. It should be noted that tax-transparent entities, which may be treated as permanent establishments of a Luxembourg company, can also qualify as CFCs. Entities that qualify as CFCs but report an annual profit lower than either (i) €750,000, or (ii) 10% of their operating costs in their commercial balance sheet, are excluded from the scope of the CFC rules.

Foreign entities shall qualify as CFCs when the following two conditions are cumulatively met:

- the Luxembourg taxpayer holds itself and/or with "associated enterprises", directly or indirectly, more than 50% of the share capital or 50% of the voting rights in the CFC, or owns the right to receive more than 50% of the profits of the CFC; and
- the taxation paid by the CFC is lower than the difference between (i) the taxation that would have been due in accordance with the LITL, and (ii) the taxation actually paid by the CFC.

In accordance with Article 164 (3) LITL, benefits perceived by the CFC that (i) have not been distributed to the Luxembourg taxpayer during the same financial year, and (ii) result from non-authentic arrangements having the purpose of obtaining a tax advantage, have to be included in the taxable income of the Luxembourg taxpayer.

8 Taxation of Commercial Real Estate

8.1 Are non-residents taxed on the disposal of commercial real estate in your jurisdiction?

Yes, non-residents are subject to capital gains tax upon disposal of real estate located in Luxembourg, as per domestic law. Such position might be overruled under DTTs signed with Luxembourg.

8.2 Does your jurisdiction impose tax on the transfer of an indirect interest in commercial real estate in your jurisdiction?

Luxembourg does not impose such tax unless the sale is carried out by a tax-transparent entity from a Luxembourg point of view; then the non-resident company directly above the tax-transparent entity is taxable on capital gains realised on the sale of the real estate in question.

Further, the 2021 Budget Law (*Loi de budget des recettes et des dépenses de l'État pour l'exercice 2021*) has introduced a new levy of 20% on certain gains on the disposal of real estate assets situated in Luxembourg and realised by certain tax-exempt Luxembourg entities. Only some types of vehicles are considered in scope: undertakings for collective investments ("**UCIs**") under the law of 17 December 2010; specialised investment funds ("**SIFs**") under the law of 13 February 2007; and RAIFs under the law of 23 July 2016, with a separate legal personality. Vehicles set up as limited partnerships ("**SCS**") are expressly excluded from the scope. Income and gains include those realised under sales.

8.3 Does your jurisdiction have a special tax regime for Real Estate Investment Trusts (REITs) or their equivalent?

No, Luxembourg does not have a special tax regime for REITs.

9 Anti-avoidance and Compliance

9.1 Does your jurisdiction have a general anti-avoidance or anti-abuse rule?

Luxembourg has a GAAR embedded in its legislative framework (Article 6 *Steueranpassungsgesetz*, "**StAnpG**"), which applies to any Luxembourg taxpayer (capital companies, individuals and partnerships).

A specific GAAR was also introduced to implement the provisions of Directive 2014/86/EC of 8 July 2014, amending the PSD, introducing a GAAR on the participation exemption regime.

More recently, Luxembourg modified its existing GAAR under Article 6 StAnpG to align it with the GAAR provided for by ATAD 1. According to the amended rule, a misuse of forms and institutions of law (i.e. an "arrangement") that has been carried out for the main purpose or one of the main purposes of achieving a tax advantage, and which is not commercially genuine, should be ignored. An arrangement is considered ingenuine if it has not been put into place for valid commercial reasons that reflect economic reality.

However, one shall remember that the GAAR is still subject to EU law and its interpretation by the CJEU. In this context, the CJEU *Cadbury Schweppes* case law and the notion of wholly artificial arrangements should be taken into account when applying the GAAR.

Over the past few years, the Luxembourg tax administration has increasingly relied on the concept of abuse of law in order to challenge a taxpayer's tax return. We also observe a clear increase in case law referring to the abuse of law.

9.2 Is there a requirement to make special disclosure of avoidance schemes or transactions that meet hallmarks associated with cross-border tax planning?

Luxembourg implemented the fifth amendment to Directive 2011/16/EU as regards mandatory automatic exchange of

information in the field of taxation in relation to reportable cross-border arrangements with the law of 25 March 2020 (the "**Luxembourg DAC 6 Law**"). The Luxembourg DAC 6 Law is largely based on the wording of the Directive.

Reporting obligations rely, in principle, on so-called "intermediaries", or, if only exempt intermediaries are involved in the arrangement, such obligations are shifted to the relevant taxpayer.

As per the Luxembourg DAC 6 Law, all transactions the first steps of which have been implemented after 25 June 2018 are in the scope of a potential reporting obligation. Such reporting would, however, only need to take place in case of cross-border transactions, specifically transactions involving more than one EU Member State or transactions involving an EU Member State and a third country.

Furthermore, transactions that fall within the scope of at least one hallmark as provided for in the Appendix to the Luxembourg DAC 6 Law will need to be disclosed to the Luxembourg tax authorities. Hallmarks A to C1 are subject to an additional main benefit test. However, very little guidance is given as to the interpretation of a "main tax benefit", thus giving room to different applications of these hallmarks between Member States. The Luxembourg tax authorities have provided and updated implementation guidelines; however, they do not provide specific interpretation in this respect.

The first reporting date for cross-border reportable transactions was set on 1 July 2020. However, with regard to the COVID-19 pandemic, Luxembourg opted to defer reporting obligations to 1 January 2021 as foreseen by the EU Commission. Reporting obligations must be fulfilled within 30 days from the beginning of implementation of the reportable transaction.

9.3 Does your jurisdiction have rules that target not only taxpayers engaging in tax avoidance but also anyone who promotes, enables or facilitates the tax avoidance?

Indeed, the DAC 6 Framework not only involves taxpayers but also all intermediaries involved in the transaction. Under the Luxembourg DAC 6 Law, intermediaries are defined as being persons who design, market, organise or make the arrangement available for implementation. Such intermediaries are primarily responsible for filing the information on reportable cross-border arrangements with the tax authorities.

Furthermore, secondary intermediaries are under the obligation to report. Secondary intermediaries are persons that, having regard to all the relevant facts and circumstances and based on the available information and the relevant expertise and understanding required to provide such services, know or could be reasonably expected to know that they have undertaken to provide, directly or by means of other persons, aid, assistance or advice with respect to designing, marketing or organising a reportable cross-border arrangement, or making available for implementation or managing the implementation of a reportable cross-border arrangement.

Despite qualifying as intermediaries as per the abovementioned definitions, lawyers, as well as chartered accountants and audit professionals, are exempt from the reporting obligation under the Luxembourg DAC 6 Law, being covered by professional secrecy. That said, Luxembourg exempted intermediaries must notify all other intermediaries or, if need be, the taxpayer directly if they consider the transaction reportable. Such notification has to occur within 10 days from the beginning of implementation of the reportable transaction.

In the context of the Panama Papers, however, 2021 case law waived the professional secrecy of lawyers approached as third parties in the context of a tax audit carried out by the Luxembourg tax administration. This recent development is being closely monitored by Luxembourg practitioners as potentially harmful to the fundamental rights of taxpayers.

9.4 Does your jurisdiction encourage "co-operative compliance" and, if so, does this provide procedural benefits only or result in a reduction of tax?

A corporate entity may approach the tax administration and request an advance tax ruling, which constitutes a binding agreement with the tax authorities and a confirmation of the tax treatment.

9.5 Are there rules requiring special disclosure where a company is taking a position on a tax issue that is uncertain (open to dispute from a technical perspective)?

There is no specific requirement for uncertain tax position disclosure under the Lux GAAP.

However, for entities taxed under the International Financial Reporting Standards ("**IFRS**"), IFRIC 23 clarified the accounting recording for uncertainty in income tax treatment. Entities should assess the tax uncertainty with regard to the likelihood of acceptance of the treatment by the tax authorities. Moreover, entities shall determine whether to disclose their assessment and assumptions and estimates made in order to determine the taxable profit.

The IFRS as adopted by the EU are required for the consolidated financial statements of all domestic companies whose debt or equity securities trade in a regulated market. They are permitted in both the consolidated financial statements and the separate company financial statements of all domestic companies whose securities do not trade in a regulated market.

10 BEPS, Tax Competition and the Digital Economy

10.1 Has your jurisdiction implemented the OECD's recommendations that came out of the BEPS project?

Luxembourg has implemented many changes to align its law with the BEPS Action Plan:

- Action 1: implementation of the VAT Directive addressing VAT on business to customer digital services.
- Actions 2–4: implementation of ATAD 1, which deals with CFCs and interest limitation rules, which were implemented into Luxembourg law on 1 January 2019. Hybrid rules under ATAD 2 were transposed into Luxembourg national law as of 1 January 2020, aiming to neutralise the effects of hybrid mismatch arrangements. In addition, rules providing for the limitation of the deductibility of interest and royalties paid to entities located in non-cooperative jurisdictions have been implemented as of 1 March 2021.
- Action 5: Luxembourg introduced a BEPS-compliant new intellectual property ("**IP**") box regime as of the fiscal year starting in 2018.
- Action 6: on preventing the granting of treaty benefits in inappropriate circumstances. Action 6 will include minimum standards to combat contractual abuse.
- Action 7: prevention of the artificial avoidance of permanent establishment status.
- Actions 8–10: introduction of the new Article 56*bis* LITL (please refer to question 3.9 above).

- Action 12: as per the introduction into domestic law of DAC 6 (please refer to question 9.2 above).
- Action 13: transfer pricing documentation as requested by the new transfer pricing rules (please refer to question 3.9 above); and country-by-country reporting ("**CbCR**"), which is applicable in Luxembourg for financial years starting on or after 1 January 2016.
- Action 14: Luxembourg chose to opt for mandatory arbitration under the MLI, which will be improved due to the new BEPS-MLI.
- Action 15: Luxembourg signed the MLI.

10.2 Has your jurisdiction adopted any legislation to tackle BEPS that goes beyond the OECD's recommendations?

No, Luxembourg has implemented all the mandatory measures that derive from the EU parliament initiative. However, as a competitive jurisdiction, it does not plan to impose measures that would go beyond other recommendations of the BEPS report. The interesting exception to that is the introduction of the mandatory binding arbitration, which is not required under the MLI instrument. Also, it is worth noting that the Luxembourg law on transfer pricing expressly makes reference to the OECD transfer pricing guidelines when interpreting national law.

10.3 Does your jurisdiction support information obtained under Country-by-Country Reporting (CBCR) being made available to the public?

Yes, Luxembourg has transposed EU Directive 2016/881 concerning automatic and mandatory exchange of tax information by the law of 23 December 2016 concerning CbCR. The law requires the annual filing of a CbCR declaration by every ultimate parent company residing in Luxembourg for tax purposes (or a designated reporting entity). The CbCR must be filed within 12 months from the last day of the fiscal year in question. There is also an obligation to submit a notification stating whether the entity is either the ultimate parent of the group, a substitute parent or the designated reporting entity; if it performs none of these functions, the notification shall clearly state the identity and fiscal residence of the reporting group entity no later than on the last day of the fiscal year of the group. The notification is submitted electronically.

Information obtained under CbCR is not public. In this respect, Luxembourg has implemented measures to ensure the appropriate use of information.

10.4 Does your jurisdiction maintain any preferential tax regimes such as a patent box?

Yes, the law dated 22 March 2018 replaced the IP box regime that was abolished in 2016. In addition, the Luxembourg tax authorities published a circular on 28 June 2019, L.I.R. n° 50*ter*/1, clarifying the IP box. The law introduced a new Article 50*ter* LITL that provides for an 80% exemption on income derived from the commercialisation of certain IP rights, as well as a full exemption from NWT. The new rules are applicable as from the fiscal year 2018. Qualifying assets include the following IP rights:

- patents (broadly defined) and functionally equivalent rights that are legally protected by utility models, extensions of patent protection for certain drugs and phytopharmaceutical products, plant breeder's rights, and orphan drug designations; and
- copyrighted software.

In line with the BEPS Action 5 recommendations, marketing-related IP can no longer benefit from the IP box regime.

Qualifying income includes the following:

- income derived from the use of, or a concession to use, qualifying IP rights (i.e. royalty income);
- IP income embedded in the sales price of products or services directly related to the eligible IP asset. The principles of Article 56*bis* LITL must be used to separate income unrelated to the IP (e.g. marketing and manufacturing returns);
- capital gains derived from the sale of the qualifying IP rights; and
- indemnities based on an arbitration ruling or a court decision directly linked to a breach of a qualifying IP right.

The regime applies on a net income basis, meaning that expenses relating to the qualifying IP assets need to be deducted from the gross qualifying income. The proportion of qualifying net income entitled to the benefits will be determined based on the ratio of qualifying expenditures and overall expenditures (nexus ratio). The previously qualifying IP assets can continue to benefit from the old regime during the grandfathering period, running until 30 June 2021.

10.5 Has your jurisdiction taken any unilateral action to tax digital activities or to expand the tax base to capture digital presence?

No unilateral action has been taken by Luxembourg, as any digital services tax would be detrimental to the fiscal politics of Luxembourg.

Although France has introduced a digital services tax, such actions are not expected in Luxembourg.

It is worth noting that the Luxembourg VAT authorities issued Circular n° 787 of 11 June 2018 to extend the VAT exemption applicable to financial transactions to virtual currencies (which follows the CJEU's position in the *Hedqvist* case (C-264/14)).

Concurrently therewith, the Luxembourg direct tax administration issued Circular n° 14/5-99/3-99*bis*/3 of 26 July 2018, which classifies virtual currencies as intangible assets for CIT, MBT and NWT rather than currency. It is interesting to note that both tax administrations have a diverging interpretation on the assessment of cryptocurrencies. However, Luxembourg agreed to the multilateral statement of the OECD international tax reform in July 2021, to be implemented in 2023.

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