GUIDE TO GOING GLOBAL

TAX

Luxembourg

DLA PIPER

INTRODUCTION

Welcome to the 2023 edition of DLA Piper's *Guide to Going Global – Tax*.

GUIDE TO GOING GLOBAL SERIES

Many companies today aim to scale their businesses globally and into multiple countries simultaneously. In order to help clients meet this challenge, we have created a handy set of global guides that cover the basics companies need to know.

The *Guide to Going Global* series reviews business-relevant corporate, employment, intellectual property and technology, global equity and tax laws in key jurisdictions around the world.

TAX

Multinational companies continue to expand globally at an ever faster pace. Successful expansion depends, in part, on strategic and effective tax planning and compliance. This guide, brought to you by DLA Piper's Tax group summarizes the key features of tax laws in 41 popular jurisdictions.

This guide addresses common tax questions, by jurisdiction, including:

- Taxation of resident companies and non-resident companies
- Availability of tax holidays, rulings, and favorable tax regimes
- Ability to use losses to offset income
- Anti-deferral (ie CFC) rules
- Withholding taxes
- Employment tax issues

With more than 300 tax lawyers and economists in offices throughout the Americas, Europe and Asia Pacific, DLA Piper's global tax advisory services help multinational companies address the complex challenges of international commerce and business operations as well as manage and resolve tax audits. Our global tax group also assists clients in structuring a wide range of transactions, from private equity deals to corporate acquisitions and disposals. We provide these tax services across our global platform, while at the same time offering clients the benefits of the attorney-client and work-product privileges.

The information in this guide is an accessible, high-level summary of the tax laws in each jurisdiction. This is not a substitute for legal or tax advice. If you have specific questions or require detailed advice, we encourage you to contact one of the attorneys listed in the contributors section of this guide.

We hope that you find this guide valuable and we welcome your feedback.

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This is a general reference document and should not be relied upon as legal advice. The application and effect of any law or regulation upon a particular situation can vary depending upon the specific facts and circumstances, and so you should consult with a lawyer regarding the impact of any of these regimes in any particular instance.

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LUXEMBOURG

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RESIDENCE AND BASIS FOR TAXATION

A company is considered a resident if its legal seat or central administration is in Luxembourg.

Domestic

A resident company is taxed on its worldwide income, unless a double tax treaty provides for an exemption.

Foreign

A non-resident company is only taxed on Luxembourg-source income.

TAXABLE INCOME

Domestic

Taxable income is calculated based on the profit as stated in the commercial balance sheet, plus certain adjustments provided under the tax law (eg, non-deductibility of taxes, exemption for dividends).

Foreign

A corporate non-resident entity is subject to corporate income tax only on income generated in Luxembourg.

Income from Luxembourg sources include commercial income realized by, for example, a permanent establishment/representative in Luxembourg, income from the lease of property and securities income.

TAX RATES

For the fiscal year 2022, the corporate income tax (CIT) is 17 percent, leading to an overall tax rate for companies of 24.94 percent in Luxembourg City (taking into account the solidarity surtax of 7 percent and including 6.75 percent municipal business tax (MBT) rate applicable and which may vary depending on the seat of the company).

TAX COMPLIANCE

The tax year for a company is either the calendar year or the company's accounting year ending in a particular calendar year.

Corporate income tax, net worth tax and municipal business tax returns must be submitted before May 31 of the following tax year.

Failure to submit a tax return or a late filing may be subject to a penalty of 10 percent of the tax due and a fine up to EUR25,000.

Under the Country-by-Country (CbC) law, a Luxembourg tax resident entity that is the ultimate parent entity of a multinational group with consolidated group revenue of EUR750 million or more in the previous fiscal year and prepares consolidated financial statements must file a CbC report with the Luxembourg tax authorities within 12 months after every fiscal year-end of the group. A Luxembourg tax resident entity can be appointed as a surrogate parent entity to file a CbC report in Luxembourg on behalf of the group.

ALTERNATIVE MINIMUM TAX

Not applicable for this jurisdiction. However, please see the developments on minimum wealth tax discussed below.

TAX HOLIDAYS, RULINGS AND INCENTIVES

Tax holidays

Not applicable for this jurisdiction.

Tax rulings

Luxembourg operates a system known as advance tax agreement (ATA) enabling taxpayers to request an advance tax decision from the Luxembourg tax authorities. An administrative fee will apply.

Advance tax agreements granted before January 1, 2015 were, according to the former practice of the Luxembourg tax administration, not limited in time. Such advance tax agreements became automatically null and void as from the end of the 2019 tax year.

Taxpayers relying on advance tax agreements granted before January 1, 2015 will benefit from the provisions of such agreements for the last time when filing their tax return for 2019. Henceforth, new advance tax agreement requests will have to be introduced in accordance with the new procedure which has been applicable since January 1, 2015. This new procedure already contains a 5-year validity period for advance tax agreements.

Tax incentives

Various incentive programs exist in Luxembourg in the areas of risk capital, audiovisual activities, environmental protection, R&D (experimental development, experimental development and cooperation, industrial research, industrial research and cooperation or fundamental research), intellectual property, professional training and recruitment of unemployed persons. Most of the incentives are granted as tax credit.

Intellectual property may benefit from the new Intellectual Property (IP) regime introduced in March 2018. The Luxembourg tax law provides for a partial exemption of 80 percent on the net income derived from eligible IP assets, as well as a 100 percent exemption from net wealth tax. Under this law, patents and copyrights on computer software, among others, are eligible assets for the preferential tax treatment. Eligible income that will qualify for preferential tax treatment includes net income from direct use, royalties from the granting of licenses or income from the sale of eligible IP assets. The IP activity of the company should be properly documented to demonstrate the link between the eligible IP assets and the related expenses. The taxpayer must also be ready to share this information with the Luxembourg tax authorities, if requested.

Furthermore, several incentive programs exist for certain entities: investment funds (which are subject to several exemptions), private wealth management company (*Société de gestion de Patrimoine Familial* or SPF) (which is exempt from Luxembourg taxation on income and NWT in Luxembourg), securitization companies (which are exempt of NWT), venture capital companies (*Société d'Investissement en Capital à Risque* or SICAR) (incorporated under a corporate form, the SICAR is subject to income tax at the normal rate with the benefit of an exemption on income and gains (eg, dividends, capital gains, liquidation proceeds, interest) under certain conditions) and shipping companies (which are not subject to municipal business tax and can benefit from investment tax credits and accelerated depreciation).

CONSOLIDATION

A group of companies, under certain conditions, may apply the tax consolidation regime in Luxembourg. In practice, the tax consolidation regime enables the group to pool or offset the respective taxable profit of each company in the group and to be taxed on the aggregate amount (ie, a group of companies is treated as a single taxpayer). Losses incurred by one company of a group may accordingly be offset by the profits realized by another group company.

The main requirements are the following:

- A minimum shareholding (95 percent) must be held without interruption from the beginning of the financial year to which the tax consolidation regime is applied
- Group companies must begin and end their financial years on the same date and
- The companies concerned must be grouped for at least 5 financial years.

Tax consolidation is requested jointly to the tax authorities.

PARTICIPATION EXEMPTION

Dividends and gains derived by a Luxembourg entity from a qualifying participation (broadly any entity subject to a corporate income tax rate of at least 8.5 percent applied on a tax base determined by the application of rules similar to those existing in Luxembourg) may be tax exempt if certain conditions in terms of shareholdings are met.

The application of the participation exemption regime on capital gains is subject to a recapture rule under which capital gains will remain taxable up to the aggregate amount of expenses connected with the qualifying participation such as financing cost and write-downs, which have reduced the parent's taxable base in prior years or in the year of disposal.

CAPITAL GAIN

Capital gains generally are taxed as ordinary income at the standard corporate tax rates. Nonetheless, capital gains derived from the sale of shares may be exempt from corporate tax if the conditions for the participation exemption are met and subject to the recapture rule.

DISTRIBUTIONS

Not applicable.

LOSS UTILIZATION

Carryforward: Losses generated from January 1, 2017 can be carried forward for a maximum period of 17 years.

Point of interest: Losses generated before this date are not subject to these limitations and may be carried forward indefinitely.

Carryback: Not applicable for this jurisdiction.

TAX-FREE REORGANIZATIONS

Luxembourg tax law allows for tax neutrality company reorganization provided that certain conditions are met and in the following cases:

- Transformation of the corporate form of an entity into another corporate form
- Merger or demerger of Luxembourg or EU resident companies or
- Exchange of shares when the acquiring company gets the majority of voting rights in the acquired company or increases the majority of voting rights already held.

ANTI-DEFERRAL RULES

Luxembourg has introduced controlled foreign company (CFC) rules in the context of the transposition of the EU Anti-Tax Avoidance Directive 2016/1164 of July 12, 2016 (ATAD). The CFC rules are applicable from January 1,

2019. The CFC rules attribute net income to a Luxembourg taxpayer when its subsidiary or permanent establishment is located in a low-tax or no-tax jurisdiction, even if this income is not distributed. Such income will be subject to CIT at a rate of 17 percent.

A CFC can be either:

- A collective entity in which the Luxembourg taxpayer holds a direct or indirect participation of more than 50 percent or
- A permanent establishment.

CFC rules will be triggered if the tax paid by the CFC is lower than the difference between the CIT that would have been paid on the same profits in Luxembourg and the actual CIT paid in the CFC state.

The CFC rules do not apply to a CFC whose profits do not exceed:

- EUR750,000 or
- 10 percent of its operating costs within the tax period.

If the CFC rules are triggered, the CFC's undistributed income will be taxed in Luxembourg provided that such income arises from non-genuine arrangements that are put in place essentially for the purpose of obtaining a tax advantage.

FOREIGN TAX CREDITS

A Luxembourg tax resident company is taxed on its worldwide income. Foreign-source income is taxable in Luxembourg, unless a double tax treaty (DTT) provides for an exemption. Dividends from foreign subsidiaries are also taxed, unless a DTT provides for an exemption.

Profits of a foreign branch that are not exempt under a DTT may benefit from a foreign tax credit. Taxes paid in excess of the tax credit are deductible as expenses.

SPECIAL RULES APPLICABLE TO REAL PROPERTY

Municipalities impose a land tax of 0.7 percent to 1 percent on the unitary value of real property.

Certain tax opaque Luxembourg investment vehicles owning real estate assets located in Luxembourg may be subject to a 20 percent real estate levy tax (*prélèvement immobilier*) which applies on derived income such as gross rental income or capital gains realized upon asset or share deal).

TRANSFER PRICING

According to the Luxembourg transfer pricing legislation, transactions between related parties (both located in Luxembourg as well as where 1 party is taxed in a foreign jurisdiction) must be governed by the arm's-length principle. This obliges the taxpayer to report in its tax return either an upward or downward adjustment of profits whenever transfer prices do not reflect the arm's-length principle. The Luxembourg tax authorities may request from the taxpayer all facts relevant for verifying a tax liability. Therefore, the taxpayer should provide all necessary supporting documentation to facilitate the task of tax authorities.

The circular L.I.R. n° 56/1 – 56bis/1, published by the Luxembourg tax authorities on December 27, 2016, focuses on the transfer pricing requirements for intermediary, intragroup financing activities in Luxembourg. A strong emphasis is put on the analysis of the risks assumed by the companies performing intragroup financing transactions. Companies should perform an analysis to determine the necessary capital at risk using the accepted methodologies in this area. These companies must have the financial capacity to assume such risks. Furthermore, the circular provides that, in order to be able to control the risks, the company performing intragroup financing transactions should comply with specific substance requirements.

Moreover, a company may request an advance pricing agreement (APA) from the Luxembourg tax authorities. An administrative fee will apply depending on the complexity of the matter.

WITHHOLDING TAX

Dividends, royalties, interest, rents, etc.

Dividends paid to a non-resident company generally are subject to withholding tax at 15 percent, unless the rate is reduced under a tax treaty.

No tax is withheld on dividends paid to a qualifying company under the EU parent-subsidiary directive (2003/123/CE), except if the transaction qualifies as an abuse of law under the general anti-abuse rule. The benefits of the directive have been extended to parent companies resident in non-EU tax treaty countries (under certain conditions).

Luxembourg does not levy withholding tax on ***royalties***.

Luxembourg does not levy withholding tax on ***interest,*** except for interest payments to Luxembourg resident individuals, in certain cases. Nonetheless, profit-sharing bonds and debt instruments with remuneration linked to the issuer's profits are taxed as dividends (15 percent), and interest payments can be requalified into dividends (and are then subject to a 15-percent withholding tax) where a Luxembourg company is over-indebted in light of thin capitalization rules or where a Luxembourg company does not comply with transfer pricing regulations.

Interest payments made by Luxembourg resident paying agents to Luxembourg resident individuals are subject to a 20-percent WHT. There is an exemption from WHT if the amount due does not exceed EUR250. Where interest payments are made or credited by foreign paying agents located in a member state of the EU or in a state of the European Economic Area, the Luxembourg resident taxpayer may opt for a 20-percent WHT.

Service fees

Luxembourg does not levy withholding tax on ***service fees***.

CAPITAL DUTY, STAMP DUTY AND TRANSFER TAX

No capital duty is levied in Luxembourg (except in particular cases). A registration fee of EUR75 is imposed on incorporation or amendments to bylaws.

There is no stamp duty in Luxembourg.

A transfer tax is applied to a transfer of immovable property. A 6 percent basic rate and a 1 percent transcription tax are applicable. For real estate located in Luxembourg City, an additional charge amounting to 50 percent of the transfer tax is imposed (exemptions are available).

EMPLOYMENT TAXES

Social security contributions apply to wages and salaries and are due from both the employer (rates approximately 12 to 15 percent) and the employee (around 12 percent). Contributions for both employers and employees are computed on a capped basis and must be withheld by the employer. Self-employed individuals must register for social security purposes and pay approximately the same rates as the combined rates for an employer and an employee.

OTHER TAX CONSIDERATIONS

Net Wealth Tax (NWT)

Both Luxembourg resident companies and Luxembourg branches of non-resident companies are subject to NWT. As of January 1, 2016, a new scale of rates has been introduced as follows:

- 0.5 percent up to EUR500 million and
- 0.05 percent over EUR500 million.

Interest deduction limitation

In practice, the tax administration uses a debt-to-equity ratio of 85:15 for the financing of participations. Luxembourg has introduced an interest limitation rule in the context of the transposition of ATAD. As from January 1, 2019, exceeding borrowing costs (ie, tax-deductible borrowing costs which exceed underlying interest income and economically equivalent income) are only deductible up to the higher of 30 percent of earnings before interest, taxes, depreciation and amortization (EBITDA) of the taxpayer and EUR3 million.

Exceeding borrowing costs which are not deductible in a tax period may be carried forward without time limitation. Unused interest capacity in a given tax period may be carried forward for 5 years.

The interest limitation rule is not applicable to exceeding borrowing costs:

- On loans concluded before June 17, 2016, so long as the loans are not subsequently modified;
- On loans to finance EU long-term public infrastructure projects; or
- On loans incurred by standalone entities and "financial undertakings."

Intra-EU hybrid mismatches

As from January 1, 2019, hybrid mismatch provisions apply in an intra-EU context as a result of ATAD.

The rule aims at preventing hybrid mismatches which result in a double deduction (ie, a deduction of the same expenses both in Luxembourg and in the other EU member state) or a deduction without inclusion (ie, a deduction of expenses in Luxembourg and no corresponding inclusion of the income in the taxable basis of the other EU member state).

The anti-tax avoidance directive provisions provide that when a structure includes a hybrid mismatch with double deduction, the deduction shall only be granted in the EU member state where the payment has its source. When a structure includes a hybrid mismatch with deduction without inclusion, the EU member state of residence of the payer shall deny the deduction of such payment.

Hybrid mismatches with third countries (ATAD 2) and covering a wider range of intra-EU mismatches have been implemented and came into force on January 1, 2020, with the additional "reverse hybrid" measures applying from the 2022 tax year.

Payments to EU black-listed entities

Interest or royalties paid or due to related enterprises as of 1 March 2021 are not tax deductible in Luxembourg if the recipients are corporate entities established in countries that are 'black-listed' as being 'non-cooperative' for tax purposes (based on the so-called EU blacklist adopted by the EU Council in 2017, as revised).

DAC 6

On March 25, 2020, the Law implementing the Council Directive (EU) 2018/822 (on administrative cooperation in the field of taxation, of May 25, 2018) introduces an obligation on a wide range of intermediaries to disclose cross-border tax arrangements to the tax authorities.

A reportable cross-border arrangement means any cross-border arrangement that contains at least one of the hallmarks foreseen by DAC 6, which refer to characteristics, features and examples of cross-border arrangements that present an indication of potential risk of tax avoidance. In principle, a cross-border arrangement becomes reportable if it meets one or more hallmarks, while certain hallmarks can only be triggered if a main benefit test (MBT) is also satisfied (ie, when the main benefit or one of the main benefits that a person can reasonably expect to obtain from the arrangement, taking into account all relevant facts and circumstances).

The first reportable transactions are those whose first implementation step occurred between June 25, 2018 and June 30, 2020 and should be reported by February 28, 2021. In addition, starting from January 1, 2021, any other reportable arrangements implemented as from July 1, 2020 that would fall under DAC 6 should be reported within 30 days of their implementation (ie, any reportable arrangements implemented between July 1, 2020 and December 31, 2020 should be reportable by January 31, 2021). These are the new deadlines that have been extended by the government within the context of the COVID-19 pandemic.

Proposed EU Directive to fight against the misuse of shell entities for tax purposes

On December 22, 2021, the EU Commission published a proposed Directive to tackle legal entities with no or minimal substance and no economic activities that are used for improper tax purposes.

The Directive introduces reporting requirements for EU tax-resident companies with certain mobile and passive income streams and inadequate operational substance. In certain cases of inadequate substance, the benefits of tax treaties and EU Directives may be denied, resulting in an increased withholding tax burden as well as potential penalties for failure to report or incorrect reporting.

The EU Commission recommended that Member States should incorporate the Directive into their national law by June 30, 2023, for the rules to enter into force on January 1, 2024.

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