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New Luxembourg tax measures

Luxembourg tax alert

The Luxembourg parliament approved recently a number of tax modifications for the fiscal years 2015 and 2016. The main direct tax measures affecting companies include the modification of the scope of the tax consolidation regime, the revision of the parent subsidiary regime, the abolition of the minimum corporate income tax, the revision of the net worth tax, the repeal of the intellectual property box regime and the extension of the deferred tax payment upon exit.

Expansion of the scope of the tax consolidation regime as from fiscal year 2015

The new measures have extended the scope of the vertical tax consolidation (already permitted) and have introduced horizontal tax consolidation (i.e., sister companies with the same direct or indirect parent company can form a fiscal integration together without the parent company forming part of the consolidation).

Enlargement of the scope of the vertical tax consolidation

Vertical tax consolidation now allows for a Luxembourg permanent establishment of a non-resident company subject to a tax equivalent to Luxembourg corporate income tax, to form part of the tax consolidation as an integrated entity subject to the conditions under article 164bis of the Luxembourg income tax law ("LITL").

Introduction of the horizontal tax consolidation

The purpose of the extension of the scope of the tax consolidation regime with the horizontal tax consolidation is to comply with European case law. Indeed in 2014, the European Court of Justice concluded that a fiscal unity regime was incompatible with the freedom of establishment principle where two sister companies located in the same Member State and held by a European parent company were prevented from forming a "horizontal tax consolidation".

One year after the European Court of Justice's judgement, Luxembourg decided to enlarge the scope of its fiscal unity regime under article 164bis LITL. Within the horizontal tax consolidation, the results are regrouped at the level of the chosen integrating company and not at the level of the non-integrated direct or indirect parent company. As an example, in a tax consolidation where the non-integrating parent company holds two companies (LuxCo 1 and LuxCo 2) which each in turn hold one company (LuxCo 3 and LuxCo 4), the regrouping of results can occur at the level of LuxCo 1 or LuxCo 2.

The conditions to benefit from this new clause are as follows:

i. The non-integrating parent company must be either:

   a. A fully taxable resident company;

   b. A European Economic Area ("EEA") resident company subject to a tax equivalent to Luxembourg corporate income tax;

   c. A Luxembourg permanent establishment of a non-resident company subject to a tax equivalent to Luxembourg corporate income tax; or

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d. An EEA permanent establishment of a non-resident company, both subject to a tax equivalent to Luxembourg corporate income tax.

ii. The non-integrating parent company must directly or indirectly hold a minimum 95% participation in the integrating companies and the 5 year minimum holding period condition must be met.

iii. A written request must be made and the non-integrating parent company should nonetheless be joined to this request, even though it will not form part of the tax consolidation, in order to ensure the non-integrating parent company meets the holding requirements for a minimum period of 5 years.

Also, each integrated member of the tax consolidated group is accountable for the tax liabilities, interest for late payments, charges and penalties of the integrating parent company or integrating subsidiary company.

The other conditions to benefit from the tax consolidation regime with regards to the participation and holding period remain the same. The request is to be introduced before the end of the first year of the period for which the tax integration is requested. It should be noted that a company cannot simultaneously form part of more than one tax consolidation regime.

New tax measures applicable as from January 1, 2016

Transposition into national law of the amendments to the Parent-Subsidiaries Directive

The goal of the Parent-Subsidiaries Directive is to prevent double taxation of dividends distributed by European subsidiaries to their European parent company. Nevertheless, the application of the Directive may have led to situations where dividends were not taxed at all. The European Member States reached an agreement in 2014 on the following two amendments which must be transposed by all Member States into their respective national tax law:

- **An anti-hybrid loan mismatches provision** to prevent double non-taxation by providing that the Member State of the parent company would only refrain from taxing profits from the European subsidiary to the extent that such profits are not deductible by the latter; and
- **A common anti-abuse rule to prevent misuse of the Parent Subsidiaries Directive** and to ensure a greater consistency in its application in different Member States. The application of the anti-abuse rule should be proportionate and should serve the specific purpose of tackling an arrangement or a series of arrangements that are not put into place for valid commercial reasons which reflect economic reality.

To implement such changes, article 147 of the LITL as well as article 166 LITL and §9 of the Municipal Business Tax Law have been partially amended. Capital gains under the participation exemption regime, as well as net wealth tax aspects, are not impacted by these modifications.

Provisions relating to the general anti abuse rule and anti-hybrids mismatches are included in article 166 LITL (and §9 of the Municipal Business Tax Law). Therefore, dividend payments received by an eligible Luxembourg parent entity from an eligible subsidiary located in another Member State will not be exempt under the participation exemption regime in cases where such revenues are deductible in that Member State. The benefits of the participation exemption regime will also not apply where the transaction qualifies as an abuse of law following the common anti-abuse rule. However, other provisions of article 166 LITL should continue to apply.

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Furthermore, article 147 LITL has also been amended to insert the general anti-abuse rule. Therefore, in cases where an eligible Luxembourg entity distributes dividends to an eligible entity located in another Member State, the withholding tax exemption under the participation exemption regime (article 147.2 (a) or (d) LITL) will be denied if the operation qualifies as an abuse of law following the common anti-abuse rule). However, the exemption, based on the other conditions as stated in article 147.2 LITL, should continue to apply.

Abolition of minimum corporate income tax and revision of net wealth tax

The minimum corporate income tax, introduced in 2011, is abolished to bring Luxembourg in line with EU law (based on a letter from the European Commission in which the Commission stated that it considered the minimum corporate income tax not to be fully in line with EU law). It will be replaced by a minimum Net Wealth Tax ("NWT") as from tax year 2016.

The **attached diagram** summarizes the new minimum NWT regime.

The calculation of the reduction of the NWT charge will also be adjusted with the introduction of the minimum NWT regime.

The NWT rate as from 1st January 2016 will depend on a company's total net assets:

- Rate of 0.5% on total net assets up to EUR 500 million (unchanged from the current rule); and
- Rate of 0.05% on total net assets of more than EUR 500 million.

Repeal of the current IP regime

The repeal of Luxembourg's IP regime (article 50bis LITL) echoes the international tax political agreement reached for patent box regimes, under which IP regimes must comply with the new "modified nexus approach". The nexus approach is based on a substantial activity requirement, i.e. there must be a direct nexus between the income receiving benefits and the activity contributing to that income. However, under the above mentioned political agreement, existing IP regimes may be maintained during a transitional period beginning on 1 July 2016 and ending on 30 June 2021.

The repeal of Luxembourg's IP regime will be applicable as from 1 July 2016, and as from 1 January 2017 for NWT purposes. Nevertheless, taxpayers benefiting from the current Luxembourg IP regime that create, acquire or definitively improve qualifying IP rights before 1 July 2016 will be able to continue to benefit from this regime until 30 June 2021. New entrants also could be admitted to the existing regime until 30 June 2016. This transitional period is however subject to two "safeguard" conditions:

- The benefit of the transitional period will not apply after 31 December 2016 for IP rights that are acquired directly or indirectly from related parties after 31 December 2015, unless the IP rights were eligible at the time of their acquisition for the Luxembourg IP regime or a foreign IP regime corresponding to the Luxembourg regime.
  The term "related parties" is broadly defined by reference to Luxembourg's Income Tax Law as an undertaking participating directly or indirectly in the management, control or capital of another undertaking, or a situation in which the same persons participate directly or indirectly in the management, control or capital of two undertakings.
- For taxpayers benefiting from the current Luxembourg IP regime in connection with IP rights acquired or created after 6 February 2015, there will be a spontaneous exchange of information three months after the Luxembourg tax authorities have been informed, or no later than one year after the filing of the tax returns by the taxpayer.

For the purpose of the transitional period, IP rights transferred through a tax-neutral corporate reorganization (e.g. a merger, division or contribution) would be deemed to be acquired on the date of the reorganization.

Extension of the deferred tax payment upon exit to countries outside the EEA

In 2014, Luxembourg introduced a regime for situations where a Luxembourg company migrates to another EEA Member State. Upon request, tax payments on unrealised gains are deferred until said gains are realised (exit taxation). In order to benefit from this regime, two conditions must be met: the corporate taxpayer should: (i) remain resident in an EEA Member State following the migration out of Luxembourg and (ii) continue to own the transferred assets. This regime is also applicable to any taxpayer resident in an EEA Member State who transfers, subject to the above conditions, a Luxembourg enterprise or permanent establishment to another EEA Member State.

The ownership of the transferred assets must be documented each year to secure deferred taxation. No late interest payment is charged and no financial guarantee is required.

The scope of the deferred tax payment regime will be expanded as it will be permitted for transfers to the non-EEA Member States under the same requirements as the existing regime, provided that an international agreement (bilateral or multilateral) including a clause on the exchange of information on request is in force between Luxembourg and the concerned State. This clause should conform substantially to article 26 paragraph 1 of the OECD model convention, meaning that Luxembourg tax treaties that differ slightly from the OECD model convention (i.e. such as those with China, India and the United States), could still be included in the scope of the amended regime.

The same regime will also apply in case of mergers and demergers. Moreover, if the Luxembourg company transfers its statutory seat to another eligible State and later on transfers its seat to another eligible third State, the deferral of the tax payment will still apply. This deferral is applicable provided that all conditions continue to be met and the company commits itself to pay the tax due when required in the future.

Other measures

There are also new measures concerning tax amnesty, the tax credit for investment regime (expanded to lessors of international maritime vessels as from tax year 2015) as well as the tax credit for hiring unemployed persons (extension from the 31 December 2014 to the tax year ending 31 December 2016).

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