

## Luxembourg Tax Alert

### Luxembourg introduces draft law as defensive measures in relation to the EU black list

2 April 2020

As from tax year 2018, the Luxembourg tax authorities have imposed [specific reporting requirements](#) in relation to transactions of Luxembourg companies with related enterprises located in jurisdictions that are included on the [list of non-cooperative jurisdictions for tax purposes](#) (the EU black list).

The Luxembourg government has recently filed a new draft law to consider non-deductible tax expense interest and royalties paid or due to related undertakings established in a country or territory included on the EU black list as from 1 January 2021. Concerning more particularly the 2021 fiscal year, only interest or royalties paid or due as from 1 January 2021 will be concerned if parliament approves the draft law.

This measure is in line with the European Council's new guidelines issued at the end of 2019 encouraging all EU Member States to implement legislative measures designed to impose specific penalties on jurisdictions placed on the EU black list. Following those guidelines, EU Member States must apply at least one of the following tax measures:

- Application of controlled foreign corporation rules
- Limitation or disallowance of deductibility of costs
- Limitation of any participation exemption on profit distributions
- Withholding tax.

The new non-deductible interest and royalties provisions would apply under the following conditions:

- The beneficiary of the interest or royalties would be a collective undertaking within the meaning of Article 159 LITL (i.e. excluding "look-through" entities). If the recipient of the payments is not the beneficial owner, it is the beneficial owner of the payments that shall be considered for the purpose of applying the rule.
- The collective undertaking would be an associated enterprise within the meaning of Article 56 LITL (as defined by Article 9(1) of the OECD Model Tax Convention i.e. any direct or indirect participation in the management, control or capital could lead to classification as an associated enterprise).
- The collective undertaking would be established in a country or territory appearing on the EU black list.

However, the present rule would not apply if the taxpayer can demonstrate that the transaction generating the accrual or payment of interest or royalties would be driven by sound business reasons who reflect the economic reality.

Therefore, where the above conditions are met and where a Luxembourg company cannot provide economic justification for the transaction, the interest or royalties paid or due would not be tax deductible.

Where a Luxembourg company can justify that the interest or royalties correspond to a transaction put in place for commercial reasons reflecting the economic reality, the expense would be tax deductible. In this case, the concerned expense could be subject, where appropriate, to other tax provisions that could lead to a limitation or a refusal of the deduction (such as the application of the interest limitation rule).

The draft law states that a Luxembourg company would demonstrate, taking into account all the facts and circumstances, that the economic reasons would be relevant by presenting a sufficient economic advantage beyond any tax advantage obtained through the operation.

The draft law refers to Article 2 of the Directive 2003/49/CE for the purpose of the definition of “interest” and royalties. The term interest means interest and arrears paid or due that relate to debt-claims of every kind, even if they are secured by mortgage or carrying a right to participate in the debtor's profits, and on other hand, the remuneration of any paid or due for the use or concession of the use of rights or goods therein mentioned. The term royalties means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematograph films and software, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience. It also includes payments for the use of, or the right to use, industrial, commercial or scientific equipment shall be regarded as royalties.

The draft law also mentions that the government may propose to parliament the list of concerned countries with effect as from 1 January 2021. Its content would be determined according to the latest version of the EU black list on the date of such a proposal.

There are now 12 jurisdictions on the black list: American Samoa, Cayman Islands, Fiji, Guam, Oman, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, US Virgin Islands, and Vanuatu. The next revision to the full list is expected by October 2020.

Concerning the Cayman Islands, its government is already working with EU officials to begin the process of being removed from the EU black list as the legislative changes relating to investment funds have already taken effect. [It is anticipated that the Cayman Islands should be removed from the EU black list upon its expected next updated in October 2020.](#)

It should also be noted that the subsequent update of the list may be done once per year.

Thus, according to the draft law, a new list would be proposed, if necessary, during the second half of 2021. The list should be effectively applicable as from 1 January following the update.

## Next steps

The draft law will now follow the legislative process. A final vote is expected before the end of the year.

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