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New Luxembourg Legislative Proposals

Luxembourg Tax Alert

On 5 August 2015, the draft law (no. 6847) transposing the amendments to the Parent-Subsidiaries Directive was presented to the Luxembourg Parliament. This draft law is also an opportunity for Luxembourg to propose new favourable tax measures for taxpayers concerning, amongst others: the respective expansion of the scope of the tax consolidation, exit tax and tax credit for investment regimes.

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 therefore reached an agreement in 2014 on the following two amendments which must be transposed by all Member States in 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.

- **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 anti-abuse rules 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; and

To implement such changes, the draft law amends article 147 of the Luxembourg income tax law ("LITL") as well as Article 166 LITL and §9 of the Municipal Business Tax Law.

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.

On the basis of the proposal, 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 will be denied if the operation qualifies as an abuse of law following the common anti-abuse rule.

The draft law foresees these amendments to be applicable on revenues allocated after 31 December 2015.

Expansion of the scope of the tax consolidation regime

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 whereby 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. In such a case, the results would be 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 fully taxable resident company;
- A European Economic Area ("EEA") resident company subject to a tax equivalent to Luxembourg corporate income tax;
- A Luxembourg permanent establishment of a non-resident company subject to a tax equivalent to Luxembourg corporate income tax; or
- 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.

The draft law also enlarges the scope of "vertical tax consolidation". Currently, article 164bis LITL allows for a tax consolidation whereby the results of a consolidated group of companies are regrouped at the level of the Luxembourg resident parent company or Luxembourg permanent establishment of a non-resident parent company. Vertical tax consolidation will now allow a Luxembourg permanent establishment of a company, resident in a Member State of the EEA, and subject to a tax equivalent to Luxembourg corporate income tax, to form part of the tax consolidation as an integrated company subject to the conditions under article 164bis LITL.

The other conditions to benefit from the tax consolidation regime with regards to the participation and holding period remain the same. It should be noted that a company cannot simultaneously form part of more than one tax consolidation regimes.

Each integrated member of the tax consolidated group will be accountable for the tax liabilities, interest for late payments, charges and penalties of the integrating parent company or integrating subsidiary company.

The draft law foresees this amendment to be applicable as from tax year 2015.

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.

With the current legislative proposal, the scope of the deferred tax payment regime will be expanded. The tax deferral 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 be substantially conform 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 current draft legislation further states that, where the Luxembourg company transfers its statutory seat to another eligible State and then again transfers its seat to another eligible third State, the deferral of the tax payment will still apply. The same applies to mergers and demergers. 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.

The draft law foresees this amendment to be applicable as from tax year 2016.

Amendment to the credit investment regime

Currently, lessors of international maritime vessels are excluded from the benefits of the tax credit for investment regime under Article 152bis LITL.

The draft law proposed that this tax credit for investment is expanded to lessors of international maritime vessels as from tax year 2015, provided the other conditions are fulfilled.

Extension of tax credit timeline for hiring unemployed persons

The tax credit available for hiring unemployed persons has been extended from the 31 December 2014 to the tax year ending 31 December 2016.

The draft law should be adopted and voted in the coming months. The new tax measures proposed demonstrate the commitment by Luxembourg to encourage further investment in the country.

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