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ICEbreakers: Unlocking Luxembourg

Hot topics

BEPS-compliant IP regime: A new intellectual property (IP) regime voted on March 22, 2018 is based on the OECD nexus approach. The regime is applicable as from a taxpayer's fiscal year starting or ending after January 1, 2018 with respect to certain IP rights, mainly patents and copyrights on software created, developed or improved after December 31, 2007. Since the regime adopts the nexus approach, only expenditure incurred by the taxpayer based on DEMPE functions will be considered (through the nexus ratio) in determining the net IP income (acquisition costs will not be considered). The regime maintains an 80% exemption on net income derived from the commercialization/disposal of eligible IP rights, as well as a full exemption from net wealth tax.

2018 budget law: Tax measures in the 2018 budget law that apply as from January 1, 2018 include a reduction of the corporate income tax rate from 19% to 18% and the introduction of a tax credit for investment in purchased software (vs. self-developed).

EU Anti-Tax Avoidance Directive (ATAD): The ATAD II extends the scope of the ATAD I to hybrid mismatches (i.e. hybrid entities, hybrid permanent establishments (PEs) and hybrid instruments leading to a deduction without an income inclusion or a double deduction) with respect to transactions involving non-EU jurisdictions, and encompasses forms of hybrid mismatches not covered by the ATAD I. The article in Luxembourg law on hybrid mismatches has been amended, and the article in the ATAD II must be transposed into domestic law by December 31, 2019 to apply as from January 1, 2020 (the provisions relating to reverse hybrid mismatches must be applied as from January 1, 2022).

OECD multilateral instrument (MLI): Luxembourg, one of the countries that signed the MLI on June 7, 2017, has indicated that it intends to adopt the following provisions:

- *Minimum standards*: The introduction of a preamble stating that a treaty should not create opportunities for nontaxation through tax evasion or avoidance; measures to counter treaty abuse (Luxembourg will adopt the principal purpose test only option); and measures to improve dispute resolution.
- *Transparent entities*: Income derived by/through a tax transparent entity or arrangement will be considered income of a resident of a contracting state to the extent the income is treated as the income of a resident of the state for purposes of taxation by that state.
- *Elimination of double taxation*: The residence state will not apply the exemption method where the source state already has applied the treaty to exempt income or capital from tax (applicable only to certain treaty articles).
- *Artificial avoidance of PE status*: The exception from PE qualification for preparatory or auxiliary activities will be broadened.
- *Arbitration procedure*: A procedure can be launched if the mutual agreement procedure does not resolve the issue within two years.

The MLI provisions will apply only if both parties to a treaty sign the MLI and opt for the same provisions (reciprocity). A ratifying law is required and is expected sometime in 2018 to allow an application date in 2019.

Legislative updates

- **Certificates of tax residence for investment funds**: The tax authorities have issued guidance that provides an expanded list of tax treaties granting access to investment funds (UCITS funds, SIFs and RAIFs) and guidelines on how to request a certificate of tax residence from the Luxembourg tax authorities.
- On April 16, 2018, the government presented a draft bill to parliament that would introduce a **VAT group regime** in Luxembourg. Under this regime, entities that are financially, economically and organizationally linked will be regarded as a single VAT taxable person. The regime will be particularly attractive for the financial sector, which has been negatively affected by recent decisions of the European Court of Justice, which denied VAT-exempt treatment to such entities under the independent group of persons regime.

Tax treaty developments

- **Tax treaty with France** – The treaty and accompanying protocol signed with France on March 28, 2018 reflects the provisions in the 2017 OECD model tax treaty, recommendations under the OECD BEPS project and the multilateral instrument. The treaty will enter into force once the two countries exchange their instruments of ratification.
- **New treaties** with Brunei, Hungary, Ukraine and Uruguay apply as from January 1, 2018.
- A tax treaty was signed with **Kosovo** on December 8, 2017, but the treaty is not yet in force.
- A **protocol** to the treaty with Moldova has been agreed and is awaiting signature.
- **New treaties** are being negotiated with Australia, Democratic Republic of Congo, Iran, Ivory Coast, New Zealand, Peru and Turkmenistan.

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