Luxembourg

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General

1. What are recent tax developments in your country which are relevant for M&A deals?

Luxembourg has implemented Directive 2014/86/EU of 8 July 2014 which amends the EU Parent Subsidiary regime so as to stop situations of double non-taxation created by the use of certain hybrid instruments and Directive 2015/121 of 27 January 2015 which introduces a de minimis General Anti-Abuse Rule (GAAR).

2. What is the general approach of your jurisdiction regarding the implementation of OECD BEPS actions (action Plan 6 specifically) and, if applicable, the amendments to the EU Parent-Subsidiary Directive?

Luxembourg is supportive of the implementation of BEPS recommendations.

However, since the release of the final BEPS report on Action 6, no action has been undertaken yet other than the implementation of the 2 Directives referred to under question 1 above. Luxembourg will probably await the final outcome of EU BEPS recommendations and directives before taking any additional actions. Still, the Luxembourg Tax Authorities (LTA) already require minimum substance requirements for Luxembourg companies performing intragroup financing activities (please refer to question 17 for more details).

3. What are the main differences among acquisitions made through a share deal versus an asset deal in your country?

a. Share deal

A share deal in Luxembourg enables the target company to continue to carry forward its losses.

There are no taxes levied on a share sale unless the securities that are sold are those in a Luxembourg tax transparent entity (société civile) holding at least one Luxembourg real estate asset. The duties applicable upon disposal of certain assets (essentially real estate) in a share deal are lower than in an asset deal.

b. Asset deal

In an asset deal, the target's losses may not be carried forward by the purchaser, but the purchaser will dispose of a higher basis for depreciation in the future. Indeed, a financial participation cannot be amortised.

Another disadvantage of asset deals is the relatively high Luxembourg registration duty applicable on the disposal of certain assets (essentially real estate) where registration is mandatory. The registration duties in an asset deal are higher than in a share deal.

Immovable asset

In case of disposal of a real estate located in Luxembourg, regardless of whether the contract is executed in Luxembourg or elsewhere, a transfer tax applies at the standard rate of 6%. If the real estate is located in Luxembourg City, an additional municipal surcharge of 3% is levied. A 1% transcription tax (droit de transcription) is also due on the sale of a Luxembourg real estate property. If the real estate asset sold is located abroad, no registration duty is due in Luxembourg.

Movable asset

There is no need to register the sale of a movable asset. However, if the contract is voluntarily registered, it is subject to a proportional registration duty at a rate of 6% (reduced to 1.2% where the sale is by way of judicial proceeding).

Debt instruments

It is not compulsory to register a document evidencing a debt instrument. However, a registration duty of 0.24% is due if such a document is voluntarily registered, unless the debt instrument is created under the form of a negotiable instrument (such as a bond).

Buy-side

4. What strategies are in place, if any, to step up the value of the tangible and intangible assets in case of share deals?

In principle, in share deals, it is not possible to perform a step-up in value in Luxembourg.

5. What are the particular rules of depreciation of goodwill in your country?

In principle, goodwill may be depreciated for tax purposes over a 10-year period.

6. Are there any limitations to the deductibility of interest on borrowings?

Luxembourg has three types of limitation to the deductibility of interest on borrowings: limitations related to the purpose of the expense, limitations based on transfer pricing rules and limitations based on the re-characterisation of the interest expense into a dividend.

Limitations related to the purpose of the expense

Only expenses incurred exclusively for business purposes are tax-deductible. The purpose of this rule is to draw a line between operational and personal expenses (a comment relevant mostly for individual commercial enterprises). Thus, interest payments are deductible if the debt is contracted in the company's interest. One limitation to this rule is that expenses which are economically connected to tax-exempt income are not deductible. Based on this rule, limitations on interest deduction apply to an exempt dividend, income derived through a foreign permanent establishment or exempt capital gains on the disposal of shares.

Limitations based on transfer pricing rules

Transfer pricing principles are defined in articles 56 and 164(3) LITL.

Article 56 LITL provides a legal basis for transfer pricing adjustments where associated enterprises deviate from the arm's length standard. In other words, where a Luxembourg company shifts advantages to another group company, the Luxembourg tax authorities may increase the company's taxable income (upward adjustment). Conversely, where a Luxembourg company receives an advantage from an associated company, the taxable income of the Luxembourg company may be reduced by a downward adjustment.

The scope of Article 56 LITL is not limited to cross-border transactions and is applicable to transactions between Luxembourg companies.

Article 164(3) LITL provides that hidden distributions (i.e., direct or indirect advantages granted by the company to its shareholder which, absent the shareholding relationship, would otherwise not have been granted) are non-deductible from the taxable basis of the company.

The Luxembourg tax authorities released two circulars regarding intragroup financing activities.

Amongst other requirements, such circulars provide for the transfer pricing guidelines to be relied upon by Luxembourg companies involved in intragroup financing activities to evidence that the remuneration and the activity carried out is in line with third-party transaction characteristics, as well as the procedure to follow to obtain a binding advance pricing agreement from the Luxembourg tax authorities on the financing activity

Limitations based on the re-characterisation of the interest expense into a dividend

Based on the "substance over form" approach, an instrument is qualified as debt or equity based on its economic nature - that is, not necessarily based on its legal qualification. If an instrument is re-qualified from debt into equity, the proceeds are no longer considered as interest but are instead as dividend for tax purposes and the payment will not be tax-deductible.

Article 164(2) LITL furthermore includes specific situations where interest might be re-characterised into dividends. Distributions of any kind made to holders of shares, founder's shares, parts bénéficiaires, parts de jouissance or any other titles, including variable interest bonds entitling the holder to a participation in the annual profits or the liquidation proceeds, are to be treated as dividend distributions and thus non-deductible.

7. What are usual strategies to push-down the debt on acquisitions?

Tax consolidation between the profit-making entity and the debtor entity may be one way to push down debt on acquisitions.

Another strategy is to form a domestic holding company which, in turn, forms a temporary merger subsidiary used to perform the acquisition. Upon the consummation of the transaction, the merger subsidiary is merged into the target, and the proceeds are disbursed to the selling shareholders in exchange for their stock. Financing is arranged for the merger subsidiary, which is subsequently assumed by the target as the successor to the merger. Financing may come directly from third parties or internally through back-to-back loans.

(For specific interest deductibility conditions in the context of intragroup financing activity, please refer to section "Limitations to the deductibility of interest on borrowings" above.)

If the acquisition is initially done without using debt at the local level, it can subsequently be introduced in Luxembourg through a variety of means. Direct financing of the target and a distribution of the proceeds may be one way.

Causing the target to be sold to a newly formed domestic subsidiary of the foreign parent for a note may be another. Caution should be exercised, however, as such transactions may create a dividend, giving rise to withholding tax.

8. Are losses of the target company(ies) available after an acquisition is made?

In an asset deal, losses of the target may not be carried forward by the purchaser.

In a share deal, existing losses of the target cannot be used through a tax consolidation.

9. Is there any indirect tax on transfer of shares (stamp duty, transfer tax, etc.)?

Since 2009, Luxembourg companies are no longer subject to the 0.5% capital duty that was formerly levied on the value of the assets contributed to the company upon incorporation and capital increases.

Contributions of real estate assets situated in Luxembourg are, however, now subject to the following regime:

- Contributions remunerated by shares are subject to a 0.6% registration duty plus a 0.5% transcription tax;
- Contributions remunerated by other means than shares are subject to a 6% registration duty plus a 1% transcription tax (4% for Luxembourg city).

Transfers made in the context of a corporate restructuring (i.e., contributions of all assets and liabilities, contributions of one or more branches of activities and contributions of all assets and liabilities of the 100%-held subsidiary) are exempt from proportional duties. The transfers must, however, be mainly remunerated (i.e., with more than 50%) with securities that represent share capital of the companies involved.

10 . Are there any restrictions on the deductibility of acquisition costs?

Acquisition costs are in principle reported in the balance sheet, as part of the acquisition price of the asset. Therefore, acquisition costs can be depreciated. If the acquisition costs are not recorded as "fixed assets", there is no limitation to their deductibility.

11. Can VAT (if applicable) be recovered on acquisition costs?

Within the framework of the M&A transactions, a specific attention must be paid on whether the deal is structured as an asset deal or a share deal.

For both asset deal and share deal (in case of VAT exempt transaction or transaction outside of the scope of VAT), the input VAT incurred on acquisition costs should in principle not be recoverable.

However, VAT could potentially be recoverable in some particular cases and under certain conditions.

It is however important at early stage of the M&A transaction to elaborate the cost structure in such a way that an optimal recovery of input VAT could be achieved.

12. Are there any particular issues to consider in the acquisition by foreign companies? (for example non-resident taxation rules/substance rules and tax efficient exit routes)

Foreign companies acquiring Luxembourg resident companies or assets should pay attention to the following:

- Provided no double tax treaty which grants the exclusive taxation right to the country of the non-resident investor applies, capital gains derived from the sale of a substantial participation (i.e. more than 10% of the shares) in a Luxembourg company are taxable in Luxembourg if the period between the acquisition and the disposal is 6 months or less;
- Dividends distributed by a Luxembourg resident company to the foreign acquiring company are in principle subject to a 15% withholding tax in Luxembourg, unless the foreign acquiring company is eligible to the Luxembourg withholding tax exemption regime, or unless it benefits from an exemption or reduced rate based on a double tax treaty;
- The taxation of capital gains realised upon transfers of a Luxembourg company, a Luxembourg permanent establishment or Luxembourg business assets to another EU Member State, to a country of the European Economic Area (EEA) or to countries with which Luxembourg has concluded either a Double Tax Treaty with exchange of information provisions in line with the OECD Model Tax Convention or a tax information exchange agreement can be deferred upon request until the effective realisation of the gain.

13. Can the group reorganise after the acquisition in a tax neutral environment through mergers or a tax group?

Luxembourg's corporate income tax law provides for a special tax-neutral regime applicable to certain qualifying corporate restructurings (such as mergers, demergers, etc.), based on the tax regime of the EU Council Directive 90/434/EEC (as further amended) on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different member states, known as the EU Merger Directive.

In Luxembourg, tax-neutral mergers are possible for purely domestic reorganisations or if a Luxembourg company transfers its assets to another EU company in the course of a merger or demerger involving a company from another EU member state. A cash payment of a maximum of 10% of the nominal value of the shares allocated to the shareholders of the absorbed company is allowed. The merger is tax-neutral only to the extent Luxembourg retains the right to tax the deferred gain in the future, which generally means that a permanent establishment has to continue in Luxembourg. The transfer of permanent establishments located outside Luxembourg is also covered: if the permanent establishment is located in an EU treaty country, Luxembourg exempts the transfer of this permanent establishment by a Luxembourg company.

In the absence of a tax treaty between said country and Luxembourg, Luxembourg retains the right to tax the gain on the transfer of this permanent establishment. If the absorbing company has a participation in the absorbed company which is cancelled at the time of the merger, this participation is deemed sold at fair market value, even if the merger is realised in a tax-neutral manner. A tax exemption is available based on the participation exemption regime where the absorbing company holds a qualifying participation of 10%, or has an acquisition value of at least EUR1.2 million in the absorbed company for at least 12 months. In addition, the gain realised upon the cancellation of the participation in the absorbed company is tax-exempt if the absorbing company has had a participation of at least 25% in its subsidiary, without any holding period requirement.

A tax-neutral demerger is possible for purely domestic reorganisations under the condition that all or part of the assets of a company are transferred to several Luxembourg-resident capital companies in the course of the demerger.

Under similar conditions, a tax-neutral demerger is available in an EU context.

The partners or shareholders of the demerged company have to receive shares in the beneficiary companies on a basis which is proportional to their participation in the demerged company. A cash payment not exceeding 10% of the nominal value of the shares allocated to the shareholders of the absorbed company is allowed. The assets transferred have to constitute an enterprise or a branch of activity.

14. Is there any particular issue to consider in case of companies of which main assets are real estate?

Contributions of real estate assets situated in Luxembourg are subject to the following registration duties:

- Contributions remunerated by shares are subject to a 0.6% registration duty plus a 0.5% transcription tax;
- Contributions remunerated by other means than shares are subject to a 6% registration duty plus a 1% transcription tax (4% for Luxembourg city).

Where a Luxembourg company acquires foreign real estate directly or through a local real estate company, the double tax treaty provisions should be checked carefully together with the local tax regime to analyse how the income from the investment will qualify and where it will be taxed. Some treaties entail specific provisions applicable to income from real estate entities. This income might either be considered as capital gain or as real estate income and thus be taxable either in the country where the real estate is located or in the country of residence of the beneficial owner of the income. Even though the income of the company might be exempt by application of such rules, a minimum amount of corporate income tax will be payable according to the principles mentioned under section 6 above.

Sell-side

15. How are capital gains taxed in your country? Is there any participation exemption regime available?

Capital gains are in principle fully subject to corporate income tax and municipal business tax at a rate of currently 29,22% in Luxembourg. Subject to conditions, capital gains can be exempt based on the Luxembourg participation exemption regime.

Participation exemption regime

Capital gains deriving from the sale of shares held in a subsidiary should be fully exempt from taxation in Luxembourg at the level of the holding company should the conditions below be met:

The beneficiary is a Luxembourg fully taxable company, which holds a shareholding in:

- an undertaking resident of the EU covered by article 2 of the Council directive 2011/96/EU; or
- a Luxembourg resident capital company fully liable to Luxembourg tax; or
- a non-resident company liable to a tax corresponding to Luxembourg corporate income tax. For that purpose, a taxation of at least 10.5% on a basis comparable to the Luxembourg basis is usually required by the Luxembourg tax authorities.

At the date the capital gain is realised, the holder has held or commits itself to hold a direct and continuous shareholding of at least 10% in the capital of its subsidiary or the acquisition price of which amounted to at least EUR 6 million for an uninterrupted period of at least 12 months.

The beneficiary may hold its participation through a tax transparent entity as defined in article 175(1) of LITL, the underlying shareholding will be valued according to the proportion held in the net assets of the tax transparent entity.

Based on the recapture rule, capital gains will remain subject to tax up to the sum of all related expenses that were deducted for tax purposes in the year of disposal or in previous financial years. Expenses include, for instance, interest expenses on loans used to purchase the shares or any write-downs of the participation. However, the amount is usually offset by the tax losses carried forward previously incurred by the shareholder.

16. Is there any fiscal advantage if the proceeds from the sale are reinvested?

Luxembourg tax law enables a Luxembourg company to defer a capital gain realised on a corporate reorganisation if an amount corresponding to the sale proceeds of a fixed asset realised is reinvested into another fixed asset, including substantial participations.

Upon the sale of such participations, the participation exemption is, however, denied. The exemption is available for shares acquired as a contribution of assets or for shares exchanged in the course of a share or asset merger. If shares not forming part of a participation qualifying for the dividend and/or capital gains exemption are exchanged for a participation which meets the participation threshold for such exemptions, the participation exemption will nevertheless be denied for a period of five years, to avoid reorganisations which are exclusively tax driven, i.e. the benefit of the participation exemption regime.

17. Are there any local substance requirements for holding/finance companies?

From a Luxembourg tax perspective, a company is considered tax resident in Luxembourg if its statutory seat or its central administration (i.e., place of effective management) is located in Luxembourg.

Luxembourg companies or Luxembourg permanent establishments of foreign companies performing an intragroup financing activity are subject to substance requirements as detailed in the Circular 164/2 dated January 28, 2011 issued by the Luxembourg tax authorities:

- Board of managers: The majority of the managers have to be either residents in Luxembourg or non-residents who perform a professional activity in Luxembourg and have at least 50% of their income taxable in Luxembourg (typically the case for commuters, i.e. persons living in a neighbouring country who work in Luxembourg). If a member of the board is a legal entity, the statutory seat and the central management will be located in Luxembourg. These directors/managers have to possess the required competencies to perform their function and have to be empowered to take decisions, which will bind the company.
- Management: The key decisions have to be taken in Luxembourg. In case shareholder meetings have to take place based on company law, these have to take place at least once a year at the address mentioned in the bylaws of the company.
- Employees: The company will have qualified employees (either employees of the company or external personnel) to execute and book the transactions performed by the company. The company will be able to supervise the activities performed by these employees.
- Bank account in Luxembourg: the company will have at least one bank account in Luxembourg.
- Filing of tax returns: the company will make sure that it has fulfilled all its obligations in terms of filing of tax returns in respect of taxes for which the direct tax authorities are competent.
- Tax residence: the company will not be considered a tax resident in another jurisdiction.

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