LUXEMBOURG

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INTERNATIONAL DEVELOPMENTS

1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

- As part of its 2017 tax reform, Luxembourg introduced among others the following **Corporate tax changes: Corporate income tax (CIT) rate – a two-step decrease** – The CIT rate applicable to income exceeding EUR 30,000 is brought down from 21% to 19% in 2017 and finally to 18% in 2018. Taking the Municipal Business Tax (MBT) and the solidarity surcharge into account, it brings the global corporate tax rate applicable to companies in Luxembourg-city from currently 29.22% down to 27.08% in 2017 and 26.01% in 2018
- **Minimum net wealth tax (NWT) increased** – The minimum NWT applicable to SOPARFIs (holding and financing companies) amounting currently to EUR 3,210 has been increased to EUR 4,815 as of 2017. For the entities which are not considered as SOPARFIS, the minimum NWT ranges from EUR 535 to EUR 32,100 (depending on the total of the balance sheet)
- **Limitation to the carry forward of losses** – While tax losses generated until 2016 remain tax deductible without any limitation, the carry forward of tax losses generated as from 2017 is limited to 17 years. The oldest losses will have to be used first. This new limitation applies for both CIT and MBT purposes
- **0.24% tax abolished** – Since 2017, deeds including the assignment of receivables are no longer subject to the 0.24% registration duty

2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

Luxembourg has implemented into its internal law 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).

Luxembourg is supportive of the implementation of BEPS recommendations and has already implemented the following BEPS-related EU Directives:

- Directive EU 2015/2376 on automatic exchange of information on tax rulings
- EU Directive 2016/881 of 25 May 2016 which extends administrative cooperation in tax matters to Country-by-Country (CbC) reporting

Based on the Luxembourg law implementing this directive and related administrative circular, the first CbC reports will have to be filed by 31 December 2017 at the latest and the Luxembourg tax authorities had to be notified of the identity and tax residence of reporting entities by 31 March 2017 at the latest.

Luxembourg has not implemented yet the anti-tax avoidance directives (ATAD) but is expected to do so as any other EU Member State in order to make sure that the measures of ATAD become effective in accordance with the timing requirements set by the directive.

The Multilateral Instrument (MLI)

On 24 November 2016, more than 100 jurisdictions, including Luxembourg, have adopted the text of the multilateral instrument that will implement some of the BEPS recommendations into more than 2,000 tax treaties worldwide. Luxembourg is expected to sign the MLI at the signing ceremony which will be held in June 2017 in Paris.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

Tax advantages:

A share deal in Luxembourg enables the target company to continue to carry forward its losses. However, losses incurred as from 2017 can only be carried forward over 17 years. There are no taxes levied on a share sale unless the securities that are sold are those in a Luxembourg tax transparent entity (e.g. 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.

Tax disadvantages:

In a share deal, the assets in the company sold will not be revaluated at fair market value.

B. Asset deal

Tax advantages:

In an asset deal, the purchaser will dispose of a higher basis for depreciation in the future.

Tax disadvantages:

A first disadvantage of the asset deal is the fact that 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. Finally, in an asset deal, the target's losses may not be carried forward by the purchaser.

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. However, in certain cases, it is possible to perform internal restructurings allowing for a step-up in value and tax deferrals.

5. WHAT ARE THE PARTICULAR RULES OF AMORTISATION OF GOODWILL IN YOUR COUNTRY?

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

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

Luxembourg has three types of limitation to the deductibility of interest on borrowings: (i) limitation related to the purpose of the expense, (ii) limitation based on transfer pricing rules and (iii) limitation based on the recharacterisation of the interest expense into a dividend.

Limitation 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.

Limitation based on transfer pricing rules

Transfer pricing principles are defined in articles 56, 56bis and 164(3) of the Luxembourg income tax law (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. Article 56 LITL has been amended in 2015 so as to formalise the application of the arm's length principle under Luxembourg tax law.

In 2017, a new article 56bis LITL has been introduced, which complements Article 56 of the LITL, formalises the authoritative nature of the OECD TP Guidelines and provides for some definitions and guiding principles in relation to the application of the arm's length principle.

On 27 December 2016, the Luxembourg tax authorities released a new circular on the tax treatment of intra-group financing activities. The new circular follows the introduction of the new article 56bis LITL and provides guidance on the practical application of the arm's length principle to intra-group financing activities, ensuring consistency with all international transfer pricing standards.

The new circular replaces Circular 164/2 of 28 January 2011 and Circular 164/2bis of 8 April 2011 and became applicable as from 1 January 2017. Advance Pricing Agreements which have been granted in accordance with the old rules are no longer valid.

Finally, 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.

Limitation based on the recharacterisation 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 requalified 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 recharacterised 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.

Finally, the Luxembourg government has not announced yet the way it will implement the interest deduction limitation rule provided in ATAD. However, as soon as those rules will be in place in Luxembourg, additional limitations to the deductibility of interest expenses will apply.

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 THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

In Luxembourg, there are no specific tax incentives regarding the equity funding of assets.

9. 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, the target company continues to carry forward its losses for an unlimited period of time. However, losses incurred as from 2017 can only be carried forward over 17 years. Existing losses of the target cannot be used through a tax consolidation.

10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

In addition to the general request of information, the following documents should be reviewed in the frame of a tax due diligence of a Luxembourg company:

- Tax assessments issued by the Luxembourg tax authorities in order to see whether the tax losses carried forward of the company can be considered as final or whether they are only based on the automatic assessment made by the tax authorities upon receipt of the tax return
- Tax statements issued by the LTA
- Advance tax agreement and/or advance pricing agreement granted by the LTA
- Transfer pricing studies prepared for intra-group activities.

11. 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.

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.

12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX 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.

However, specific rules apply to the acquisition of a shareholding: if the acquisition costs of the shareholding are recorded in the balance sheet as part of the acquisition price, they cannot be depreciated given that the shareholding is an asset which cannot be depreciated. If, instead, the costs are recorded as an expense in the P&L account, they will be deductible in a first step but subject to the recapture rule. According to this rule, upon disposal of the shareholding, any capital gains realised 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. However, the taxable part of the gain can be offset against the tax losses carried forward which was generated by the expenses.

13. CAN VAT (IF APPLICABLE) BE RECOVERED ON ACQUISITION COSTS?

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

Except under some particular cases, 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.

Therefore, it is important at an early stage of the deal to elaborate the cost structure in such a way that an optimal recovery of input VAT could be achieved.

14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION BY FOREIGN COMPANIES?

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.

15. 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 (see question 18) where the absorbing company holds a qualifying participation of 10%, or has an acquisition value of at least EUR 1.2 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 10% 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.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET 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 question 1 above.

17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

Horizontal and vertical tax consolidation regimes are available in Luxembourg for CIT and MBT purposes. The consolidation should exist for at least 5 fiscal years. Each consolidated company files its own tax returns. In addition, the integrating entity files a single tax return combining individual results of the group with corrections to eliminate from the taxable result of the group double deductions or double taxations resulting from the application of the consolidation regime. However, intercompany operations do not need to be eliminated under the Luxembourg fiscal integration regime. Losses incurred before the fiscal integration can be used during the integration only by the integrated entity to the extent that the company that incurred them realises a profit and only up to the amount of profit realised by that company. Losses incurred during the fiscal integration can only be used by the integrating entity. In case the consolidation is broken before the 5-year period has elapsed, the entities part of the consolidation will be retroactively taxed on a stand-alone basis.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

Capital gains are in principle fully subject to corporate income tax and municipal business tax at a rate of currently 27.08% (26.01% as of 2018) 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 are fully exempt from CIT and MBT in Luxembourg, provided the following conditions are 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
- A Luxembourg resident capital company fully liable to Luxembourg tax
- A non-resident company liable to a tax corresponding to Luxembourg corporate income tax

For that purpose, a taxation of at least 9.5% (i.e. half of the CIT rate) 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 for an uninterrupted period of at least 12 months a direct and continuous shareholding of at least 10% in the capital of the subsidiary or of a minimum acquisition price of EUR 6 million.

The beneficiary may hold its participation through a tax transparent entity as defined in article 175(1) of LITL. In such case, 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.

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES 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.

20. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING 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 tax law does not include any additional specific substance requirements and in practice, the needs in terms of substance requirements are in most cases driven by the expectations of the foreign jurisdictions involved in the structure, meaning that the appropriate level of substance has to be determined on a case by case basis. However, in 2 specific situations (financing activities and application of the parent-subsidiary regime in an EU context, as explained below), additional economic substance may be required from a Luxembourg point of view.

Luxembourg does not have specific requirements regarding the substance of the foreign holding entities. However, when it comes to the application of the exemption of dividends received from/distributed to EU subsidiaries, the General Anti-Abuse Rule introduced by the Directive 2014/86/EU of 8 July 2014 applies. In this case, the substance should be sufficient at all levels of the holding structure, having regard to the activities performed. Otherwise, the exemption may be denied based on the fact that the dividend would be considered as being part of an arrangement or series of arrangements that, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage which defeats the object or purpose of this Parent-Subsidiary Directive, is not genuine having regard to all relevant facts and circumstances.

21. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

The Luxembourg regime is widely inspired by the European directives.

Based on article 170(1) of the LITL, the merger of 2 Luxembourg companies should be considered as a deemed liquidation of the absorbed company and as such should trigger the realisation of all assets and liabilities of the absorbed company at fair market value (article 169 of the LITL), i.e. all latent capital gains should be disclosed and accordingly subject to tax in Luxembourg.

Provided that the following conditions are met, mergers and spin-offs may however be conduct in tax neutrality:

- the absorbing company must be a fully taxable Luxembourg company (or a resident company in an EU member State)
- all the assets and liabilities of the absorbed company must be transferred as a result and at the time of a dissolution without liquidation
- the transaction must be performed by way of the cancellation of the shareholding held by both companies
- the latent capital gains transferred to the absorbing company must be subject to Luxembourg taxation in the future

Based on the Luxembourg VAT Law, the transfer of a business as a going concern is not subject to VAT (17 %) provided certain conditions are met. Following the transfer, the new owner should be in possession of a business that can be operated as such.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

Capital gains realised by non-resident managers on the sale of a shareholding in a Luxembourg company are not taxable in Luxembourg, provided that the manager holds less than 10% in the Luxembourg company and the sale is performed more than 6 months following the acquisition of the shares. Capital gains realised by Luxembourg resident managers on the sale of shareholdings are exempt under the same conditions. In addition, in case of a sale after more than 6 months of a shareholding of 10% or more, Luxembourg resident managers benefit from a EUR 50.000 deduction and a taxation of the gain at a reduced rate (½ of the applicable income tax rate - Maximum of 22,89% for 2017).

The remuneration of the managers may also be structured through the implementation of a stock option plan which benefits from an attractive income tax regime.

Luxembourg provides an attractive tax regime for highly skilled employees who are expatriated to Luxembourg. This regime allows the employer, under certain conditions, to deduct in part or in full the costs the employer will have to bear in relation with the change of residence of its employee. At the level of the employee, these expenses are not treated as an additional remuneration and benefit therefore from an income tax exemption.

Following the publication of Circular n°781 on 30 September 2016, the Luxembourg VAT authorities confirmed that director services constitute an economic activity and that Luxembourg based directors have to be considered as VAT taxable persons, irrespective of whether the director is a company or a private individual. As a rule, VAT at the rate of 17 % is therefore applicable to director services located for VAT purposes in Luxembourg. Some exceptions to the application of the VAT exist (management of funds, honorific activity, etc.).

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