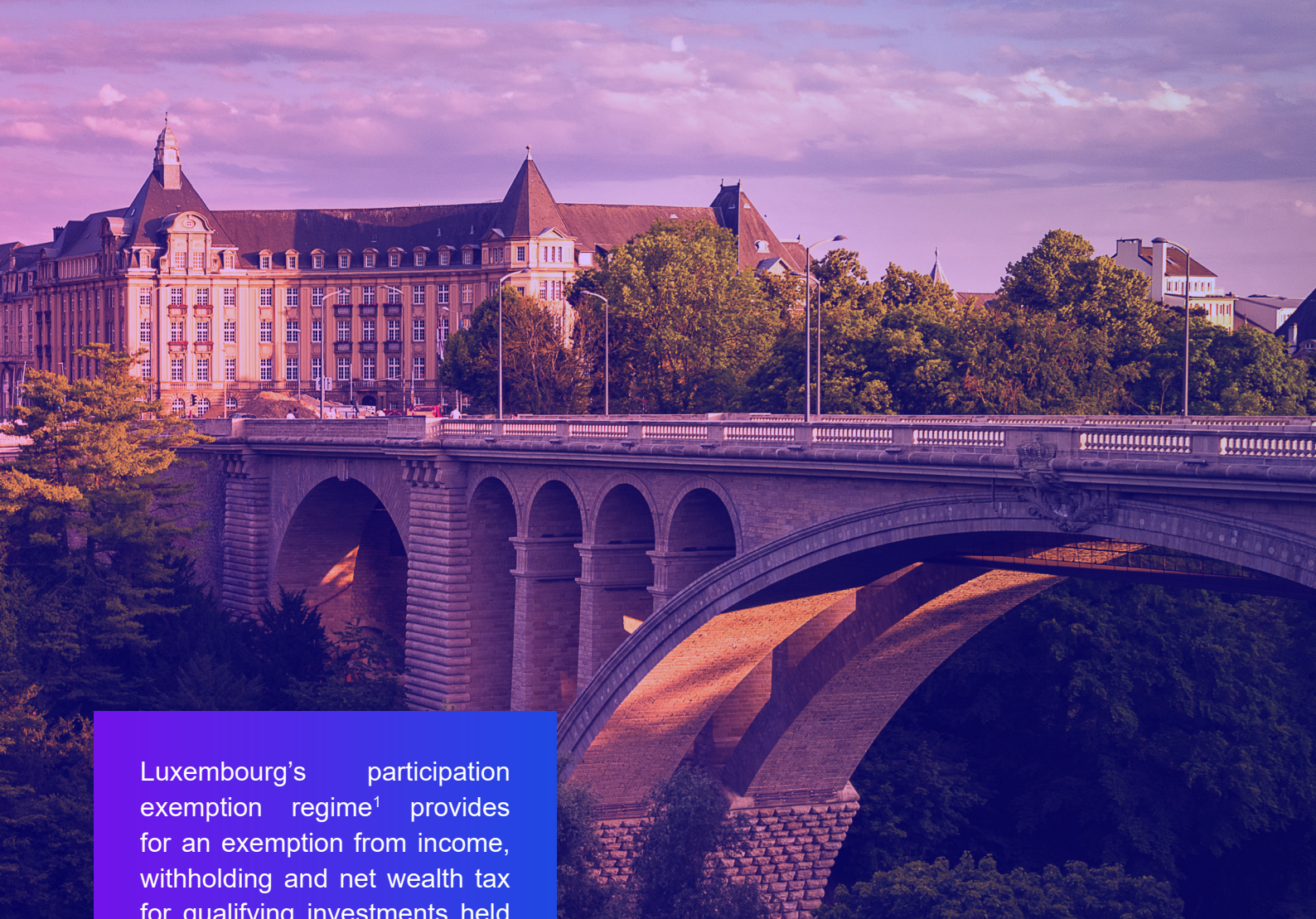




Luxembourg Participation Exemption 2022

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Luxembourg's participation exemption regime¹ provides for an exemption from income, withholding and net wealth tax for qualifying investments held by qualifying entities.

The exemption from income tax is extensive, covering dividends, capital gains and liquidation proceeds. In addition, no withholding tax applies on dividend distributions if the conditions of the participation exemption are met.

Finally, participations qualifying for the participation exemption are exempt from net wealth tax.

The domestic participation exemption regime has been modified with effect as of 1 January 2016, in order to comply with the amendments of July 2014² and January 2015³ made to the EU Parent-Subsidiary Directive⁴ to introduce a general anti-abuse rule and an anti-hybrid rule.

The conditions that must be met to qualify for the exemptions are summarized below. In some cases, tax treaties may provide for more favorable conditions. Whether the exemptions apply to a particular set of circumstances must be determined on a case-by-case basis.

1. Articles 147 and 166 of the Luxembourg income tax law (LITL), paragraph 9 of the municipal business tax law (MBT) and paragraph 60 of the evaluation law of 16 October 1934 (BewG).
2. Council Directive 2014/86/EU.
3. Council Directive 2015/121/EU.
4. Council Directive 2011/96/EU.

Income tax exemption

Tax exemption for dividends, capital gains and liquidation proceeds received - participation exemption

Status of the Luxembourg recipient entity

- Fully taxable resident collective entity listed in article 166 LITL paragraph 10⁵; or
- Fully taxable resident corporation not listed in article 166 LITL paragraph 10⁶; or
- Luxembourg permanent establishment of either:
 - a collective entity that is covered by the Parent-Subsidiary Directive⁷; or
 - a corporation resident in a country with which Luxembourg has signed a tax treaty; or
 - a corporation or a co-operative company that is resident in an EEA country other than a member state of the European Union⁸.

Status of the subsidiary

- Collective entity covered by the Parent-Subsidiary Directive⁹; or
- Fully taxable resident corporation not listed in article 166 LITL paragraph 10¹⁰; or
- Non-resident corporation fully subject to an income tax comparable to the Luxembourg corporate income tax. A minimum income tax rate of 8.5% (since 2019) generally satisfies this requirement as long as the taxable basis is determined according to rules and criteria similar to those applicable in Luxembourg.

The exemption also applies to participations held in a qualifying company through tax transparent entities.

Size of participation

The minimum participation in the share capital that qualifies for the exemption is:

- A 10% participation; or
- An acquisition price of at least € 1,200,000 to qualify for the dividend and liquidation proceeds exemption; or
- An acquisition price of at least € 6,000,000 to qualify for the capital gains exemption.

According to the Luxembourg supreme court in direct tax matters, capital contributions into account 115 do not represent a holding in the share capital of the subsidiary¹¹ for the purposes of the above requirements.

Minimum holding period

The participation must have been held for an uninterrupted period of at least 12 months on the date the income is allocated or realized for tax purposes.

A commitment to hold the minimum shareholding for an uninterrupted period of at least 12 months satisfies this condition. The test applies to the participation in general rather than on a share-by-share basis.

Deduction of expenses

Expenses directly related to a participation that qualifies for the exemption (e.g., interest expenses) are only deductible to the extent that they exceed exempt income arising from the relevant participation in a given year.

Other rules can limit the deduction of expenses linked to the qualifying participation (e.g., Luxembourg anti-hybrid and interest limitation rules¹²).

5. These are basically entities with a legal form as covered by the Parent-Subsidiary Directive.

6. These are basically corporations set up in a non-European Union country, but tax resident in Luxembourg.

7. On 1 December 2020, the new Circular L.I.R. n° 147/2, 166/2 and Eval. n° 63 excludes companies incorporated in Gibraltar from the benefits of the Parent-Subsidiary Directive for the application of the participation exemption regime, starting 1 January 2021 as a result of the decision of the CJEU case (C-458/18) of 2 April 2020.

8. Luxembourg permanent establishment of a corporation or a co-operative company that is resident in Liechtenstein, Iceland or Norway.

9. See footnote 7

10. See footnote 6

11. Cour administrative, 31 mars 2022, n°46067C : in this specific court case, the shareholder acquired less than 10% in the share capital of a Luxembourg subsidiary and made a subsequent contribution into the account 115. Although the EUR 1.2mio threshold was reached on an aggregate basis, the court considered that the minimum acquisition price was not met.

12. According to the Anti-Tax Avoidance Directives 1 and 2 as transposed into Luxembourg domestic laws (respectively law of 21 December 2018 and law of 20 December 2019).



Write-down in value of a participation qualifying for the exemption is deductible, except if it results from tax exempt dividend distributions.

The exempt amount of a capital gain realized on a qualifying participation is, however, reduced by the amount of any expenses related to the participation, including write-down in value, that have previously reduced the company's taxable income.

If a parent company writes off part or all of a loan to its subsidiary, the value adjustment is treated in the same way as any write-down in value of the participation, i.e. the exempt part of the capital gain will also be reduced by the amount of loan's write off having previously reduced the company's taxable income.

General anti-abuse rule and anti-hybrid rule

A general anti-abuse rule and an anti-hybrid rule were introduced into Luxembourg domestic tax law in order to comply with the amendments of July 2014¹³ and January 2015¹⁴ made to the Parent-Subsidiary Directive.

Profit distributions falling within the scope of the Parent-Subsidiary Directive are not tax exempt in Luxembourg where the subsidiary is a collective entity covered by the Parent-Subsidiary Directive (see first bullet point above under "Status of the subsidiary"), if:

1. such distributions are deductible by the payer located in another EU Member State (anti-hybrid rule); or if
2. the transaction is characterized as abusive within the meaning of the Parent-Subsidiary Directive (general anti-abuse rule). In this respect, a transaction may be considered as abusive if it is an arrangement, or a series of arrangements, that is not "genuine" (i.e., that has not been put in place for valid commercial reasons reflecting economic reality) and has been put in place for the main purpose or one of the main purposes of obtaining a tax advantage that is not in line with the objective of the Parent-Subsidiary Directive.

Other anti-hybrid rules arising from the Anti-Tax Avoidance Directive 2 can prevent the exemption of profit distributions, if treated as tax deductible in the hands of the foreign non-EU payor.

Finally, a specific anti-abuse rule applies in case of tax neutral share-for-share exchanges. In this case, the income from the participation received cannot be tax exempt before the end of the fifth fiscal year following the exchange, if the income arising from the participation given would not have been tax exempt in the absence of such exchange.

Dividends received - not qualifying for participation exemption

Dividends received by a Luxembourg entity that do not qualify for the participation exemption are taxed at the full rate of 24.94%, which is the aggregate of corporate income tax, municipal business tax and the employment fund levy, for companies established in Luxembourg City.

50% of these dividends can be exempt from taxation, i.e. they will be subject to a 12.47% effective tax rate, if they are paid by:

- A fully taxable resident corporation; or
- A corporation resident in a country with which Luxembourg has signed a tax treaty and that is fully subject to an income tax comparable to the Luxembourg corporate income tax; or
- A company that is covered by the Parent-Subsidiary Directive.

13. see footnote 2

14. see footnote 3

Withholding tax exemption

Application of participation exemption

Status of the recipient

- Collective entity covered by the Parent-Subsidiary Directive¹⁵; or
- Fully taxable resident corporation not listed in article 166 LITL paragraph 10¹⁶; or
- Permanent establishment of one of the above qualifying entities; or
- Collective entity resident in a treaty country and fully subject to an income tax comparable to the Luxembourg corporate income tax as well as a Luxembourg permanent establishment of such a collective entity; or
- Corporation that is resident in and subject to corporate tax in Switzerland without benefiting from an exemption; or
- Corporation or co-operative company resident in a member state of the EEA other than an EU Member State and fully subject to an income tax comparable to the Luxembourg corporate income tax; or
- Permanent establishment of a corporation or of a co-operative company resident in an EEA Member State other than an EU Member State.

Status of the Luxembourg subsidiary

- Fully taxable resident collective entity listed in article 166 LITL paragraph 10¹⁷; or
- Fully taxable resident corporation not listed in article 166 LITL paragraph 10¹⁸.

The exemption also applies to a participation in a qualifying company held through tax transparent entities.

Size of participation

The minimum participation in the share capital¹⁹ that qualifies for the dividend withholding tax exemption is:

- A 10% participation; or
- An acquisition price of a minimum of € 1,200,000.

Minimum retention period

The recipient must have held (or, subject to specific conditions, commits to hold) the participation for at least 12 months on the date that the dividend is allocated or realized for tax purposes.

The test applies to the participation in general rather than on a share-by-share basis.

General anti-abuse rule

A general anti-abuse rule was introduced into Luxembourg domestic tax law in order to comply with the amendment of January 2015²⁰ made to the Parent-Subsidiary Directive.

Dividends falling within the scope of the Parent-Subsidiary Directive, which are paid by a Luxembourg fully taxable company to a collective entity covered by the Parent-Subsidiary Directive (see first bullet point above under “Status of the recipient”), or its EU permanent establishment, will not benefit from a withholding tax exemption if the transaction is characterized as an abuse of law within the meaning of the Parent-Subsidiary Directive.

In this respect, a transaction may be considered as abusive if it is an arrangement, or a series of arrangements, that is not “genuine” (i.e., that has not been put in place for valid commercial reasons reflecting economic reality) and has been put in place for the main purpose or one of the main purposes of obtaining a tax advantage that is not in line with the objective of the Parent-Subsidiary Directive.

15. See footnote 7

16. See footnote 6

17. See footnote 5

18. See footnote 6

19. See footnote 11

20. See footnote 3



Non-application of participation exemption

Where the conditions of the Luxembourg participation exemption are not met, a 15% withholding tax is levied on dividends distributed by a Luxembourg resident fully taxable corporation.

This rate may be reduced to 0% under applicable double tax treaties.

In addition, Luxembourg law provides for several entities which are subject to a specific tax regime. The following entities are, in this context, not subject to withholding tax on dividend distributions: undertakings for collective investment (UCIs) governed by Luxembourg law including SICAV/Fs and FCPs operated as retail funds or specialized investment funds (fonds d'investissement spécialisés - SIFs), or reserved alternative investment funds (fonds d'investissement alternatifs réservés - RAIFs), undertakings for collective venture capital investment (sociétés d'investissement en capital à risque - SICARs), and family asset holding companies (sociétés de gestion de patrimoine familial - SPFs).

Also, no withholding tax is levied on dividend distributions from a securitization company, as the shareholders in a securitization company are treated like bondholders.

No withholding tax on liquidation proceeds

No withholding tax is levied on the remittance of liquidation proceeds, regardless of the tax status of the liquidated company or the recipient.

Net wealth tax exemption

Status of parent entity, of subsidiary and size of participation

The conditions to be met for the exemption of qualifying participations from net wealth tax are generally the same as for the exemption from income tax of dividends received by Luxembourg resident parent companies²¹.

Minimum retention period

The net wealth tax exemption is not subject to any condition pertaining to a retention period.

Debt financing

Debts relating to the acquisition of exempt participations are not deductible from the net wealth tax basis.

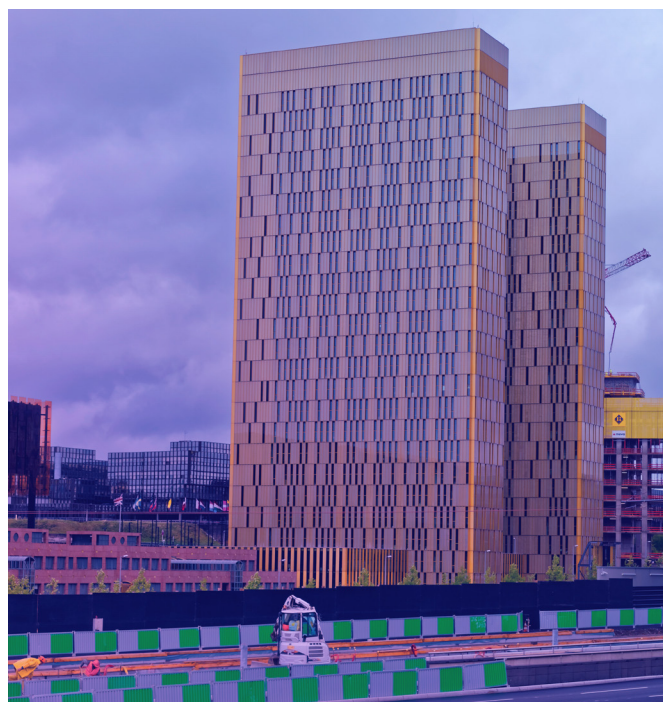
Capital gains taxation for non-residents

If a non-resident shareholder is tax resident in a country that has a double tax treaty with Luxembourg, the treaty usually allocates the taxation right to the country of residence of the shareholder (this should be verified on a case-by-case basis).

If a non-resident shareholder is tax resident in a country that has no such double tax treaty with Luxembourg, capital gains on the sale of shares in a Luxembourg company are taxable in Luxembourg if:

- The non-resident shareholder has held directly or indirectly a stake of more than 10% of the shares in the Luxembourg company; and
- has disposed of such shares within a period of 6 months following the acquisition.

A taxable gain is subject to 18.19% corporate income tax if realized by a non-resident corporate shareholder with no Luxembourg permanent establishment.



21. Please refer to pages 3 and 4 of this publication for a summary of these conditions.



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