Tax controversy series

Administrative court judgment on tax ruling and permanent establishment

On 29 September 2023, the Luxembourg administrative court of first instance (*Tribunal administratif*) confirmed the tax adjustment carried out by the Luxembourg tax authorities (*Administration des contributions directes*) denying the recognition of a foreign permanent establishment ("PE") within the meaning of the double tax treaty between the Unites States of America ("U.S.") and Luxembourg, thus nullifying the tax ruling previously granted to the taxpayer (*Trib. administratif, 29 septembre 2023, n°46470*).

Summary of the case

On 21 September 2016, the tax office informed the complainant – a Luxembourg-based company ("Company") active since more than a decade – about its intention to challenge the tax return filed by the Company for the fiscal year 2013. The Luxembourg tax authorities disagreed on the existence – claimed by the taxpayer – of a PE located in the U.S. and therefore on the Luxembourg exemption of the profits and wealth reportedly allocated to such PE.

On 15 November 2016, the Company sent an amended tax return for 2013 to the tax office, as well as a revised balance sheet to effectively attribute to the U.S. branch a dividend in kind that was one of the aspects discussed in the case. The Luxembourg tax authorities, however, denied the existence of any PE abroad, and consequently refused to proceed to any correction of the tax assessment issued.

On 27 December 2016, the complainant filed an administrative claim (*réclamation*) to which the Director of the Luxembourg tax authorities failed to answer. Faced with the Director's silence for more than six months – as required by the law – the Company finally decided to file an appeal with the Luxembourg administrative court of first instance.

Context of the decision

The use of U.S. branches by fully taxable Luxembourg resident companies to perform holding and intra-group financing activities has been popular with multinational enterprise in the 2010's.

On 19 June 2018, the Luxembourg government issued bill of law 7318 for the transposition into Luxembourg domestic tax law of Directive (2016/1164) of 12 July 2016, referred to as the Anti-Tax Avoidance Directive (ATAD 1)[1]. This bill was voted on by the Luxembourg Parliament in December 2018 and published on 21 December 2018[2]. The scope of the law of 21 December 2018 is not limited to the transposition of the ATAD 1. It notably also modifies the domestic definition of PE.

§16 StAnpG defines the concept of PE under Luxembourg domestic law. The law of 21 December 2018 added provisions regarding the definition of PEs when they are located in countries that have concluded a tax treaty with Luxembourg. The law of 21 December 2018 also amended the StAnpG by adding a new §16(5), which is designed to resolve conflicts in interpretation regarding the existence of a PE that could arise from the interaction between the provisions of domestic law and those of the relevant tax treaty. The Administrative Circular of 22 February 2019[3] clarified certain aspects of the new text. The modification of the domestic definition of the notion of PE took place in the context of the drop down by the European Commission of its State aid investigation on McDonald's and the political willingness to ease potential challenges of alleged PE lacking economic substance[4].

The judgment under review is, however, based on the previous version of §16 StAnpG.

The Luxembourg administrative court of first instance's decision illustrates once more that when it comes to establishing the presence or not of a foreign PE, the Luxembourg judge conducts a thorough examination of the facts and evidence brought by the taxpayer to support the claim. This is nothing new. Recent court cases have already shed light on the level of details in which the Luxembourg tax authorities are willing to go when conducting this type of analysis[4].

However, the judgement of 29 December 2023 goes one step further, as it takes place in a context where a tax ruling had initially been granted by the Luxembourg tax authorities on the very topic at the core of the litigation, i.e., the existence or not of a PE of the Company in the US. Indeed, prior to filing its 2013 tax return, the Company provided the Luxembourg tax authorities with a detailed description of their envisaged restructuring and requested their confirmation that, because of such restructuring, its U.S. branch had the required substance to qualify as a PE within the meaning of the double tax treaty between Luxembourg and the US.

The Luxembourg tax authorities approved the tax ruling with the express mention, though, that based on the rule of good faith, the tax ruling shall terminate if either the facts or circumstances described were incomplete or inaccurate, the key elements of the actual transaction differ from the description provided in the request for information, or the decision is no more compliant with the national or international law. The taxpayer tried to rely on such tax ruling, first in its administrative claim, and then subsequently before the administrative court, to sustain its view that the Company actually had a PE in the U.S. for the period covered. This proved unsuccessful.

The principle of good faith mentioned in the tax ruling, the syntax used, and reservations made when the tax ruling was approved are common practices and consistent with the general principle according to which a tax ruling is a mere interpretation of the law based on facts and circumstances.

This judgement clearly underscores that a tax ruling, by itself, does not shield a taxpayer from scrutiny by the Luxembourg tax authorities. In the context of PEs, the Luxembourg tax authorities consistently requests the submission of evidence proving the actual existence of the PE, hence the importance of preemptively documenting such structures.

Decision of the administrative court

While the administrative court of first instance acknowledged that the taxpayer benefited from a tax ruling recognizing the existence of a PE in the U.S., it hastened to clarify that such tax ruling is not automatically applicable and that it was granted based on a specific situation described by the taxpayer at the time of the request.

The court also noted that the tax ruling contained several express reservations, meaning that certain conditions or limitations were explicitly specified in the tax ruling.

To decide on the case, the judge followed the same approach as the Luxembourg tax authorities and focused on verifying whether the situation at hand factually matched with the one initially described by the taxpayer, based on which the tax ruling was granted.

Several factors led the judge to deny the recognition of a PE in the U.S. (and consequently the distribution allegedly allocated to it), despite existence of the tax ruling:
- No evidence of the actual payment of dividends to the U.S. branch has been provided;
- In its board resolution, the Company, as the sole shareholder of the distributing U.S. company, approved the distribution directly for its own account, without any reference to a distribution to the U.S. branch;
- Some documents provided by the taxpayer exhibit inconsistencies with each other, or they remain vague and ambiguous, especially regarding the dates of the various transactions, not allowing for a sufficient level of certainty to establish that the restructuring as it was described in the tax ruling request actually took place;
- Even in the context of its appeal, the Company put forward certain dates that did not match those indicated in the documents provided in support of its claim.

The judge noted inconsistencies between the documents provided by the complainant and the description of the facts in the tax ruling as well as between the documents themselves. Thus, the court concluded that it was not established unequivocally that the key elements of the transaction in the case at hand corresponded to those described in the tax ruling request. Consequently, according to the Luxembourg administrative court of first instance, the Luxembourg tax authorities were under no obligation to honor the tax ruling, particularly regarding the recognition of the U.S. branch as a PE and, by extension, the exemption of the profits and wealth allegedly allocated to such PE.

In light of its detailed and factual analysis, the court approved the tax office's decision to disregard the revised tax balance submitted by the complainant, along with the amended tax return, hence confirming the tax assessment for 2013 issued by the Luxembourg tax authorities. Reading this judgement, it appears clear that the consistency and robustness of the legal documentation is absolutely key.

We will be monitoring this case closely, and notably whether or not the taxpayer intends to lodge an appeal against the decision, as it still has a few more days to decide, as of the date of publication of this article.

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1) Council Directive (EU) 2016/1164 of 12 July 2016 Laying Down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, OJ L 193 (2016), Primary Sources IBFD.
2) Loi du 21 décembre 2018 1) transposant la directive (UE) 2016/1164 du Conseil du 12 juillet 2016 établissant des règles pour lutter contre les pratiques d'évasion fiscale qui ont une incidence directe sur le fonctionnement du marché intérieur; 2) modifiant la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; 3) modifiant la loi modifiée du 1er décembre 1936 concernant l'impôt commercial ("*Gewerbesteuergesetz*"); 4) modifiant la loi d'adaptation fiscale modifiée du 16 octobre 1934 ("*Steueranpassungsgesetz*"); 5) modifiant la loi générale des impôts modifiée du 22 mai 1931 ("*Abgabenordnung*"), Mémorial A-No. 1164 du 21 décembre 2018.
3) Circular L.G., No. 19, 22 Feb. 2019.
4) E. Lebas, «Recent Amendments to EU, Luxembourg and US Tax Laws, and Their Implications for US Holding and Financing Branch Structures», *Bulletin for International Taxation*, IBFD, vol. 73, nº 11, 2019.
5)Please refer to E. Lebas and V. Plateau, "Administrative court judgement on U.S. branches", Agefi Luxembourg, September 2023, p 13 (on the judgment of 23 May 2023, n°45030).

** The authors wish to thank Sylvain Rabouine, Tax advisor (KPMG Luxembourg) for his collaboration and invaluable research assistance.*