



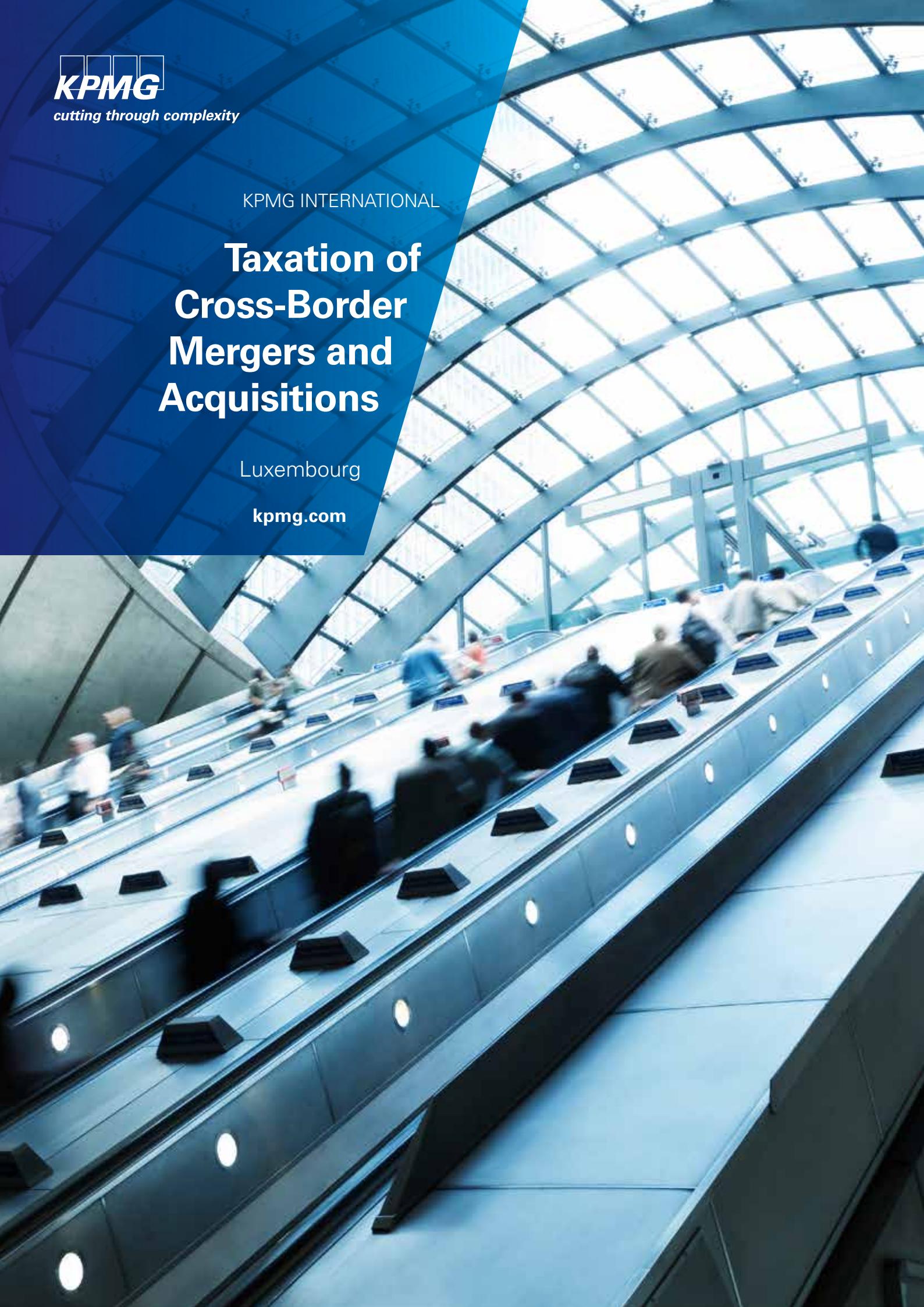
cutting through complexity

KPMG INTERNATIONAL

Taxation of Cross-Border Mergers and Acquisitions

Luxembourg

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Luxembourg

Introduction

To strengthen Luxembourg's financial sector and attract more cross-border transactions, the Luxembourg legislator has passed several laws designed to simplify and facilitate the legal framework for cross-border mergers and acquisitions (M&A) involving Luxembourg entities and to create more flexible restructuring schemes.

Luxembourg companies may be involved in domestic and cross-border mergers and demergers in various ways. Luxembourg has implemented the European Union (EU) Merger Directive to create several possibilities for tax-neutral company reorganizations.

This chapter provides a general overview of tax and other issues relating to cross-border M&A in Luxembourg and clarifies the frameworks within which the different operations may take place. The following aspects are analyzed in particular:

- opportunities available to the acquirer when purchasing shares or assets
- choice of acquisition vehicles available to the acquirer
- questions relating to funding of the acquisition.

Corporate law framework

Luxembourg corporate law has always been a strong support to the Luxembourg global pro-business approach. To the extent possible, corporate law rules are set up with a view to fulfilling entrepreneurs' goals and expectations. As a global financial center, Luxembourg is eager to facilitate cross-border transactions. In this respect, cross-border mergers have become strategic concerns for groups of companies over the years, either in terms of internal restructuring or in the context of acquisitions of new businesses. As a result, Luxembourg saw the need for a set of rules that would fulfill these objectives.

The law of 10 August 1915 on commercial companies was first amended by the law dated 23 March 2007, which provides the current framework and facilitates mergers and divisions of Luxembourg companies.

Since 2007, cross-border mergers involving Luxembourg companies without forming a European company (*societas Europaea*) were permitted under Luxembourg law.

At the time, Luxembourg law was at the avant-garde of most of other European jurisdictions, which did not foresee the

benefits of a cross-border merger mechanism. In a nutshell, Luxembourg commercial companies were entitled to take part in cross-border mergers, either as absorbing or absorbed entities, to the extent that the legislation of the other jurisdiction did not prohibit such merger. However, the 2007 law did not provide a comprehensive legal framework.

This deficiency was resolved pursuant to the law of 10 June 2009, which transposed several EU directives relating to cross-border merger into Luxembourg law. True to its standard proactive and business-friendly approach, the Luxembourg legislator took the opportunity to exceed the minimum requirements set forth in the EU directives.

Any Luxembourg company can be merged into a foreign company where:

- The foreign company or economic interest group is formed in accordance with the law of a foreign state.
- The law governing the foreign entity allows cross-border mergers as a matter of principle.
- The foreign entity complies with the national provisions and formalities of the foreign state.

Cross-border merger legal framework

As mentioned, the Luxembourg corporate law sets out a simplified framework for both domestic and cross-border mergers, easing restructuring and cooperation across borders on a European and international level. The Luxembourg cross-border legal framework is an example of the continuing modernization of Luxembourg company law. The framework is designed to make Luxembourg more competitive and enable domestic companies to benefit further from the single market and from the flexibility of the Luxembourg corporate law system.

Scope

The scope of Luxembourg law is wider than that of Directive 2005/56/EC, in that it allows for cross-border mergers between all types of Luxembourg companies vested with legal personality and EU companies, as well as non-EU companies, insofar as the law of the non-EU country does not prohibit such mergers. Where one merging company operates under an employee participation system and the company resulting from the merger must also operate under such a system and is a Luxembourg company, it can only take the form of a *société anonyme*.

Luxembourg has rejected the option that the national authorities could oppose a cross-border merger on public interest grounds, as suggested in article 4 (1) (b) of Directive 2005/56/EC.

Luxembourg includes undertakings for collective investment in transferable securities (UCITS) within the scope of the law, thus allowing for mergers among Luxembourg UCITS, unlike Directive 2005/56/EC, which explicitly excludes UCITS from its scope. Luxembourg also chose to apply the law to cooperative companies.

Procedural steps for cross-border merger

The legal regime of cross-border mergers is the same as the regime applying to national mergers. This is an improvement, given that the EU directives set more stringent conditions for cross-border mergers.

Directive 2005/56/EC sets out 12 items to be included in the written 'common draft terms' of cross-border mergers that involve Luxembourg limited liability companies. These draft terms must be established by the management of the merging companies. They include the same basic principles required in the common draft terms for mergers of Luxembourg companies and additional information for cross-border mergers and mergers resulting in the creation of a European company (EC).

The common draft terms of mergers must be published in the relevant national gazette at least one month before the general meeting of shareholders of the merging companies, which is convened to approve of the merger. The management of the merging companies must draw up a report explaining the economic and legal aspects of the merger and its impact on shareholders, employees and creditors.

For cross-border mergers, this report must be made available at least one month before the general meeting of shareholders of the merging companies. In the absence of unanimous approval of the merger by the shareholders of both companies, an independent expert appointed by the management of the merging companies must prepare a report on the proposed merger.

The expert and management's reports inform the decision of the general meetings of the merging companies on the proposed merger, which must be approved with the same quorums and majorities required for amending the companies' articles. The independent expert's report and relevant documents are only necessary where they are required by the

national law of the absorbed or absorbing company and where the absorbing company holds 90 percent or more but not all the shares and securities that confer rights to vote in the general meetings of the absorbed company.

Validity and effect of the merger

In Luxembourg, the notary is the national authority in charge of verifying the legality of the merger and, in particular, in charge of ensuring that the merger proposal has been agreed on the same terms by each merging company.

The notary may be required to issue a certificate attesting to the legality of the merger.

The merger is effective in relation to third parties as of the publication of the deed of the general meeting approving it or, if no such meeting is required, on publication of the notary's certificate.

Once merged, the absorbed company ceases to exist and all its rights and obligations are transferred to the absorbing company. If the cross-border merger has taken place in accordance with the law, it cannot be declared null and void.

Asset purchase or share purchase

Purchase of assets

The purchase of an asset usually increases the cost base of the asset and is taxable in the hands of the seller. However, Luxembourg tax law differs in its treatment of transfers of 'private' and 'business' assets. For business assets (held by a company), a capital gain on disposal must be included in the business profit of the seller.

Capital gains realized on assets other than real estate or a substantial participation held as private property (i.e. not held by a company) are exempt unless they qualify as speculative gains under article 99bis of the Income tax Law, that is, unless the gain is realized within the 6 months of the acquisition of the asset or the disposal precedes the asset's acquisition.

Liabilities associated with the transferred asset remain with the seller and are not transferred with the asset.

Purchase price

When a Luxembourg entity directly acquires a business, the acquisition price of the assets normally represents the basis for their depreciation for Luxembourg tax purposes.

The (depreciated) acquisition cost determines gains or losses arising on a subsequent disposal. However, where a business is acquired from a related party at a price deemed not to be arm's-length, a tax adjustment may be made.

Goodwill

Under Luxembourg tax law, each asset transferred should be allocated its own distinct value, which forms the base cost for depreciation purposes. Where the total value exceeds the sum of the values attributed to each asset, the excess is deemed to constitute goodwill. In principle, goodwill is depreciable under Luxembourg tax law, and the normal practice is to write off goodwill over 10 years. However, Luxembourg companies may write off goodwill over a longer period, provided it does not exceed the useful economic life of the asset.

Financial fixed assets, such as participations, are not generally depreciable, even where there is a goodwill element in the purchase price. A deductible write-down in value is permitted following a prolonged reduction in the value of the participation.

Depreciation

Fixed assets are, in principle, subject to an annual depreciation that should be deductible from the taxable income of the Luxembourg company. Generally, the straight-line method is used to compute the amount of depreciation. The declining-balance method may be used in certain cases but not for buildings and intangible assets.

With the approval of the tax administration, depreciation on the basis of asset use may be applied to assets whose annual use fluctuates widely. Extraordinary depreciation may also be permitted if there is excessive wear and tear or other sharp reductions in value of the assets. Buildings used for business purposes may be depreciated over their useful lives, but land may not be depreciated.

Apart from a few assets covered by administrative circulars, there are no specified rates of depreciation. The depreciation period should reflect the useful life of the asset. Rates commonly used in practice are as follows:

Buildings	1.5–5%
Machinery and equipment	10–25%
Vehicles	20–25%

Source: KPMG in Luxembourg, 2014

Reference is generally made to German rules for depreciation periods.

Tax attributes

Losses that arise on the disposal of assets may offset other taxable income of the Luxembourg company. Losses that exceed taxable income may be carried forward indefinitely against future profits of the Luxembourg entity. However, any tax losses available for indefinite carry forward of the Luxembourg company selling the assets may not be transferred to the buyer of the assets.

Value added tax

The normal value added tax (VAT) rate is 15 percent. When assets are transferred individually, the transferred items within the scope of VAT are subject to the normal VAT rules for goods and services.

However, a merger or division generally is not subject to VAT because the transfer of all assets forming all or part of a business is not deemed to constitute a supply of goods for VAT purposes. There is deemed to be continuity between the transferee and the transferor.

Stamp duty and stamp duty land tax

No stamp duty is generally payable on the transfer of assets. The transfer of immovable property is subject to registration duty of 6 percent of the value of the real estate, plus an additional transfer duty of 1 percent. For certain real estate in Luxembourg City, there is a supplementary municipal duty of 3 percent. A registration duty of 0.24 percent may apply on debt that is mentioned in notarized deeds or presented to certain Luxembourg public authorities.

No proportional registration duties apply to the transfer of other assets (e.g. shares in Luxembourg companies) where the transfer is subject to VAT.

Purchase of shares

Generally, the purchase of a target company's shares should not affect the book values of its assets. The assets of the target company cannot be revalued to reflect fair market values.

The acquirer should record the participation acquired in its balance sheet at the acquisition price, plus costs directly connected with the acquisition.

Tax indemnities and warranties

Since the purchaser is taking over all the liabilities, including contingent liabilities, the purchaser requires more extensive indemnities and warranties than in the case of an acquisition of assets. Due diligence of the target company's tax position is advisable, particularly when the amounts involved are significant.

In principle, indemnity payments received by a Luxembourg company pursuant to a warranty clause are subject to tax in the hands of the company. In principle, a Luxembourg company making such an indemnity payment may deduct it for tax purposes.

Tax losses

Generally, tax losses may only be deducted by the company that originally incurred them. Hence, where a Luxembourg company is absorbed by an existing or a newly incorporated company, its tax loss carry forward may not be transferred. However, it may be possible to disclose latent capital gains of the absorbed company to be offset by unused tax losses. Accordingly, the absorbing company may acquire assets on a stepped-up basis and benefit from higher depreciations.

As long as a Luxembourg company continues to exist following these types of restructuring, its tax losses may be carried forward in certain conditions. Conversely, where two or more Luxembourg companies are merged to create a new company, the tax loss carry forward of each disappearing entity is lost.

Crystallization of tax charges

While there are no specific rules under Luxembourg tax law, a purchaser should perform a due diligence to assess the tax position and related risks of the target company.

Pre-sale dividend

The treatment of pre-sale dividends (distributions by the subsidiary of retained earnings before disposal) may benefit from the participation exemption. When the subsidiary company distributes dividends to its parent company, any write-down in value of the participation held by the parent company in the subsidiary is not deductible to the extent of the amount of dividends distributed.

Stamp duty

No stamp duty is payable on the transfer of shares in capital companies. Registration duty may be levied on the transfer of all or most of the shares in certain vehicles that hold only real estate. In some cases, the tax authorities may apply a look-through and consider that the real estate, rather than the company, has been transferred and levy duty accordingly. Special rules apply in the case of a transfer of partnership interests with underlying real estate.

Tax clearances

Generally, the taxpayer can ensure the Luxembourg tax treatment of a restructuring by applying for a written advance tax clearance from the tax authorities.

Choice of acquisition vehicle

Several potential acquisition vehicles are available to a foreign purchaser, and tax factors often influence the choice. Following the abolition of Luxembourg duty on capital contributions as of 1 January 2009, the incorporation of Luxembourg companies and subsequent increases in capital are no longer subject to capital duty.

Local holding company

Instead of acquiring the assets and liabilities comprising a business, which is often not tax-efficient, purchasers may choose to set up a holding company to acquire the shares of the target company.

The two legal forms of limited liability company widely used in Luxembourg are as follows:

- Public limited company (*société anonyme*): a joint stock company with freely transferable shares. As of 25 August 2007, the one-person public limited company (*société anonyme unipersonnelle*) was introduced to Luxembourg company law. The conditions are the same except that, at the organization level, the board of directors may be represented by one director and the general shareholders meeting may be attended by the sole shareholder.
- Limited liability company (*société à responsabilité limitée*): a private limited company with restrictions on the transfer of shares. The one-person limited liability company (*société à responsabilité limitée unipersonnelle*), introduced in 1992, also may have only one shareholder.

These companies are fully taxable corporations with equity investments, and they may benefit from the Luxembourg participation exemption regime unless they are subject to a specific tax regime.

Following the abolition of the 1929 holding regime, Luxembourg tax legislation provides for the private family asset holding company (*Société de gestion de patrimoine familial* – SPF), an investment vehicle for individuals introduced by the law of 11 May 2007. This type of company is specially designed to meet the business needs of family-owned holding companies managing financial assets. The exclusive objectives of an SPF are the acquisition, holding, management and disposal of financial assets, to the exclusion of any commercial activity.

In addition, Luxembourg domestic law provides for other types of entities, including:

- partnership limited by shares
- *societas Europaea*
- partnership
- limited partnership
- special limited partnership
- joint venture
- cooperative society
- civil company
- economic interest grouping.

Foreign parent company

The foreign purchaser may choose to make the acquisition itself, perhaps to shelter its own taxable profits with the financing costs. Generally, this should not trigger any adverse Luxembourg tax consequences. In principle, interest payments are not subject to Luxembourg withholding tax (WHT). Dividend payments generally are subject to 15 percent Luxembourg dividend WHT, but an exemption is provided under domestic tax law if certain conditions are met. As of 1 January 2009, the scope of this WHT exemption is extended (subject to certain conditions) to parent companies resident in countries with which Luxembourg has concluded a tax treaty.

Non-resident intermediate holding company

Where the foreign country taxes capital gains and dividends received from the Luxembourg target company, an intermediate holding company resident in another jurisdiction

could be used for tax-deferral purposes, among other things. Luxembourg tax treaties often do not include extensive anti-treaty shopping rules.

Local branch

As an alternative to the direct acquisition of the target's trade and assets, a foreign purchaser may structure the acquisition through a Luxembourg permanent establishment (PE). The income attributable to the PE is subject to Luxembourg taxation, but dividends and capital gains realized on disposal of a shareholding in a Luxembourg company may, under certain conditions, benefit from the Luxembourg participation exemption regime. The repatriation of profits to the foreign head office does not trigger additional taxes on branch profits.

Joint venture

Whenever a joint venture takes a form in which the company is legally and fiscally recognized as an entity distinct from the participants, it is taxed according to the regime applicable to corporations (see earlier in this chapter).

In other cases, the income is taxable in the hands of the individual venturers under the rules applicable to partnerships (see earlier in this chapter), which is the case for European economic interest groupings (*Groupement européen d'Intérêt économique* – GEIE).

The profits are allocated on the basis of the joint venture agreement.

Choice of acquisition funding

To fund an acquisition, the acquiring company may issue debt, equity or a combination of both. Below we discuss the tax aspects that should be considered when deciding the funding structure.

Debt

Interest expenses incurred to fund the acquisition of assets generally are deductible as long as the arm's length principle is satisfied.

On an acquisition of shares, the interest deduction may be restricted or subject to clawback (i.e. a recapture provision that taxes part of the capital gain on a disposal of the shareholding) where the acquiring company benefits from the participation exemption. Expenses relating to a participation qualifying for the participation exemption are deductible only to the extent that they exceed exempt income (dividends) arising from the participation in a given

year. Depending on the circumstances, there are several ways to achieve a deduction of interest even where the debt is used to finance participation.

No WHT is levied in Luxembourg on interest payments unless the loan is a direct profit-participating loan, bond and similar security. Further, where the recipient of the interest payments is an EU-resident or Luxembourg-resident individual, WHT may be due on the grounds of the EU Savings Directive or Luxembourg domestic final WHT.

Deductibility of interest

Luxembourg tax law does not stipulate a specific debt-to-equity ratio. The tax authorities require companies to comply with the arm's length standard. For a holding company, a debt-to-equity ratio of 85:15 is required to finance shareholdings. Provided the shareholders give no guarantees, third-party debt is disregarded in this computation.

Where the required ratio is not met, the portion of interest paid in excess of the ratio could be regarded, for Luxembourg tax purposes, as a hidden profit distribution. In principle, a hidden profit distribution is not tax-deductible and is subject to 15 percent WHT, subject to relief under the EU Parent-Subsidiary Directive or a tax treaty.

Withholding tax on debt and methods to reduce or eliminate it

Luxembourg domestic tax law does not levy WHT on arm's length interest payments, except for interest on profit-participating bonds and similar securities. In principle, interest payments on such financing instruments is subject to Luxembourg WHT of 15 percent where:

- The loan is structured in the form of a bond or similar security.
- In addition to the fixed interest, supplementary interest varying according to the amount of distributed profits is paid, unless the supplement is stipulated to vary inversely with the fixed interest.

It is possible to use profit-participating financing instruments that do not fall within the above scope, such that the interest payments are not subject to Luxembourg WHT.

Where recipients of interest payments are EU-resident individuals, WHT tax may be due under the EU Savings Directive.

Checklist for debt funding

- In principle, interest payments are not subject to Luxembourg WHT.
- The maximum 85:15 debt-to-equity ratio must be respected when financing participations.

Equity

As of 1 January 2014, the cumulative corporate tax (municipal business tax plus corporate income tax) for companies established in Luxembourg City amounts to 29.22 percent. Moreover, as of 1 January 2013, a minimum corporate tax equal to 3,210 Euros (EUR) (which includes a 7 percent employment fund surcharge) applies to companies the assets of which are comprised of at least 90 percent financial assets. As of 2013, corporate taxpayers (other than a *Société de Participations Financières* – SOPARFI) that have their statutory seat or effective place of management in Luxembourg are subject to a minimum tax, which is determined on the basis of the balance sheet total of the tax year concerned. The minimum tax ranges from EUR500 (EUR535 including a 7 percent solidarity surcharge) for a balance sheet total less than EUR35,000, to EUR20,000 (EUR21,400 including the 7 percent solidarity surcharge) for a balance sheet total exceeding EUR20,000,000.

Where the investor wants to fund the acquisition to the extent possible with debt, the Luxembourg tax law is flexible since it does not impose any strict debt-to-equity ratios on ordinary taxable companies. Informal limits are applied by the tax authorities for the financing of an acquisition of a subsidiary (participation) by intragroup loans. In this situation, the tax authorities generally consider a ratio of 85:15 as being in line with the arm's length principle, which means that 85 percent of the purchase price of the participations held may be financed by an intragroup loan. Where interest rates exceed market rates, part of the interest may be treated as a hidden profit distribution, subject to 15 percent dividend WHT.

For the purposes of determining the debt-to-equity ratio, an interest-free loan from shareholders may be treated as equity for corporate income tax purposes, so it may be possible to structure funding with a 99:1 debt (interest-free/bearing)-to-equity ratio.

Scenario	Equals
Subscribed and paid-in capital	1
Interest-free shareholder loan	14
Total equity for debt-to-equity purposes	15
Maximum interest-bearing liabilities	85

Source: KPMG in Luxembourg, 2014

By using certain exit instruments, such as tracking loans, a debt-to-equity ratio of 99:1 could also be achieved.

Such a funding structure should be analyzed on a case-by-case basis.

Any excess interest payments that result from exceeding the debt-to-equity ratio are reclassified as hidden profit distribution.

Dividends are subject to WHT at a rate of 15 percent. Where a tax treaty or the participation exemption regime applies (see later in this chapter), there should be an exemption from WHT.

No WHT tax is levied on liquidation or partial liquidation proceeds.

Share-for-share exchange

Description

A share-for-share exchange is the contribution of shares by the shareholders of the target company to the acquiring company against allocation of shares in the acquiring company to the shareholders of the target company, or the 'exchange' of shares in the target company against shares in the acquiring company in the context of a merger/division at the level of the shareholder of the target.

Tax treatment

In principle, a share-for-share exchange constitutes a taxable sale followed by an acquisition by the disposing shareholder. However, Luxembourg tax law provides for tax-neutral restructuring in the following circumstances.

Article 22bis of the Luxembourg income tax law provides a limited list of share exchanges at book value that may be tax-neutral at the level of the Luxembourg shareholder (i.e. no realization of capital gains):

- transformation of the legal form of corporation to another legal form of corporation

- merger/demerger of resident companies or EU-resident companies (entities that are covered by Article 3 of the EU Directive 434/90) or capital companies or cooperative companies resident in a European Economic Area (EEA) state other than an EU Member State fully subject to a tax corresponding to the Luxembourg corporate income tax
- exchange of shares (in an EU/EEA resident company or a capital company fully taxable subject to a comparable effective tax rate of 10.5 percent computed on a similar base as the Luxembourg one), where the acquiring company (being a EU-resident company or a capital company fully taxable subject to a comparable effective tax rate of 10.5 percent computed on a similar base as the Luxembourg one) obtains the majority of the voting rights in the acquired company or increases the majority of voting rights already held.
- participation exemption for qualifying investments held by resident taxable companies and qualifying branches of non-resident companies (article 166 of the Luxembourg income tax law – LIR), an extensive exemption that covers capital gains triggered by a share-for-share exchange
- provides for rollover relief where sales proceeds are invested in a qualifying asset or participation under certain conditions (article 54 LIR).

Where none of these relieving provisions can be applied, the share-for-share exchange is, in principle, fully taxable (specific structuring may be possible to achieve tax-neutrality, depending on the economic circumstances). However, where the shareholders are resident individuals, the gain is taxed in accordance with Luxembourg tax law only if the participation realized represented at least 10 percent of the shares of the target company. Such a gain may be taxable at half the normal rate.

Non-Luxembourg resident shareholders are taxed only where a participation representing at least 10 percent of the shares of the target company is sold within a period of 6 months following the acquisition of the shares, or where the foreign shareholder, having been a resident of Luxembourg for more than 15 years, disposed of the participation within 5 years since becoming non-resident. Most of Luxembourg's tax treaties provide for capital gains to be taxed in the state of residence of the entity or individual realizing the gain.

Transfer of the assets at book value

Article 170, paragraph 2 LIR provides for the possibility of transferring assets at their book value or at a value between their book and market value. This allows for the transfer of assets without the realization and thus taxation of underlying capital gains. This provision does not give a definitive tax exemption of the capital gains attached to the transferred assets but merely allows a deferral until their subsequent realization.

The following conditions must be fulfilled:

- The absorbed and absorbing company must be resident in Luxembourg (within the meaning of article 159 of the LIR) and fully subject to Luxembourg corporate income tax.
- The shareholders of the absorbed company must receive, in consideration of the transfer of its shares, shares of the absorbing company newly issued for this purpose. Where the absorbing company has a participation in the absorbed company, the participation must be canceled. The absorbed company must be dissolved.
- The parties must take steps to ensure that the capital gains (hidden reserves) ultimately will be taxable. Thus, the absorbing company must make an entry in its fiscal financial statements reflecting the book value of the assets transferred to it by the absorbed company.
- Where the absorbing company holds a participation in the absorbed company, the former must produce evidence to the tax administration to the effect that the merger is based on sound business principles.

Where the transfer is not made at book value, to the extent the value attributed to the assets exceeds their book value, this will create taxable income in the absorbed company (offering a useful way of absorbing losses of the absorbed company, which would otherwise disappear). The higher reported amount of the assets transferred in the balance sheet of the recipient company would result in a higher depreciation of the acquisition costs of the transferred assets.

Transfer of a business by the target company

Description

Contribution of the entire business of the target company or contribution of only an independent branch of activity of the target company can be made to an acquiring company

in exchange for shares in the acquiring company (a share capital company). In this case, the target company remains in existence and, depending on the size of the companies involved, the company acquiring the business may become a subsidiary of the target company whose sole remaining activity is the holding of shares in the acquiring company.

Tax treatment

Article 59 LIR applies where either all assets and liabilities are transferred by the target company or a branch of activity is transferred (the target company remaining in existence). Under this article, in principle, hidden reserves cannot be transferred to the acquiring company because the assets involved are revalued to market value, thus exposing any increase in value over book value to taxation at normal rates at the level of the target company. Thus, the minimum value at which the acquiring company may value the assets transferred is book value.

However, where both the target and acquiring companies are fully taxable companies that are resident in Luxembourg or in another EEA/EU Member State, articles 59(3) and 59 bis (1) LIR provide that the assets may be transferred to the acquiring company at book value, market value or an intermediate value at the election of the target company, thus deferring taxation. The maximum value at which the acquiring company may value the assets transferred is market value.

If the receiving company is resident in another EU Member State, any Luxembourg-based assets must be transferred to a Luxembourg PE of that company to benefit from a tax-neutral treatment.

Hybrids

Hybrid financing instruments may be treated as equity in Luxembourg for Luxembourg tax purposes and as debt in another country, or vice versa. Some countries have a formal approach to classifying an instrument, while others have an economic approach and analyze the effective characteristics of the instrument. Such differences of approach between countries can give rise to international tax planning opportunities, such as profit-sharing loans.

One example of such an opportunity is where a Luxembourg contractual partnership is set up in the form of a typical silent partnership. This type of business participation is treated in Luxembourg as debt, so profit allocations to the

silent partner are deductible in Luxembourg where certain conditions are met. By contrast, the foreign partners may be resident in countries where the participation is treated as equity, and so the distribution of its profits may be treated as a dividend and be eventually tax-exempt, depending on the foreign tax law and the relevant tax treaty.

Discounted securities

The tax treatment of securities issued at a discount to third parties normally follows their accounting treatment under Luxembourg Generally Accepted Accounting Principles (GAAP). As a result, the issuer should be able to obtain a tax deduction for the discount accruing over the life of the security.

Deferred settlement

Where acquisitions involve elements of deferred consideration (i.e. the amount of the consideration depends on the business's post-acquisition performance), such future consideration should be regarded as part of the sale price.

Where the sale price relates to shares disposed of, the deferred settlement may be eligible for the Luxembourg participation exemption regime as an element of a capital gain on shares.

Other considerations

Concerns of the seller

A sale of shares of a Luxembourg company may be tax-exempt, where the seller is either a Luxembourg corporation under the capital gains substantial participation exemption or a non-resident. Luxembourg usually loses the right to tax capital gains under tax treaties, and non-resident sellers who do not benefit from treaty protection when disposing of shares in a Luxembourg company are not taxable in Luxembourg after a six-month holding period has elapsed.

The sale of shares does not trigger registration or stamp duty (except in some cases where sellers hold Luxembourg real estate).

In an acquisition for cash of all the assets of a Luxembourg company, the seller is subject to Luxembourg corporation tax on any capital gains. Certain techniques are available to the

seller to defer taxation, for example, by reinvesting the sale proceeds in fixed assets or by reducing the tax basis where the sale takes place in the course of the liquidation of the seller.

Company law and accounting

Merger

Following the enactment into domestic law of the Third and Sixth EU Company law Directives in 1987, mergers of two or more Luxembourg public limited companies (SA) can be effected only by absorption of an existing company or incorporation of a new entity. In both cases, the target companies of the merger are dissolved without liquidation, and all assets and liabilities are contributed to the absorbing or newly created entity.

The law of 23 March 2007, as further detailed by the law of 10 June 2009, amended Luxembourg company law to simplify the rules and conditions for mergers and divisions. This law allows a cross-border merger between any Luxembourg company with a legal personality and companies governed by a European or foreign law, where the national law of the relevant country does not oppose such merger (entities with legal personality are the *société anonyme*, *société en commandite par actions*, *société à responsabilité limitée*, *société en nom collectif*, *société en commandite simple*, *the société coopérative*, *société civile*, and *groupement d'intérêt économique*).

A merger can also occur where one or more of the companies or economic interest groupings that are acquired or will cease to exist are the subject of bankruptcy proceedings relating to litigation with creditors or a similar procedure, such as the suspension of payments, control of the management of the company, or proceedings instituting special management or supervision of one or more of such companies. A merger is effected by the acquisition of one or more companies by another (merger by acquisition) or by the incorporation of a new company (merger by incorporation of a new company). In exchange, the shareholders receive shares and possibly a cash payment not exceeding 10 percent of the nominal value of the shares issued. In both cases, the target companies of the merger are dissolved without liquidation, and all assets and liabilities are transferred to the absorbing or newly created entity.

Division

Luxembourg company law defines a division as an operation in which the company being divided, after dissolution but without going into liquidation, contributes its assets and liabilities to two or more pre-existing or newly formed companies (the recipient companies) in exchange for the issue of shares to shareholders, possibly with a cash payment not exceeding 10 percent of the nominal value of the shares issued.

The law of 23 March 2007 simplified the rules and conditions for mergers and divisions. This law allows a cross-border division between any Luxembourg company having a legal personality and a European or a foreign law-governed company where the national law of the relevant country agrees.

Group relief/consolidation

Under Luxembourg tax law, resident companies may be authorized to file consolidated tax returns for corporate income tax and municipal business tax, but not for net wealth tax. An application must be made for a period of at least 5 years. Where a company leaves the group within 5 years, the overall group results will be adjusted where tax savings have been made through compensation for the losses of the departing company. Qualification for fiscal integration requires financial integration (that is, 95 percent, or, in some cases 75 percent, of the shares in the subsidiary or the Luxembourg PE must be held directly or indirectly by the fully taxable resident capital company or by a Luxembourg PE of a non-resident capital company fully liable to a tax that corresponds to Luxembourg corporate income tax). An organizational or economic integration is not required.

If the participation is held indirectly, it is necessary for the companies through which the parent company or the Luxembourg PE holding 95 percent of the share capital of the subsidiary that is to be integrated for tax purposes to be capital companies fully liable to a tax that corresponds to Luxembourg corporate income tax; namely, a tax compulsorily levied by public authorities at a rate of at least 10.5 percent of a base calculated in accordance with rules and criteria similar to Luxembourg's. The 95 percent shareholding condition must be satisfied continuously from the beginning of the first accounting period for which tax consolidation is requested.

Losses incurred prior to a company's inclusion in a fiscal integration group cannot be offset against other group companies' profits on fiscal integration. Losses may continue to be carried forward by the company that realized them and set off against profits subsequently made by that company within the fiscal integration group.

Transfer pricing

Except for intragroup financing activities, there are no transfer pricing rules in Luxembourg applicable to M&A operations. The Organisation for Economic Co-operation and Development's (OECD) transfer pricing guidelines are generally followed in practice.

Where a business asset is sold to a non-resident related party, the Luxembourg tax authorities may reassess the transfer value of the assets where the value is below market value and results in a shift of taxable profits to the benefit of a non-resident taxpayer linked directly or indirectly to the transferor. This is simply an application of common transfer pricing rules.

Where transfer prices are exclusively motivated by a relationship between a Luxembourg undertaking and a non-resident taxpayer and motivated by sound business reasons, the Luxembourg tax authorities may reassess the undertaking's taxable profit (articles 56 and 164 LIR). Therefore, a shift of profits outside Luxembourg between related parties, through excessive indebtedness, for example, which implies excessive deductible expenses, may be challenged under common transfer pricing rules.

According to article 164 LIR, a hidden profit distribution arises when a direct or indirect shareholder receives proceeds or other advantages from a company that they would not have received in the absence of this relationship. No tax deduction is available at the company level for these expenses, and the proceeds or advantages are treated as dividends subject to dividend WHT, unless a tax treaty or the participation exemption applies.

The transfer pricing practice is still developing in Luxembourg. On 28 January 2011, the Luxembourg tax authorities issued Circular 164/2 on the tax treatment of intragroup financing companies. However, the provisions outlined in the circular do not apply to cross-border M&As.

Dual residency

Cases of dual residency may be beneficial for tax purposes, in a few specific cases. Tiebreaker clauses in tax treaties tend to have a direct impact for Luxembourg tax purposes.

Foreign investments of a local target company

Luxembourg tax law includes no controlled foreign company legislation.

Comparison of asset and share purchases

Advantages of asset purchases

- Buyer may depreciate the purchase price of assets acquired, including goodwill.
- Possible to acquire only part of the business.
- Losses within the acquiring group may be absorbed by a profitable business acquired from the target company.
- Buyer generally is not liable for claims on or previous liabilities of the target company.

Disadvantages of asset purchases

- The business is effectively being carried on by another entity, which may require renegotiation of trading and employment contracts, etc.
- Pre-acquisition losses incurred by the target company are not transferred with the business. They remain with the target company or are lost.
- Generally, there is a need to renegotiate supply, employment and technology agreements.
- An asset purchase could be more expensive than a share purchase where, from a tax perspective, it is unattractive for the seller.

- Accounting profits may be affected by the creation and depreciation of goodwill.
- Transfer registration duties are due on transfers of real estate.

Advantages of share purchases

- Contractual continuity because the target company may remain active, with only the shareholders changing.
- Pre-acquisition tax losses incurred by the target company may be retained, despite the change of shareholder, if certain conditions are met.
- The acquiring group companies may use losses incurred by the target company following an acquisition under fiscal integration provisions (excluding losses incurred prior to the fiscal consolidation).
- Losses incurred by acquiring group companies within fiscal integration may be offset against profits of the target company.
- Registration duties on the transfer of real estate may be avoided.

Disadvantages of share purchases

- Participation cannot be amortized.
- There is liability for claims on or previous liabilities of the target company.
- Where the participation exemption applies, direct funding costs related to the acquisition of the subsidiary may not be entirely deductible.

Luxembourg – Withholding tax rates

This table sets out reduced withholding tax rates that may be available for various types of payments to nonresidents under Luxembourg's tax treaties. This table is based on information available up to 15 March 2014.

Source: *International Bureau of Fiscal Documentation, 2014*

	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies ² (%)		
Domestic rates				
<i>Companies:</i>	15	0	0/15	0
<i>Individuals:</i>	15	N/A	0/15/35	0
Treaty rates				
<i>Treaty with:</i>				
Armenia	15	5 ³	0/10 ⁴	5
Austria	15	5	0	0/10 ⁵
Azerbaijan	10	5 ⁶	10	5/10 ⁷
Bahrain	10	0	0	0
Barbados	15	0 ⁸	0	0
Belgium	15	10 ⁹	0/15 ¹⁰	0
Brazil	25	15	-/15 ¹¹	15/25 ¹²
Bulgaria	15	5	0/10	5
Canada	15	0/5 ¹³	0/10 ¹⁴	0/10 ¹⁵
China (People's Rep.)	10	5	0/10	6/10 ¹⁶
Czech Republic	15	5	0	0/10 ¹⁷
Denmark	15	5	0	0
Estonia	10	5	0/10	5/10
Finland	15	5	0	0/5
France	15	5 ¹⁸	10	0
Georgia	10	0/5 ¹⁹	0	0
Germany	15	5 ²⁰	0	5
Greece	7.5	7.5	8	5/7
Hungary	15	5	0	0
Hong Kong	10	0 ²¹	0	3
Iceland	15	5	0	0
India	10	10	10	10
Indonesia	15	10	10	12.5
Ireland	15	5	0	0

	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies ² (%)		
Israel	15	5	5/10	5
Italy	15	15	10	10
Japan	15	5 ²²	10	10
Kazakhstan	15	5 ²³	10	10
Korea (Rep.)	15	10	5/10	10/15 ²⁴
Latvia	10	5	10	5/10
Liechtenstein	15	0/5 ²⁵	0	0
Lithuania	15	5	10	5/10
Macedonia	15	5	0	5
Malaysia	10	0/5 ²⁶	10	8
Malta	15	5	0	10
Mauritius	10	5	0	0
Mexico	15	5	0/10	10
Moldova	10	5 ²⁷	0/5 ²⁸	5
Monaco	15	5	0	0
Morocco	15	10	10	10
Netherlands	15	2.5	0/2.5/15 ²⁹	0
Norway	15	5	0	0
Panama	15	5	5	5
Poland	15	0	5	5
Portugal	15	15	10/15	10
Qatar	10/5 ³⁰	0	10/15	10
Romania	15	5	10	10
Russia	10/15 ³¹	5 ³²	0	0
San Marino	15	0 ³³	0	0
Seychelles	10	0	5	5
Singapore	10	5	10	10
Slovak Republic	15	5	0	0/10
Slovenia	15	5	5	5

	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies ² (%)		
South Africa	15	5	0	0
Spain	15	5 ³⁴	10	10
Sweden	15	0	0	0
Switzerland	15	0/5 ³⁵	0/10 ³⁶	0
Tajikistan	15	0	12	10
Thailand	15	5	10/15	15
Trinidad and Tobago	10	5	0/7.5/10 ³⁷	10
Tunisia	10	10	7.5/10 ³⁸	12
Turkey	20	5	10/15 ³⁹	10
United Arab Emirates	10	5	0	0
United Kingdom	15	5	0	5
United States	15	0/5 ⁴⁰	0	0
Uzbekistan	15	5	0/10	5
Vietnam	15	5/10 ⁴¹	7/10 ⁴²	10

Notes:

1. Many treaties provide for an exemption for certain types of interest, e.g. interest paid to the state, local authorities, the central bank, export credit institutions or in relation to sales on credit.
2. Unless indicated otherwise, the rate in this column generally applies if the recipient company holds, directly or indirectly, at least 25 percent of the capital or the voting power of the paying company, as the case may be.
3. The rate applies if the recipient company owns at least 10 percent of the distributing company's capital or voting power, as the case may be. Special conditions may apply (e.g. holding periods and invested amounts).
4. The lower rate applies, *inter alia*, to interest paid to a bank or other financial institution. Conditions may apply.
5. The higher rate applies if the Austrian company owns more than 50 percent of the capital in the Luxembourg company.
6. The rate applies if the Azerbaijani company owns, directly or indirectly, at least 30 percent of the capital in the Luxembourg company and has invested at least USD300,000 in that company.
7. The lower rate applies to royalties for computer software, patents, designs or models, plans, secret formulas or processes or know-how not older than 3 years (in each case).
8. The zero rate applies if the beneficial owner, for an uninterrupted period of at least 12 months, owns directly at least 10 percent of the capital of the distributing company or a participation of at least EUR1.2 million.
9. The rate applies if the recipient company owns at least 25 percent of the distributing company's capital or if the purchase price of the recipient company's direct holding is at least EUR6,197,338 (LUF250 million).
10. The zero rate applies if the recipient is an enterprise; this does not apply to (a) interest on bonds and (b) interest paid by a company to a company owning at least 25 percent of the paying company's voting power or shares.
11. The domestic rate applies to interest paid by public bodies (under the treaty such interest is taxable only in the source state and there is no reduction). The zero rate applies, *inter alia*, to interest paid by a public body.
12. The higher rate applies to trademarks and copyrights of films, etc.
13. The 5 percent rate applies if the Canadian company owns at least 10 percent of the Luxembourg company's voting power. The zero rate applies if (i) the Canadian company has owned directly at least 25 percent of the voting stock in the Luxembourg company for at least 2 years and (ii) the dividends are paid out of profits derived from the active conduct of a trade or business in Luxembourg; and if the dividends are exempt in Canada.
14. The lower rate applies, *inter alia*, to interest paid by a public body.
15. The lower rate applies to copyrights of literary, dramatic, musical or artistic works (excluding films, etc.), computer software, patents and know-how.
16. The lower rate applies to equipment rentals.
17. The lower rate applies to copyrights of literary, artistic or scientific work (including films, etc.).
18. The rate only applies if the recipient company owns at least 25 percent of the distributing company's capital, or if two or more recipient companies together do so, provided that one of these owns more than 50 percent of the other(s).
19. The 5 percent rate applies if the Georgian company holds directly or indirectly at least 10 percent of the capital in the Luxembourg company and has invested at least EUR100,000 in that company. The zero rate applies if the Georgian company holds directly or indirectly at least 50 percent of the capital in the Luxembourg company and has invested at least EUR2 million in that company.
20. This rate applies if the receiving company, not being a partnership, owns directly at least 10 percent of the capital of the company paying the dividends.
21. This rate applies if the beneficial owner is a company (other than a partnership) which holds directly at least 10 percent of the capital of the company paying the dividends or if it acquired the capital for an amount of at least EUR1.2 million.

22. This rate applies if the beneficial owner is a company which owns at least 25 percent of the voting shares of the company paying the dividends during the period of 6 months immediately before the end of the accounting period for which the distribution of profits takes place.
23. This rate applies if the beneficial owner is a company (other than a partnership) which holds directly at least 15 percent of the capital of the company paying the dividends.
24. The lower rate applies to equipment rentals and to know-how.
25. The 5 percent rate applies if the Liechtenstein company owns directly at least 10 percent of the capital of the Luxembourg company and 0 percent if the Liechtenstein company for an uninterrupted period of at least 12 months owns directly at least 10 percent of the capital of the Luxembourg company or a participation of at least EUR 1.2 million.
26. The 5 percent rate applies if the Malaysian company owns directly at least 10 percent of the capital in the Luxembourg company. The zero rate applies if it has owned directly at least 25 percent of the capital in the Luxembourg company for at least 12 months and the Luxembourg company is engaged in the active conduct of a trade or business in Luxembourg.
27. The 5 percent rate applies if the Moldovan company holds directly at least 20 percent of the capital in the Luxembourg company.
28. The lower rate applies, *inter alia*, to interest paid by a public body or paid to a financial institution.
29. Interest on loans secured by mortgages on immovable property is exempt. Interest on profit-sharing bonds is treated as dividends.
30. The lower rate applies to individuals who own directly at least 10 percent of the capital of the company paying the dividends and have been residents of the other country for at least 48 months preceding the year in which the dividends were paid.
31. The 10 percent rate applies if the individual or corporate recipient holds directly at least 30 percent of the capital of the Luxembourg company and the price of acquisition of the holding is at least EUR75,000.
32. This rate applies if the company receiving the dividends owns at least 10 percent of the capital of the company paying the dividends and has invested at least EUR80,000 or the equivalent in RUB in that company.
33. This rate applies if the beneficial owner is a company which has held directly at least 10 percent of the capital of the company paying the dividends for an uninterrupted period of at least 12 months.
34. This rate applies if the beneficial owner is a company (other than a partnership) which holds directly at least 25 percent of the capital of the company paying the dividends and if the beneficial company has held the capital for a period of at least 1 year prior to the distribution of the dividends.
35. The 0 percent rate applies if the Swiss company owns directly at least 10 percent of the distributing company's capital. The exemption applies if it has owned such a holding for a continuous period of 2 years prior to the payment. The exemption also applies to dividends paid to a recognized pension fund or pension scheme. The 5 percent rate applies if the beneficial owner (not a partnership) holds at least 10 percent of the capital of the distributing company.
36. The higher rate applies to interest on bonds and other similar securities and to interest on bank deposits.
37. The exemption applies, *inter alia*, to interest paid by a public body. The 7.5 percent rate applies to interest on bank loans, interest on bank deposits not represented by bearer instruments and interest paid in relation to sales on credit.
38. The lower rate applies to interest on loans guaranteed or insured by the state of Tunisia or by a Tunisian resident financial institution, provided that the loan has a term of at least 5 years.
39. The lower rate applies to interest paid on a loan made for a period of more than 2 years.
40. The 5 percent rate applies if the US company owns directly at least 10 percent of the voting stock in the Luxembourg company. The zero rate applies if it has owned directly at least 25 percent of the voting stock in the Luxembourg company for at least 2 years and the Luxembourg company is engaged in the active conduct of a trade or business in Luxembourg.
41. The 5 percent rate applies if the Vietnamese company holds at least 50 percent of the capital of the Luxembourg company or has made a contribution of more than USD10 million. The 10 percent rate applies if it holds at least 25 percent (but less than 50 percent) of the capital and the contribution does not exceed USD10 million.
42. The rate is 7 percent as long as Vietnam does not levy a withholding tax on interest.

KPMG in Luxembourg

Giuliano Bidoli

KPMG Luxembourg S.à r.l.
9, allée Scheffer
L-2520 Luxembourg

T: +352 22 51 51 5528
E: giuliano.bidoli@kpmg.lu

kpmg.com

kpmg.com/socialmedia



kpmg.com/app



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