Luxembourg is popular as an attractive location for holding activities. This attractiveness is mainly due to the favorable Luxembourg tax regime for dividends and capital gains, namely the participation exemption regime for equity investments.

Luxembourg's participation exemption regime[1] 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 on dividend distributions applies if the conditions for the participation exemption are met. Finally, participations qualifying for the participation exemption are exempt from net wealth tax.

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

Income tax exemption

Participation exemption for dividends, capital gains and liquidation proceeds received

Status of Luxembourg beneficiary

- Fully taxable resident collective entity listed in article 166 LITL paragraph 10[2]; or
- Fully taxable resident corporation not listed in article 166 LITL paragraph 10[3]; or
- Luxembourg permanent establishment of either:
  > a collective entity that is covered by the Parent-Subsidiary Directive; 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 Union[4].

[1] Articles 147 and 166 of the Luxembourg income tax law (LITL) and paragraph 60 of the valuation law of 16 October 1934 (BewG).

[2] These are basically entities with a legal form as listed in the Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (Parent-Subsidiary Directive).

[3] These are corporations set up in a non-European Union country.

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

Status of subsidiary

- Collective entity listed and covered by the Parent-Subsidiary Directive; or
- Fully taxable resident corporation not listed in article 166 LITL paragraph 10[5]; or
- Non-resident corporation fully subject to income tax comparable to the Luxembourg corporate income tax. A minimum income tax rate of 10.5% as of 2009 (11% before) 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 that qualifies for the exemption is:

- 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.

Minimum retention period

The participation must have been held for an uninterrupted period of at least 12 months on the date the income is allocated or realised 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. Decreases in the acquisition cost of a participation that qualifies for the exemption are deductible. The exempt amount of a capital gain realised on a qualifying participation is, however, reduced by the amount of any expenses related to the participation, including decreases in the acquisition cost, that have previously reduced the company's Luxembourg taxable income.

However, decreases in the acquisition cost that result from dividend distributions are not tax deductible to the extent the dividends are tax exempt.

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 decrease in the acquisition cost of the participation, i.e. this write-off is taken into account when calculating the exempt portion of the capital gain.

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 29.22%, 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 are exempt from taxation, i.e. they will be subject to a 14.61% 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 income tax comparable to the Luxembourg corporate income tax; or
- A company that is covered by the Parent-Subsidiary Directive.

[5] These are corporations set up in a non-European Union country.

Withholding tax exemption

Application of participation exemption

Status of recipient

- Collective entity listed and covered by the Parent-Subsidiary Directive; or
- Fully taxable resident corporation not listed in article 166 LITL paragraph 10[6]; or
- Permanent establishment of one of the above qualifying entities; or
- Collective entity resident in a treaty country[7] and fully subject to 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 taxation 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 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 subsidiary

- Fully taxable resident collective entity listed in article 166 LITL paragraph 10[8]; or
- Fully taxable resident corporation not listed in article 166 LITL paragraph 10[9].

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

Size of participation

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

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

Minimum retention period

The participation must have been held for an uninterrupted period of at least 12 months on the date that the dividend is allocated or realised 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.

Non-application of participation exemption

Where the conditions of the Luxembourg participation exemption are not met, 15% withholding tax is levied on dividends distributed by a Luxembourg resident and fully taxable corporation. This rate may be reduced even to 0% under applicable tax treaties.

Luxembourg law provides in addition 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 specialised investment funds (fonds d'investissements spécialisés - SIFs), undertaking for collective venture capital investments (sociétés d'investissement en capital à risque - SICARs), and family asset holding companies (sociétés de gestion de patrimoine familiale - SPFs).

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.

[6] These are corporations set up in a non-European Union country.

[7] The exemption was extended to collective entities resident in a treaty country as of 1.1.2009. In 2008 only Luxembourg permanent establishments of corporations resident in a treaty country and fully subject to comparable tax qualified for the exemption.

[8] These are basically entities with a legal form as listed in the Parent-Subsidiary Directive.

[9] These are corporations set up in a non-European Union country.

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 the same as for the exemption from income tax of dividends received by Luxembourg resident parent companies[10].

Minimum retention period

The net wealth tax exemption is not subject to any condition relating to the retention period.

Debt financing

Debts relating to the acquisition of exempt participations are not deductible.

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 for capital gains to the country of residence of the shareholder.

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

- The non-resident shareholder has held 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 22.47% corporate income tax if realised by a non-resident corporate shareholder.

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[10] Please refer to page 1 and 2 of this publication for a summary of these conditions.