KPMG

Luxembourg Country Profile

EU Tax Centre

June 2021

Key tax factors for efficient cross-border business and investment involving Luxembourg

EU Member State Yes.

Double Tax Treaties With the following countries, territories and jurisdictions:

Albania[(a)]	Estonia	Kuwait[(a)]	Pakistan[(a)]	Tajikistan
Andorra	Ethiopia[(a)]	Kyrgyzstan[(a)]	Panama	Taiwan
Armenia	Finland	Laos	Poland	Thailand
Argentina[(a)]	France [(c)]	Latvia	Portugal	Trinidad and Tobago
Austria	Georgia	Liechtenstein	Qatar	Tunisia
Azerbaijan	Germany	Lithuania	Romania	Turkey
Bahrain	Ghana[(a)]	Malaysia	Russia[(c)]	Ukraine
Barbados	Greece	Mali[(a)]	San Marino	UAE
Belgium	Guernsey	Malta	Saudi Arabia	UK
Botswana[(a)]	Hong Kong SAR	Mauritius	Senegal	US
Brazil	Hungary	Mexico	Serbia	Uruguay
Brunei	Iceland	Moldova	Seychelles	Uzbekistan
Bulgaria	India	Monaco	Singapore	Vietnam
Canada	Indonesia	Mongolia[(b)]	Slovakia	
Cape Verde[(a)]	Ireland	Morocco	Slovenia	
Chile[(a)]	Isle of Man	Netherlands	Spain	
China	Israel	New Zealand[(a)]	South Africa	
Croatia	Italy	North Macedonia	South Korea	
Cyprus	Japan	Norway	Sri Lanka	
Czech Rep.	Jersey	Oman[(a)]	Sweden	
Denmark	Kazakhstan		Switzerland	
Egypt[(a)]	Kosovo			

Note: (a) Treaty initialed/signed/approved, but not yet in force
(b) Terminated by Mongolia with effect as from 1-1-2014
(c) Recently renegotiated/new Protocol ratified

Most important forms of doing business Public limited liability company ("société anonyme - SA"), private limited liability company ("société à responsabilité limitée - S.à r.l.").

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Legal entity capital requirements

SA: minimum share capital of EUR 30,000, 1/4 of which must be paid up at incorporation. Share capital may be represented by bearer and/or registered shares, as well as by voting and non-voting shares, redeemable shares or tracking shares.

SARL: minimum share capital of EUR 12,000 fully paid up at incorporation. Capital is divided into registered shares and may be represented by redeemable shares or tracking shares.

Residence and tax system

Tax resident companies are subject to tax on their worldwide income and non-resident companies are subject to tax on Luxembourg-sourced income.

A company is a tax resident in Luxembourg if its statutory seat or its place of central administration is in Luxembourg.

With effect from January 1, 2019, new provisions on the definition of permanent establishments (PEs) located in treaty countries have been added to Luxembourg Law.

These new provisions state that the treaty definition shall in general prevail and, unless the treaty provides otherwise, a PE shall be recognized if the taxpayer is engaged in an independent activity which participates to the general economic life in the other country.

The Luxembourg tax authorities shall have the right to request the taxpayer to provide a certificate from the foreign tax authorities with regard to the recognition of the foreign PE.

Compliance requirements for CIT purposes

The tax year is the calendar year. Corporate tax returns (including corporate income tax, municipal business tax and net wealth tax returns) are due by May 31 (based on an administrative practice) of the following year (extension to December 31 possible). Advance payments of corporate income tax (CIT) are due quarterly on March 10, June 10, September 10 and December 10. Advance payments of municipal business tax and net wealth tax are due quarterly on February 10, May 10, August 10 and November 10. The amount of the advance payment is based on the latest tax assessment. For certain payments (e.g. dividends), specific withholding tax returns are required.

Corporate income tax rate

For companies with a taxable income above EUR 200,000, the CIT rate is 17 percent. The aggregate rate for these companies in Luxembourg-City is 24.94 percent, including municipal business tax of 6.75 percent and the contribution to the employment fund of 1.19 percent (i.e. 7 percent of the 17 percent CIT rate).

For companies with a taxable income between EUR 175,000 and EUR 200,000, the CIT due is determined as follows: a flat amount of EUR 26,250, plus 31 percent of the income exceeding EUR 175,000 (up to EUR 200,000). In addition, these companies should be subject to municipal business tax of 6.75

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percent (in Luxembourg-City) and to the contribution to the employment fund (7 percent of the CIT rate).

For companies with a taxable income not exceeding EUR 175,000, the CIT rate is 15 percent. The aggregate rate for these companies in Luxembourg-City is 22.80 percent, including municipal business tax of 6.75 percent and the contribution to the employment fund of 1.05 percent (i.e. 7 percent of the 15 percent CIT rate).

Interest limitation

For financial years starting from January 1, 2019, the deduction of exceeding borrowing costs (i.e. the net interest expense, corresponding to the positive difference between deductible interest expense and interest income) of entities subject to CIT is limited to the higher amount of 30 percent of their tax EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) or EUR 3 million.

The definition of interest expenses includes interest expenses on all forms of debt, other costs economically equivalent to interest and expenses incurred in connection with the raising of finance.

The definition of interest income covers taxable interest revenues and other economically equivalent taxable revenues.

Corporate taxpayers under the fiscal unity regime have the option to apply the interest limitation rule on either a tax consolidated or a standalone basis.

Luxembourg taxpayers are able to carry forward, without time limitation, interest expenses exceeding the thresholds and, for a maximum of five years, unused interest capacity.

The net interest expense of stand-alone entities (i.e. not being part of a group of companies) is not limited by this rule.

Long-term infrastructure projects in the EU as well as financial undertakings such as credit institutions, insurance or reinsurance, pension funds, AIFs, UCITS, securitization vehicles (within the meaning of article 2, point (2) of Regulation (EU) 2017/2402), AIFMs and UCITS managers are also excluded from the rule.

Furthermore, loans concluded before June 17, 2016 are excluded from the rule (grand-fathering period), but the exclusion does not extend to any subsequent modification of such loans. In case of a subsequent modification, the grandfathering remains applicable to the original terms of the loans.

Taxpayers that are part of a financial consolidated group may also benefit from an equity escape rule (based on equity comparison between the group and the taxpayer), in order to fully deduct the net interest expense (subject to conditions).

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The current recapture rules have not been modified (e.g. expenses in connection with tax-exempt income remain non-tax deductible).

Withholding tax rates

On dividends paid to non-resident companies

15 percent (may be reduced, even to 0 percent, under applicable treaties or domestic participation exemption regime).

On interest paid to non-resident companies

0 percent (except for profit participating bonds).

On patent royalties and certain copyright royalties paid to non-resident companies

0 percent.

On fees for technical services

No.

On other payments

Yes, on certain payments (e.g. salaries, directors' fees, payments connected to non-residents' literary activities, artists' performances and sports activities in Luxembourg, in certain cases).

Branch withholding taxes

0 percent.

Holding rules

Dividends and liquidation proceeds received from resident/non-resident qualifying subsidiaries

Participation exemption (100 percent) applies (at least 10 percent shareholding or acquisition price of EUR 1,200,000, minimum uninterrupted holding period of 12 months or commitment to hold for 12 months).

Capital gains obtained from resident/non-resident qualifying subsidiaries

Participation exemption (100 percent) applies (at least 10 percent shareholding or acquisition price of EUR 6,000,000, minimum uninterrupted holding period of 12 months or commitment to hold for 12 months).

Tax losses

Carry-forward of tax losses incurred as of January 1, 2017 is limited to 17 years. The older tax losses must be deducted first.

Tax losses incurred between January 1, 1991 and December 31, 2016 can still be carried forward without any time limitation.

No carry-back of tax losses possible.

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Tax consolidation rules/Group relief rules

Yes, for CIT and municipal business tax, but not for net wealth tax purposes. A Luxembourg fully taxable parent share capital company (or a Luxembourg PE of a non-resident share capital company fully subject to a tax comparable to Luxembourg CIT) and its direct or indirect 95 percent subsidiaries (a Luxembourg fully taxable share capital company or a Luxembourg PE of a non-resident share capital company fully subject to a tax comparable to Luxembourg CIT) can, under certain conditions, apply for fiscal integration.

As of the 2015 tax year, "horizontal" fiscal integration is possible, whereby domestic fully taxable share capital companies / a Luxembourg PE of a non-resident share capital company fully subject to a tax comparable to Luxembourg CIT can consolidate under certain conditions without the parent company (which could be a fully taxable Luxembourg share capital company, or a domestic PE of a non-resident share capital company fully subject to income tax comparable to Luxembourg CIT, or a EEA resident share capital company fully subject to income tax comparable to Luxembourg CIT, or a EEA PE of a share capital company, both fully subject to income tax comparable to Luxembourg CIT) participating in the fiscal integration.

Registration duties

A fixed fee of EUR 75 is due upon incorporation of a Luxembourg company, upon amendment of its by-laws and upon transfer of its statutory seat.

When Luxembourg real estate property is contributed to a Luxembourg (or foreign) company in consideration for shares only, registration and transfer duties of 4.6 per cent and 3.4 per cent respectively apply, depending on whether the property is in Luxembourg City. When Luxembourg real estate property is contributed to a Luxembourg (or foreign) company in consideration for shares and debt, the registration and transfer duties range between 7 per cent and 10 per cent (see the following section on transfer duties).

The fixed fee of EUR 75 also applies when the contributed assets/liabilities can qualify as restructuring operation.

Transfer duties

On the transfer of shares

0 percent (provided the company is not a Luxembourg real estate property holding company).

On the transfer of land and buildings

The transfer of Luxembourg 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.

When the acquirer formally declares in the deed of purchase that they acquire the real estate property with the intent to resell, specific rates apply.

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Stamp duties

On any deed that is registered, depending on the size of the document (mainly notarial deeds).

Exit taxation

For financial years starting from January 1, 2020, exit tax rules provide for the taxation of the difference between the fair market value of the assets at the time of transfer less their value for tax purposes in the following cases:

i. asset transfer from a Luxembourg head office to a foreign PE,

ii. asset transfer from a Luxembourg PE to a foreign PE or its head office,

iii. Luxembourg taxpayer transferring its tax residency to another state, or

iv. Luxembourg taxpayer transferring its Luxembourg PE to another state.

For i, ii, and iv, exit taxation occurs insofar as Luxembourg loses its taxation right. For iii, taxation occurs unless a PE is kept in Luxembourg.

The exit tax is not applicable in certain cases (e.g. assets pledged as collateral) of short-term transfers (i.e. when the assets are transferred back to Luxembourg within 12 months).

The Luxembourg taxpayer should be subject to immediate payment of the exit tax, but with a possible payment in linear installments over five years. However, this is only possible for transfers to another EU country or to an EEA country with which Luxembourg or the European Union has concluded a mutual assistance agreement for the recovery of tax debts (i.e. Norway, Iceland and Liechtenstein). This deferral is not subject to a guarantee having to be provided or the payment of late interest.

It should be noted that tax deferrals granted before 2020 (with no time limit based on the previous rules) continue to apply and are not impacted by the new rules.

Controlled Foreign Company rules

For financial years starting from January 1, 2019, controlled foreign company (CFC) rules aim to attribute and tax undistributed profits from a low-taxed foreign subsidiary or PE (i.e. the CFC) at the level of its Luxembourg parent entity/head office. The CFC income will be subject to CIT in Luxembourg (i.e. 17 percent in 2021, plus 1.19% of contribution to the employment fund), but not to municipal business tax.

The rule targets EU and non-EU CFCs if there is a ‘direct or indirect’ participation (together with associated enterprises) of more than 50 percent in voting rights, capital or profit entitlement and if the actual corporate tax assessed and paid by the CFC is less than 50 percent of the CIT that would be due in Luxembourg (i.e. in reference to the 17 percent CIT rate excluding contribution to the employment fund and municipal business tax).

The CFC income is income from non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage. Arrangements are considered non-genuine when the CFC would not own the assets or would

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not have undertaken the risks which generate all or part of its income if it were not controlled by a company (i.e. the Luxembourg company) where the significant people functions linked to these assets are carried out and play an essential role in generating the CFC's income.

CFC income is attributed to the Luxembourg company or head office in proportion to its participation in the CFC but is limited to amounts generated through assets and risks linked to significant people functions carried out by the Luxembourg entity.

The following CFCs should be considered as out of scope of the rules:

- CFC with accounting profits of no more than EUR 750,000.
- CFC of which the accounting profits amount to no more than 10 percent of its operating costs for the relevant tax period.

Transfer pricing rules

General transfer pricing rules

The Luxembourg income tax law makes explicit reference to the arm's length conditions agreed between independent businesses as a standard for evaluating the conditions agreed between related parties. Article 56*bis* of the Luxembourg Income Tax Law (LITL) requires to delineate and document the arm's length character of all intercompany transactions. This means that the arm's length character of all intercompany transactions (not only financing transactions) needs to be documented from a transfer pricing perspective. This standard is applied for both resident and non-resident parties and allows for upward or downward adjustments of profits for transfer pricing purposes.

Moreover, according to a circular for intra-group financing companies (issued on December 27, 2016), a transfer pricing study should - based on a comparability analysis - identify the functions performed, the assets used and the risks related to the intra-group financing activity. The aforementioned circular states that Luxembourg entities performing intermediary, intra-group financing activities should be able to:

- document the arm's length character of the interest rate applied on the Luxembourg entity's intra-group loans;
- perform a comprehensive risk analysis to determine the adequate level of equity that the Luxembourg entity needs in order to support the risks assumed as part of the intermediary, intra-group financing activity;
- document that the Luxembourg entity has adequate organizational substance to control and monitor the risks related to its financing activity; and
- determine the margin to be realized by the Luxembourg entity. The return on equity at risk is the minimum net margin that the Luxembourg entity should realize and should, in principle, be subject to direct taxation in Luxembourg.

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Documentation requirement

Yes.

Thin capitalization rules

In the absence of legal provisions on debt-to-equity ratio requirements, the Luxembourg tax authorities can request an analysis supporting the arm's length nature of the debt-to-equity ratio used in the transactions based on the general transfer pricing principles embedded in Luxembourg tax law and as a result of the OECD Transfer Pricing Guidance on Financial Transactions released in February 2020, which put special emphasis on debt and equity funding of the companies.

General Anti-Avoidance rules (GAAR)

For financial years starting from January 1, 2019 Luxembourg amended its General Anti Abuse Rule (GAAR) according to the Anti-Tax Avoidance Directive (ATAD) 1.

The GAAR targets all non-genuine transactions (not put in place for valid commercial reasons that reflect economic reality) performed in a domestic or a cross-border situation.

It applies to transactions, which having been put in place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances.

Transactions considered as abusive will be ignored by the Luxembourg tax authorities, and taxes will be computed based on the 'genuine route' with regard to all relevant facts and circumstances.

Luxembourg tax authorities will first have to prove that the constituting elements of an abuse are identified. It would then be up to the Luxembourg taxpayer to provide sufficient valid commercial reasons that justify the transaction.

Specific Anti-Avoidance rules/Anti Treaty Shopping Provisions/Anti-Hybrid rules

Yes, with effect from January 1, 2016, an anti-hybrid rule and a general anti-abuse rule have been included in the domestic participation exemption regime for profit distributions derived from participations falling within the scope of the EU Parent-Subsidiary Directive. The general anti-abuse rule also applies to profit distributions made by a Luxembourg fully taxable company to entities falling within the scope of the EU Parent-Subsidiary Directive.

With effect from January 1, 2019, anti-hybrid rules relating to cross-border hybrid mismatches involving hybrid entities, hybrid instruments and structured arrangements within the EU (but not with third countries) have been implemented as part of the ATAD implementation into domestic law.

For financial years starting as from January 1, 2020, the scope of the anti-hybrid rules has been extended to mismatches involving third countries and to the following situations: income allocation mismatches and deemed payments involving PEs, disregarded PEs, imported mismatches, hybrid transfers

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resulting in multiple relief for withholding tax, and dual residency resulting in double deductions.

Anti-hybrid rules target hybrid mismatch outcome (double deduction or deduction without inclusion) arising between associated enterprises or in the context of structured arrangements. The associated enterprise test is met, among others, when some participation thresholds are met either on a stand-alone basis or on an “acting together” basis. Unless otherwise demonstrated, an individual or entity holding, directly or indirectly, less than 10% in the shares/units of an investment fund, and who is entitled to receive less than 10% of the profit of this investment fund, is deemed not to act together with the other investors.

The rule provides that, when a structure includes a hybrid mismatch with a double deduction of a payment, expense or loss in the payer jurisdiction and in another jurisdiction (investor jurisdiction): the deduction shall be primarily denied for the Luxembourg investor, and as a secondary rule if the deduction is not denied for the foreign investor, the deduction shall be denied for the Luxembourg payer. No tax adjustment is required if the deduction is granted to the payer against income that is dual inclusion income.

When a structure includes a hybrid mismatch with a deduction of a payment (in the payer jurisdiction) without a corresponding inclusion for tax purposes (in the payee jurisdiction or any other jurisdiction): the deduction shall be primarily denied for the Luxembourg payer, and as a secondary rule if the payment is deductible for the foreign payer, the payment shall be included in the taxable income of the Luxembourg payee (subject to some exceptions).

Advance Ruling system

Yes.

IP / R&D incentives

The formerly applicable IP regime granting an 80 percent exemption on royalties and capital gains with regard to certain intellectual properties was repealed as of July 1, 2016 (with grandfathering rules until June 30, 2021).

The new IP tax regime follows the OECD nexus approach, took effect from tax year 2018 and provides for an 80 percent tax exemption on net income derived from eligible patents and copyrighted software.

Qualifying IP assets are also exempt from net wealth tax.

Other incentives

Investment tax credits - Incentives for new industrial activities - SICAR - Securitization regime - Investment funds - Reduced subscription tax for investments funds investing in sustainable activities.

VAT

The standard VAT rate is 17 percent, the intermediate rate is 14 percent, the reduced rate is 8 percent and the super-reduced rate is 3 percent.

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Other relevant points of attention	On April 9, 2019 Luxembourg deposited its instrument of ratification for the Multilateral Instrument (MLI) with the OECD. Luxembourg mainly implements the minimum standard provisions that were agreed as part of the BEPS initiative, i.e. the minimum standard for the prevention of treaty abuse (BEPS report on Action 6) and the minimum standard on more effective dispute resolution mechanisms (BEPS report on Action 14). The MLI entered into force on August 1, 2019 and applies to covered tax agreements as from January 1, 2020 at the earliest for taxes withheld at source, and for taxable periods starting as from February 1, 2020 for other taxes.

Source: Luxembourg tax law and local tax administration guidelines, updated 2021.

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