Luxembourg publishes draft tax law reflecting EU-wide changes to Parent-Subsidiary Directive

Executive summary

The European Union (EU) Parent-Subsidiary Directive (PSD)\(^1\) provides for tax exemption of cross-border dividends paid between related companies located in different EU Member States. Member States are obliged to transpose the PSD into their national laws, so that companies based in the EU’s single market of 28 Member States can operate on an equal footing, regardless of where they are established.

In 2014 and 2015 the European Council adopted two amendments to the PSD. Both amendments must be seen in light of the European Commission’s December 2012 Action Plan against tax evasion and tax fraud, and the Organisation for Economic Co-operation and Development’s (OECD) project on Base Erosion and Profit Shifting (BEPS). The first PSD amendment, of July 2014,\(^2\) introduces a rule preventing corporate groups from using hybrid loan arrangements to benefit from double non-taxation under the PSD (the “anti-hybrid rule”).\(^3\) Subsequently, on 27 January 2015, the Council adopted a binding general anti-abuse rule (GAAR) to be included in the PSD.\(^4\) The anti-abuse rule aims at preventing Member States from granting the benefits of the PSD to arrangements that are not “genuine,” i.e., that have been put in place to obtain a tax advantage without reflecting economic reality.\(^5\) Member States have until 31 December 2015 to implement these two amendments into national law.

On 5 August 2015, Luxembourg published a draft law (the Draft Law) which, if adopted, will enact the anti-hybrid clause and the anti-abuse clause. Based on the Draft Law, these clauses will only apply within the intra-EU context.

Luxembourg also took the opportunity to propose a further alignment of Luxembourg law with EU law by introducing the so-called “horizontal tax consolidation” in the Draft Law. If enacted, a tax consolidation will become possible between two or more
Luxembourg-resident companies owned by the same nonresident parent company, provided the parent is a taxable resident of a State of the European Economic Area (EEA). Other proposed amendments are an increased scope of the investment tax credit (in particular for the maritime sector), the extension of the benefit of the tax deferral for certain migrations (triggering exit taxation) from Luxembourg to any tax treaty country, and the extension of the tax credit for hiring unemployed persons until 31 December 2017.

Detailed discussion

Transposition of the latest amendments to the PSD

In order to implement the anti-hybrid rule into Luxembourg legislation, the Draft Law amends the Luxembourg participation exemption regime for dividends received from qualifying EU subsidiaries. Luxembourg law sets out the general conditions under which the income (dividends) derived from such a qualifying EU participation is tax exempt at the level of the Luxembourg recipient. Pursuant to the proposed amendments, the Luxembourg tax exemption for income derived from an otherwise qualifying EU subsidiary will not be applicable to the extent that this income is deductible by the EU subsidiary. It should be noted that this new anti-hybrid rule will only apply within the EU, i.e., it is not applicable to hybrid arrangements between a Luxembourg entity and a non-EU parent or subsidiary.

Copying the wording as adopted by the Council on 27 January 2015, the Draft Law also introduces an anti-abuse clause. It provides that:

(i) The participation exemption for income from qualifying EU subsidiaries, and
(ii) The exemption from Luxembourg dividend withholding tax to income (dividend) distributions to qualifying EU parent companies of a Luxembourg company, are not applicable if the income is allocated in the context of “an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the PSD, are not genuine having regard to all relevant facts and circumstances.” In line with the Council’s resolution, the Draft Law continues by stating that “an arrangement, which may comprise more than one step or part, or a series of arrangements, shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.”

If adopted, these provisions will become effective for income allocated after 31 December 2015.

Amendments to the tax consolidation regime

On 12 June 2014, the Court of Justice of the European Union (CJEU) issued its ruling on the compatibility of the Dutch fiscal unity regime in light of the so-called freedom of establishment. As it is the case in Luxembourg, the regime does not allow two Dutch subsidiary (sister) companies held by a parent company in another Member State to form a fiscal unity between them. The CJEU ruled that this constitutes a restriction of the freedom of establishment, for which no valid justification is available.

Luxembourg law currently provides for the “vertical tax consolidation,” i.e., a tax consolidation between two or more Luxembourg resident companies owned by the same Luxembourg resident parent-company or by the same Luxembourg permanent establishment of a nonresident company which is fully liable to a tax corresponding to the Luxembourg corporate income tax. The Draft Law proposes to align the Luxembourg tax consolidation regime with this CJEU decision by introducing the possibility of a so-called “horizontal tax consolidation.” The horizontal tax consolidation is a consolidation between two or more Luxembourg resident companies owned by the same nonresident parent, provided the parent company is resident in a State of the EEA. New is also that Luxembourg permanent establishments of companies resident in a Member State of the EEA and fully liable to a tax corresponding to Luxembourg corporate income tax may enter into a tax consolidation. Currently, only Luxembourg-resident capital companies are eligible to be part of a tax consolidation group.
Other proposed amendments

In 2014, Luxembourg enacted legislation that allows companies transferring (migrating) out of Luxembourg to defer the normally applicable exit taxes. It introduced the possibility to opt for a payment deferral, without interest becoming due, of the tax normally due upon transfer of (i) the statutory seat and place of effective management of a resident company and of (ii) a Luxembourg permanent establishment to another Member State of the EEA. Further to the Draft Law, the benefit of this tax deferral will be extended to migrations to any country which is not within the EEA provided that this third country has concluded a double taxation treaty with Luxembourg containing a clause allowing the exchange of information in line with the OECD principles. In the absence of such clause, the existence of a bi- or multilateral agreement ensuring the exchange of information according to the OECD standards is required. It is also proposed to enlarge the scope of the tax credit for investments, especially for the maritime sector. Upon certain conditions, the benefit of the tax credit is to be extended to the lessor for vessels used in international traffic.

Finally, given that the labor market situation remains tight, the draft law extends the benefit of the tax credit for hiring unemployed persons to 31 December 2017.

Endnotes

1. Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.


6. The EEA includes the EU Member States and also Iceland, Liechtenstein and Norway.

7. SCA Group Holding BV and others, Joined cases C-39/13, C-40/13 and C-41/13; see EY Global Tax Alert, *EU Court of Justice holds Dutch fiscal unity regime contrary to EU law in SCA-Holding case*, dated 12 June 2014.
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