



LUXEMBOURG

Luxembourg Tax Update

TAX

AGENDA

- ◆ Individual taxation
- ◆ Corporate taxation
- ◆ Jurisprudence – Luxembourg Tax Court
- ◆ Jurisprudence – European Court of Justice
- ◆ Outlook for 2008/2009
- ◆ Q&A
- ◆ Cocktail



Individual Taxation

Tax classes and tax credit for children

- ◆ Abolition of the specific tax classes for taxpayers with dependent children
- ◆ Remaining tax classes: 1, 1A and 2
- ◆ Payment in cash of the tax credit (“boni pour enfant”) amounting to EUR 922.50 per child per annum, irrespective of the taxable income of the parents
- ◆ The number of children is still considered to determine the ceilings for deductions (debit interest, life insurance premiums, etc...)

Tax classes and tax credit for children

◆ Principles

- The equivalent of the tax credit is paid in cash to the taxpayer by the “Caisse nationale des prestations familiales” in the case where children are entitled to child benefits in Luxembourg
- The tax credit is granted to the taxpayer through the assessment of the tax return / tax reclaim in the limits of the income tax due in the case where children are not entitled to child benefits in Luxembourg

2008 Tax rates and brackets

- ◆ Increase of the tax brackets by 6%
- ◆ Marginal tax rate remains unchanged at 38.95% (including the 2.5% surcharge for unemployment)
- ◆ New withholding tax rates applicable to additional remuneration (holders of a second tax card)
 - Tax class 1 – Rate : 30%
 - Tax class 1a – Rate : 18%
 - Tax class 2 – Rate : 12%

Joint taxation for partners

- ◆ **Principle: joint taxation (tax class 2) for partners upon request**
- ◆ **Beneficiaries**
 - Resident and non-resident taxpayers
 - Taxpayers linked by a civil partnership contracted in Luxembourg or abroad during the whole tax year
- ◆ **Procedure**
 - The joint taxation is requested through the completion of the tax return
 - Not possible to obtain the tax class 2 on the tax card

Article 157ter LIR (non residents)

- ◆ **Amendment of the optional tax regime for non-resident taxpayers**
- ◆ **Possibility for non-resident taxpayers to claim for the deduction of their mortgage interests on their principal residence**
- ◆ **Conditions:**
 - At least 90% of the taxpayer's professional income deriving from Luxembourg (50% for Belgian tax-residents)
 - All foreign income need to be included for the calculation of the global tax rate (vs. only foreign professional income previously)

Overtime

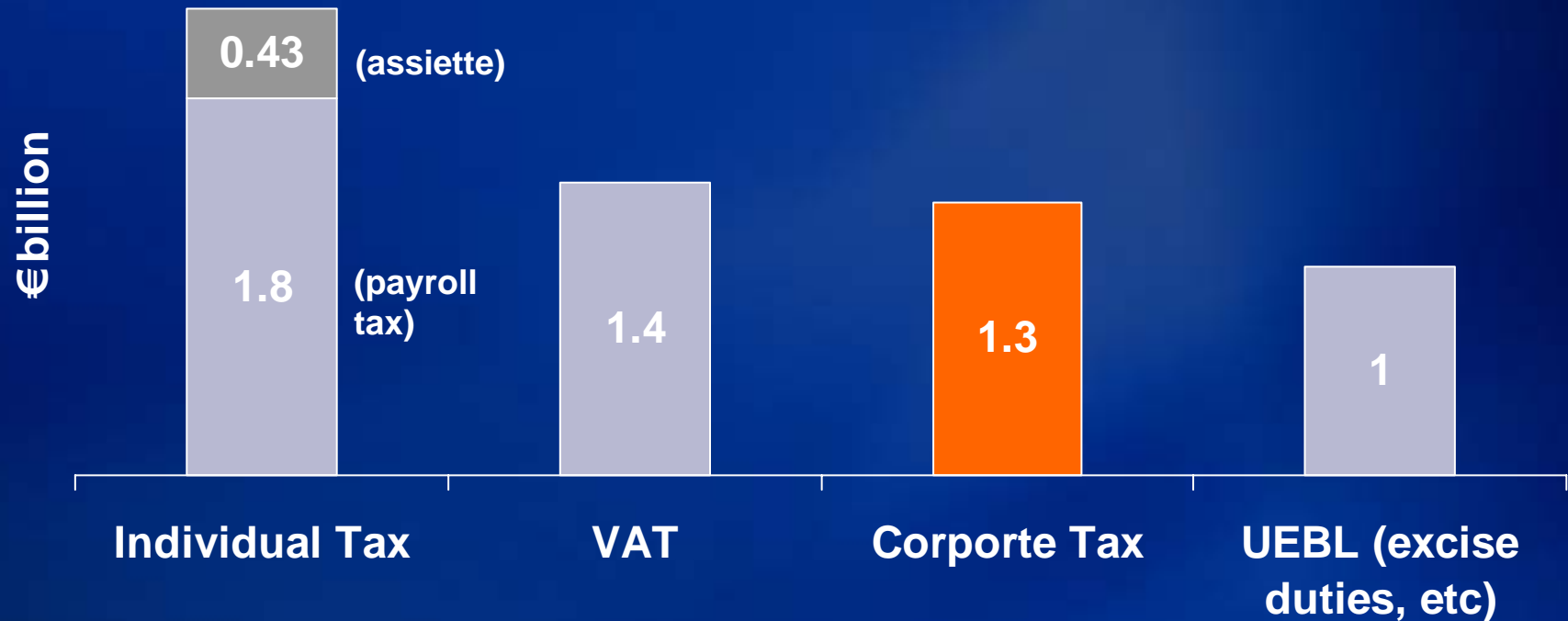
◆ Principle: Exemption of overtime hours

- Applicable to overtime reported to the Employment Administration (art. L.211-23 of Luxembourg Labor Law)
- Full exemption for all employees for work at night, on Sundays and public holidays
- Full exemption for standard overtime for employees covered by the “Statut Unique”, e.g. all employees of the private sector
- Exemption capped at EUR 1,800 per annum for employees not covered by the “Statut Unique”, e.g. public civil servants

Corporate Taxation

2007 Final Budget

"Recettes" (out of a total of app. €8 billion)



Investment Tax Credit

- ◆ Investment tax credit on additional investment increased from 10 to 12% of the eligible additional investment
- ◆ Applies in addition to (and in a similar way to) the credit on gross investment
- ◆ Applies to investments in depreciable tangible goods other than buildings, software, personal cars, mineral deposits and fossil fuels

Intellectual Property

- ◆ **New article 50*bis* LIR**
- ◆ **80% exemption on net positive income from certain types of IP (including software copyrights, patents, trademarks, service marks, designs, model...)**
- ◆ **Effective corporate tax rate of 5.93% on qualifying net IP income**
- ◆ **Also applicable to internet domain names**
- ◆ **Copyrights of literary or artistic works, plans, secret formulae or processes are not covered**
- ◆ **80% exemption also applies to net capital gains realized on qualifying IP**

Intellectual Property (cont.)

- ◆ 80% deemed income deduction for self-developed patents
- ◆ Law also applies to qualifying IP not yet patented, but for which an application process has been started
- ◆ Recapture system
- ◆ Anti-abuse provisions
- ◆ Simple valuation methods for small and medium size businesses
- ◆ Law introduces a common rule; it is not an optional regime

Intellectual Property (cont.)

◆ Limitations of the law

- IP acquired or developed after 31 Dec 2007
- Expenses, amortizations, write-downs economically related to the IP must be capitalized on the company's balance sheet and included in the profit/loss account as from the first fiscal year the company wishes to benefit from the deemed IP deductions
- Exemption generally does not apply to IP acquisitions involving directly related companies where there is common and direct ownership between them of at least 10%:
 - If either seller / buyer companies are direct owners of each by at least 10%
 - If both seller / buyer companies are directly owned 10% or more by same common parent
- IP acquisitions between indirectly owned companies are covered by the law

Double Tax Treaties

- ◆ **Currently 51 tax treaties in force**

- ◆ **Treaties entered into force**

- Latvia, Lithuania, San Marino (1.1.2007)
- Estonia (1.1.2008)
- France (protocol – 1.1.2008)

- ◆ **18 tax treaties pending**

- *approved*: Argentina (air traffic), Ukraine
- *signed*: Azerbaijan, Hong Kong, Kuwait, Moldavia, United Arab Emirates
- *initialed*: Bahrain, Cyprus, Georgia, Kazakhstan, Qatar
- *negotiations*: Barbados, India, Lebanon, Pakistan, Serbia & Montenegro, United Kingdom (renegotiation)

Capital Duty & VAT

◆ Capital duty

- Reduction from 1% to 0.5% as from 1.1.2008

◆ VAT

- Super-reduced 3% rate (currently applicable to the reception and TV broadcasting services) similarly applies to fees paid to “tele-distributors”
 - Covers both the content as well as the mere transmission
 - Mode of transmission irrelevant

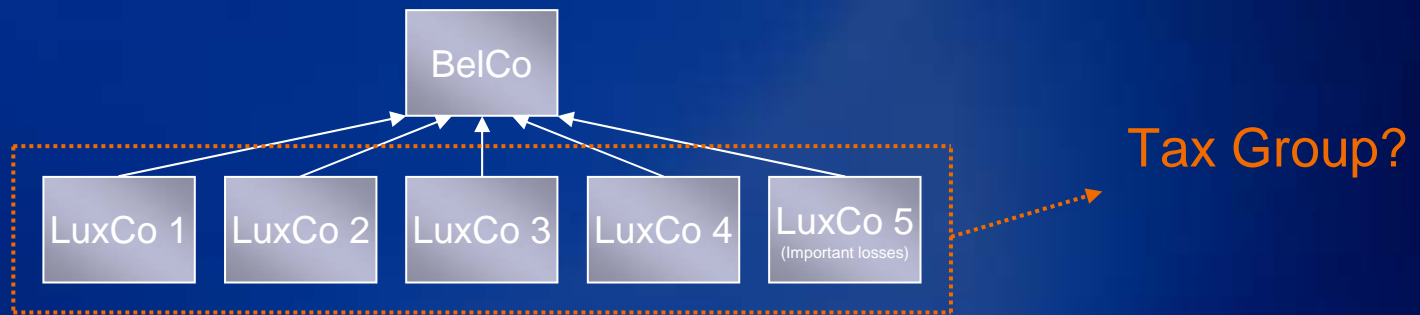
Law of 21 Dec 2007 (app. as from 1.1.2007)

- ◆ **Implementation of amended Merger Directive**
 - Extension of the current regime to SEs / SCEs as well as to companies that are corporate taxpayers in their State of residence but are considered fiscally transparent by other Member States
 - Reduction of the minimum holding percentage to qualify for a tax exemption on capital gains accruing to the absorbing company on the cancellation of its holding in the transferring company from 25% to 10% (art 171 §3 LIR).
- ◆ **Extension of the benefits of both the Merger and Parent-Subsidiary Directives to qualifying entities of the European Economic Area (EEA) that are subject to income tax at a rate comparable to the Luxembourg income tax rate**
- ◆ **Recognition of the company status of co-operatives including the SE under Luxembourg tax law (art 159 LIR)**
- ◆ **Implementation of Directive 2006/98/CE, extending the application of the main tax Directives to Romania and Bulgaria further to their accession to the European Union as of 1 January 2007.**

Jurisprudence Luxembourg Tax Court

Tax Group – Case 19879

- ◆ Luxembourg Tax Authorities refuse tax group on the basis of the Luxembourg Law



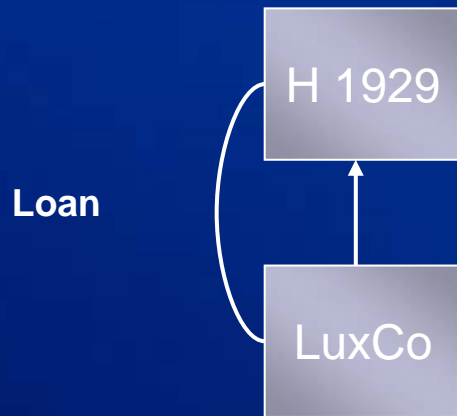
- ◆ Luxembourg Administrative Tribunal accepts tax group:
 - Reject tax group is contrary to the double tax treaty. It would consist in treating the Luxembourg subsidiary worse only because the parent is non-resident

Tax Group – Case 19879

- ◆ **Luxembourg Administrative Court refuses tax group:**
 - Luxembourg companies cannot form tax group between subsidiaries either, i.e. no horizontal tax grouping possible for subsidiaries
 - The Court rejects appeal before the European Court of Justice (ECJ): the claimant is wrongly assuming that the Luxembourg Law allows tax grouping of Luxembourgish subsidiaries of a resident parent company and prohibits this same tax grouping of Luxembourgish subsidiary companies with a non-resident parent company
- ◆ The group appeals to the European Commission (EC) for violation of European Law

Hidden Distribution – Case 21466

No information on ultimate beneficiaries



- ◆ **The Luxembourg Tax Authorities re-qualify the loan as “hidden contribution”, thus**
 - Interest payments are not deductible
 - Withholding tax has to be applied on interest payments
 - The loan is non-deductible for net wealth tax purposes

Hidden Distribution – Case 21466

- ◆ **The Administrative Tribunal accepts that loan does not constitute “hidden capital” and confirms at arm’s length interest rates and risk bonus rates:**
 - There is no hint that the loan would not be reimbursed one day
 - The company has equity of 30%
 - Interest rate equaling EURIBOR is acceptable
 - Exceeding amount qualifies as risk bonus
 - Risk Bonus of 0.5%-2% is acceptable (Tribunal does not indicate legal basis)
 - Effective bonus: higher than 2%
 - Excess of 2% constitutes a “hidden distribution”
- ◆ **This judgment has been taken to Court of Appeal (Case No. 23.053C)**
 - Risk bonus of 1.7% is acceptable

Hidden Dividend Distribution – Case 22777

- ◆ A Luxembourg company pays two bills from its Lebanon parent company for services related to research and development
- ◆ The Luxembourg Tax Authorities refuse the deductibility of the bills as costs, qualify the amount as a hidden dividend distribution and ask for a 25% WHT on the amount
- ◆ According to the Luxembourg Administrative Tribunal, the Luxembourg Tax Authorities may consider that there is a decrease of the Luxembourg company's profits and there is a hidden distribution if the circumstances allow for such an argument without having to justify every single aspect. In other words, the taxpayer is left with no other choice but to prove that the criteria of a profit decrease or hidden distribution are not met.
- ◆ Since the taxpayer does not provide any proof, the claim is rejected

Chamber of Commerce Fees – Case 22636

- ◆ In 2007, the parties involved in the “Gondwana Case” refuse to pay the Luxembourg Chamber of Commerce Fees
- ◆ Every Luxembourg trade or business, company or individual, however, is liable to the Luxembourg Chamber of Commerce. This liability, 0.2% tax on the commercial profit, without the possibility of reporting financial losses, is governed by the law of 4 April 1924
- ◆ The law provides that the assessment and levying procedure of the fees has to be fixed by a Grand-Ducal decree. This decree, however, had not been published at the time of the decision

Chamber of Commerce Fees – Case 22636

- ◆ **The assessment and levying procedure are based on the internal statutes of the Luxembourg Chamber of Commerce and agreed-upon administrative practice**
- ◆ **The Administrative Tribunal held that:**
 - Since there is no legal basis and no Grand-Ducal decree, the assessment and levying procedure are unlawful.
 - The provisions on the assessment and levying procedure as defined in the 1924 law are not sufficiently detailed to be directly applicable
- ◆ **The Chamber of Commerce will appeal against the decision on 31 January 2008 (Case No. 23.755C)**
- ◆ **Luxembourg has issued a Grand-Ducal decree on 21 December 2007**

Deductibility of Commissions

Cases 21330 / 23068C

- ◆ A Luxembourg company pays commissions to sales agents, e.g. foreign off-shore companies or companies not identified in the social accounts of the company, for attracting business within the framework of domiciling companies
- ◆ In 2005, the Luxembourg Tax Authorities consider these commissions to be disputable in the tax returns of 2000, 2001 and 2002
 - What is the actual counterpart of the commission?
 - To whom and how is the commission paid?

Deductibility of Commissions

Cases 21330 / 23068C

- ◆ **In line with §§ 204, 205 AO, the Luxembourg Tax Authorities ask the company to enumerate the beneficiaries and actual amounts of the commissions paid**
 - The Luxembourg company provides the Luxembourg Tax Authorities with an amended version
 - The Luxembourg Tax Authorities consider the information as insufficient and apply the sanction of non-deductibility of these commissions
- ◆ **In 2007, the Luxembourg Administrative Tribunal, in line with Article 45 LIR, disagrees with the Luxembourg Tax Authorities and qualifies the commissions as deductible expenses. In line with §§ 170, 171 AO, however, the Luxembourg Tax Authorities are allowed to require a detailed analysis of the commission payments from the Luxembourg company**

Jurisprudence European Court of Justice

Jäger (C-256/07 – 17 January 2008)



Germany



France

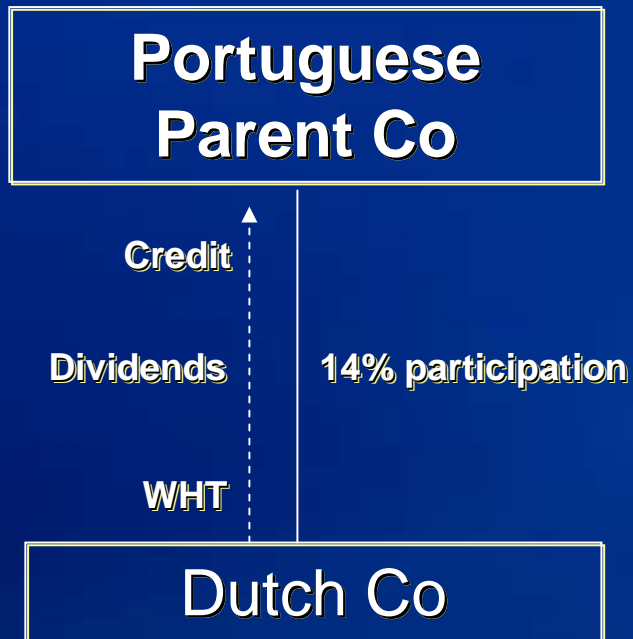
Immovables in Germany have lower taxation value than immovables in France

ECJ Decision:

- ◆ Restriction of freedom of capital that is not justified

Amurta case (C-379/05 – 8 November 2007)

Facts:

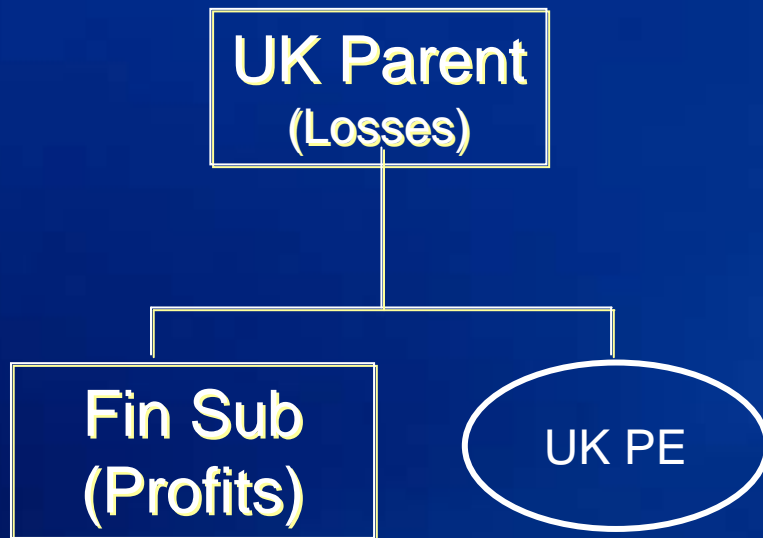


ECJ Decision:

- ◆ Dutch rules violate the free movement of capital
- ◆ A full tax credit in the other member state does not eliminate the restrictive nature of these rules
- ◆ The discriminatory character may be neutralized through the conclusion of a DTT. It is the role of the referring court to answer whether the DTT should be taken into account

Oy AA (C-231/05 – 18 July 2007)

Facts:



- ◆ A Finnish company may transfer profits as a “group contribution” to another Finnish group company (>90% subsidiary, parent, sister).
- ◆ Such contribution is deductible from the taxable income of the contributing company and added to the taxable income of the recipient company.
- ◆ Is the application limited to resident companies a restriction on the EU freedom of establishment?

Oy AA (C-231/05 – 18 July 2007)

- ◆ **Preliminary note: a group contribution system is different from a group relief system:**
 - Transfer of profits
 - No requirement that recipient company bears / will bear losses (even though the system is essentially used for offsetting losses)
 - Recipient company may be a 90% parent, subsidiary, or sister company

Oy AA (C-231/05 – 18 July 2007)

ECJ decision:

1. **Finnish group contribution system consists of a restriction of the freedom of establishment**
2. **Though such restriction is justified by, taken together:**
 - The need to protect « the balanced allocation of power to impose taxes between Member States »: companies should not be given the choice as to where to subject to tax their profits
 - The need to prevent tax avoidance, particularly the organization of business activities, by means of purely artificial arrangements, in such a way that profits are transferred to companies, created for that purpose, in another Member State where they would be taxed at a lower rate or be tax exempt

In respect of the “need to prevent losses being used twice”, accepted in the Marks & Spencer case, the ECJ simply stated here that the Finnish system does not concern the deductibility of losses.

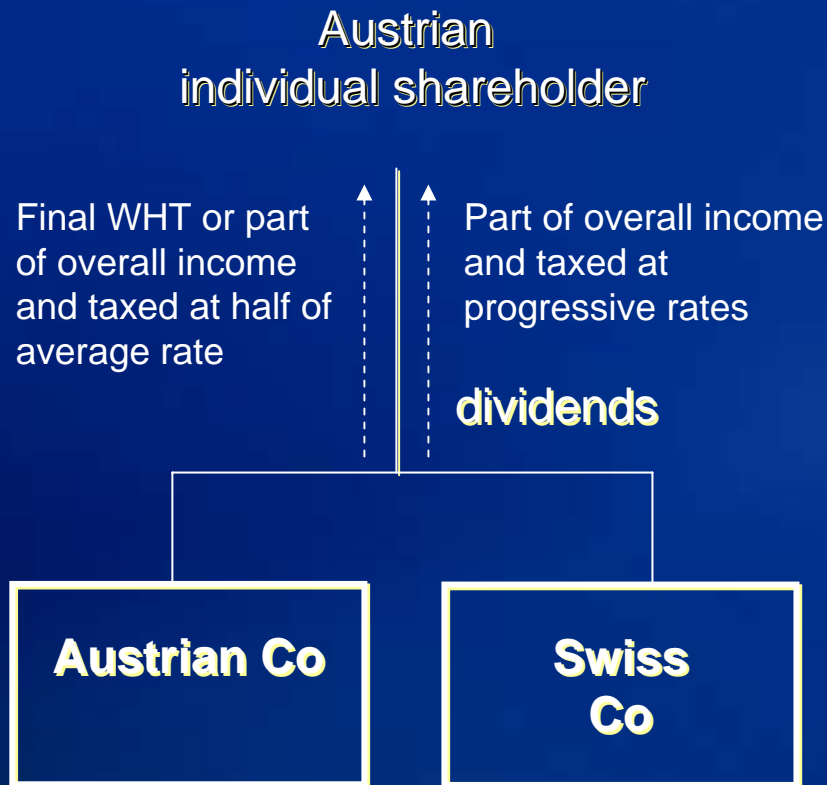
Oy AA (C-231/05 – 18 July 2007)

3. Such justified restriction is also proportionate to the objective pursued by it:

- Even though the rules are not specifically designed to prevent purely artificial arrangements,
- To allow deduction of a cross-border contribution under conditions related to the tax treatment in the recipient Member State or to the existence of losses incurred by the recipient company, would nevertheless mean that the choice of the Member State of taxation would be a matter for the group of companies, which would have a wide discretion in that regard.

Holböck (C-157/05 – 24 May 2007)

Facts:



- ◆ Intended scope of the Austrian rules (applicable until 1 April 2002): all shareholdings
- ◆ Participation of 2/3 of the shares in the present case
- ◆ Insofar as freedom of establishment applies, it does not affect a holding in a non-EU (Swiss) Co.
- ◆ Insofar as free movement of capital applies, it does not affect the application of the Austrian pre-1994 rules to direct investment

Lasertec (C-492/04 – 10 May 2007)

Facts:



- ◆ Intended scope of the German thin cap rules: substantial shareholdings only
- ◆ Substantial shareholding in the present case
- ◆ Consequently, freedom of establishment applies. However, no application in present case of participation by a non-EU (Swiss) Co.

Application of the freedoms to movements to/from third countries

Intended scope of the tax provision?

Substantial
shareholdings only

All
shareholdings

Shareholding in the present case?

Substantial
shareholding

Minor
shareholding

Freedom of establishment
applies

Free movement of capital
applies

Application of the freedoms to movements to/from third countries

Freedom of establishment applies

Within EU

1. **Restriction / Discrimination**
2. **Not justified**
3. **Or justified but not proportional**

Prohibited

Between EU and non-EU

Restriction / Discrimination

Allowed

Application of the freedoms to movements to/from third countries

Free movement of capital applies

Within EU

1. Restriction / Discrimination
2. Not justified
3. Or justified but not proportional

Prohibited

Between EU and non-EU

1. Restriction / Discrimination
2. Effective after 1994
3. Not justified (*)
4. Or justified but not proportional (*)

1. Restriction / Discrimination
2. Effective prior to 1994
3. And related to direct inv., establishment, fin. services or admission of securities

Allowed

Outlook 2008/2009

Shopping list

- ◆ Abolition capital contribution
- ◆ Abolition net wealth tax
- ◆ Initiative extension 147 LIR
- ◆ Eliminate conditions 166 LIR
- ◆ Enlargement of investment tax credit
- ◆ Deductible reserve for future investments
- ◆ Notional interest deduction
- ◆ VAT grouping
- ◆ Administrative simplification
- ◆ Reduction in nominal tax rate (broaden the base)
- ◆ Reduction withholding tax rate on dividends 10 %
- ◆ Reduce taxe d'abonnement on funds
- ◆ Functional currency

Prioritizing criteria

Objective: enhance competitiveness and source additional tax income by attracting new business

- Simplification
- Modernization of tax system
- Raise effectiveness of public services
- Coherent strategy to attract investments
- Limit the investment (budgetary impact) / maximizing return

Brainstorming actions

- ◆ Abolition of capital taxes (+- Mio 150 €)
- ◆ Functional currency
- ◆ Align 147 LIR and 166 LIR
- ◆ Find onshore replacement Holding 29 / attract finance vehicles / enhance private banking
- ◆ Carried interest private equity business
- ◆ Alternative minimum tax

In progress for 2008

- ◆ **Cooperation VAT- Income Tax Authorities – Ministries**
- ◆ **Self assessment system**
- ◆ **IFRS and tax implications**
- ◆ **OECD transfer pricing rules**
- ◆ **Savings directive 15% - 20%**
- ◆ **Process of review of the savings directive**

Q&A



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