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Luxembourg Certain Tax issues for corporations

Luxembourg is not a tax haven but it offers interesting tax regimes for corporate structures who can benefit from participation exemption, attractive taxation of intellectual property, securitisation and venture capital.

It also has a well developed network of double tax treaties[1] as it has entered into close to 60 double taxation treaties based , for most of them, on the model convention worked out by the OECD, and its company law is perceived as being extremely flexible.

Companies which are liable to corporate taxation (public limited liability companies (société anonyme); private limited liability companies (société à responsabilité limitée); partnership limited by share (société en commandite par actions)) are subject to corporate income tax law, to municipal business tax, to wealth tax and to subscription tax at the chamber of commerce of an annual minimum amount of 70,-eur for a private limited liability company and 140,-eur for a public limited liability company (subject to an additional amount based on 0,02% the commercial profits of the year n-2) .

Corporate income tax is governed by the Income Tax Law of 4 December 1967 *("Loi concernant l'impôt sur le revenu "LIR")* and municipal business tax is governed by a law dated 1 December 1936.

These two corporate taxes are levied at a combined rate of 28.59% (corporate income tax is levied at a rate of 21% and municipal business tax is levied at a rate of 6.75% in the city of Luxembourg.) and are applied to the worldwide income, subject to applicable double tax treaties.

Wealth tax is governed by two laws of German origin and dated 16 October 1934.

In the context of the financial crisis, it has been announced that the a minimum flat tax for companies that do not pay tax of 1.500 EUR will be introduced and only due for companies investing for up to 90% in financial assets but the law has not yet been enacted.

Banking secrecy

Under Luxembourg banking secrecy, the tax administration is prevented from asking information pertaining to income or assets of a given taxpayer to a bank and to other financial intermediaries. However in order not to be considered by the OECD as an uncooperative country Luxembourg has accepted to grant exchange of information on demand under double tax treaties, according to OECD standards even if information has to be given by a bank by a law dated 31 March 2010.

1 Afrique du Sud, Allemagne, Autriche, Arménie, Azerbaijan, Belgique, Brésil, Bulgarie, Canada, Chine, Corée, Danemark, Espagne, Estonie, Etats-Unis d'Amérique, Etats Arabes Unis, Finlande, France, Georgie, Grande-Bretagne, Grèce, Hongrie, Hong Kong, Inde, Indonésie, Irlande, Islande, Israël, Italie, Japon, Lettonie, Lituanie, Malaisie, Malte, Maroc, Maurice, Mexique, Moldavie, Mongolie, Norvège, Ouzbékistan, Pays-Bas, Pologne, Portugal, Quatar, Roumanie, Russie, Saint Marin, Singapour, Slovaquie, Slovenie, Suède, Suisse, République Tchèque, Thaïlande, Trinité et Tobago, Tunisie, Turquie, Vietnam.

Intellectual property rights

By a law dated 21 december 2007 tax measures were introduced to render investments in intellectual property rights quite attractive.

The provisions introduced by this law concern income generated by the use or licensing for use and also capital gains resulting from the sale of the following intellectual property rights (IPR):
Copyright applicable to software (all other copyrights are excluded);

Patents;

Trademarks;

Domain names;

Designs and models.

This law (introducing article 50bis (1) LIR grants an exemption on 80% of income generated from the use or licensing of use of an IPR and applies to net positive income and net losses remain deductible subject to recapture rules. In case of sale up to 80% of the capital gains are exempted (subject to recapture of the losses meaning that the capital gains remain taxable for 80% of deducted ansd not compensated losses).

The law also applies to a taxpayer who has personally created a patent and uses it for its own activities. This deduction only applies to patents.

These favourable tax provisions are subject to the following conditions:

1. *an IPR mentioned in article 50bis LIR (see above)*
2. *an IPR acquired or self-developed after December 31st, 2007*
3. *an IPR not acquired from an associated company*

The term “associated company” is expressly defined in article 50bis LIR as:

- the company which holds a direct participation of at least 10% in the share capital of the beneficiary of the IPR income;
- the company of which at least 10% of the share capital is directly held by the beneficiary of the IPR income;
- the company of which at least 10% of its share capital is directly held by a third company which holds itself at least 10% in the share capital of the beneficiary of the IPR income.

Soparfi

Soparfi stands for financial participation company although the participation exemption is available to all Luxembourg companies. The Soparfi regime is to be read in conjunction with the wealth tax participation exemption.

The participation exemption is available to Luxembourg fully taxable companies and to certain permanenent establishments of foreign companies. A direct participation of the parent in its subsidiary is required and the owner must have full ownership of the relevant shares.

1. Incoming dividends

The incoming dividends benefit of the participation exemption in case of cumulative conditions related to the qualification of the subsidiary, the participation threshold and the holding period are met (participation exemption - article 166 CIT).

Qualification of the subsidiary

The subsidiary must be either (i) a Luxembourg fully taxable resident company non mentioned into the list of the parent-subsidiary directive, or (ii) a company listed into the parent-subsidiary directive, or (iii) a non resident company having capital divided into shares subject to a similar tax treatment of the Luxembourg corporate income tax in its jurisdiction of residence.

The tax authority considers that the condition of a similar tax treatment requires a foreign corporate income tax rate being at least half of the Luxembourg corporate income tax rate (i.e. 10,5%) and a tax basis determined by the application of rules similar to these existing in Luxembourg.

Participation threshold

The participation must be of (i) at least 10% in the share capital of the subsidiary or (ii) the acquisition price must be of at least 1.200.000,-eur. This criteria must remain satisfied over all the holding period.

Holding period

At the time of a distribution of dividends, (i) the participation must be held for at least a continued period of 12 months or (ii) the parent company must commit itself to respect this condition in the future.

2. Capital gains and liquidation surplus

The capital gains and liquidation surplus paid by the subsidiaries to the Luxembourg parent company also benefit of the participation exemption in the respect of the same conditions and rules that above mentioned for incoming dividends (qualification of the subsidiary - participation threshold - holding period) (article 166 CIT and règlement grand-ducal as of December 21, 2000).

Rem: the alternative criteria of the acquisition price with regard to the participation threshold condition must be of at least 6.000.000,-eur in case of a capital gain.

Withholding tax exemption

The out-coming dividends benefit of the exemption of the Luxembourg withholding tax on dividend at the rate of 15% of the gross amount under conditions concerning the participation threshold and the holding period for which same rules that for incoming dividends apply (see above) and concerning the qualification of the beneficiary, which must be (i) a Luxembourg fully taxable resident company having capital divided into shares, (ii) a company benefiting from the parent-subsidiary directive, (iii) a public entity, (iv) a permanent establishment of an EU company, (v) a permanent establishment of a company having capital divided into shares enjoying treaty protection, (vi) a Swiss fully taxable company having capital divided into shares (v) a non resident company having capital divided into shares enjoying treaty protection subject to a similar tax treatment of the Luxembourg corporate income tax in its jurisdiction of residence (article 147 CIT).

Holding 1929 regime

On December 31, 2010, the privileged tax status of Holding 1929 shall be definitively abrogated with consequence that the companies benefiting of this tax regime shall become as of January 01, 2011 fully taxable resident companies in the scope of Luxembourg corporate income tax law subject to a taxation of their commercial profits (incoming dividends, royalties for the license of trademarks, interests etc.) at the global rate of 28,59%.

Additionally, these companies being taxable entities shall benefit of the protection of double tax treaties as well as of the parent-subsidiary directive, while as holding 1929 the companies were formally excluded.

Familiy estate management companies (SPF)

Following the abolishment of the 1929 holding company tax regime , and in order to enable holding companies involved in the earea of private wealth management to continue to operate, the legislator introduced on 11 May 2007 the Family Estate Management company (SPF Société de gestion de Patrimoine Familial).

1. ***Authorised activities***

The exclusive object of a SPF is the acquisition, the detention, the management and the realisation of financial assets [2], all commercial activities being excluded.

Furthermore, interest free advances can be granted as an accessory activity by the SPF to a direct participation and in the same way guaranties can be granted to such a subsidiary.

2. By financial assets is being understood: financial instruments (including shares in companies and other securities equivalent to shares in companies) and all cash and assets of any kind which can be held on an account.

2. Eligible investors

The eligible investors (shareholders) must be (i) natural persons acting in the frame of the management of their private assets (ii) or patrimonial entities which act exclusively in the interest of private assets of one or several natural persons (iii) or finally an intermediary who acting for the account of investors.

The concept of “patrimonial entity” means trusts, private foundations, fiduciaries and all similar entities having as an object or function management of all or part of the private asset of natural persons with the exclusion of all companies or commercials enterprises.

3. Tax regime

Direct taxation
Preliminarily, the SPF is formally excluded from the benefit of the protection of double tax treaties.
This exclusion is motivated by the fact that (as for a holding 1929) the incomes (dividends, capital gains, interests etc.) of the SPF are exempted from corporate income tax and its business wealth is excluded from wealth tax, respectively no withholding tax applies on interests (subject to the saving directive) and dividends paid by the SPF.

Indirect taxation
From a VAT point of view, the SPF is not a taxable person.
From a subscription tax point of view, the SPF is submitted to the annual subscription tax fixed at 0,25% of the paid up share capital increased, if applicable, by the issue premium and part of the debts under what ever form their have, which exceed eight times the paid up capital and issue premiums (debt equity ratio) limited to a minimum of 100,-eur and a maximum of 125.000,-eur.

Finally, it has to be noted that if during a tax year at least 5% of the total amount of incoming dividends of the SPF comes from non resident participations which are not registered with a Stock Market Exchange and not subject to a similar tax treatment of the Luxembourg corporate income tax in their jurisdiction of residence, the SPF is excluded of the benefit of the derogatory tax regime for the tax year in question with consequence the taxation of its incomes and its business wealth as a fully taxable company.

Venture capital companies (SICAR)

A law of 15th June, 2004 has introduced venture capital companies (*sociétés d'investissement en capital à risque SICAR*) into Luxembourg law.

The participation exemption often proved impracticable as investments in venture capital companies did not always meet the substantial participation test required for the capital gains exemption (a participation of at least 10% or an acquisition value of the participation of a minimum of €6 million).

Companies which invest in ventures carrying a high risk of volatility or liquidity with a view to sustaining their development and their possible IPO, may benefit from the SICAR law.

To be governed by the SICAR law, the venture capital company has to opt specifically for its application by including a corresponding reference in the corporate object clause of its articles of association.

Venture capital companies are open only to institutional investors and professional investors and investors either (i) adhering in writing to the status of qualifying investor and which invest at least €125,000 in the venture capital company or (ii) providing a certificate from a credit institution, a professional from the financial sector or a management company confirming that he/she has the necessary expertise to appraise correctly the risks of venture capital investments.

The law does not impose conditions in terms of risk diversification.

A minimum share capital of €1 million must be reached, at the latest 12 months after the SICAR has been agreed by the Luxembourg banking supervisory authorities. It is possible to provide for a variable share capital in the articles of association of the venture capital company, except where it is established as a limited partnership (*société en commandite simple*).

The SICAR is not subject to corporation tax on income generated by the securities held by it or to capital gains on the disposal of these securities. It does not matter whether these securities are in the form of shares, other equity instruments or bonds. Losses on investments are consequently not tax deductible. Short-term investments in liquid assets, immediately prior to the acquisition of targets, are ignored if cash or cash-equivalent instruments are held for less than twelve months. No wealth tax is due by a SICAR. The venture capital activity of the SICAR may thus be conducted in a tax-free environment.

Dividend distributions by a SICAR are not subject to dividend withholding tax. Thus, a SICAR may basically be held by individual investors or by investors set up outside the European Union without their return being reduced by Luxembourg withholding tax. Indeed, under normal circumstances, a 20% withholding tax is due on Luxembourg-source dividend payments, subject to tax treaty reductions and to an exemption, by application of the domestic provisions implementing the EC parent-subsidiary directive. No withholding tax is due, in general, on the payment of liquidation payments.

Non-resident investors (not acting via a Luxembourg branch) are never subject to Luxembourg income tax on capital gains on the sale of shares in a SICAR, regardless of the stake held by the investors or the holding period of such participation.

Migration

Upon migration of a Luxembourg company abroad, the Luxembourg company will be taxable on all latent gains existing on its assets. Such taxation may a priori only be avoided in the case where a permanent establishment is kept in Luxembourg with respect to the asstes allocated to this permanent establishment.

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