The Luxembourg government released bill 6847 (the Bill) on 5 August 2015. The Bill includes proposed tax measures for corporations and follows several recent announcements from Finance Minister Pierre Gramegna.

If approved by Parliament, these measures would amend the existing Luxembourg participation exemption regime to incorporate the latest European Union’s (EU’s) Parent-Subsidiary Directive (the Directive) amendments, expand the Luxembourg tax unity regime, and make other changes to the country’s corporate tax rules.

The participation exemption regime

1. **Background**

The Bill would implement the Directive’s latest amendments, including the anti-hybrid provision and the European general anti-avoidance regime (GAAR) provision.

The changes would affect the withholding tax exemption (article 147 of the Luxembourg Income Tax Law (LITL)) and dividend exemption (article 166 LITL) of the participation exemption regime. As of today, there are no propositions to update the participation exemption for capital gains and net wealth tax (NWT).

The Bill would adopt the European GAAR as provided by the Directive, subject to practical interpretation.

2. **Withholding tax exemption**

Under the GAAR, the participation exemption regime would not apply to abusive transactions within the Directive’s meaning, as amended on 27 January 2015.

The proposed text provides that:

> Are excluded from the [withholding tax exemption] the income covered by EU Directive 2011/96/EU [...] paid to corporations resident in another Member State, covered by article 2 of the [Parent-Subsidiary Directive], or to a permanent establishment located in another Member State, of a corporation resident in another Member State and covered by article 2 of the [Parent-Subsidiary Directive], if that income is distributed as part of an arrangement or a series of arrangements.
which, having been put into place for the main purpose or with one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. For the purposes of the GAAR, an arrangement 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.

3. Participation exemption for dividends

Income derived from EU participations covered by the Directive would no longer be exempt under the Luxembourg participation exemption regime if it is deductible in another member state.

As with the withholding tax exemption, the Bill would add a new paragraph to article 166 of the LITL and paragraph 9 of the Municipal Business Tax law. The proposed new paragraph provides that:

[The] exemption does not apply to income distributed by a corporation resident in another Member State and covered by article 2 of the [Parent-Subsidiary Directive] as part 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 Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. For the purposes of the GAAR, an arrangement 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.

4. Other proposed amendments

The Bill would expand the scope of the participation exemption in article 166 of the LITL and of the NWT law to include certain Polish and Romanian companies.

Tax unity

1. Background

The European Court of Justice (ECJ) holding in the SCA Holding case, dated 12 June 2014, concerns both vertical indirect tax unity (cases C-39/13, C-41/13) and horizontal tax unity (C-40/13) with regard to the Dutch tax rules.

Under Dutch rules, subsidiaries may form a tax unity only with their parent company. According to the ECJ, the Dutch legislation created different treatment for Dutch parent companies, which could offset a subsidiary’s losses against the parent’s profits or another subsidiary’s profit, and parent companies resident in another member state with subsidiaries in the Netherlands, which could not benefit from the tax unity regime.

The ECJ noted that Dutch law concerning fiscal consolidation creates a disadvantage for EU situations vis-a-vis purely domestic situations. Because this disadvantage
constitutes a restriction on the freedom of establishment, the ECJ decided in favor of allowing horizontal tax consolidation under the Dutch rules.

The Bill addresses similarities between the Luxembourg tax unity regime and the Dutch regime that could be deemed to violate EU law.

2. Proposed modification

The Bill proposes to expand the tax unity regime to provide for horizontal integration between qualifying companies held by a common parent company that is established in a European Economic Area (EEA) country and is subject to a corporate tax comparable to the Luxembourg corporate income tax.

A tax unity also could include a Permanent Establishment (PE) of a company established in another EEA country that is subject to tax.

Accordingly, article 164bis LITL would be replaced by a new article of law. The current requirements to benefit from this regime would still apply.

Other new tax measures

**Investment tax credit for maritime sector.** To extend the investment tax credit to the maritime sector, particularly with respect to the leasing of ships used in international traffic, point (4) of paragraph 9 of article 152bis LITL would be deleted. Under the Bill, the lessor of such ships could benefit from the investment tax credit.

**Recovery of tax claims.** The Bill introduces special provisions regarding the recovery of tax claims for the bankruptcy of a group’s parent company or a subsidiary by amending Paragraph 114 of the general law (Abgabenordnung (AO)).

**Exit tax in case of migration.** The Bill would expand the scope of the exit tax’s deferral through Paragraph 127 of the AO. It would include transfer of a Luxembourg company, a Luxembourg PE, or business assets to countries with which Luxembourg has concluded a treaty that includes an exchange of information clause in line with the OECD Model, or to countries with which a Tax Information Exchange Agreement (TIEA) has been signed.

**Tax credit for employment.** The Bill would amend the consolidated law dated 24 December 1966, to extend the application period of the tax credit for hiring unemployed individuals to 31 December 2017.

Effective dates

If enacted, these measures would apply as follows:

- New tax measures related to the participation exemption regime would apply to income distributed or received after 31 December 2015.

- New measures relating to the exit tax would take effect for tax year 2016.

- All other new tax measures would take effect for tax year 2015.
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