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TAX ADVISERS LUXEMBOURG

INSIGHTS

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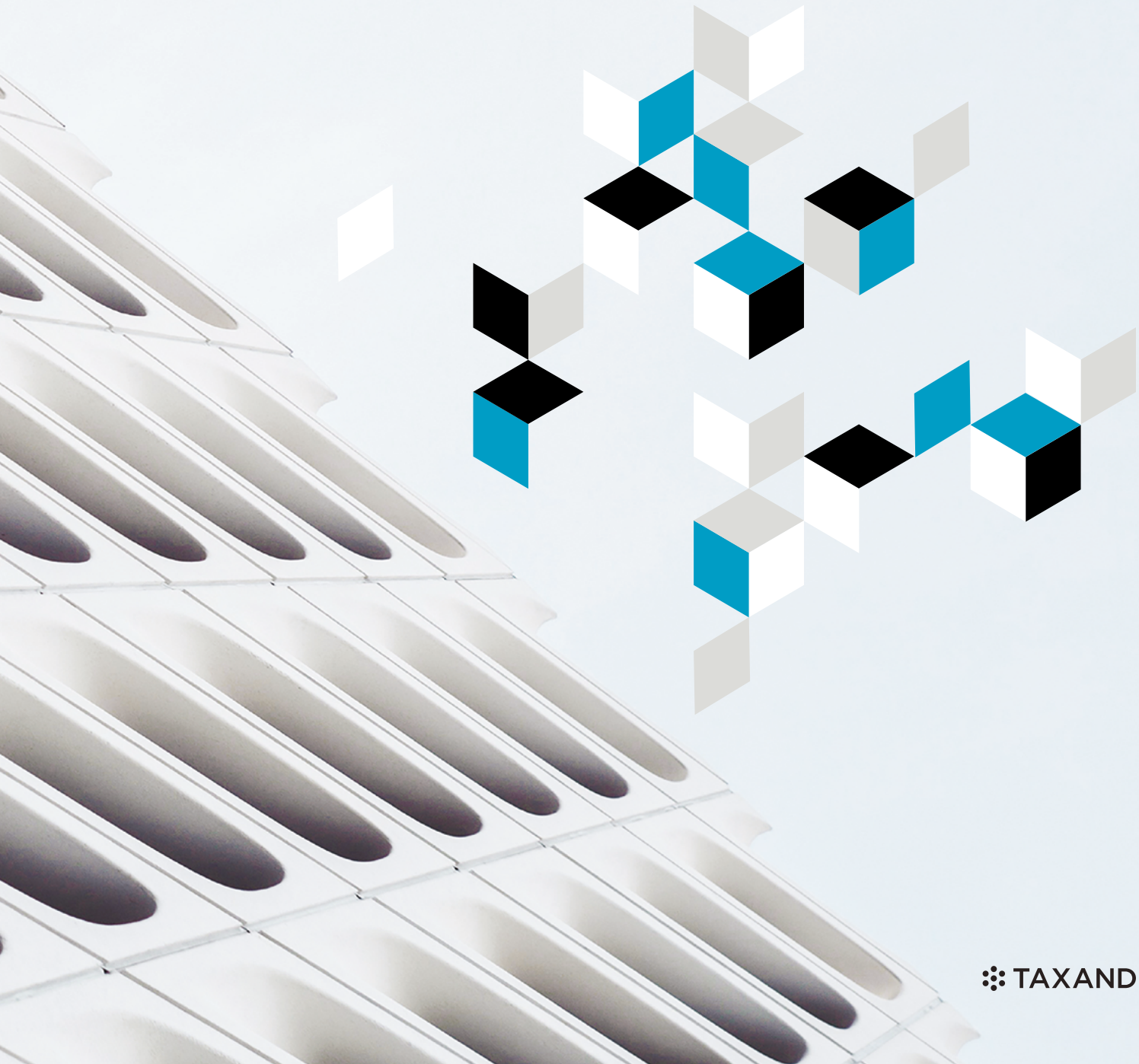

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EDITORIAL

Greetings!

Summer is already in full swing, so it is time to provide you with a few insights on what happened in Luxembourg and abroad over the past few months.

In June, the long-awaited new double tax treaty between the UK and Luxembourg was finally signed. We present the most important changes to be introduced by the new treaty, which, for some of them, may have a significant impact on Luxembourg entities with real estate investments in the UK. Also in June, a draft law implementing the 7th version of the Directive on Administrative Cooperation in the field of taxation ("**DAC7**"), on digital platforms, into domestic legislation was presented to the Luxembourg parliament. We summarise the changes to be introduced, which will apply as from next year. The Luxembourg tax authorities have also been quite productive over the past months in terms of releasing clarifying guidelines, including one on the Luxembourg administrative and legislative defensive measures against non-cooperative tax jurisdictions.

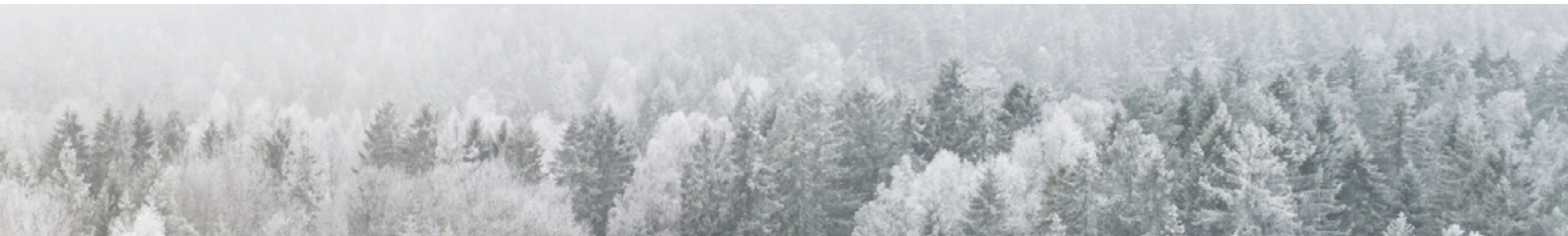
At EU level, the European Commission keeps on working on reforming the corporate tax system with, among others, a new EU Directive Proposal called "DEBRA" introducing a kind of notional interest deduction (the debt-equity bias reduction allowance) and new rules limiting, once again, the deductibility of interest for corporate income tax purposes. At the same time, the EU is still trying to reach an agreement on its pillar two directive proposal. We explain where we stand in the legislative process and explain why the proposal could not be adopted so far.

As far as VAT is concerned, we comment some recent case-law on the VAT deduction rights of holding companies and on the liability of company directors.

Finally, the CSSF released some new guidance for consumers investing in virtual assets with the aim of helping consumers, who despite the risks inherent to virtual assets are willing to invest in them. The CSSF outlines some minimum steps to be taken before investing, which we present and which are built on two pillars: Educate yourself and prefer regulated entities.

We hope you enjoy reading our insights.

The ATOZ Editorial Team



Luxembourg signs new double tax treaty with the UK

OUR INSIGHTS AT A GLANCE

- On 7 June 2022, Luxembourg signed a new double tax treaty with the UK.
- As expected, the main change introduced by the new double tax treaty is in relation to the taxation of Luxembourg entities with real estate investments in the UK where the impact of the new provisions should be carefully monitored.
- The DTT further introduces changes regarding the rules applicable to determine the tax residence of companies in case of dual residence. The impact of this change should also be analysed in order to make sure that the current tax residence of dual resident companies for DTT purposes is not challenged in the future.
- Positive changes introduced by the new double tax treaty include the granting of tax treaty benefits to Luxembourg collective investment vehicles and a full generous exemption of withholding tax on dividend distributions.
- Should Luxembourg and the UK manage to finalise the ratification of the double tax treaty before year-end, the new provisions could become applicable as from 1 January 2023.

On 7 June 2022, Luxembourg and the UK signed a new double tax treaty (the "**DTT**") and an additional Protocol which will replace the double tax treaty signed back in 1967 (the "**old tax treaty**"). The aim of the signature of this new DTT is for the UK and Luxembourg to have a tax treaty which is in line with the latest international tax standards agreed upon at OECD level over the past years. While some of these standards were already reflected in the old tax treaty through the modifications introduced recently by the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**Multilateral Instrument**" or "**MLI**"), the new DTT goes a step further with some additional changes, which, for some of them, may have a significant impact on Luxembourg entities with real estate investments in the UK. We provide an overview of the most important changes to be introduced by the DTT for corporate taxpayers.

Tax residence

Luxembourg CIVs get DTT benefits

In contrast to the old tax treaty, based on Article 2 of the Protocol to the DTT, Luxembourg CIVs will be granted DTT benefits under the following conditions:

- A CIV which is established and treated as a body corporate for tax purposes in Luxembourg and which receives income arising in the UK shall be treated as an individual who is a resident of Luxembourg and as the beneficial owner of the income it receives (provided that a resident of Luxembourg receiving the income in the same circumstances would have been considered as the beneficial owner thereof), but only to the extent that the beneficial interests in the CIV are owned by equivalent beneficiaries.
- However, if at least 75% of the beneficial interests in the CIV are owned by equivalent beneficiaries, or if the CIV is an undertaking for collective investment in transferable securities ("**UCITS**"), the CIV shall be treated as a resident of Luxembourg and as the beneficial owner of all of the income it receives (provided that a resident of Luxembourg receiving the income in the same circumstances would have been considered as the beneficial owner thereof).

"Equivalent beneficiary" means a resident of Luxembourg, and a resident of any other jurisdiction with which the UK has arrangements that provide for effective and comprehensive information exchange who would, if he

received the particular item of income for which benefits are being claimed under this DTT, be entitled under an income tax convention with the UK, to a rate of tax with respect to that item of income that is at least as low as the rate claimed under this DTT by the CIV with respect to that item of income.

For the purposes of this provision, CIV means: UCITS subject to Part I of the Luxembourg law of 17 December 2010; UCIs subject to Part II of the Luxembourg law of 17 December 2010; Specialised Investment Funds ("**SIF**") and Reserved Alternative Investment Funds ("**RAIF**") subject to the "SIF-like" tax regime, as well as any other investment fund, arrangement or entity established in Luxembourg which the competent authorities of the Contracting States agree to regard as a CIV.

The granting of DTT benefits to Luxembourg CIVs is a very positive change compared to the situation of CIVs under the old tax treaty. The fact that the "equivalent beneficiary" requirement will not apply to UCITS is also very positive as, in practice, investors in UCITS are numerous and may change daily, which makes it extremely difficult, if not impossible, in practice to track particular income streams to particular investors in order to determine whether the UCITS is held by equivalent beneficiaries. Still, for non-UCITS CIVs, so mainly for alternative investment funds, the analysis of the "equivalent beneficiary" condition will remain a challenging exercise, especially when the investor base is big, though this could be part of the various disclosures contained in the fund subscription documentation. Finally, as far as the CIV definition is concerned, the fact that RAIFs subject to the SICAR regime are not CIVs within the meaning of this provision makes sense because they are fully taxable entities under Luxembourg tax law and should, as such, already be considered as Luxembourg tax resident under Article 4 of the DTT as any other fully taxable company.

New tie-breaker rule for dual resident companies

So far, almost all Luxembourg tax treaties include a tie-breaker rule according to which a company is deemed to be resident in the Contracting State in which its place of effective management is situated. This is also the case of the old tax treaty with the UK.

Article 4 Paragraph 3 of the new DTT incorporates the provisions of the 2017 OECD Model tax Convention according to which, in the case of a company with a dual residence, the competent authorities of both Contracting States shall endeavour to determine, by mutual agreement, the state of residence of the company having regard to the place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, the Company shall not be entitled to any relief or exemption from tax under the DTT.

Unfortunately, since any matters requiring mutual agreement by competent authorities tend to be lengthy, this change will bring a lot of tax uncertainty to corporate taxpayers which rely on DTT benefits and have their place of incorporation in one of the Contracting States and their place of effective management in the other Contracting State. For these corporate taxpayers, the place of effective management criterion will no longer prevail automatically when determining the tax residence. Instead, the competent authorities of Luxembourg and the UK will first have to agree on a case-by-case basis on where the Company should be considered as a tax resident for DTT purposes.

The Protocol to the DTT provides a non-exhaustive list of factors which will be considered when the authorities of the 2 countries will perform their case-by-case analysis:

- place where the senior management of the company is carried on;
- place where the meetings of the board of directors or equivalent body are held;
- place where the headquarters are located;
- the extent and nature of the economic nexus of the Company to each State; and
- whether determining that the Company is a resident of one of the Contracting States but not of the other State for the purposes of the DTT would carry the risk of an improper use of the DTT or inappropriate application of the domestic law of either State.

Finally, the Protocol to the DTT provides that the competent authorities of Luxembourg and the UK will not seek to revisit the tax residence status determined under the old tax treaty rules (i.e. based on the place of effective management criterion), but only as long as all the material facts remain

the same. In case these material facts change after the entry into force of the DTT and the competent authorities determine that the company should be regarded as a resident of the other State (or the competent authorities do not reach a mutual agreement), that new determination (or the loss of treaty benefits pursuant to the absence of a mutual agreement) will apply only to income or gains arising after the new determination (or notice to the taxpayer of the absence of an agreement).

Dividends

While the old tax treaty only reduced the withholding tax on dividends up to 5% under certain conditions, Article 10, Paragraph 1, of the DTT introduces a full exemption from dividend withholding tax ("**WHT**"), provided that the recipient of the dividend is the beneficial owner of the income.

However, according to Article 10 Paragraph 2 of the DTT, except in the case where the beneficial owner of the dividend is a recognised pension fund[1] established in the other Contracting State, this exemption will not apply if the dividend is paid out of income (including gains) derived directly or indirectly from immovable property by an investment vehicle which distributes most of this income annually (that would be the case of a REIT) and whose income from such immovable property is exempted from tax. In such case, the DTT provides a maximum withholding tax of 15%. The UK does not levy WHT on dividends, other than for certain distributions from UK REITs, which are subject to 20% UK WHT. Based on the new DTT, the WHT applicable on these distributions will be reduced to 15%.

Interest

As in the old tax treaty, Article 11 of the DTT provides that interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in the State of residence of the beneficiary. Therefore, in such case, interest will be exempt from withholding in the source country under the DTT. While Luxembourg tax law does not provide any withholding tax on interest, the UK does at 20%.

Royalties

While the old tax treaty only grants a withholding tax reduction of 5% where the recipient is the beneficial owner of the royalties, Article 12, Paragraph 1 of the new DTT fully exempts from WHT royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State. While Luxembourg tax law does not provide any WHT on royalties, the UK does at 20%. The DTT exemption of WHT on royalties will be of primary benefit to Luxembourg taxpayers holding IP investments in the UK who could no longer rely on the exemption provided by the EU Interest and Royalty Directive due to Brexit but will now be able to benefit from the WHT exemption provided by the new DTT.

Capital gains & real estate rich companies

The old tax treaty currently prevents the UK from taxing gains realised by Luxembourg investors on the sale of shares or other interest in real estate rich companies holding real estate assets in the UK. Under the old tax treaty, such gains are only taxable in the country of the seller (i.e. Luxembourg) who can benefit from a full exemption under the Luxembourg internal participation exemption regime if the relevant conditions are met.

Article 13, Paragraph 2 of the new DTT introduces a real estate rich company clause according to which gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, deriving more than 50% of their value directly or indirectly from immovable property, situated in the other Contracting State may be taxed in that other State.

Based on this new provision, the UK will now be able to tax gains realised by Luxembourg investors on shares or comparable interests in another company (no matter the country in which that company is a tax resident), which derives more than 50% of its value directly or indirectly from UK immovable property.

[1] Luxembourg recognised pension funds includes pension-savings companies with variable capital (*sociétés d'épargne-pension à capital variable*, "SEPCAV), Pension-savings associations (*associations d'épargne-pension*: "ASSEP"), Pension funds subject to supervision and regulation by the Insurance Commissioner (*Commissariat aux assurances*) and the Social Security Compensation Fund (*Fonds de Compensation de la Sécurité Sociale*: "SICAV-FIS").

This change was anticipated as the UK changed its domestic law in April 2019 to tax non-UK resident owners of commercial property (both direct and indirect). So far, the UK was not able to tax Luxembourg investors on such gains since the old tax treaty granted an exclusive taxing right to Luxembourg. Based on this new provision, the UK will now be able to tax gains realised by Luxembourg investors on shares or comparable interests in companies considered to be "property-rich" from a UK tax perspective.

Methods to eliminate double taxation

Luxembourg will generally apply the exemption method to eliminate double taxation.

However, the credit method will apply in certain situations, including when tax is levied in the UK in accordance with Article 10 (dividend WHT) or Article 13, Paragraph 2 (capital gain taxation). In such case, the deduction shall not exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from the UK.

Prevention of DTT abuse

The so-called "principal purpose test" already included in the old tax treaty since the entry into force of the MLI is also included in the new DTT. Accordingly, a DTT benefit shall not be granted in respect of an item of income or capital, or a capital gain, if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the DTT.

In addition, the preamble to the DTT, which was also included in the old tax treaty since the entry into force of the MLI, is included in the DTT and provides that the UK and Luxembourg intend to conclude a DTT without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this DTT for the indirect benefit of residents of third States).

Entry into force

The new DTT will enter into force as soon as it has been ratified by both Luxembourg and the UK.

In Luxembourg, it will apply:

- in respect of taxes withheld at source, to income derived on or after 1 January of the calendar year next following the year in which the DTT enters into force - that would be 1 January 2023 at the earliest; and
- in respect of other taxes on income, and taxes on capital, to taxes chargeable for any taxable year beginning on or after 1 January of the calendar year next following the year in which the DTT enters into force - that would also be as from tax years beginning on or after 1 January 2023 at the earliest.

In the UK, the DTT will apply

- in respect of taxes withheld at source, to income derived from 1 January of the calendar year following the DTT coming into force – the earliest would therefore also be 1 January 2023;
- in respect of income and capital gains tax, to any year of assessment from 6 April following of the calendar year after – the earliest would therefore be 6 April 2023; and
- for corporation tax (including corporation tax on capital gains), for any financial year beginning on or after 1 April of the calendar year after the DTT coming into force – here, that would be 1 April 2023 at the earliest but most probably rather 1 January 2024 at the earliest given that most companies have financial years starting on 1 January.

Implications

The new DTT brings, above all, potential negative tax implications for Luxembourg taxpayers investing in real estate in the UK which should carefully review their existing investment structure in order to assess the potential impact of the DTT and analyse whether any action needs to be taken. The impact of the new DTT should also be carefully analysed by dual resident companies in order to make sure that their current tax residence for DTT purposes is not

impacted. Finally, the DTT will be positive for Luxembourg CIVs investing in the UK as they will now be able, under certain conditions, to benefit from an exemption of UK withholding tax on interest and they already benefit from the dividend WHT exemption under the UK internal rules.

Whether the changes to be introduced by the new DTT will apply as soon as 2023 will depend on how quickly Luxembourg and the UK launch their internal ratification procedure. We will keep you updated on any development as they occur.

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Luxembourg introduces new reporting obligations as implementing DAC7

OUR INSIGHTS AT A GLANCE

- On 13 June 2022, a draft law implementing the 7th version of the Directive on Administrative Cooperation in the field of taxation ("**DAC7**") into domestic legislation was presented to the Luxembourg parliament.
- DAC7 introduces new reporting obligations for digital platform operators and brings clarifications and improvements to the existing rules on administrative cooperation. To this effect, it introduces notably a definition of the "foreseeable relevance" of the information requested by foreign tax authorities about one taxpayer individually or a group of taxpayers. In addition, it provides a framework for the competent authorities of two or more member states to conduct joint audits.
- DAC7 will require Luxembourg to exchange information on an automatic basis for at least four categories of income and capital relating to taxable periods beginning on or after 1 January 2025.
- The draft law introduces these measures into Luxembourg law.

On 13 June 2022, a draft law (the "**Draft Law**") implementing Council Directive (EU) 2021/514 of 22 March 2021 amending Directive 2011/16/EU on administrative cooperation in the field of taxation (so-called "**DAC7**") into domestic legislation was presented to the Luxembourg Parliament. DAC7 amends the Directive 2011/16/ EU on administrative cooperation in the field of taxation ("**DAC**") for the sixth time notably to create an obligation for digital platform operators to report the income earned by sellers of goods and services who make use of their platforms and for member states to automatically exchange this information.

DAC7 also brings clarifications and improvements to the existing rules on administrative cooperation and introduces notably, for that purpose, a definition of the "foreseeable relevance" of the information requested by foreign tax authorities on a taxpayer individually or on a group of taxpayers. In addition, the new rules provide a framework for the competent authorities of two or more member states to conduct joint audits and update the list of income that will be subject to mandatory automatic exchange of information from taxable periods beginning on or after 1 January 2025.

The Draft Law introduces these measures into Luxembourg law and will come into force as of 1 January 2023.

Platform operators subject to new mandatory automatic exchange of information

The Draft Law extends the scope of the automatic exchange of information with respect to the information to be reported by digital platform operators.

For that purpose, the Draft Law provides for:

- an obligation on Luxembourg reporting platform operators to collect and verify information in line with due diligence procedures.
- an obligation on Luxembourg reporting platform operators to report information on the reportable sellers that use the platform on which they operate, to sell their goods and provide their services.
- an obligation on the Luxembourg authorities to communicate the reported information to the competent authority of appropriate member states.

Scope of the digital platform operators reporting under the Draft Law

a) Who will bear the burden of the new reporting duties?

DAC7 targets the digital platform economy through platform operators, which makes the traceability and detection of taxable events by tax authorities very difficult. Under the Draft Law, "platform" means any software, including a website or a part thereof and applications, including mobile applications, accessible by users and allowing sellers to be connected to other users for the purpose of carrying out a targeted activity, directly or indirectly, to such users.

It also includes any arrangement for the collection and payment of a consideration in respect of the relevant activities. A software that exclusively allows the processing of payments in relation to a targeted activity, users to list or advertise a relevant activity, or the redirecting or transferring of users to a platform, without any further intervention in carrying out a relevant activity, is not a platform under the Draft Law.

"Sellers" are defined by the Draft Law as platform users, either individuals or entities, who/which are registered at any moment during the reportable period on the platform and carry out, for consideration, activities which include the rental of immovable property, the provision of personal services, the sale of goods (i.e., tangible properties) and the rental of any mode of transport (the "Relevant Activities").

A "personal service" is a service involving time- or task-based work performed by one or more individuals who act either independently or on behalf of an entity. This service is carried out at the request of a user, either online or physically offline after having been facilitated via a platform.

A "Platform Operator" is an entity that contracts with sellers to make available all or part of a platform to such sellers.

Under the Draft Law, the reporting obligation will fall on a "Reporting Platform Operator" described as any platform operator which is:

- either a tax resident in Luxembourg or is incorporated under the laws of Luxembourg or has its place of management (including effective management) or a permanent establishment in Luxembourg (referred to as "Lux Platforms").
- neither resident for tax purposes, nor incorporated or managed in a member state, nor has a permanent establishment in a member state, but facilitates the carrying out of a Relevant Activity by reportable sellers or the rental of immovable property located in a member state (referred to as "Foreign Platforms Operators").

Reporting Platform Operators which have demonstrated upfront and on an annual basis to the satisfaction of the Luxembourg tax authorities, that their entire business model is such that it does not have Reportable Sellers, are nevertheless considered as excluded Reporting Platform Operators.

Every Reporting Platform Operator and every excluded Platform Operator is required to register with the Luxembourg tax authorities.

For the sake of simplification and mitigation of compliance costs, DAC7 provides that platform operators can report income earned by sellers through the use of the digital platform in one single member state. For that purpose, according to the Draft Law, a Reporting Platform Operator can choose a member state other than Luxembourg to fulfil its reporting obligations there. In such case, it shall notify the member state of its choice to the Luxembourg tax authorities. In that case, the Reporting Platform will be exempted from registration in Luxembourg.

The Reporting Platform Operator must register in Luxembourg or notify its choice to register in another member state by 31 December 2023 at the latest.

b) What will be reportable?

Under the Draft Law, a Reporting Platform Operator will need to collect and report information on any Seller other than an excluded Seller (i.e., a governmental entity) which, during the reportable period, either carries out a Relevant Activity or is paid or credited consideration in connection with a Relevant Activity, and is resident in Luxembourg or in a member state or rented out immovable property located in Luxembourg or in a member state ("Reportable Seller").

A Reportable Seller is considered resident in a member state if, during the reportable period, it had its primary address in a member state, it had a TIN or VAT identification number issued in a member state or, for a Seller that is an entity, it had a permanent establishment in a member state. Notwithstanding

these criteria, a Reporting Platform Operator shall consider a Seller resident in each member state confirmed by an electronic identification service made available by a member state or the EU to ascertain the identity and tax residence of the Seller.

Governmental entities, or entities (or related entities thereof) whose stock is regularly traded on an established securities market, and entities for which the platform operator facilitates more than 2,000 Relevant Activities by means of the rental of immovable property in respect of what is called a "property listing" during the reporting period are nevertheless excluded from any reporting under the Draft Law. The Draft Law defines property listing as all immovable property units located at the same street address, owned by the same owner, and offered for rent on a platform by the same seller.

The Draft Law also sets up a threshold for being considered as a Reportable Seller. As a result, Sellers for which the platform operator facilitates less than 30 Relevant Activities by means of the sale of goods and for which the total amount of consideration paid or credited does not exceed EUR 2,000 during the reporting period are out of the scope of the reporting under the Draft Law.

New duties for Reporting Platform Operators

a) Due diligence procedures

According to the Draft Law, a Reporting Platform Operator will have to carry out due diligence procedures to identify Reportable Sellers. For that purpose, the Reporting Platform Operator will have to collect information for each Seller (individuals and entities) and will then have to determine whether or not the information collected is reliable, using all information and documents available to the Reporting Platform Operator in its records, as well as any electronic interface made available by a member state of the EU free of charge to ascertain, for example, the validity of the TIN and/or VAT identification number.

Where the Reporting Platform Operator has reason to know that any of the information may be inaccurate, it will have to request the Seller to correct information items which were found to be incorrect and to provide supporting documents, data or information which are reliable and of independent source, such as a valid government-issued identification document or a recent tax residency certificate.

Where a Seller is engaged in a Relevant Activity involving the rental of immovable property, the Reporting Platform Operator will have to collect the address of each property listing and, where issued, respective land registration number. If a Reportable Seller does not provide the information required to the Reporting Operating Platform after two reminders following the initial request but not prior to the expiration of 60 days, the platform will have to close the account of such Seller and prevent it from re-registering on the platform for a six-month period or withhold the consideration payment to that seller as long as it does not provide the information requested.

Reporting Platform Operators will have to collect the required information, verify its accuracy and make it available by 31 December of the calendar year in respect of which reporting is being completed (the "Reportable Period"). As the Draft Law provisions will apply as from 1 January 2023, the first Reportable Period will be the 2023 calendar year and the first due diligence duties will have to be completed by 31 December 2023. In that case, for Sellers that were already registered on the platform as of 1 January 2023 or as of the date on which an entity became a Reporting Platform Operator, the due diligence procedures will have to be completed by 31 December of the second Reportable Period for the Reporting Platform Operator (i.e., 31 December 2024 in this case).

A Reporting Platform Operator will be allowed to rely on the due diligence procedures conducted in previous Reportable Periods, provided that the required information has been collected or verified within the last 36 months, and it does not have reason to believe that the information collected has become unreliable or incorrect. A Reporting Platform Operator will also be allowed to designate another Platform Operator or a third party to assume the obligations with respect to due diligence procedures, but such obligations shall still remain the responsibility of the Reporting Platform Operator. Upon election, a Reporting Platform Operator will finally be allowed to complete the due diligence procedures for active Sellers only.

Pursuant to the Draft Law, Reporting Platform Operators shall not engage in practices designed to circumvent reporting.

They shall keep records of the steps taken and any information used to ensure the performance of due diligence procedures and reporting obligations for a period of ten years after the end of the Reporting Period to which the information relates. They shall establish policies, controls, procedures, and computer systems to ensure the performance of their reporting and due diligence obligations.

b) Reporting duties

According to the Draft Law, the information, as collected and verified, will have to be reported within one month following the end of the Reportable Period in which the Seller is identified as a Reportable Seller (i.e., no later than 31 January 2024 if the Seller is identified as a Reportable Seller in 2023).

Reporting will only be made in one member state (i.e., single reporting). A Reporting Platform Operator will report to the competent authority of the member state where it is registered, whether Luxembourg or another member state.

Where there is more than one Reporting Platform Operator, any of those Reporting Platform Operators shall be exempt from reporting the information if it has proof that the same information has been reported by another Reporting Platform Operator.

The information to be reported, as listed in the Draft Law, will provide member states' tax administrations with sufficient information to correctly assess and control gross income earned in their countries from commercial activities performed with the intermediation of digital platforms. This information includes income earned by Sellers of goods and services that make use of the platforms. Information about the consideration paid and other amounts will have to be reported based on the quarterly figures of each Reportable Period in which the consideration was paid or credited. The definition of the "consideration" under the Draft Law excludes any fees, commissions or taxes withheld or charged by the Reporting Operating Platform.

The Reporting Platform Operators will have to inform each individual concerned that information will be collected and reported to the competent authorities and to provide all information the data controllers are required to provide under the General Data Protection Regulation ("**GDPR**") before the information is reported.

Automatic exchange of information reported by Reporting Platform Operators

According to the Draft Law, the information reported in Luxembourg by Reporting Platform Operators will have to be exchanged by the Luxembourg authorities with the member states where the Reportable Seller is a resident and/or the immovable property is located within two months following the end of the Reportable Period (i.e., by the end of February).

Penalties for non-compliance at Luxembourg level

Reporting Platform Operators will be subject to penalties applied by Luxembourg if the obligations laid down in the Draft Law are not respected.

The Luxembourg tax authorities may charge a fine of 5,000 euros against Reporting Platform Operators which have not registered or notified their choice to register in another member state within the legal deadline, or which have provided incomplete or incorrect information or which have not updated such information when required within the legal deadline. Likewise, a fixed fine of 5,000 euros may be charged to Platform Operators that did not file their reports within the legal deadline. Such offences are established as soon as the legal deadline is not respected, independently of any intentional element.

Finally, a fine of up to 250,000 euros may be charged, following an audit, when Reporting Platform Operators fail to comply with their obligations under the Draft Law, except for obligations relating to registration, notification, and reporting in due time, as well as the obligations regarding the protection of personal data. The intentional nature of the offence will be taken into account when setting the amount of the fine. Currently, in Luxembourg, the penalties for noncompliance with the Common Reporting Standard ("**CRS**") and the mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements ("**DAC6**") regulations also amount to a maximum of 250,000 euros.

Other clarifying measures included in DAC7 and implemented by the Draft Law

The Draft Law also brings various amendments to existing provisions on exchange of information and administrative cooperation, notably to clarify some requirements. For that purpose, the Draft Law proposes for example to amend the law dated 29 March 2013 on the administrative cooperation in the tax field (the "**2013 Law**") but also the Luxembourg law implementing DAC6, the Country-by-Country Reporting ("**CbCR**") or the CRS.

Exchange of information upon request: Conditions of the request

a) Foreseeable relevance and exhaustiveness – individual and Group requests

The "foreseeable relevance" of the information requested by one member state to Luxembourg conditions whether Luxembourg shall be required to comply with the request for information, and thus constitutes one of the legal bases of the information order addressed by the Luxembourg authorities to a relevant person in Luxembourg and of the penalty imposed on that person for failure to comply with the information order.

DAC7 delineates the standard of foreseeable relevance, to ensure effectiveness of the exchanges of information and prevent unjustified refusals of requests, as well as to provide legal clarity and certainty to both tax administrations and taxpayers. For those purposes, the Draft Law transposes the DAC7 definition of the standard of foreseeable relevance. It introduces the following definition in the 2013 Law: "The requested information is foreseeably relevant where, at the time the request is made, the requesting authority considers that, in accordance with its national law, there is a reasonable possibility that the requested information will be relevant to the tax affairs of one or several taxpayers, whether identified by name or otherwise, and be justified for the purposes of the investigation".

The Draft Law also lays down procedural requirements which the requesting authority must observe. Thus, "with the aim to demonstrate the foreseeable relevance of the requested information, the requesting competent authority shall provide at least the following information to the Luxembourg authorities:

- the tax purpose for which the information is sought; and
- a specification of the information required for the administration or enforcement of its national law".

Considering that there is sometimes a need for issuing requests for information that concern groups of taxpayers which cannot be identified individually but are instead described by a common set of characteristics, the Draft Law addresses, by providing for the possibility for tax administrations to make group requests for information, the issue of group requests in the context of a request for information. In such a case, the requesting authority must provide the Luxembourg authority with a set of information including a comprehensive description of the characteristics of the group and an explanation of the applicable law and of the facts and circumstances which led to the request.

As per DAC7, the Draft Law details in this respect the information which the requesting authority shall provide where a request relates to a group of taxpayers who cannot be identified individually:

- a detailed description of the group;
- an explanation of the applicable law and of the facts based on which there is reason to believe that the taxpayers in the group have not complied with the applicable law;.
- an explanation how the requested information would assist in determining compliance by the taxpayers in the group; and
- where relevant facts and circumstances related to the involvement of a third party that actively contributed to the potential non-compliance of the taxpayers in the group with the applicable law.

Automatic exchange of information: Extension of the list of income subject to mandatory automatic exchange between member states

DAC7 requires member states to exchange information on an automatic basis for at least four categories of income and

capital and relating to taxable periods beginning on or after 1 January 2025. For the time being, Luxembourg exchanges information in the following three categories of income: employment income, directors' fees, and pensions.

The Draft Law aims to amend the 2013 Law to propose the introduction of automatic and mandatory exchange of information for a new and fourth category of income and capital. As from taxable periods on or after 1 January 2025, Luxembourg will exchange automatically information relating to the ownership of real estate in addition to the three categories of income mentioned above.

With a view to the automatic exchange of information, the *Administration du cadastre et de la topographie* shall provide to the Luxembourg tax authorities in charge of the exchange, the information available in the land registers relating to individuals and legal entities who/that are resident in a member state and who are owners of real estate located Luxembourg.

Joint audits

The Draft Law also provides for the possibility for a competent authority of one or more member states to request the Luxembourg authorities, or vice versa, to conduct joint audits.

That request may however be rejected on justified grounds. To ensure legal certainty, joint audits should be conducted in a pre-agreed and coordinated manner, and in accordance with the laws and procedural requirements of the member state where the activities of a joint audit take place. The audited person(s) shall be informed of the outcome of the joint audit, including a copy of the final report within 60 days of its issuance. To ensure legal certainty, the final report of a joint audit should reflect the findings the competent authorities concerned agreed on. Moreover, the concerned competent authorities could also agree that the final report of a joint audit includes any issues where an agreement could not be reached.

For the purpose of exchanging information that is foreseeable relevant for the administration and enforcement of the domestic laws of the requesting member state, the Draft Law also provides that officials authorised by a requesting state may, at the request of the latter:
(a) be present in the offices where the Luxembourg administrative authorities carry out their duties.
(b) be present at administrative investigations carried out on the territory of the Grand Duchy of Luxembourg.
(c) participate in administrative enquiries conducted by the Luxembourg requested authority using electronic means of communication, where appropriate.

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New guidelines on Luxembourg defensive measures against non-cooperative jurisdictions for tax purposes

OUR INSIGHTS AT A GLANCE

- Further to the adoption of the first list of "non-cooperative" jurisdictions for tax purposes at EU level on 5 December 2017, the EU member states agreed on the introduction of at least one defensive administrative measure regarding listed countries ("**Blacklisted jurisdictions**").
- In this context, by means of a circular dated 7 May 2018, Luxembourg introduced as from tax year 2018 a requirement, for Luxembourg corporate taxpayers, to indicate in their corporate tax returns whether they have concluded transactions with related parties located in Blacklisted jurisdictions.
- On 5 December 2019, the European Council recommended to the member states to also apply at least one defensive legislative measure as of 1 January 2021 amongst a predefined list of measures. Following this recommendation, Luxembourg introduced a new article into the Luxembourg Income Tax law, which denies under certain conditions the corporate income tax deduction of interest and royalty expenses due as from 1 March 2021 to entities located in Blacklisted jurisdictions.
- On 31 May 2022, the Luxembourg tax authorities released a new circular L.I.R. n°168/2 which replaces the former circular LG n°64 of 7 May 2018 with the aim of providing additional guidance on the application of this new defensive legislative measure. The content of the New Circular related to the defensive administrative measure remains unchanged.

Further to the adoption of the first list of "non-cooperative" jurisdictions for tax purposes at EU level (the "**Blacklist**") on 5 December 2017, the EU member states agreed on the introduction of at least one defensive administrative measure regarding listed countries ("**Blacklisted jurisdictions**").

In this context, on 7 May 2018, the Luxembourg tax authorities (the "**Tax Authorities**") issued the circular L.G. – A n°64 which implemented as from tax year 2018 a requirement, for Luxembourg corporate taxpayers, to indicate in their corporate tax returns whether they have concluded transactions with related parties (within the meaning of article 56 of the Income Tax Law, "**ITL**") located in Blacklisted jurisdictions (the "**defensive administrative measure**").

On 5 December 2019, the European Council recommended to the member states to also apply at least one defensive legislative measure as of 1 January 2021 amongst a predefined list of measures. Following this recommendation, Luxembourg introduced by the law of 10 February 2021 the new Article 168 n°5 of the ITL which denies under certain conditions the corporate income tax deduction of interest and royalty expenses due as from 1 March 2021 to entities located in Blacklisted jurisdictions.

On 31 May 2022, the Tax authorities released a new circular L.I.R. n°168/2 (the "**New Circular**") which replaces the former circular LG n°64 of 7 May 2018 with the aim of providing additional guidance on the application of the defensive legislative measure introduced by Article 168 n°5 of the ITL. The content of the New Circular related to the defensive administrative measure remains unchanged.

Based on Article 168 n°5 of the ITL, as from 1 March 2021, interest and royalties due to entities located in Blacklisted Jurisdictions are no longer tax deductible, if the following cumulative conditions are met:

- The beneficiary of the interest or royalty is a collective undertaking within the meaning of article 159 of the ITL. If the beneficiary is not the beneficial owner, then the beneficial owner has to be taken into account;

- The beneficiary of the interest or royalty is an associated enterprise within the meaning of article 56 of the ITL; and

- The collective undertaking which is the beneficiary of the interest or royalty is established in a Blacklisted Jurisdiction.

Interest and royalties remain however tax deductible if the taxpayer can demonstrate that the operation which the interest or royalties relate to has been put in place for valid economic reasons which reflect economic reality.

The key guidelines provided by the New Circular are related to the scope and conditions of the application of this defensive legislative measure and are as follows:

Scope of application of the measure

The New Circular clarifies that the measure applies to Luxembourg tax resident entities and to non-Luxembourg tax resident entities taxable in Luxembourg on their Luxembourg source income.

As to the interest and royalties to be taken into account, the New Circular provides that:

- The definition of interest and royalties within the meaning of Article 168 n°5 of the ITL is similar to the one contained in article 2 of the EU directive 2003/49/CE (the so-called "Interest and royalties" directive) and also to the one contained in articles 11 and 12 of the OECD Model Tax Convention.
- The interest and royalties are to be considered at the time they are accrued and cash payments are irrelevant for the application of the measure. This is because Article 168 n°5 refers to interest or royalties due and not to interest and royalties paid.

Beneficiary of the interest and royalties

The New Circular provides the following important clarifications with respect to the beneficiary of the interest and royalties:

- When the interest or royalty is due to a tax transparent entity within the meaning of Article 175 of the ITL, a look through approach applies and the partners are considered as the beneficiaries of the interest and royalties in proportion to their participation in the tax transparent entity.
- In addition, the beneficiary is understood to be the beneficial owner of the interest and royalties. The New Circular clarifies that the beneficial owner should be determined based on an economic approach. It is the economic owner of the interest and royalties which is the beneficial owner within the meaning of article168 n°5 of the ITL. For example, an agent or any other representative will not be considered as the beneficiary of the interest and royalties.
- In order to determine whether the beneficial owner is a foreign collective undertaking within the meaning of article 159 of the ITL, it is necessary to analyse, on the basis of the specific characteristics of the foreign entity, as they result from the legal and statutory provisions applicable to it, whether it corresponds to a collective undertaking listed in article 159 of the ITL. Therefore, a comparative analysis based on legal and statutory characteristics is required.

Timing of the application of the measure

The measure applies to interest and royalties due as from 1 March 2021 to entities located in Blacklisted Jurisdictions based on the latest Blacklist available as of 1 March 2021, i.e. based on the Blacklist published on 26 February 2021, which includes the following twelve countries: American Samoa, Anguilla, Dominica, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, US Virgin Islands and Vanuatu.

For subsequent years, the measure applies as of 1 January of each subsequent year with respect to the countries and territories listed in the latest version of the Blacklist available as of 1 January of the subsequent year in question. The EU Blacklist is generally updated twice a year, in February and October. For the year 2022, since the list to refer to is the latest available as of 1 January, the relevant Blacklist is the one published in the Official Journal ("**OJ**") of the EU on 12 October 2021, which, following the removal of Anguilla,

Dominica and the Seychelles, includes the nine following countries: American Samoa, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, US Virgin Islands and Vanuatu.

Given that additions of countries to the Blacklist have only an effect as from the next calendar year whereas a removal of a country out of the list may only have an immediate effect under certain circumstances, the New Circular provides some useful examples to clarify the timing application of the measure in case countries are removed/added to the Blacklist:

- If a country is added to the latest list available as of 1 January (i.e. the list released in October of the previous year), it will be taken into account for interest and royalties due as from 1 January of the following year (i.e. there will be no retroactive nor immediate effect but only an impact as from the following calendar year).
- If a country is added to the Blacklist in the February update but is removed in the October update, interest and royalties due to this country will not be taken into account for the application of the measure in the given year and as of January 1st of the following year, so the change in February will have no effect. This is because the latest list available (i.e. the list released in October of the previous year) is the only list to refer to.
- If a country is removed from the Blacklist in the February update but is added back in the October update, since the latest list available as from 1 January is always the list to refer to when applying the measure, the fact that the country was removed from the list in February will have no effect and the measure will apply with respect to interest and royalties paid to this country for the entire year as well as for the subsequent year.
- If a country is removed from the Blacklist in the February update and is not added back to the Blacklist prior to 1 January of the subsequent year, this country will no longer be taken into account for interest and royalties due as from the date of the publication of the relevant Blacklist in the OJ of the EU (i.e. the removal will have an immediate effect as from February).
- If a country is removed from the Blacklist in the October update, this country will no longer be taken into account for interest and royalties due as from the date of the publication of the relevant Blacklist in the OJ of the EU (i.e. the removal will have an immediate effect as from October).

Exception to the application of the rule

Interest and royalties remain tax deductible if the taxpayer can demonstrate that the operation which the interest or royalties relate to has been put in place for valid economic reasons which reflect economic reality.

The New Circular is not giving any real guidance with respect to the economic reasons which may be considered as valid for the application of this exception.

Based on the new Circular, it is not sufficient for the taxpayer to simply state some economic reasons for these reasons to necessarily be considered as valid by the tax authorities. It is necessary that these reasons, considering all the relevant facts and circumstances, can be considered genuine and providing sufficient economic benefits beyond any tax advantage. The tax authorities will appreciate the validity of such reasons on a case-by-case basis considering the relevant facts and circumstances.

In this respect, the New Circular also states that the taxpayer may request (under the usual tax ruling procedure) a tax ruling from the tax authorities in order to confirm (and so be exempt from the measure) that the operation to which the interest or royalties relate has been put in place for valid economic reasons which reflect economic reality.

Implications

While the New Circular does not introduce any additional defensive measure against Blacklisted Jurisdictions, Luxembourg corporate taxpayers should still keep on following closely the evolution of the legislation of jurisdictions under the radar of the EU Council in order to anticipate an addition to or a removal from the Blacklist in the future and thus a change in the scope of application of the Luxembourg defensive measures. In addition, Luxembourg corporate taxpayers with investments into and from Blacklisted Jurisdictions should seek advice from their tax advisers in order to analyse the impact on their investments and whether they should still be out of the scope of the legislative defensive measure because the operation which the interest or royalties relate to has been put in place for valid economic reasons which reflect economic reality. The possibility to submit a tax ruling request in order to get certainty on the existence of valid economic reasons and thus the exemption from the measure should also be considered.

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European Commission releases DEBRA Directive Proposal

OUR INSIGHTS AT A GLANCE

- On 11 May 2022, the European Commission released a Directive Proposal to address Debt-Equity bias.
- The Proposal is one of the targeted measures announced by the European Commission in May 2021 in its Communication that promote productive investment and entrepreneurship and ensure effective taxation in the EU.
- The Proposal lays down rules on the deduction, for corporate income tax purposes, of an allowance on increases in equity and rules on the limitation of the tax deductibility of exceeding borrowing costs. These rules apply to taxpayers that are subject to corporate income tax in one or more Member States, including permanent establishments in one or more Member State of entities resident for tax purposes in a third country. However, financial undertakings are exempt from those rules.
- Based on the current version of the Proposal, the new rules would apply from 1 January 2024.

On 11 May 2022, the European Commission released a Directive Proposal to address Debt-Equity bias (Proposal for a Council Directive on laying down rules on a debt-equity bias reduction allowance and on limiting the deductibility of interest for corporate income tax purposes, hereafter referred to as the "**Proposal**").

The Proposal follows the announcement made by the European Commission in its Communication on Business Taxation for the 21st century back in May 2021, which sets out both a long-term vision to provide a fair and sustainable business environment and EU tax system, and a tax agenda for the next two years with targeted measures that promote productive investment and entrepreneurship and ensure effective taxation. DEBRA is one of these targeted measures.

The Proposal introduces a Debt-Equity bias reduction allowance ("**DEBRA**") to encourage companies to finance their investments through equity contributions rather than through debt financing and so to mitigate debt bias. It lays down two separate measures that apply independently: On the one hand, rules on the deduction, for corporate income tax purposes, of an allowance on increases in equity and, on the other hand, rules on the limitation of the tax deductibility of exceeding borrowing costs.

Based on the current version of the Proposal, Member States shall adopt the Directive by 31 December 2023 at the latest and they shall apply the provisions of the Directive from 1 January 2024.

Scope of application of the Proposal

The Proposal applies to taxpayers that are subject to corporate income tax in one or more Member States, including permanent establishments in one or more Member State of entities resident for tax purposes in a third country.

However, the Directive Proposal does not apply to entities defined in the Proposal as Financial Undertakings. It is interesting to note that the definition of Financial Undertakings within the meaning of the Proposal is identical to the one included in the recent Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU. However, the definition of the Proposal is broader than the definition included in the ATAD.

Financial undertakings which are out of the scope of both the allowance on equity and the interest limitation rules introduced by the Proposal are the following undertakings

within the meaning of the various EU Directives and Regulations:

- Credit institutions;
- Investment firms;
- Alternative investment fund managers ("**AIFM**"), including managers of EUVECA, EUSEF and ELTIFs;
- Management Companies of Undertakings for collective investment in transferable securities ("**UCITS**");
- Insurance undertakings;
- Reinsurance undertakings;
- Institutions for occupational retirement provision;
- Pension institutions operating pension schemes which are considered to be social security as well as any legal entity set up for the purpose of investment of such schemes;
- Alternative investment funds ("**AIF**") managed by an AIFM;
- UCITS;
- Central counterparties;
- Central securities depositories;
- Insurance or reinsurance special purpose vehicles;
- Securitization special purpose entities;
- Insurance holding companies or mixed financial holding companies;
- Payment institutions;
- Electronic money institutions;
- Crowdfunding service providers; and
- Crypto-asset service providers.

Allowance on equity

The first measure to be introduced by the Proposal (Article 4 of the Proposal) is an allowance on equity granted for 10 consecutive tax years, which is deductible from the corporate income tax base of corporate income taxpayers up to 30% of the taxpayer's EBITDA.

Allowance on equity = Allowance Base X Notional Interest Rate ("NIR")

Allowance base (net equity increase)

The allowance base is the difference between the net equity at the end of the current tax year and net equity at the end of the previous tax year. This means that the allowance on equity is granted only for the sum of equity increases over a specific year and not for the overall equity.

Equity is defined by reference to Directive 2013/34/EU (the "**Accounting Directive**") as the sum of paid-up capital, share premium account, revaluation reserve and reserves and profits or losses carried forward. Net equity is then defined as the difference between the equity of a taxpayer and the sum of the tax value of its participation in the capital of associated enterprises and of its own shares. This definition is meant to prevent cascading the allowance through participations

Notional Interest Rate ("NIR")

The NIR is the 10-year risk-free interest rate for the relevant currency, increased by a risk premium of 1% or, in the case of SMEs, a risk premium of 1.5%.

NIR = Risk Free Rate + Risk Premium
Risk Premium = 1% (or 1.5% for SMEs)

Risk-free interest rate is the risk-free interest rate with a maturity of 10 years, in which the allowance is claimed, for the currency of the taxpayer.

Risk premium is set at either 1% or at 1.5% in the case of taxpayers qualifying as small or mediumsized enterprises, to better reflect the higher risk premium they incur to obtain financing.

Maximum deductible amount

Once the allowance has been computed, each year, it will be necessary to double check whether the amount of the allowance does not exceed 30% of the taxpayer's earnings before interest, tax, depreciation and amortisation ("**EBITDA**") as the allowance is only deductible up to 30% of the taxpayer's EBITDA for each tax year.

Deductibility limited in time

The allowance on equity is deductible for 10 consecutive tax

years, as long as it does not exceed 30% of the taxpayer's EBITDA.

Therefore, it is deductible in the year it was incurred (TY) and in the next successive nine years (TY+9). If, in the following year (TY+1), a new increase in a taxpayer's equity also qualifies for an allowance on equity, the new allowance on equity will also be deductible for the tax year it was incurred and the following nine years since its incurrence (until TY+10).

Carry forward mechanism

Taxpayers will be able to carry forward, without time limitation, the part of the allowance on equity that would not be deducted in a tax year due to insufficient taxable profit.

In addition, taxpayers will be able to carry forward, for a period of maximum 5 years, unused allowance capacity, where the allowance on equity does not reach the aforementioned maximum amount.

Implications in case of a subsequent equity decrease

If the allowance base of a taxpayer that has already benefitted from an allowance on equity under the rules of the Proposal, is negative in a given tax period (equity decrease), a proportionate amount will become taxable for 10 consecutive tax periods and up to the total increase of net equity for which such allowance has been obtained, unless the taxpayer provides evidence that this is due to losses incurred during the tax period or due to a legal obligation.

Anti-abuse measures (Article 5 of the Proposal)

The Proposal provides the following limitations which are anti-abuse measures aiming to ensure that the rules on the deductibility of an allowance on equity are not used for unintended purposes:

i. To avoid multiplying the allowance on equity at group level: Exclusion from the allowance base of equity increases that originate from intra-group loans, intra-group transfers of participations or existing business activities and cash contributions under certain conditions.
ii. To prevent the overvaluation of assets or purchase of luxury goods for the purpose of increasing the base of the allowance: specific conditions for taking into account equity increases originating from contributions in kind or investments in assets.
iii. To make sure that the allowance does not apply to old equity converted into new equity as the result of the reorganisation of a group: Exclusion of the equity (or part thereof) that already existed in the group before the reorganisation.

Limitation to interest deduction

As a second measure, and independently from the allowance on equity, Article 6 of the Proposal introduces a limitation to the tax deductibility of exceeding borrowing costs. The measure would limit the deductibility of interest to 85% of the exceeding borrowing costs incurred during the relevant tax period. This new limitation to the deductibility of interest would apply together with the limitation already applicable in the EU (since 1 January 2019) under Article 4 of the Anti-Tax avoidance Directive ("**ATAD**").

Definition of exceeding borrowing costs

To define exceeding borrowing costs, reference is made to the definition provided in Article 4 of the ATAD, i.e. "the excess of borrowing costs over interest income and other economically equivalent taxable revenues".

As far as borrowing costs are concerned, even though no reference is made to ATAD in this respect, it is understood that the same definition should be applied, i.e. "interest expenses on all forms of debt, other costs economically equivalent to interest and expenses incurred in connection with the raising of finance as defined in national law, including, without being limited to,

- payments under profit participating loans,
- imputed interest on instruments such as convertible

bonds and zero coupon bonds,
- amounts under alternative financing arrangements, such as Islamic finance,
- the finance cost element of finance lease payments,
- capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest,
- amounts measured by reference to a funding return under transfer pricing rules where applicable,
- notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings,
- certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance,
- guarantee fees for financing arrangements,
- arrangement fees and similar costs related to the borrowing of funds".
- Computation and how to apply both interest limitation rules (under ATAD and under the Proposal)

Given that interest limitation rules already apply in the EU based on Article 4 of the ATAD, taxpayers will apply the rule of Article 6 of the Proposal as a first step and then calculate the limitation applicable in accordance with article 4 of the ATAD.

As noticed above, since the definition of financial undertakings under ATAD is not the same as the one under the Proposal (the Proposal excludes more entities than ATAD does), some undertakings (e.g. Securitization special purpose entities within the meaning of EU Regulation No 2017/2402) will only be subject to the interest limitation rules of ATAD and not to the ones of the Proposal.

If the result of applying the ATAD rule is a lower deductible amount, the taxpayer will be entitled to carry forward or back the difference in accordance with Article 4 of ATAD.

By way of example, if a company has exceeding borrowing costs of 100, it should:

(1) First, apply Article 6 of the Proposal that limits the deductibility to 85% of 100 = 85;
(2) Second, compute the amount that would be deductible under Article 4 of the ATAD. If the deductible amount is lower, e.g. 80 (and subsequently the non-deductible higher, i.e. 20), the difference in the deductibility, i.e. the additional non-deductible amount (i.e. 85-80 = 5) would be carried forward in accordance with the conditions of Article 4 of ATAD, as transposed in national law.

The outcome for the company would be that that 15 (100 - 85) of interest borrowing costs are non-deductible and a further 5 (85 – 80) of interest borrowing costs are not deductible but can be carried forward.

Considerations regarding Luxembourg companies

How a business finances its operations is an important business decision that depends on a range of factors. While the deductibility of interest expenses is one factor to be considered, the decision as to whether a company should be financed by equity or debt is generally not tax driven and there are a number of good commercial reasons why intra-group loans can be preferable to a contribution of equity.

The question arises as to what the impact of the Proposal would be on Luxembourg companies that perform holding and financing activities.

When Luxembourg companies hold participations qualifying for the Luxembourg participation exemption regime, interest expenses incurred in relation to the financing of such participation are only deductible if certain conditions are met. When interest expenses would otherwise be deductible, the non-deductibility of 15% of the exceeding borrowing costs may result in a reduction of deductible interest expenses. However, as the income derived from qualifying participations should be tax exempt, the impact of this measure would be limited.

As regards financing activities, Luxembourg companies should realise an arm's length remuneration. Consequently, Luxembourg finance companies should realise a positive finance margin (i.e. the company should realise more interest income than it incurs interest expenses). Here, in the absence of exceeding borrowing costs, the Proposal would not result in the non-deductibility of part of the interest expenses.

Nevertheless, when Luxembourg companies invest into assets (or perform business activities) that generate taxable

income that cannot be classified as interest income or economically equivalent revenues, the 15% non-deductibility of interest expenses may have a severe impact on the overall tax profile of the investment. Therefore, the developments in regard to DEBRA need to be carefully monitored by Luxembourg taxpayers.

Critical review

The Proposal raises a number of issues, including, in particular:

- Is the allowance on equity in line with transfer pricing principles? It can be assumed that a risk premium of only 1% (or 1.5%) to be added to the risk free rate should hardly be consistent with the arm's length principle.
- The non-deductibility of 15% of the exceeding borrowing costs may likely be inconsistent with the Constitution of many EU Member States given that taxpayers should, as a very fundamental principle, be able to deduct their costs.
- The Proposal would result in significant complexity related to:
  - the interaction with the interest limitation rules of ATAD,
  - the determination of the allowance on equity, including intricate anti-abuse provisions,
  - the 10 year adjustment period that would require tracking on an annual basis, and
  - the carry-forward mechanism.
- Given the complexity of the allowance computation and the need to track it over 10 years, why not making the system optional to taxpayers (the wording used in the Proposal seems to suggest that the allowance is granted automatically with no possible op-out by the taxpayers concerned).

Next steps

Based on the current version of the Proposal, Member States shall adopt the Directive by 31 December 2023 at the latest and they shall apply the provisions of the Directive from 1 January 2024. However, since we are at a very early stage of the procedure, it remains to be seen whether and if so, how quickly, all EU Member States will manage to agree on the Proposal. Therefore, both the specificities of the new rules and the time as from which these rules would become applicable remains to be confirmed.

We will monitor the developments over the legislative procedure and provide regular updates.

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Pillar Two: Why has the the EU directive proposal on Global Minimum Tax not yet been adopted?

OUR INSIGHTS AT A GLANCE

- Back in December 2021, the model rules to give effect to the GloBE rules (also called "Pillar Two") were published by the OECD and the EU published a proposed Directive.
- Some concerns were raised by the EU Member States, so the EU Council published two amended proposals for a Directive on GloBE, in March 2022. The final amended Directive proposal differs slightly from the initial proposal, mainly on the time limit for transposition.
- It was initially expected that the Directive would have been adopted by the end of June 2022. Nevertheless, a consensus was not reached at the ECOFIN meetings on 5 April 2022 and 17 June 2022.
- Politically, the EU is struggling to have this Directive proposal adopted, giving a new argument to critics of the unanimity voting requirement in tax matters.

The Global Anti-Base Erosion ("GloBE") rules, also called "Pillar Two", agreed upon on 8 October 2021 by the OECD/G20 Inclusive Framework ("IF") on BEPS in the Statement to Address the Tax Challenges Arising from the Digitalisation of the Economy and the Detailed Implementation Plan, provide for a coordinated system of taxation intended to ensure large multinational enterprise ("MNE") groups pay a minimum level of tax on the income arising in each of the jurisdictions they operate in. The model rules to give effect to the GloBE rules (the "OECD Model Rules") were published by the OECD on 20 December 2021.

Two days later, the EU Commission published a proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the UE ("GloBE Directive Proposal"). The GloBE Directive Proposal follows the OECD Model Rules closely, with some differences to ensure its compatibility with EU law, and sets out how to calculate and apply the OECD global minimum taxation so that it is properly and consistently applied across the EU.

The initial aim of the EU Commission was to have this GloBE Directive Proposal adopted within 6 months. Nevertheless, practically, the EU is struggling to reach unanimous agreement on the GloBE Directive Proposal.

Here is the state of play:

Following to the ECOFIN meeting held in January 2022, where concerns were raised by a few Member States on the GloBE Directive Proposal, the EU Council published an amended GloBE Directive Proposal (the "Compromise Proposal"), dated 12 March 2022, which differed slightly from the initial Directive proposal, mainly, on the time limit for transposition. As four Member States were still not in a position to approve the Compromise Proposal at the ECOFIN meeting held on 15 March 2022, further work was done to address those last concerns. As a result, the EU Council published a new amended Directive Proposal dated 28 March 2022 (the "Presidency Compromise Text" or, together with the Compromise Proposal the "Amended GloBE Directive Proposal").

Even though the French Council Presidency was confident that an agreement could be reached soon and that the Compromise Proposal could have been approved at the following ECOFIN meeting to be held on 5 April 2022, this approval was delayed once again. On 5 April 2022, during the ECOFIN meeting, things did not really happen as expected by the French Presidency. If Estonia, Sweden, and Malta were finally in a position to approve the Amended GloBE Directive Proposal because they were confident

that their concerns had been addressed in the Presidency Compromise Text, Poland maintained its position that Pillar One and Pillar Two should be seen as a package in a single reform and that a Council statement to that purpose wasn't sufficiently binding legally to assure the implementation at EU level of both the 2 Pillars.

Everybody seemed ready to adopt the GloBE Directive Proposal but…

After negotiations, Poland is finally ready to accept a Council declaration that reaffirms the commitment of the EU to the Statement on a Two-Pillar Solution and to support the Amended GloBE Directive Proposal. Nevertheless, many EU commentators consider that Poland has in fact used its veto right as a lever to obtain the validation of its Polish national recovery and resilience plan, which has been blocked, mainly due to breaches of the "rule of law" principles.

As all Member States had expressed their support to the Amended GloBE Directive Proposal except Poland and Poland was now finally ready to support the proposal, all EU Member States seemed ready to adopt the Directive Proposal at the ECOFIN meeting held on 17 June 2022. But this was without counting on the unexpected reversal of Hungary's position.

At the ECOFIN meeting held on 17 June 2022, Hungary raised new concerns – the war in Ukraine which is a major economic and social shock for the continent; the unfavourable geopolitical situation and increasing prices of energy and commodities in the whole European economic region; the increasing interest rates and inflation, the disrupted supply chains. According to Hungary, the EU Commission and Member States should pay attention to the consequences of the war as all these unfavourable developments cause significant losses to companies and household families, and under such circumstances introducing the global minimum tax, at such an early stage, would cause serious damage to the European economies. Secondly, after the recent general elections in Hungary, more vocal and critical voices regarding the Global minimum tax can be heard from many representatives in the Hungarian parliament.

Furthermore, Hungary has consistently stressed that the implementation of Pillar Two, as part of a large-scale package including also Pillar One, at OECD level was key. And in this respect, currently, significant further work is still required regarding Pillar Two, both on substantial and procedural questions before the practical application of the global minimum tax rules. Moreover, the OECD has already declared that the Pillar One project will not be able to meet its agreed deadline. As none of the EU partners neither in America, nor in Asia have transposed Pillar Two yet, the EU is not late and, as the technical work is not ready at the OECD level, taxpayers cannot fully launch the preparation for this complex system either.

As a results of these elements, at that stage, Hungary withdrew its support of the adoption of the Amended GloBE Directive Proposal.

Implications of the reversal of Hungary's position

The declaration of Hungary came as a surprise because Hungary had previously expressed their support to the Amended GloBE Directive Proposal, even after the war had started. This is not very common, and we have no recollection of this happening before, i.e. a Member State reconsiders its positive position and applies its "veto".

Even if the French Presidency was still working to reach political agreement to the Draft Proposal by the end of June, substantial obstacles must be overcome to that aim. Indeed, the EU has very little if any control over the justifications raised by Hungary, such as the Ukrainian war, the economic environment, the result of the national elections and the absence of implementation of the Pillar Two rules elsewhere amongst the OECD jurisdictions.

As no agreement could be reached before the end of the French Presidency of the EU Council on 30 June 2022, the procedure for the adoption of the Directive Proposal will progress under the Czech Presidency beginning on 1 July 2022. The Czech Presidency will then have to start to discuss with Hungary the conditions under which the Directive Proposal could get Hungarian support. In this respect, the question is whether Hungary has other issues – as Poland was rumoured to have in relation to its national recovery and resilience plan – and used its veto right as a lever.

In any case, this saga brings the question of the unanimity required for the adoption of tax measures at EU level back on the table. Bruno Le Maire and Paolo Gentiloni stressed in this respect that the current negotiations and recent vicissitudes on minimum taxation are a good example of why the EU should move from unanimity to qualified majority voting in tax matters. According to Bruno Le Maire "*On key texts like this one, we cannot rely on unanimity anymore and we need to have qualified majority voting*" to speed up the process. "*If this was QMV (…) years ago we would already have a new tax regime which would have enabled to have new tax resources meeting the concerns of our citizens*".

Fueled by the Hungarian veto on the Amended GloBE Directive Proposal after endorsing Pillar Two at the OECD level and supporting the adoption of that proposal in previous ECOFIN meetings, members of the European Parliament discussed, in a plenary session on 23 June 2022, recent failures to adopt EU legislation in the field of taxation because of the opposition of a single Member State.

Some MEPs are in favour of a prompt solution: either by moving forward with an enhanced cooperation procedure or by moving from the unanimity voting to a qualified majority voting in the Council in the field of taxation. The latter option has been widely debated in the past months. Conversely, other MEPs strongly oppose the push by the Commission and the French Presidency for an agreement where a sovereign State has already expressed its veto, claiming that this persistence is also a breach of the Rule of Law and of the sovereignty principle.

First, it must be pointed out that the aim of the unanimity voting in the field of taxation is not to slow down the process, but to respect the sovereignty principle of Member States in the field of taxation, as taxation impinges on the Member States own finances and budgets. It also guarantees, in a way, the constitutional principle shared by many Member States that there should be "no taxation without representation". In this respect, the EU Commission is not elected by the citizens and in principle, no delegate of Member States at the EU Council should approve a directive proposal in the taxation field at the ECOFIN meeting without the support of its own democratically elected parliament. Indeed, once an EU directive is approved at EU level, national parliaments must implement it and do not have the opportunity to oppose to it anymore. Recently, in a sign of opposition to this principle, the Hungarian Parliament voted a resolution to reject the approval of the Amended GloBE Directive Proposal.

Nevertheless, if the reversal of Hungary's position is questionable, the pitfalls met in this case are not the best foundation on which to challenge unanimity voting. Indeed, first, Poland opposed to the Proposal because of its own interpretation of the OECD agreement that the proposal is supposed to implement. Second, Hungary does not oppose the adoption of the content of the Proposal itself, but the timing of its adoption taking into consideration the worldwide economic situation and the implementation process of the same rules on global minimum taxation by the other OECD jurisdictions - elements on which the EU has no control over. And this is probably something that the EU will have to live with, especially when it will come to the implementation of worldwide regulations where the EU is not the main but only one of the actors of a broader scene.

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VAT deduction right of holding companies: Important judgement of the Court of Cassation

OUR INSIGHTS AT A GLANCE

- The Luxembourg Court of Cassation (hereafter the "Court") ruled that the VAT deduction right of a holding company does not have to be limited by the 1:1 ratio when it can be demonstrated that the input VAT incurred is related to the part of its turnover granting a VAT deduction right.
- The Court ruled that a discrepancy between the volume of costs borne and the income granting a VAT deduction right earned shall not lead automatically to a limitation of the VAT deduction right.
- In line with EU VAT principles, this judgment is very welcome for Luxembourg holding companies performing VAT taxable activities (e.g. holding providing management services to group companies, etc.).

On 17 March 2022[2], the Luxembourg Court of Cassation (hereafter the "**Court**") ruled that the VAT deduction right of a holding company does not have to be limited by the 1:1 ratio when it can be demonstrated that the input VAT incurred is related to the part of its turnover granting a VAT deduction right. The Court ruled that a discrepancy between the volume of costs borne and the income granting a VAT deduction right earned shall not lead automatically to a limitation of the VAT deduction right.

Background

In the case at hand, a Luxembourg company X, member of a real estate group, provided management services to subsidiaries and to related parties. Furthermore, X held shares in subsidiaries to which it also granted loans.

From a VAT perspective, X performed both activities granting a VAT deduction right (i.e. management services) and activities not granting such a VAT deduction right (i.e. the holding of shares and the granting of EU financing). To limit its VAT deduction right, X used a prorata amounting to 94% for 2004 and of 91% for 2005.

The VAT authorities challenged the VAT recovery right of X on the ground that the costs incurred by the company were higher than the turnover granting a VAT deduction right earned. According to the VAT authorities and in order to benefit from the deduction right, X had to demonstrate that the costs incurred were:

- directly and immediately linked to its economic activity granting a VAT deduction right, and
- incorporated in the price of the services provided granting a VAT deduction right.

Noticing that the costs incurred by X were higher than its turnover, the VAT authorities considered that the costs were not incorporated in the price of the services rendered and, therefore, the VAT deduction right of X should be limited in due proportion to its turnover granting a VAT recovery right (the so-called "1:1 ratio").

The decision of the Director of the VAT authorities was brought to the Luxembourg District Court and to the Court of Appeal. In the frame of the litigation and to assess the "direct and immediate link", an expert was mandated by the District Court to determine whether the costs borne by X were effectively related to its activity granting a VAT deduction right. The conclusion of the expert report was

[2] n°43/2022 from 17 March 2022

that the costs borne by X were related to its management activity (i.e. to its activity granting a VAT recovery right).

Position of the Court

The Court confirmed the position of the Court of Appel based on which X was entitled to deduct the input VAT incurred:

- considering the demonstrated "direct and immediate link" of the input VAT incurred by X in relation to its economic activity granting a VAT recovery right,
- irrespectively of the huge difference between the volume of costs incurred and the limited income granting a VAT deduction right earned.

The Court also confirmed that the decision of the Court of Appeal was not challengeable on the ground that the incorporation of the costs borne by X in its turnover granting a VAT deduction right was not verified. In other words, the Court confirmed that the demonstration of the incorporation of the price of the costs borne in the turnover granting a VAT deduction right is not a condition to benefit from the right to deduct.

Actions to be taken

This case has a positive impact on the VAT deduction right of active holding companies, i.e. companies whose activities go beyond the mere passive holding of shares and which provide services, such as management or administrative services to their subsidiaries. To the extent that the "direct and immediate link" is demonstrated by factual elements (agreements, invoices, etc., making a clear link between the costs and the turnover), Luxembourg holding companies should no longer see their VAT deduction right challenged by the VAT authorities using the 1:1 ratio.

We recommend active holding companies to review their VAT deduction methodology and the documentation available to demonstrate the "direct and immediate link". Our VAT experts, Thibaut Boulangé, Silvin Leibengut and Ophélie Saine-Bourgeois are available to discuss the outcome of that case and to assess the VAT recovery right of active holding companies.

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Director's liability for non-payment of the VAT to the Treasury: Recent Luxembourg case law

OUR INSIGHTS AT A GLANCE

- The director of a Luxembourg limited company is jointly liable for the payment of the VAT to the Treasury when his failure to carry out its obligations is considered as a fault.
- The District Court of Luxembourg concluded that the non-payment of the VAT is constitutive of a fault if the director gives priority to the payment of the salaries to employees over the payment of the VAT to the Treasury.
- Directors should be aware of the VAT obligations of the company they manage to avoid potential joint liability towards the VAT authorities.

The director of a Luxembourg limited company is jointly liable for the payment of the VAT to the Treasury when his failure to carry out its obligations is considered as a fault. On 24 November 2021[3], the District Court of Luxembourg concluded that the non-payment of the VAT is constitutive of a fault if the director gives priority to the payment of the salaries to employees over the payment of the VAT to the Treasury.

Background

Mr. A. was director of a limited company between 2017 and 2019. While the company was in a precarious financial situation, Mr. A. took the decision to pay the salary of employees instead of the VAT due to the Treasury. The company finally went bankrupt in 2019 and the VAT authorities considered that Mr. A. was personally and jointly liable for the payment of the VAT debt of the company.

The position of the VAT authorities was notably based on article 67-1 of the Luxembourg VAT law. Based on this provision, directors have the obligation to ensure that the company they manage is compliant with the VAT law and that the VAT is paid to the Treasury with the financial means of the company.

Mr. A. introduced a claim against the decision of the Director of the VAT authorities ("Bulletin d'appel en garantie") arguing notably that the non-payment of the VAT was not the consequence of a fault in the case at hand.

Position of the Luxembourg District Court

In carrying out its analysis, the Court reviewed the criteria to be met to engage the liability of directors. Articles 67-2 and 67-3 of the VAT law detail these conditions.

- First condition: Non-fulfillment of the company's VAT obligations

In the case at hand, the District Court concluded that the company did not fulfill its VAT obligations as the VAT due to the Treasury was unpaid.

- Second condition: Non-fulfillment of the company's VAT obligations results from a fault of the director.

In its reasoning, the District Court started by recalling that the liability of a director can be engaged only in case of faulty non-execution of its obligation. Mr. A, as a director, had the obligation to ensure that the company managed was compliant with the VAT law and that the VAT due was paid to the Treasury with the financial means of the company.

[3] 2021TALCH08/00162

Since the company did not pay the VAT to the Treasury, the District Court checked whether the non-payment was the consequence of a fault of Mr. A. In other words, did the director took all the possible reasonable actions to have the VAT paid to the Treasury? Based on the file submitted to the District Court, it appeared that the Director gave priority to the payment of the salaries over the payment of the VAT. Following these salary payments, the company had not enough financial means left to pay its VAT debt to the Treasury. On that ground, the Court concluded that the company had the financial means to pay its VAT liability and that the non-payment resulted from a choice of the director to give priority to the payment of the salaries. According to the Court, such a choice of the director was constitutive of a fault and the VAT authorities were therefore well founded to seek its liability.

Actions to be taken

The outcome of this case should draw the attention of directors on their own liability with respect to the VAT obligations of the companies they manage.

While paying the VAT to the Treasury following the filing of VAT returns is obvious, attention should also be paid to companies not registered for VAT but having obligations to do so. This could notably be the case for companies with VAT exempt turnover (e.g. interest income earned from EU borrowers) receiving taxable services from abroad and being not registered for Luxembourg VAT purposes.

We strongly recommend that directors review the VAT status of the companies they manage to ensure compliance with the Luxembourg VAT law and to avoid potential risks of joint liability. Our VAT experts, Thibaut Boulangé and Silvin Leibengut, are available to discuss the outcome of that case and to perform VAT compliance sanity checks.

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New CSSF guidance for consumers investing in virtual assets

OUR INSIGHTS AT A GLANCE

- On 27 April 2022, the Commission de Surveillance du Secteur Financier ("**CSSF**") released some new guidance to the attention of consumers who have obtained an increasing access to virtual assets through a wide variety of means and are exposed to promotion campaigns done via a high number of - sometimes untraditional - media, including social media platforms or other digital communication channels.
- This new guidance follows previous warnings to consumers issued on 14 March 2018 by the CSSF in relation to virtual assets and initial coin offerings and is in line with the traditional position of the CSSF to promote a neutral and prudent regulatory approach.
- The guidance is published "*with the aim of helping consumers, who despite the risks inherent to virtual assets are willing to invest in them, by outlining some minimum steps to be performed before investing*" and is built on two pillars: "*educate yourself*" and "*prefer regulated entities*".

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The guidance is published "*with the aim of helping consumers, who despite the risks inherent to virtual assets are willing to invest in them, by outlining some minimum steps to be performed before investing*", and is built on two pillars:

"Educate yourself"

Any consumer contemplating an investment in virtual assets is invited to have the highest level of understanding and knowledge of the instrument in which it intends to invest. The CSSF rightly points out that virtual assets may be of very diverse nature, have very different features and functions, and may, therefore, entail very different risks, far from the basic representation one may have from this asset class.

This warning is of particular importance given the absence of a detailed legal framework for virtual assets, and the absence of technical standards or transparency rules for the industry. The Terra (Luna) collapse, or the Celsius Network incapacity to honour redemptions in a bear market, are just a few examples that demonstrate where certain misconceptions may arise from.

In brief, consumers are invited to only invest an amount of money that they can afford to lose. This reminder is somewhat in line with the restriction imposed by the CSSF, whereby investments in virtual assets may only be offered by alternative investment funds to professional investors.

"Prefer regulated entities"

It is quite interesting to note that the CSSF recommends consumers to direct their investment to entities that are regulated or partially regulated, this being intended to

minimise risks relating to money laundering, terrorist financing or criminal activities, as well as fraud and manipulation.

The CSSF goes even further and points out that "*additional risks may arise if an entity is under some regulation in a foreign country which entails the application of the legal framework of a foreign jurisdiction*", thus favouring the investment through Luxembourg regulated or partially regulated entities.

We may only concur with this approach. Over the last two to three years, significant investments have been made by market participants in Luxembourg to build and offer a comprehensive and high-end suite of investment products relating to virtual assets, as well as services pertaining directly or indirectly to such products: Investment management, fund administration, custody, etc.

More is yet to come, and market participants rely on the regulator to maintain a constructive and agnostic approach, ahead of the upcoming Markets in Crypto-Assets Regulation ("**MiCA**").

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