Tax on Inbound Investment

In 31 jurisdictions worldwide

Contributing editors
Peter Maher and Lew Steinberg

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GETTING THE DEAL THROUGH

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Luxembourg

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Acquisitions (from the buyer's perspective)

1 Tax treatment of different acquisitions

What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?

An asset deal generally allows a buyer to achieve a step-up in basis in respect of the acquired assets and liabilities, whereas a share deal does not result in such a step-up (although there will obviously be a step-up in basis for the acquired shares). Depending on the nature of the assets and liabilities, the acquisition thereof may result in a non-resident buyer to be considered to have a taxable presence in Luxembourg via a fixed place of business or permanent establishment which would bring the buyer within the scope of Luxembourg taxation, namely, direct taxes such as (corporate or personal) income tax and net wealth tax and indirect taxes (VAT). The acquisition of shares in a Luxembourg company does not necessarily result in a taxable presence in Luxembourg, however when acquiring a substantial participation in a Luxembourg company the buyer becomes subject to the Luxembourg non-resident capital gains taxation which could, albeit rarely, result in a gain to be subject to Luxembourg non-resident capital gains tax (as explained in more detail in question 16).

2 Step-up in basis

In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?

As mentioned above, the buyer enjoys a step-up in basis only in case of an asset deal. Goodwill and other intangibles can be depreciated for Luxembourg tax purposes only when they are specifically identified and acquired within the framework of an asset deal and depending on their nature (intangibles that do reduce in value may not be depreciable). In case of a share deal, goodwill held by the acquired company can neither be depreciated by the buyer nor by the acquired company itself if such goodwill has not been acquired separately but has been built up over time.

3 Domicile of acquisition company

Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?

For an asset deal there is not much difference between an acquisition of such assets by a foreign company or by a Luxembourg company, when the business continues to be carried out in Luxembourg via a permanent establishment. A permanent establishment in Luxembourg of a foreign company is generally subject to the same income tax and net wealth tax as is the case for a Luxembourg company. However, where profit repatriations from Luxembourg permanent establishments or branches to the foreign head office are not subject to Luxembourg withholding tax, dividend distributions made by Luxembourg companies are in principle subject to 15 per cent dividend withholding under Luxembourg domestic tax rules, unless a reduced rate or exemption applies on the basis of a tax treaty or pursuant to Luxembourg domestic tax law. Dividend withholding tax exemptions available under Luxembourg tax law are addressed in question 13.

For a share deal, a Luxembourg acquisition company may allow for a better way to push down the acquisition debt to the business of the target company, for example, via a legal merger or via the establishment of a tax consolidation. A Luxembourg permanent establishment of a foreign company can act as the consolidating parent in a Luxembourg tax consolidation, provided the foreign company is a capital company (ie, joint stock company with a capital divided and represented by shares) which is subject to a tax in its country of residence which is comparable to Luxembourg corporate income tax (ie, a tax levied on a compulsory basis by a public authority at a statutory rate of at least 10.5 per cent on a taxable basis that is comparable to the taxable basis determined under Luxembourg rules).

For buyers who are not protected by a tax treaty or who do not qualify for dividend withholding tax exemption, it may make sense to acquire the shares of a Luxembourg target company via a Luxembourg acquisition company so as to ensure a tax efficient profit repatriation in the future via a proper funding of the Luxembourg acquisition company.

4 Company mergers and share exchanges

Are company mergers or share exchanges common forms of acquisition?

Mergers are common as a way to push down the acquisition debt to the level of the operating business. Interest expenses on debt taken up to acquire the target are, in principle, deductible within the limits of Luxembourg thin capitalisation. However, such expenses are, in any tax year, only deductible to the extent they exceed the amount of exempt dividend received from the target in the same tax year, in other words, up to the amount of the exempt dividend, the expenses will not be tax deductible. Any excess expenses so deductible could result in the company producing tax losses for carry forward.

Furthermore, any such deductible interest remains subject to Luxembourg's recapture rules: as and when shares in the target would be transferred at a (deemed) gain, such gain will, up to the amount of recapture, be subject to Luxembourg income tax irrespective of the fact that the target may satisfy the conditions of the Luxembourg participation exemption. To the extent that the capital gain exceeds the amount subject to recapture, the gain continues to be exempt from Luxembourg income tax (participation exemption). The amount of taxable gain can be offset by the losses available for carry-forward. Consequently, unless the amount of interest on acquisition debt has effectively been offset against other items of taxable income, the application of the recapture rule should not result in an effective tax liability for the acquiring entity.

Since the Luxembourg tax consolidation regime does not result in a full tax integration of its members, the above basically remains applicable even if a tax consolidation exists. A tax consolidation therefore does not achieve the same result as a debt pushdown carried out via a legal merger. Moreover, the tax consolidation regime requires a consolidation for at least five years. Failing to meet this condition would result in the tax consolidation to be retroactively denied.

5 Tax benefits in issuing stock

Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

Luxembourg imposes 15 per cent dividend withholding tax and 0.5 per cent annual net wealth tax (the tax basis of which equals the estimated fair market value of the asset minus the liabilities). However, Luxembourg generally does not impose withholding tax on arm's-length interest, unless the interest would fall within the scope of the EU Savings Directive or would have a profit sharing nature. Consequently, there is generally no Luxembourg tax benefit for the buyer to finance the acquisition of the target via the issuance of new shares (unless the seller is co-investing). In fact, from a Luxembourg (tax) perspective, it is generally more efficient and flexible to finance the acquisition with debt (or a combination of debt and equity) within the limits of Luxembourg thin capitalisation rules.

6 Transaction taxes

Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

Asset deals are subject to VAT (the general rate of which equals 15 per cent), and may be subject to registration duties or transfer taxes, as is the case for real estate situated in Luxembourg (the transfer of real estate situated in Luxembourg City is subject to up to 10 per cent registration and transcription duties). An exemption of VAT is available in case of a transfer of a whole business or a business unit (acquisition of a going concern). VAT and real estate transfer taxes are borne by the buyer of the assets.

The transfer of shares in a Luxembourg company are not subject to any stamp duties or registration. Under very exceptional circumstances, the transfer of a Luxembourg real estate company could be considered the transfer of the underlying real estate and therefore trigger real estate transfer taxes.

7 Net operating losses, other tax attributes and insolvency proceedings

Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

Under Luxembourg tax law, tax losses can be carried forward indefinitely, whereas loss carry back is not possible. Luxembourg tax law does contain specific change of control rules that prohibit loss carry forward. However, tax losses can only be carried forward and claimed by the legal person that has incurred such losses. Consequently, tax losses may be lost in case of mergers or demergers. Generally, and where possible, the reorganisation ensures the loss making company to be the surviving entity. Alternatively, tax-neutral rollovers (which are available under certain conditions) are carried out only partially in view of utilising the tax losses before they would be lost.

A change of shareholders of a Luxembourg company, which has tax losses available for carry forward, does not automatically result in such tax losses to be lost. This may be different in cases of abuse. On the basis of certain case law and a circular letter issued by the Luxembourg tax authorities, loss carry forward and usage of such losses could be denied in case of a change of shareholder if, on the basis of facts and circumstances, it appears that the transfer has been solely carried out for the purpose of using the tax losses. Examples of facts and circumstances that could indicate such abuse would be the discontinuation of the activity having given rise to the losses; the absence of any real value of the (assets of the) transferred company (no economic substance); a change of activity concomitantly with the transfer of the shares, etc.

Debt waivers made in the framework of reorganisation may also lead to a reduction of losses carried forward.

8 Interest relief

Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

Genuine business expenses are deductible insofar as they remunerate real services provided to the company, they are not economically linked to exempt income, considering they are arm's-length and, as regards interest expenses, they are not profit-sharing.

Expenses which are economically linked to exempt income are not tax deductible. Under the above conditions, financing expenses incurred by the buyer are thus deductible for Luxembourg income tax purposes (subject to recapture; see question 4).

Luxembourg tax law does not codify thin capitalisation rules, as such, and general transfer pricing rules apply. A company can thus be funded in compliance with thin capitalisation rules if it is funded under a debt-equity ratio under which an unrelated party would have funded the company having as sole collateral the assets held by the company. If such ratio cannot be demonstrated by the taxpayer, the tax authorities tend to apply an 85:15 debt-equity ratio in respect of the financing of participations. This ratio aims at avoiding excessive interest charges only. Consequently, debt funding in excess of this ratio is still acceptable provided the interest rate is reduced accordingly so that the total amount of interest would still be in line with an 85:15 debt-equity funding.

Interest expenses that are economically linked to exempt income are not deductible. However, for participations that qualify for the Luxembourg participation exemption regime, interest on acquisition debt is considered not linked to exempt income, and is thus fully tax deductible, insofar as the amount of interest for any given tax year exceeds the amount of exempt income (dividends or capital gains) derived from such participation during the same tax year. Such interest, therefore, continues to be tax deductible, albeit subject to recapture (as mentioned in question 4).

Luxembourg does not levy a withholding tax on arm's-length interest, unless the interest is paid on certain types of profit sharing debt instruments and arrangements or in case the interest would fall within the scope of the EU Savings Directive (ie, interest which is paid to or secured for the benefit of individuals residing in the EU or to residual entities as defined in the EU Savings Directive).

Other than in view of the application of the EU Savings Directive, the residence of the lender is of no relevance for the above. Contrary to other jurisdictions, Luxembourg does not have special rules which would deny or limit the deduction of interest depending on whether or not the beneficiary of such interest would be taxable on the interest income. The deduction is dependent on the ordinary Luxembourg tax rules, including the application of transfer pricing rules. Consequently, for a debt push down structure, the same rules regarding deduction limitations and thin capitalisation rules, as mentioned above, apply. For debt pushdown techniques ('reverse' or 'down-stream' merger, tax consolidation, etc), reference is made to what is stated in question 4 above.

9 Protections for acquisitions

What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?

Protection takes the form of generally and internationally accepted representation and warranties combined with amounts left in escrow and or earn-out payments. An indemnity payment received is generally treated as a correction of the initial acquisition price (whether for asset deals or share deals), and should not lead to taxable income. Likewise, withholding tax issues should not arise unless payments (such as guarantees) represent interest payments due in which withholding taxes may arise under, for example, the EU Savings Directive as mentioned above.

Post-acquisition planning

10 Restructuring

What post-acquisition restructuring, if any, is typically carried out and why?

Post-acquisition restructuring that typically comes to mind would be debt pushdowns, however Luxembourg does not have a very active domestic mergers and acquisitions market and mergers and acquisitions transactions involving Luxembourg entities very often concern targets in foreign jurisdictions.

11 Spin-offs

Can tax-neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?

A tax-neutral spin-off is possible subject to certain conditions. A tax-neutral spin-off requires:
- the transfer of a business or an autonomous part of a business;
- a safeguarding of a later taxation of the capital gains deferred as a result of the tax-neutral spin-off (ie, tax book value of the assets it has rolled over); and
- the attribution of new shares issued to each shareholder on a pro rata basis whereby any cash payment may not exceed 10 per cent of the par value (or accounting par value) of the newly issued shares.

In case the tax book value of assets is continued following the de-merger, the historical acquisition date of such assets will also be continued.

Subject to similar conditions, a tax-neutral demerger of a Luxembourg company may be available when a business or an autonomous part thereof is split towards two Luxembourg companies, towards one or more EU resident companies as well as a combination thereof.

12 Migration of residence

Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?

Yes, this is possible.

In principle, a migration of the residence of a Luxembourg company is considered a liquidation of that company for Luxembourg tax purposes, triggering a tax liability on any unrealised profits included in the assets of the migrated company. However, insofar the assets of such company remain attributable to a permanent establishment carried on in Luxembourg, the migration can be carried out at tax book value, which prevents a tax liability to arise on the unrealised profits connected to such assets. Similarly, a tax-neutral transfer of a Luxembourg permanent establishment from a company established in an EU country (other than Luxembourg) to another company established in an EU country can be carried out, for example, upon a transfer resulting from a contribution of a business or an independent part thereof, upon merger or upon demerger or spin-off.

Furthermore, where assets are being transferred from Luxembourg to another EEA country, for example, upon migration of the Luxembourg company to such country, the taxpayer will, upon request, be entitled to a deferral of income taxation (attributable to the unrealised profit included in such assets at the time of transfer to another EEA country) for as long as it continues to be the owner of such assets and for as long as it continues to be a resident of another EEA country. The tax amount subject to deferral does not bear interest, and the taxpayer is allowed to renounce its request for tax deferral.

13 Interest and dividend payments

Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?

Luxembourg does not levy a withholding tax on arm's-length interest, with the exception of interest paid on certain types of profit sharing debt instruments and arrangements and interest that falls within the scope of the EU Savings Directive and related Luxembourg tax legislation (see question 5).

In principle, 15 per cent dividend withholding tax will be due on profits distributions made by Luxembourg resident companies (see question 3). However, a domestic dividend withholding tax exemption applies if:
- the dividend distribution is made to:
  - a fully taxable Luxembourg resident company;
  - an EU entity qualifying under the EU Parent-Subsidiary Directive;
  - a Luxembourg branch or EU branch of such EU entity or a Luxembourg branch of a company that is resident of a treaty country;
  - a Swiss resident company subject to Swiss corporate income tax without benefiting from an exemption; or to
  - a company which is resident in an EEA country or a country with which Luxembourg has concluded a tax treaty and which is subject to an income tax comparable to the Luxembourg corporate tax (ie, subject to a statutory tax rate of at least 10.5 per cent and a comparable tax base); and
- the recipient of such dividend has held or commits itself to continue to hold a direct participation in the Luxembourg company of at least 10 per cent of the share capital or such number of shares that represent a historical acquisition price of €1.2 million for an uninterrupted period of at least 12 months.

In addition to the foregoing dividend withholding tax exemptions, the liquidation of a Luxembourg company is treated as a capital (gain) transaction and is, therefore, not subject to Luxembourg dividend withholding tax.

14 Tax-efficient extraction of profits

What other tax-efficient means are adopted for extracting profits from your jurisdiction?

In the event that a dividend withholding tax exemption would not be available under Luxembourg domestic tax law (as summarised in question 13), profits can be extracted from a Luxembourg company tax efficiently by means of the (full or partial) liquidation of a Luxembourg company. Alternatively, profits can be repatriated by means of interest payments being made under convertible or income-sharing type of debt, bearing in mind previous remarks regarding debt-equity ratios and on the interest being considered at arm's length.

As is the case with a liquidation of a Luxembourg company, a repurchase and cancellation by a Luxembourg company of part of its own shares forming the entire participation of a shareholder (referred to as 'partial liquidation'), who thereby ceases to be a shareholder, is equally treated as a capital (gain) transaction and is therefore equally not subject to Luxembourg dividend withholding tax. A liquidation of a Luxembourg company or a repurchase of shares may, however, trigger non-resident capital gains tax (as explained in question 16).

Disposals (from the seller's perspective)

15 Disposals

How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

As mentioned, Luxembourg does not have a very large domestic mergers and acquisitions market. Mergers and acquisitions transactions generally encompass the acquisition, via Luxembourg companies, of target companies in foreign jurisdictions by foreign investors. Consequently, the disposition of the investment is either carried out by means of a disposition of the shares in the target company itself (eg, by the Luxembourg company) or via the disposition of the shares in the Luxembourg company (by the investor, ie, an indirect sale of the target company). Subject to meeting the conditions of the Luxembourg participation exemption, the capital gains should not be subject to Luxembourg income tax. Similarly, subject to the non-resident capital gains tax rules (as mentioned in question 16), the non-resident shareholder should not be subject to Luxembourg taxation upon a sale of the shares in the Luxembourg company.

16 Disposals of stock

Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?

Only in a very limited number of cases. Non-resident shareholders of Luxembourg companies may become subject to Luxembourg non-resident capital gains tax upon a transfer of shares in a Luxembourg company.

Gains realised by non-resident shareholders on the alienation of a substantial shareholding interest in a Luxembourg company, including distributions received upon the (full or partial) liquidation of a Luxembourg company, are taxable if the gain is realised within a period of six months following the acquisition of such shares. A shareholding is considered 'substantial' where it represents more than 10 per cent of the shares held in a Luxembourg company.

Where the non-resident shareholder (individual) has been a Luxembourg resident for more than 15 years before becoming a non-resident other rules may apply.

Moreover, depending on where the non-resident shareholder is a resident, protection against Luxembourg non-resident capital gains tax may be available under a tax treaty.

17 Avoiding and deferring tax

If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?

As mentioned, the disposition of shares in a Luxembourg company should only exceptionally result in non-resident capital gains tax (see question 16).

The disposition of business assets by a Luxembourg company generally results in taxation on the unrealised profits. Luxembourg tax law provides for some rollover relief, for example, when a Luxembourg company converts a receivable into shares issued by the debtor or for share-for-share mergers. Similarly, under certain conditions, business assets of a Luxembourg company can be transferred tax-neutrally to another legal owner by means of a legal merger or a demerger (see question 11).

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