LUXEMBOURG INTRODUCES NEW TAX MEASURE TOWARDS BLACKLISTED COUNTRIES

On 30 March 2020, the Luxembourg Finance Minister introduced the bill of law n° 7547 amending the Luxembourg income tax law (hereafter the "Bill of Law") with the Luxembourg Parliament.

The Bill of Law aims to implement into Luxembourg income tax law one of the defensive tax measures approved by the ECOFIN of 5 December 2019 towards jurisdictions listed on the EU list of non-cooperative tax jurisdictions (hereafter the "EU Blacklist").

I. Background

The ECOFIN of 5 December 2019 concluded that EU Member States should introduce at least one of the defensive tax measures endorsed by the Code of Conduct Group towards the jurisdictions listed on the EU Blacklist into their tax legislation with effect as of 2021.

The legislative defensive tax measures endorsed by the Code of Conduct Group consist of measures intended to:

- deny deductions of costs and payments directed to entities or persons in a black listed jurisdiction,
- apply additional or higher withholding taxes on payments to black listed jurisdictions,
- apply CFC rules specific for companies or permanent establishments located in a black-listed jurisdiction, or
- limit the benefits of the participation exemption.

The legislative defensive measures approved by the ECOFIN are intended to complement administrative defensive measures that EU Member States had committed to introduce following the ECOFIN of 5 December 2017.

II. Provisions of the Bill of Law

In line with the conclusions of the ECOFIN of 5 December 2019, the Bill of Law proposes, as a general rule, that interest and royalties paid or due by a Luxembourg company become non-deductible for Luxembourg income tax purposes if the beneficiary of the interest or royalty:

- qualifies as a corporate entity ("organisme à caractère collectif") within the meaning of Luxembourg income tax law,

- is a related party to the Luxembourg company within the meaning of Luxembourg income tax law, and
- is established in one of the jurisdictions included on the list of jurisdictions that are not cooperative in tax matters.

If the beneficiary of the interest or royalty due or paid is not the effective beneficiary, the interest or royalty paid should become non-deductible if the effective beneficiary meets all the above tests.

The Bill of Law foresees, however, one exception to this general rule. Thus, if the taxpayer is able to prove that the transaction under which the interest and royalties are paid or due is used for valid commercial reasons reflecting economic reality, the interest and royalties remain deductible (subject to other possible restrictions such as the interest deduction limitation rules) even if the above tests are all met.

The Bill of Law specifically defines interest and royalties that become non-deductible under the new rules. The definition is kept broad and is based on the definitions included in the OECD Model Tax Convention.

The provisions proposed by the Bill of Law will complement the administrative defensive measure introduced with effect as of 2018. As a consequence of this administrative defensive measure, Luxembourg companies are required as from their 2018 Luxembourg income tax returns to disclose if they were involved in transactions with related parties resident in a country included in the EU Blacklist. If yes, they are subject to a stricter review and audit by the Luxembourg tax authorities.

This administrative defensive measure is intended to be maintained.

III. Entry into force

The provisions of the Bill of Law are intended to apply with respect to interest or royalties paid or due as from 1 January 2021.

IV. Blacklisted jurisdictions and EU Blacklist

The Bill of Law does not yet include a list of blacklisted jurisdictions. It rather foresees that the Luxembourg Government will propose to the Luxembourg Parliament to complement the provisions of the Bill of Law at a later stage with the list of the jurisdictions that are included on the EU Blacklist.

According to the commentary of the Bill of Law the proposal of the list of blacklisted jurisdictions is expected to be made when the Luxembourg Government submits the Budget Bill for 2021 to the Luxembourg parliament. This list will be applicable to interest and royalties paid or due as of 1 January 2021.

The Bill of Law further foresees that the Luxembourg Government will propose once a year an update to the list of blacklisted jurisdictions. Again, the commentary to the Bill of Law clarify that such proposal should be made in the context of the Budget Bills to be submitted by the Luxembourg Government by the end of a calendar year for the following year. The update should be based on the latest EU Blacklist available when the Luxembourg Government proposes such update.

In case a jurisdiction is added to the list of blacklisted jurisdictions, the non-deductibility will apply to interest and royalties paid or due as of 1st January of the year following the year during which the country has been blacklisted. If a jurisdiction is removed from the list, interest and royalties paid or due should become tax deductible as from the date when the removal from the EU Blacklist has been made public (i.e. when it has been published in the Official Gazette of the EU).

The current version of the EU Blacklist includes American Samoa, the Cayman Islands, Fiji, Guam, Oman, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, the US Virgin Islands and Vanuatu. This EU Blacklist is subject to regular updates.

V. Interaction of the Bill of Law with other Luxembourg tax rules

Payments to entities established in jurisdictions that are not listed on the EU Blacklist and payments made to unrelated parties established in blacklisted jurisdictions remain subject to the general rules. Thus, payments to those entities are in principle tax deductible for Luxembourg tax payers, unless restrictions arising from the provisions implementing ATAD 1 and ATAD 2 would apply.

VI. Next steps

Luxembourg companies that have transactions with entities located in jurisdictions that are (potentially) blacklisted should assess the impact of this measure and should closely monitor the EU Blacklist. Our Tax Advisory team is at your disposal to assist you in order to assess the impact of the Bill of Law on your structure.

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