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“The notion of tax and the elimination of international double taxation or double non-taxation”

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Summary and conclusions

The concept of tax under Luxembourg domestic law is based on the basic distinction between compulsory levies that qualify as taxes (“*impôts”)* and other compulsory levies, such as fees (“*taxes”*). In general, the term tax can be defined as a compulsory monetary levy imposed by public authorities on the taxpayers in order to mainly raise revenue for which nothing is received in return. In Luxembourg, taxes can only be raised by the Luxembourg State and the municipalities in accordance with the principles of legality, equality and annuality.

The Luxembourg tax system relies on the basic distinction between direct and indirect taxes. The Luxembourg direct taxes are levied on items of income and of capital. The main Luxembourg income taxes are the individual income tax, the corporate income tax and the municipal business tax. The net wealth tax, the real estate tax and the subscription tax are the most important Luxembourg taxes levied on items of capital.

The Luxembourg notion of “tax” is crucial for the purpose of granting the domestic unilateral foreign tax credit, of applying the domestic participation exemption regime. As a rule, a foreign levy only qualifies for the purpose of such domestic provisions provided that such foreign levy is an income tax and that its main features are comparable to the Luxembourg income tax (i.e. a national income tax imposed on a similar taxable base.

The Luxembourg double tax treaty network normally follows the OECD Model Convention and it therefore provides that the Luxembourg double tax treaty applies to any taxes on income and capital levied by the State or the municipalities of each contracting state. As a rule, no specific definition of the term “tax” is included in the general definitions provision of the Luxembourg double tax treaties. A list of taxes is normally included in the treaties signed by Luxembourg, which covers the individual income tax, the corporate income tax, the municipal business tax and the net wealth tax.

Despite the inclusion of the municipal business tax in the list of taxes covered by the vast majority of the Luxembourg double tax treaties, the Luxembourg tax authorities take the view that foreign taxes can only be credited against the corporate income tax due in Luxembourg (and not against the municipal business tax due as well). The position of the Luxembourg tax authorities has been confirmed by the Luxembourg Administrative Court of Appeals in 2006. In order to avoid future disputes, as of 2006, the tax treaties signed by Luxembourg include a clear provision excluding the grant of a foreign tax credit for municipal business tax purposes.

The notion of tax is also key for the purpose of applying other treaty provisions, such as to grant access to tax treaties, the non-discrimination provision, to allocate taxing rights, to provide relief for juridical or economic double taxation (subject-to-tax clauses) and for the purpose of granting administrative assistance, being it exchange of information or assistance in the collection of taxes.

With respect to tax treaty entitlement, Luxembourg endorses the view that qualifying as a taxpayer and being subject to comprehensive taxation on the worldwide income (i.e. subjective tax liability) is sufficient to qualify as a resident for the purpose of any treaty signed by Luxembourg. However, in order to avoid tax treaty disputes, Luxembourg prefers to include provisions in its double tax treaties dealing with the treaty access of certain full or partially exempt entities, such as collective investment

vehicles and securitization vehicles. The Luxembourg tax authorities have recently released an administrative circular clarifying their position towards granting treaty benefits to Luxembourg collective investment vehicles, as well as confirming under which conditions such CIVs may obtain tax residence certificates.

As a general rule, the Luxembourg tax treaty policy is to reduce in as much as possible the scope of the exchange of information provision to the taxes listed in the relevant double tax treaty (instead of to "t*axes of every kind and description*"). The vast majority of the Luxembourg double tax treaties do not include any provision concerning assistance in the collection of any kind of taxes, being it listed in the relevant treaty (or not).

That being said, it should be noted that Luxembourg is also part of many other multilateral agreements on administrative assistance providing for a wider scope in the field of exchange of information and assistance in the collection of taxes which cover all forms of compulsory payments or taxes of any kind.

Despite the practical and crucial importance of the notion of tax and the expected growing importance of the definition of "tax" and "subject to tax" in the current international tax landscape and foreseeable developments, such as by the introduction of anti-abuse rules to address double non-taxation issues, anti-erosion rules, there is no precise or consistent definition of the term "tax".

1. The notion of tax

1.1 Domestic law meaning of tax

1.1.1 The definition of tax

The definition of the term tax (*impôt*) included in Art. 1 of the General Tax Law of 22 May 1931 (*Loi générale des impôts du 22 mai* 1931, *Abgabenordnung*) (**AO**) can be loosely translated as an occasional or a periodic compulsory monetary levy imposed by public authorities on the taxpayers in order to mainly raise revenue for which nothing is received in return.[1]

The main features for a levy to be considered as a tax can be summarized as follows:[2]

i. it is a compulsory monetary payment (and not in kind) imposed and collected by specific organs of government (i.e. the State and the municipalities)[3] in accordance with the principles of legality, equality and annuality[4];

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[1] See Olinger (1994), *Le droit fiscal: Introduction à l'étude du droit fiscal luxembourgeois*, Études Fiscales Nos. 93/94/95 (Luxembourg: Éditions Saint-Paul), p. 33, Barassi (2005), "The notion of tax and the different types of taxes: comparative approach" in Peeters, B. [et al.] (ed.), The concept of tax: 2005 EATLP Congress, Naples (Caserta), *EATLP international tax series*, vol. 3 ([s.l.]: EATLP), p. 62 and Steichen (2015), *Manuel de droit fiscal: le droit fiscal général*, 5th edition (Luxembourg: Éditions Saint-Paul), p. 24.

[2] See Olinger (1994), *op cit.*, pp. 34-35, Barassi (2005), *op cit.*, p. 62 and Steichen (2015), *op cit.*, pp. 24-27.

[3] E.g. the chamber of commerce fee is not a tax because it is imposed by the Chamber of Commerce (instead of by the Luxembourg state or the Luxembourg Municipalities).

[4] For that reason, the annual Luxembourg State Budget always includes a provision that provides for the continuity of all existing tax laws for the following calendar year.

ii. it is levied without anything received in return (i.e. not due in exchange for or to cover specific services and / or goods) in order to raise revenue to cover the State and the municipalities' budget or to serve other socio-economic aims[5];

iii. it is imposed on everybody who fits the factual and legal conditions; and

iv. it is a definitive payment (subject to certain exceptions, e.g. the tax advances exceed the total tax due).

Any compulsory payment that meets the above conditions will be considered as a tax, irrespective of its denomination.[6]

1.1.2 List of taxes levied in Luxembourg

The compulsory levies that can be considered to be taxes in Luxembourg are as follows:

- taxes on income[7]: individual income tax (**IIT**), corporate income tax (**CIT**) and municipal business tax (**MBT**);

- taxes on capital: net wealth tax (**NWT**), real estate tax, subscription tax, inheritance taxes and gift taxes; and

- indirect taxes: value added tax, customs and excise duties, registration taxes and assimilated taxes, insurance tax, taxes on motor vehicles, road and motorway tax for heavy goods vehicles and tax on licensed premises to sell/serve alcohol.

1.1.3 The distinction between taxes on income and on capital[8]

Income tax in Luxembourg comprises the IIT and CIT. Income tax is assessed on the aggregate net income derived by the relevant individual or corporate taxpayer in a calendar year.[9] There is also the MBT which is levied on the net income derived from the trading activities by corporations or partnerships in Luxembourg.

As an exception to that rule, Luxembourg corporate taxpayers may be subject to a minimum CIT whose taxable base is not determined by net income, but instead by reference to the type and / or value of the assets held by the relevant taxpayer (the **Minimum CIT**).[10]

[5] E.g. impose taxes to reduce the use of alcohol and tobacco or to promote environmentally investments (ecotaxes), e.g. taxes on motor vehicles (*vignette fiscale*) or beneficial amortization rules for ecological investments pursuant to Art. 32*bis* LIR.

[6] For example, *taxe sur la valeur ajoutée* (value added tax), *taxe d'abonnement* (subscription tax) and the *taxe de cabaretage* (tax on licensed premises to sell alcohol) are taxes, instead of fees (*taxe*).

[7] A contribution or unemployment fund surcharge is levied by the Luxembourg State on behalf of the employment fund and is assessed on the final amount of IIT and CIT due from the relevant taxpayer.

[8] Olinger (1994), *op cit.*, pp. 67-71, Poos (2002), *Notions fiscales de base concernant l'impôt sur le revenu*, Études Fiscales Nos. 124/127 (Luxembourg: Éditions Saint-Paul), pp. 24-28 and Steichen (2015), *op cit.*, pp.30-31.

[9] Arts. 6, 7 and 10-13 of the Luxembourg Income Tax Law (*Loi Concernant l'Impôt sur le Revenu of 4 December 1967*, **LIR**).

[10] Art. 174(6) LIR provides for a Minimum CIT (including the 7% unemployment fund surcharge), as follows: (i) for Luxembourg corporate taxpayers whose qualifying holding and financing assets exceed 90% of their balance sheet, the Minimum CIT amounts to EUR 3,210 (or to EUR 535 if their total assets do not exceed EUR 350,000); and (ii) for all other Luxembourg

In contrast, taxes on capital are levied on the unitary value of certain assets or net assets for tax purposes, irrespective of whether such assets produce income for their owners (or not), such as the NWT levied on the basis of the unitary value of the Luxembourg corporate taxpayers at the rate of 0.5% per annum.

1.1.4 The recognition of foreign levies as taxes under domestic law

1.1.4.1 For the purpose of granting the domestic unilateral tax credit

Luxembourg domestic law provides for a unilateral foreign tax credit under the so-called "ordinary credit method" (i.e. foreign taxes are creditable up to the amount of Luxembourg tax on the relevant foreign income).[11] The benefit of this unilateral domestic tax credit relief does not apply to income sourced in a treaty country, i.e. it does not apply to any income derived from a country with which Luxembourg has concluded a treaty for the avoidance of double taxation (**DTT**).[12] Any non-qualifying foreign taxes or excess foreign taxes that have not been credited (i.e. foreign taxes which exceed the Luxembourg tax on the relevant foreign income) may, however, be deducted as an expense for Luxembourg tax purposes.[13]

For a foreign tax to be creditable in Luxembourg under the domestic unilateral tax credit, such foreign tax must mandatorily be an income tax and its main features must be comparable to the Luxembourg income tax, which includes both the IIT and CIT.[14] In order to be comparable to the Luxembourg income tax, the foreign tax must be a national income tax imposed on a similar taxable base (i.e. on the income of the taxpayer, instead of on its capital, turnover or expenditure) and its tax rate should not be symbolic.[15] Late filing and late payment penalties, surcharges or fines triggered and paid in a foreign country are not creditable in Luxembourg under the domestic unilateral tax credit.[16] A foreign local tax may also be assimilated by law to a tax corresponding to the Luxembourg income tax.[17]

In order to be credited in Luxembourg, the foreign tax has to be final and effectively paid in money by the relevant taxpayer. The official supporting documents issued by the source state should be available and filed by such taxpayer upon request of the Luxembourg tax administration.[18]

Furthermore, if the foreign tax is paid or modified after the foreign income is taxed in Luxembourg[19], the taxpayer must inform the Luxembourg tax authorities of the payment or modification within one

corporate taxpayers, the Minimum CIT will be determined following a progressive tax scale based on the total balance sheet of the company ranging from EUR 535 to EUR 21,400.

[11] Art. 134*bis* LIR.

[12] Art. 134*bis*(1) LIR.

[13] Art. 13 LIR.

[14] Bill n° 2160, p. 1389; Circular n° 77 of 18 July 1980; Bouzidi, Feyten and Van Droogenbroek (2011), "Luxembourg National Report: Key practical issues to eliminate double taxation of business income" in *IFA cahiers de droit fiscal international 96b*, (The Hague: Sdu), pp. 403-404; Hubaux (1999), "Offsetting of foreign taxes for resident companies", 39 *European Taxation* 1 (Amsterdam: IBFD), p. 22; and Steichen (2015), *op cit.*, pp. 684-686.

[15] *Ibid.*

[16] Circular n° 77 of 18 July 1980.

[17] Art. 134*bis*(3)(a) LIR. As of 1982, the Swiss cantonal tax has been so-assimilated under the Grand-ducal regulation of 30 August 1982.

[18] Art. 134*bis*(1) LIR, Art. 2 of the Grand-ducal regulation of 3 May 1979 and Circular No. 77 of 18 July 1980.

month.[20] If the foreign tax is paid (or modified) within the Luxembourg statute of limitations period (i.e. 5 years), the tax returns may still be amended so that the amount of tax due would be increased or decreased, as the case may be.[21] Conversely, if the statute of limitations has expired at the time the foreign tax is paid or modified, it can no longer be credited (but it may be deducted as an expense in the tax year in which it is effectively incurred).[22]

Finally, only foreign taxes levied on items of income listed in the Luxembourg domestic law under Art. 134*bis*(2) LIR are creditable against the Luxembourg tax.[23]

1.1.4.2 For the purpose of granting the domestic participation exemption

One of the conditions to apply the domestic participation exemption regime regarding dividends, liquidation proceeds and capital gains[24] derived by a Luxembourg corporate taxpayer from a resident or non-resident affiliated enterprise for CIT and MBT purposes is the subject-to-tax requirement and the related classification of the foreign levy as an income tax that is comparable to the Luxembourg income tax. The same kind of subject-to-tax requirement has been implemented under Art. 147 LIR in order to provide for an exemption from withholding tax on Luxembourg-sourced dividends paid out to a resident or non-resident parent company, as well as to grant certain tax advantages or benefits to Luxembourg companies, such as the merger and divisions roll-over relief under Art. 170*bis* and the tax consolidation under Art. 164*bis*.

Generally, the Luxembourg tax authorities consider that the subject-to-tax requirement is met if the foreign levy[25] is comparable to the Luxembourg CIT, i.e. if the nominal rate of such foreign levy is at least 10.5%[26] and the taxable base is computed on the basis of rules and criteria similar to those applicable in Luxembourg, such as taxation on a worldwide basis (instead of a territorial basis). As a result, problems may arise if the foreign entity is subject to a corporate income tax that follows the territorial tax system or where foreign profits are tax exempt or taxed at a different rate. Temporary tax holidays (instead of permanent) granted to the foreign entity should not jeopardize the Luxembourg parent entity from benefiting from the aforementioned participation exemption regime.[27]

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[19] The foreign income is only recognised and taxed in Luxembourg when it is effectively recognised by the taxpayer in its accounts (*accrual basis*).

[20] Art. 134*bis*(1) LIR and Art. 3 of the Grand-ducal regulation of 3 May 1979.

[21] Art. 134*bis*(1) LIR and Bill n° 2160, p. 1389. See also, Bouzidi, Feyten and Van Droogenbroek (2011), *op cit.*, pp. 404-405; Hubaux (1999), *op cit.*, p. 24; and Steichen (2015), *op cit.*, p. 685.

[22] *Ibid.*

[23] See commentary to Art. 134*bis* LIR included in the Bill n° 2160 at pp. 1390-1392.

[24] Art. 166 LIR, the Grand-Ducal Decree of 21 December 2001 and Art. 115(15a) LIR.

[25] This rule does not apply to the foreign taxes levied by an EU country which are alluded to in Art. 2(a)(iii) and listed under Annex 1, Part B of the Parent-Subsidiary Directive (2011/96/UE).

[26] The 10.5 % minimum nominal corporate income tax rate corresponds to 50% of the Luxembourg CIT rate of 21% in 2015.

[27] For more details, please refer to Köszeghy and Simon (2013), "Taxation of companies on capital gains on shares under domestic law, EU law and Tax Treaties, Luxembourg National Report" in Maisto, Guglielmo (Ed.) *Taxation of companies on capital gains on shares under domestic law, EU law and Tax Treaties, EC and International Tax Law Series*, Vol. 9 (Amsterdam: IBFD), Para. 20.3.2.5.

1.2 Taxes covered by Tax Treaties' Distributive Articles

1.2.1 General definition of "taxes covered": the provisions corresponding to articles 2(1) and 2(2) OECD MC in the Luxembourg double tax treaties

Most DTTs signed by Luxembourg include provisions very similar to Art. 2(1) and 2(2) of the OECD MC. As these two paragraphs of the OECD MC did not change much since 1963, the provisions corresponding provisions are very similar in the old and in the most recent Luxembourg tax treaties. Compulsory payments to the Luxembourg State and local authorities include taxes (*impôts*)[28], fees (*taxes rémunératoires* and *taxes proprement dites*), parafiscal fees and *redevances*. Fees are compulsory payments for the existence (and not for the specific use) of an individual benefit granted to the taxpayer. Whilst the revenue from *taxes rémunératoires* is used to cover the costs of the service(s) provided, *taxes proprement dites* are not earmarked, and they simply increase the general public revenues[29]. According to Luxembourg courts, the main difference between *impôts* and *fees* is that the first ones are determined on the basis of the ability to pay of the taxpayer, even though the principle is not explicitly covered by the Luxembourg constitution, whereas the second ones do not[30]. Taxes are also different from parafiscal fees, which are compulsory payments made to a private or public entities, other than the State, with a specific destination (e.g. social insurance payments). They are finally different from *redevances*, which are payments made to the State or to a local authority in return for a specific service.

In accordance with the definition provided by Art. 2(2) and 2(3) OECD MC, the Luxembourg taxes covered by tax treaties can only be imposed by the State or by the municipalities. For instance, the annual fee paid to the chamber of commerce is not covered by Luxembourg DTTs, as it is due to a public entity, but not to the State or to a local authority thereof[31]. Several treaties do not include a general definition of tax such as the one in paragraphs 2(1) and 2(2) OECD MC: this is the case, for example of the DTTs with France, Brazil, Canada, Ireland, Japan, Korea, Malaysia, Mauritius, Malta, Poland, Portugal, South Africa, Sweden, Trinidad and Tobago, United Kingdom and United States. The DTT with Russia does not contain a definition of tax comparable to that in paragraph 2(2) OECD MC. Art. 2(1) of the DTT with Kuwait (not yet in force) refers to taxes levied on behalf of local communities of each contracting state, presumably to allow the application of the convention to the Kuwait's religious tax (*Zakat*). The same tax is included in the DTT with Saudi Arabia.

The "General Definitions" articles in treaties in force with Luxembourg, where present, usually do not offer additional clue on the definition "tax". It is therefore unclear whether the term "tax", "taxed" or "taxable" have an independent meaning or should be read in conjunction with the definition of "taxes covered": only the DTT with Turkey clarifies that the term "tax" means any tax covered by Art. 2. An exception is the DTT with Hong Kong, where Art. 3(2) clarifies that penalties and interest imposed under the laws of either contracting state related to the taxes covered by the same DTT are excluded from the application of the DTT. In few other treaties, Art. 3 contains a separate, and not very meaningful, reference to the domestic law of the two contracting states[32]. Likewise, the mentioned "General Definitions" articles in treaties do not provide a definition of "income" or of "capital": only the DTT with Kazakhstan contains a quite broad definition of the latter as "*the movable and immovable property and includes (but not limited to them) cash money resources, shares or other documents*

[28] For a more comprehensive definition of *impôts*, please refer to section 1.1.1 above.

[29] See Steichen (2015), *op cit.*, pp. 26-29.

[30] Barassi (2005), *op cit.,* pp. 68-69.

[31] See Winandy (2009), *Droit fiscal européen et international* (Belgium: Wolters Kluwer), p. 399.

[32] DTTs with China, Ireland, Japan, Korea, Kuwait (not yet in force), Morocco, Thailand and United Kingdom.

confirming property rights, bills, bonds or other liabilities, and also patents, trade marks, copyrights or other similar right or property".

Even though in principle Luxembourg tax treaties should be applicable to taxes levied both in cash and in kind, Luxembourg only levies taxes in cash[33] and the treaties currently in force do not contain any specific provision on the relevance or value of taxes levied in kind in the other contracting state.

In line with the OECD MC, Luxembourg tax treaties apply to the taxes covered "*irrespective of the manner in which they are levied*". The clarification in the DTT with Italy, which specifies that both the Italian and the Luxembourg taxes listed in Art. 2 of the DTT are covered "*even if withheld at source*", seems hence redundant. Luxembourg taxes are levied through withholding tax (whether final or not), assessment and advance payments in view of the future assessment.

1.2.2 The list of taxes covered

Treaties signed by Luxembourg include the following taxes as "*currently existing*":

(i) the IIT, the CIT and the NWT; and

(ii) the MBT.

Few treaties explicitly include the Luxembourg real estate tax: the DTT with Austria, Belgium, Brazil, the Netherlands and Portugal. Such inclusion should not have effect on the applicability of the real estate tax by Luxembourg as source state, which is unrestricted either by virtue of a provision corresponding to Art. 22 of the OECD MC or by the fact that such tax is not covered by the DTT. It would, however, affect the taxpayer as far as the potential relief in the residence state is concerned. It may also affect any potential discriminatory application of the real estate tax in Luxembourg, and the application of administrative assistance provisions in the relevant DTT.

The inclusion of repealed taxes (such as the special tax on directors' fees) in old DTTs that are still in force does not have any relevance in practice[34].

1.2.3 The relationship between the general definition and the list of taxes covered

Where a general definition of taxes covered in line with Art. 2(1) and 2(2) OECD MC is missing[35], the list of taxes covered in the provision corresponding to Art. 2(3) OECD MC seems to be exhaustive at least at the moment of signature of the convention, despite a different indication in the Commentary to Art. 2(3) OECD MC. On the contrary, where such general definition is present, it is reasonable to consider the mentioned list non-exhaustive[36]. For instance, in the DTT with Austria, which contains both a general definition of taxes covered and a list of these in Art. 1, it is clarified under Art. 26 that "*the Convention shall not apply to non-recurrent taxes on capital or on capital appreciation*": such specification (albeit in a very old DTT) may indicate that the list of taxes in Art. 1 is not exhaustive.

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[33] Art. 1 AO.

[34] See Schaffner (2014), *Droit fiscal international*, 3rd edition (Luxembourg: Promoculture-Larcier), p. 77.

[35] Please refer to section 1.3.1.

[36] In line with the current wording of the OECD MC, Commentary to art. 2 OECD MC, and opinion of Working Party no. 30, see Lang (2005) "«Taxes covered» – What is a «Tax» According to Article 2 of the OECD Model Convention?" 59 *Bulletin for International Taxation* 6, p. 220.

1.2.4 Future taxes, similar and ancillary payments

A provision similar to that of Art. 2(4) ensures that future taxes similar to those explicitly listed, introduced in addition or in replacement thereof, will be covered by the relevant DTT, generally further to the notification made by the competent authorities to the other contracting state, or automatically (DTTs with Brazil and UK). The DTT with France provides that if the tax legislation of either contracting state is amended in a manner substantially affecting the nature or the character of the taxes referred to in the list, the competent authorities of the two countries shall enter into consultation. The DTT with Morocco provides that the competent authorities notify each other the changes made in the tax laws of the respective countries at the end of each year.

In this respect, one may wonder whether the recent introduction of the Minimum CIT[37] (in 2011 for holding and financing companies and in 2013 for ordinary capital companies) may affect the nature of CIT as a tax on the "income" and hence trigger the refusal of contracting states to apply certain provisions of the relevant DTT. The Minimum CIT is an advance payment that becomes final only if no standard CIT is incurred in the following years. As such, it is possible that a company is subject to Minimum CIT for an indefinite period of time if the company's taxable basis is negative or lower than the taxable basis that would give rise to a tax equal to the Minimum CIT[38].

The subscription tax (*taxe d'abonnement*) is a registration tax on the negotiability of securities that applies at a rate of 0.25% on the paid-up shares and share capital of the private wealth management company, of 0.05% on the net assets of investment funds, unless special reductions apply, and at a rate of 0.01% on the net assets of specialized investment funds. It could theoretically be argued that the subscription tax is covered by Luxembourg tax treaties: for instance, one may reason that, should the subscription tax be covered by the Luxembourg convention, there would be no need to specifically exclude from the application of the same convention entities that are subject to the subscription tax: this is the case of the (now repealed) Holding 1929[39].

Certain transfers by donation and inheritance are subject to the Luxembourg succession rights and donation rights. The donation rights and the succession rights are fundamentally different from income taxes as they refer to the transfer, and not to the general ability to pay of the taxpayer. Such rights do not fall within the scope of Luxembourg DTTs, and in the absence of a domestic provision aimed at alleviating double taxation on successions and gifts, international double taxation may occur. It should be however considered that companies cannot be the beneficiaries of "gifts" for Luxembourg tax purposes[40]. As a general rule, taxes covered are considered to include surcharges, interest and penalties[41], both in general (despite the absence of guidelines in the OECD MC and Commentary thereof) and for the purposes of the assistance in the collection of taxes (in line with the specific

[37] Please refer to section 1.1.3.

[38] The matter seems to have limited practical relevance, especially as Luxembourg permanent establishments of foreign entities are not subject to Minimum CIT: for instance, (in the limited cases) where a DTT would grant an indirect foreign tax credit for the tax on income suffered by the Luxembourg subsidiary of a company resident in the other contracting state, the latter may refuse to grant a credit for the Minimum CIT, which is not linked to the actual taxable income of the subsidiary. The outright refusal to grant treaty benefits based on the argument that CIT is generally not an income tax due to the introduction of the Minimum CIT would not seem reasonable as it would not consider the CIT system as a whole, but only a marginal aspect thereof.

[39] Schaffner (2014), *op. cit.*, p. 78.

[40] For corporate tax purposes in particular, the advantages received by a company by, or paid to, a directly or indirectly related party that an unrelated company would not have received or paid would normally qualify as a hidden dividend distribution or as an informal capital contribution.

[41] Schaffner (2014), *op. cit.*, p. 75.

wording of Art. 27(2) OECD MC as far as interest and penalties are concerned). However, the DTT with the US explicitly mentions that the IIT and the CIT include the surcharge thereon for the benefit of the employment fund. The recent DTT with Germany specifically refers to supplements on listed (Luxembourg and German) taxes, which hence fall in the scope of the convention. The DTT with Hong Kong excludes penalties and interest imposed under the laws of either contracting state related to the taxes covered by the same DTT.

Social security contributions are generally not covered by Luxembourg tax treaties, as they do not formally qualify as taxes.[42]

2. Relevance of the notion of tax for residence, elimination of double taxation and non-discrimination provisions

2.1 Tax Treaty Residence Concept

2.1.1 Domestic law and DTT entitlement

Luxembourg law provides that individuals and certain collective entities that are resident in Luxembourg are subject to income tax therein on their worldwide income. In particular:

- Individuals are considered to be resident in Luxembourg when they have their fiscal domicile or their habitual abode therein; such individuals are subject to IIT;

- Corporate entities, such as capital companies and cooperatives, are considered to be resident of Luxembourg if they have their registered seat or central administration in Luxembourg. Such entities (hereinafter referred to as "companies") are subject to CIT and MBT on their worldwide income (with some exceptions as far as MBT is concerned) and to NWT on their worldwide net wealth;

- Business established in Luxembourg (whether incorporated or not) are subject to MBT. Luxembourg capital companies are always deemed to carry on a business in Luxembourg.

Most Luxembourg DTTs, in line with the OECD MC, do not provide for an autonomous rule to determine the residence status of a taxpayer, but refer to the relevant domestic rules. As such, individuals subject to IIT and entities subject to CIT and MBT on their income, wherever produced, are considered to be (at least *prima facie*) resident for Luxembourg tax purposes and can generally obtain a residence certificate from the competent authorities. The actual income tax liability of a taxpayer on a certain item of income is generally not relevant to determine whether such taxpayer is to be considered a tax resident of Luxembourg. As an exception, the protocol to the DTT with Mexico requires that the residence state specifically states that certain items of income are subject to tax in the residence state in order to benefit from reduced tax rates in the source state.

In general, taxpayers benefitting from an "objective" exemption based on the nature of the income derived are considered to be resident of Luxembourg for tax purposes[43], which however does not ensure that such taxpayers are necessarily recognised treaty benefits. The matter is somewhat more complicated for entities organized as body corporate and entitled to a "subjective" exemption[44]. In the

[42] See Winandy (2009), *op. cit.*, p. 400.

[43] This is the case, for instance, of companies holding certain qualifying participations, SICARs (*Sociétés d'Investissement en Capital à Risque*) and of securitization vehicles.

[44] In line with the Commentary to Art. 4 OECD MC, from a Luxembourg standpoint, collective investment vehicles (**CIVs**) organized as body corporate are subject to Luxembourg CIT, even though they benefit from an exemption if certain conditions are met: as such, corporate CIV are to be considered as resident of Luxembourg. This approach is however not shared by all treaty partners. Conversely, certain tax treaties recognize treaty benefits to CIV that are not organized as corporate bodies

latter case, the approach of the Luxembourg tax authorities in releasing residence certificates seems to be following the implicit or explicit agreement, if any, with the other contracting state[45]. Different kinds of residence certificate are issued by the Luxembourg tax authorities accordingly[46].

2.1.2 Residence conflicts

The Luxembourg definition of resident taxpayers, whether individuals or companies, in combination with the domestic law of the other contracting state, may give rise to cases of dual residence. In the presence of an applicable DTT, dual residence conflicts involving Luxembourg resident individuals or companies should be solved on the basis of the tie-breaker rules in the treaty. Most treaties currently in force contain a provision in line to that of Art. 4 OECD MC and as such, the tax residence is to be determined on the basis of certain facts, such as for instance the permanent home or centre of vital interest of an individual and the place of effective management of a company. The level of taxation of the dual-resident taxpayer in the other contracting state does not have relevance in this respect: a mere certificate of residence released by the other state is sufficient to determine the dual-residence status of the taxpayer in question. In case n. 33872C of 13 January 2014, for instance, the Administrative Court analysed in detail the position of a German national having his centre of economic interests in Germany and his centre of personal interest in both Germany and Luxembourg. The dual-residence case was solved in favour of the German tax residence, without taking into account the level of taxation of the individual concerned in Germany. The same approach is followed by the Luxembourg tax authorities in determining whether a non-resident is entitled to the application of a DTT: the actual taxation (or level thereof) of an item of income sourced in Luxembourg is not relevant[47].

Under the approach of the Luxembourg tax authorities, a taxpayer who is a resident of Luxembourg under the domestic law, but a resident of a treaty country by virtue of the DTT in place (i.e. Luxembourg is the "loser" state), no income taxes are levied in Luxembourg on the income that is not sourced therein. The taxpayer is nonetheless requested to submit a tax return where the Luxembourg-sourced income (if any) is declared: as such, it will often be a "zero balance" tax return. In the latter case, the taxpayer will not be entitled to a residence certificate and will not be required to withhold taxes as other resident taxpayers on certain payments[48].

2.2 The Methods for the elimination of international double taxation

2.2.1 The exemption method

(transparent CIVs). See also Winandy, Fort and Kremer (1997), "The taxation of investment funds: Luxembourg National Report", in *IFA Cahiers de Droit Fiscal International*, Vol. 82b, (The Hague: Kluwer Law International), p. 589.

[45] Winandy and Steichen (2004), "Double non-taxation: Luxembourg National Report", in *IFA Cahiers de Droit Fiscal International*, Vol. 89a, p. 522.

[46] Circulaire du directeur des contributions L.G. – A n.° 61 du 12 février 2015.

[47] Winandy and Steichen (2004), *op cit.*, pp. 520-521.

[48] Even if, according to part of the doctrine, DTTs, and hence tie-breaker rules therein, only apply to the recipients of certain items of income, and not to the payer thereof. See, for all, Van Raad (1988), "Dual Residence", 28 *European Taxation* 8 (Amsterdam: IBFD), pp. 241-246.

Luxembourg is predominantly an "exemption country"[49], as in a treaty context, as a residence state, it generally relieves juridical double taxation through an exemption system. There are however some exceptions:

(i) In some cases and for certain items of income, the treaty provides for a sharing of taxing rights between the source and the residence country, whereby the former is entitled to a primary taxing right, generally in the form of withholding tax, and the latter grants a tax credit for the tax levied at source. This is generally the case of dividends, interest and royalties, in conformity with the OECD MC. Some DTTs extend the sharing of taxing rights to other items of income, such as the treaty with Brazil (capital gains, independent personal services, directors' fees, artists and athletes, pensions and other income), with Canada (capital gains, pensions and annuities, other income), with Armenia (artistes and sportspersons) and China (certain capital gains).

(ii) Some recent treaties include a so-called "switch-over" clause, which allow Luxembourg to apply the credit method, instead of the exemption method, where the source country does not tax sufficiently a certain item of income[50].

There is no autonomous domestic definition of unilateral exemption aimed at solving juridical double taxation instances. More generally, though, an income or an entity can be defined as exempt when, even though it falls in the scope of the law regulating a certain tax, it is not subject to that tax. The exemption applies according to the so-called progressivity rule, which allows the inclusion of the income exempt under a treaty in the overall income of a resident taxpayer for the sole determination of the progressive tax rates scheme to the same taxpayer. The right of Luxembourg to apply the described progressivity clause is included in most treaties signed with Luxembourg, and a specific provision in the Luxembourg income tax law (Art. 134 LIR) implements such right. Whilst exemption with progression rules are a common tool to take into account the ability to pay of individual taxpayers deriving income in several countries, the Luxembourg tax authorities recognize them a wider application, granting a 0% overall tax rate to companies reporting (exempt) foreign losses higher than their taxable income (domestic or from other countries)[51].

The treaty exemption of items of income and of capital only applies to taxes ("*impôts*") covered in the DTT.

2.2.2 The credit method

In a DTT context, Luxembourg applies the credit system for certain items of income: generally interest, dividends and royalties. Other items of income may benefit from the application of the credit system pursuant to a specific provision in the relevant treaty or to a "switch-over" clause. The taxes eligible to be credited in Luxembourg are those specifically covered in the DTT, generally on the condition that they are paid. Certain treaties, however, include a tax sparing credit provision whereby Luxembourg shall grant a credit for taxes that are deemed to be levied in the other contracting state, such as the DTTs with Brazil, China, Greece, Malta, Morocco, Singapore, Spain, Thailand and Vietnam.

Within and without the scope of DTTs, foreign taxes levied are credited against the CIT liability but not against the MBT liability. Whilst the general exclusion of a foreign tax credit for MBT purposes is a

[49] With some relevant exceptions, such as certain provisions in the DTTs with Canada, Brazil, Malta and Mauritius.

[50] DTTs with Mauritius and Tunisia.

[51] Circulaire du directeur des contributions LIR n. 134/1 du 9 décembre 2009 and Bouzidi, Feyten and Van Droogenbroek (2011), *op cit.*, pp. 402-403.

matter that can be discretionarily decided by each jurisdiction, not granting a credit for MBT in the context of certain treaties may be considered in contrast with the wording thereof:

- MBT is listed among the "*taxes covered*" in all the existing tax treaties; and

- Most treaties signed before 2006, in the article on the double taxation relief system, provide that "*Luxembourg shall allow a deduction from the tax on the income of that resident*" or that the tax levied at source on a certain item of income "*is deducted from the tax relating to such income which is levied in Luxembourg*"[52] or that "*Luxembourg allows a deduction from the tax it levies on the income of its residents*"[53]. It seems difficult to argue that MBT is not a tax that Luxembourg levies on, inter alia, foreign income of resident taxpayers[54].

This refusal to offset foreign taxes against the MBT liability of a Luxembourg taxpayer has been justified by different arguments. When the matter was first brought before a court, the Government delegate observed that in the double taxation relief provision in the relevant DTT, reference is made to taxes levied by Luxembourg only, and not to its municipalities[55], which levy MBT. The Court of First Instance dismissed this argument and decided in favour of the taxpayer. When appealing to the mentioned decision, the Government delegate held that, had the contracting states intended to apply the tax credit for MBT purposes, they would have also established an order of priority between the CIT and the MBT[56]: MBT would then have been included in tax treaties only to settle potential conflicts over the existence of permanent establishments[57]. Such approach was endorsed by the court.

- Since 2006, the tax treaties signed by Luxembourg have been more carefully drafted to formally exclude the grant of a foreign tax credit for MBT. This solves the potential treaty override matter, but not the general double taxation arising from the refusal to grant relief for MBT purposes.

Whether in a treaty context or not, non-creditable foreign taxes may be deducted as expenses for CIT and MBT purposes, unless the income to which they refer is tax-exempt in Luxembourg. Non-creditable foreign fictitious taxes (such as those resulting from a tax sparing provision) are not deductible. For individuals, the deduction applies only for the purpose of determining the taxable income of the category to which to foreign tax refers to[58]. In a treaty context, the deduction is also granted for taxes not specifically covered by the relevant DTT.

Disagreements between Luxembourg and a treaty country over the qualification of a tax levied by the latter for the purpose of the treaty may in principle be settled by mutual agreement procedure.

2.3 Non-discrimination

[52] DTT with Belgium.

[53] DTT with Spain.

[54] See Winandy (2009), *op. cit.*, p. 337.

[55] "*Where a resident of Luxembourg derives items of income which, in accordance with the provisions of Articles 10, 11 and 12, may be taxed in Spain, Luxembourg shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in Spain*".

[56] Décision Cour Administrative 17 January 2006, n. 20316C.

[57] Joosen and Taferner (2006), "*Getting the (Foreign Tax) Credit One Deserves?", 46 European Taxation* 4, p. 176.

[58] Art. 13 LIR.

In defining the scope of the non-discrimination provisions, paragraph 6 of Art. 24 OECD MC, states that "*The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description*".

Surprisingly, the non-discrimination provision in almost half of the Luxembourg tax treaties, if present at all[59], only applies to taxes covered in the treaty itself. In these cases, the provision at stake does not add anything to what has been discussed so far.

The non-discrimination provisions in DTTs reflecting the wording of Art. 24 (6) OECD MC, in combination with the EU Fundamental Freedoms provided in the Treaty on the Functioning of the European Union (**TFEU**) played over time a relevant role in the application of the taxes covered by the tax treaties, but they seem to have a limited relevance to other taxes not covered by tax treaties. The question of the compatibility with the non-discrimination prohibition arose with regard to the capital duty exemptions. Unfortunately, the matter could not be settled before the repeal of the capital duty as from January 2009.

Levies and taxes falling outside the scope of the definition of "*taxes covered*" in the DTTs signed by Luxembourg may fall in the non-discrimination provision in the same treaties or in other provisions, such as the TFEU. However, as far as direct taxes are concerned, whilst the prohibition of non-discrimination is generally addressed to domestic rules affecting non-residents and / or non-nationals, when double taxation relief is concerned, measures preventing restrictions seem to be more relevant than measures addressing discrimination.

3. Relevance of the notion of tax in the elimination of double non-taxation

3.1 Tax treaty subject-to-tax clauses

3.1.1 Tax treaty subject-to-tax clauses and similar clauses to avoid double non-taxation situations

It derives from the Luxembourg international tax policy[60] and domestic case law[61] that the goal of the Luxembourg DTTs is to prevent and relief double taxation situations and not to prevent double non-taxation situations (potentially) resulting therefrom.[62] As a result, in order to avoid intended or unintended double non-taxation, the Luxembourg DTTs have to include subject-to-tax clauses, anti-abuse provisions or similar clauses as discussed in the following sub-sections of this report.

In order to promote foreign investment in certain foreign countries, Luxembourg is prepared to formally agree to additional clauses in a DTT which may allow for double non-taxation situations, such as

[59] The DTT with Saudi Arabia does not include a non-discrimination provision. However, the 2013 protocol to this treaty provides that, should Saudi Arabia introduce an income tax applicable to the resident in the Kingdom of Saudi Arabia, or modifying the existing tax, the contracting states will negotiate a non-discrimination provision.

[60] See Luxembourg's observation on the Commentary to Art. 1, Para. 27.6 stating that Luxembourg takes the view that domestic anti-abuse provisions may only be applied "*in specific cases after recourse to the mutual agreement procedure*" and the Luxembourg's observation on the Commentary to Art. 7, Para. 80 whereby Luxembourg takes the position that the application of domestic CFC rules is restricted by DTTs. If Luxembourg or the other treaty partner become aware of loopholes in the relevant DTT allowing for situations of double non-taxation, Luxembourg will normally either request or agree to renegotiate such DTT. A case in point is the Protocol to the 1958 DTT with France (2014) to close the unintended double non-taxation of a Luxembourg company investing in French real estate partnerships.

[61] In the La Coasta sarl decision, the Luxembourg court held that it would not be possible to close unintended loopholes of the Luxembourg DTTs and, as a result, deny the benefits of the DTT by reference to any general aim of double non-taxation pursued by the Luxembourg DTTs, cfr. Tribunal Administratif, 3 December 2001, La Coasta sarl, p. 6.

[62] Winandy and Steichen (2004), *op cit.*, pp. 515-520.

granting a foreign tax credit for a hypothetical tax in the source country (i.e. tax sparing credit)[63] or by providing for the relief of hypothetical economic double taxation in the context of dividend income derived from qualifying participations.[64]

3.1.2 Art. 4 OECD MC and "liable-to-tax test"

In international tax, there is a crucial distinction between being subject-to-tax in the sense of being qualified as a taxpayer (i.e. subjective tax liability) and in the sense of a specific item of income or capital being taxable (i.e. objective tax liability).[65] Subjective liability or being liable-to-tax is primarily relevant in the context of DTTs as a factor in determining residence status, i.e. being subject to comprehensive taxation on the relevant worldwide income, even if under certain conditions an exemption from tax may be granted. On the other hand, objective tax liability, which is increasingly used as a condition for providing double taxation relief under DTTs, means that a certain item of income or capital has effectively been subject to tax and / or an effective tax liability has been triggered thereon.

Luxembourg adheres to the interpretation that subjective tax liability or being liable-to-tax is sufficient to be qualified as a resident and to gain access to the Luxembourg DTT network.[66]

Yet, Luxembourg has always opted for a rather cautious approach with respect to granting treaty access to Luxembourg taxpayers that may benefit from a full or partial subjective exemption provided certain conditions are met, such as the so-called 1929 holding companies, CIVs and securitization vehicles. In fact, in order to clarify their treaty entitlement, Luxembourg's treaty policy is of including in as much as possible in its DTTs specific provisions dealing with the treaty access to such type of entities.[67]

As discussed earlier in this report[68], the Luxembourg tax authorities have recently issued an administrative circular clarifying their position towards granting treaty benefits to Luxembourg CIVs, as well as confirming under which conditions such CIVs may obtain tax residence certificates.

3.1.3 Specific subject-to-tax clauses in the treaties

Even though the inclusion of specific subject-to-tax clauses is not common in the Luxembourg DTTs, certain treaties do include such clauses to grant access to the treaty itself, to apply the reduced withholding tax rates for passive income, to provide relief for juridical or economic double taxation or to reverse the allocation of taxing rights under the treaties to avoid cases of double non-taxation.[69] As a

[63] E.g. Luxembourg DTTs with Brazil, Greece, Ireland, Malaysia, Malta, Morocco, Singapore, Spain and Sri Lanka.

[64] E.g. Luxembourg DTTs with Malaysia and Singapore.

[65] See OECD Commentary to Art. 4, Para. 8.6 and 8.7.

[66] Winandy and Steichen (2004), *op cit.*, pp. 515-516 and pp. 520-522.

[67] Winandy and Steichen (2004), *op cit.*, pp. 521-522.

[68] Please refer to section 2.1.1 above.

[69] For an analysis of subject-to-tax clauses in the Luxembourg DTTs, see Biewer and Höfer (2010) "Tax treaties and tax avoidance: application of anti-avoidance provisions: Luxembourg National Report" in *Cahiers de Droit Fiscal International*, Vol. 95a, pp. 501-503 and Winandy and Steichen (2004), *op cit.*, pp. 528-529.

general rule, the definition of tax under the aforementioned subject-to-tax clauses corresponds to a comprehensive income tax similar to the Luxembourg IIT or CIT.

Certain Luxembourg DTTs include a specific subject-to-tax clause in order to grant entitlement to the relevant DTT, such as the DTT with Mauritius whereby a Mauritian company will only be considered as resident for treaty purposes provided that it is subject to a tax in Mauritius at the minimum rate of 15 per cent computed on a taxable base similar to that of Luxembourg.[70] The DTT with Sweden does not apply to any Luxembourg or Swedish enterprise that derives its income primarily from third states if such income is treated preferentially in Luxembourg or Sweden.[71] In addition, most of the Luxembourg DTTs provide for a specific clause excluding from their scope any Luxembourg company benefiting from the so-called holding 1929 regime, which was repealed by the end of 2010, or any Luxembourg companies subject to similar preferential tax regimes and certain Luxembourg investment funds.

A few Luxembourg DTTs impose a subject-to-tax or activity clause in order to grant the taxpayer the benefit of the reduced withholding tax rates under the treaties[72]. The DTT with Mexico, however, requires a certificate from the relevant tax authorities attesting that certain items of income (i.e. shipping and air transport, dividends, interest, royalties and capital gains) are effectively subject-to-tax in the other country.[73]

Other Luxembourg DTTs contain specific subject-to-tax clauses in order to provide relief for juridical or economic double taxation, such as a remittance clause and related limitation of foreign tax credits under the treaties with Ireland[74], Malta[75], Malaysia[76], Singapore[77] and the United Kingdom[78], and participation exemption clauses under the treaties with, inter alia, France, Malaysia (subject to certain exceptions)[79], Portugal[80], Singapore (subject to certain exceptions)[81] and Sweden[82]. These basically require that the foreign company distributing the dividends is subject to an income tax comparable to that of Luxembourg.

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[70] Protocol to the DTT with Mauritius.

[71] Para. 2 of the Protocol to the DTT with Sweden.

[72] Art. 10bis of the DTT with France imposes a subject-to-tax clause to apply the reduced withholding tax at source on dividends interest and royalties by requiring the issuance of a certificate for that purpose by the relevant tax authorities. Art. 10(2b) of the DTT with the United States and Art. 10(3) of the DTT with Canada imposes an activity clause ("*active conduct of a trade or business in Luxembourg*") to apply the reduced withholding tax rate to dividends paid by a Luxembourg company to its US or Canadian parent company.

[73] Protocol to the DTT with Mexico regarding Arts. 8, 10, 11, 12 and 13.

[74] Art. 3(2) of the DTT with Ireland.

[75] Art. 23(3) of the DTT with Malta.

[76] Art. 26 of the DTT with Malaysia.

[77] Art. 22 of the DTT with Singapore.

[78] Art. III(2) of the DTT with the United Kingdom.

[79] Art. 25(2)(d) of the DTT with Malaysia.

[80] Art. 24(1)(c) of the DTT with Portugal.

[81] Art. 25(1)(e) of the DTT with Singapore.

[82] Art. 23(1)(c) of the DTT with Sweden.

Furthermore, certain DTTs provide for "switch-over" clauses whereby the residence state provides for relief of double taxation by way of credit rather than by way of exemption for items of income that may be taxed in the source state but which the source state has inadequately taxed.[83,84]

Finally, the Final Protocol to the DTT with Azerbaijan provides for a limitation on the application of Art. 21 (*Other Income*) to avoid cases of double non-taxation. Accordingly, the source state may tax any items of income derived by a resident of the other contracting state which is not dealt within the treaty, in case the income is not subject to tax in the residence state.

3.1.4 Anti-abuse provisions in the treaties

In general, the inclusion of any kind of anti-abuse provisions in the Luxembourg DTTs comes at the request of the other treaty partner.[85] As a result, it does not come as a surprise that only a few Luxembourg DTTs include anti-abuse provisions and that such provisions vary a lot from treaty to treaty, as follows:

- treaties that provide for an anti-treaty shopping provision[86] and for the application of domestic rules to prevent tax evasion[87];

- treaties that allow for the application of domestic rules to prevent tax evasion, tax fraud, tax avoidance or domestic anti-abuse rules[88,89,90,91,92];

- treaties that provide for general[93,94,95] or specific[96] anti-abuse provisions; and

- treaties that provide for specific[97] or general[98,99] limitation of benefit provisions.

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[83] Art. 24(3)(c) of the DTT with Mauritius and Art. 23(2)(b) of the DTT with Tunisia.

[84] See supra section 2.2.1.

[85] For more details, please refer to Biewer and Höfer (2010), *op cit.*, pp. 501-503.

[86] Art. 28 of the DTT with United Arab Emirates.

[87] Art. 29 of the DTT with India.

[88] Art. 27 of the DTT with Germany and Para. 7 of the Final Protocol to the DTT with Belgium (1970) allows for the application of domestic rules to prevent tax evasion and / or fiscal fraud.

[89] Art. 27 of the DTT with Hong-Kong allows the application of any domestic laws and measures concerning tax avoidance, whether described as such or not.

[90] Para. 4 of the Final Protocol to the DTT with Israel allows the application of any domestic rules and procedures with respect to cases of abuse of law (including tax treaties).

[91] Art. 10(4) of the DTT with Austria allows for the application of domestic anti-abuse provisions in the context of exemption of qualifying dividends.

[92] Art. 28(2) of the DTT with Canada allows the application of domestic CFC rules in a treaty context.

[93] Art. 27 of the DTT with the Czech Republic.

[94] Art. 29 of the DTT with Russia and Art. 27 of the DTT with Taiwan provide for a broad main purpose test.

[95] Art. 29 of the DTT with Poland provides that the relevant DTT does not apply in cases where the income is paid or received in connection with an artificial arrangement.

[96] Para. 4 of the Final Protocol to the DTT with Georgia provides for a main purpose test in order to apply the provisions of Arts. 10-12 of such DTT.

3.2 Domestic law anti-avoidance provisions

3.2.1 Introduction

As a general rule, when applying its income tax provisions, Luxembourg makes recourse to its anti-avoidance or anti-abuse provisions both in domestic and cross-border scenarios. However, in a DTT scenario, Luxembourg would only apply its domestic anti-abuse provisions provided that the treaty itself contains an anti-abuse provision, the treaty authorizes the application of the domestic anti-abuse provisions or such anti-abuse provisions would not be in conflict with the treaty.[100,101]

3.2.2 Domestic subject-to-tax provisions

The subject-to-tax clauses included under domestic provisions, such as to reduce the withholding tax at source in Luxembourg on outbound dividend payments or to grant a partial or total exemption for inbound dividend income, liquidation proceeds or capital gains received by a Luxembourg company from a qualifying subsidiary do not apply in cases where the Luxembourg DTTs provide for a more beneficial regime (or the opposite solution in case of the reverse scenario). This means that the Luxembourg taxpayer will always be able to benefit from the most beneficial provision provided under domestic law or under DTTs.

3.2.3 CFC rules

There are no CFC rules in Luxembourg.

3.2.4 Thin capitalization rules

Luxembourg tax law does not provide for any specific thin capitalization rules. However, in accordance with administrative practice in Luxembourg, interest payments which are economically connected with the funding of equity investments may be regarded as hidden profit distributions if the lender is a direct or indirect shareholder of the borrowing company and if the debt-to-equity ratio of the company is deemed excessive, i.e. a debt to equity ratio higher than 85:15.[102]

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[97] Art. 13 of the DTT with the Netherlands provides for a specific limitation of benefits provisions with respect to Arts. 10-12 of such DTT if earned by tax-exempt international organisations, organs or officials thereof and persons who are members of a diplomatic or consular mission of a third state, being present in one of the states.

[98] Art. 24 of the DTT with the United States provides for the standard US LoB provision.

[99] Art. 30 of the DTT with Trinidad and Tobago denies the benefit of the DTT when any resident company would pay on to an associated enterprise more than 50% of the income in tax-deductible form (“channel approach” or “base erosion rule”), unless such an arrangement is motivated by sound business reasons and does not have as its primary purpose obtaining benefits under the relevant DTT.

[100] See above footnote 60.

[101] Biewer and Höfer (2010), *op cit.*, pp. 494-496.

[102] Heintz (1999), *L’impôt sur le revenu des collectivités*, Études Fiscales Nos. 113/114/115 (Luxembourg: Éditions Saint-Paul), pp. 70 and 102-105.

It follows from the OECD MC and the commentary to Arts. 9, 10(3), 11(6) and 24(4), that it is possible for a country to impose thin capitalization rules in a treaty context and to recharacterize excessive debt into equity and the related excessive interest payments into deemed dividends, provided that such domestic thin capitalization rules are fully compliant with the arm's length principle and apply in the same way to resident and non-resident creditors. The Luxembourg treaties normally include those clauses and would therefore allow for the application of thin capitalization rules, because such rules are non-discriminatory as they apply irrespective of the creditor's country of residence; and because they are in line with the arm's length principle as the tax authorities accept higher debt-to-equity ratios applied by the Luxembourg company, provided that evidence is given that such higher debt-to-equity ratio corresponds to what a third party in the market would be prepared to grant as debt capital to finance the investments held by said Luxembourg company.

3.2.5 Simulation and substance over form principle

Luxembourg domestic law provides for a general anti-abuse rule or substance over form rule whereby any legal forms or arrangements in civil law may not be abused for the purpose of tax avoidance. If the legal form or the arrangement used for the purpose of the transaction is not appropriate in terms of its substance, the economic transaction actually intended by the taxpayer would prevail over the legally valid transaction.[103]

3.2.6 Anti-abuse rules under the European Directives

Any specific or general anti-abuse rules provided under the European tax directives once transposed to Luxembourg domestic tax law will be applied by Luxembourg. By way of example, the Luxembourg Government has recently approved a draft law amending the Parent-Subsidiary Directive in order to transpose into national law the following two measures:

- a common anti-abuse rule (2015/121/UE); and

- hybrid loan mismatches between the European parent company and its European subsidiaries (2014/86/UE).

3.3 Administrative Assistance

3.3.1 Article 26 of the OECD MC

Following the 2005 update to the OECD MC, Art. 26(1) OECD MC provides that the scope of the exchange of information between the contracting states should not be limited by the taxes listed under Art. 2 OECD MC (taxes covered), but should instead be broader and capture "t*axes of every kind and description*".

As at October 2015, the Luxembourg tax treaty network comprises 74 comprehensive DTTs for the avoidance of double taxation. Out of these 74 DTTs, 37 include a broader exchange of information clause[104], whereas the rest still provide for a more restrictive exchange of information clause based on

[103] Art. § 6 (1) of the Tax Adaptation Law (*Loi d'adaptation fiscale du 16 octobre 1934)*.

[104] The following 37 DTTs include a broader exchange of information provision: Armenia, Austria, Barbados, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Guernsey, Iceland, India, Isle of Man, Italy, Japan, Jersey, Korea, Laos, Liechtenstein, Macedonia, Mexico, Netherlands, Norway, Panama, Poland, Portugal, Qatar, Russia, San Marino, Slovenia, Spain, Sri Lanka, Sweden, Tajikistan, Turkey and United Kingdom.

the older versions of the OECD MC which only concerns the taxes covered under the DTTs (i.e. taxes on income and on capital).

Yet, from the perspective of the reporters, it is very likely that over time all the DTTs concluded by Luxembourg will provide for a broader exchange of information clause because Luxembourg is prepared to adopt such a clause in its DTTs, subject to the "*foreseeably relevant*" requirement.[105]

3.3.2 Article 27 of the OECD MC

The provision concerning assistance in the collection of any kind of revenue claims (instead of only revenue claims connected with the taxes covered by the OECD MC) was introduced in the 2003 update to the OECD MC. Most of the Luxembourg DTTs do not include an Art. 27 concerning assistance in the collection of taxes and the few treaties that include such provision limit this assistance to the taxes listed in the relevant treaty plus any interest on such taxes, surcharges and non-criminal fines,[106] save for the treaty with India that follows the broad scope of Art. 27 of the OECD MC.

3.3.3 Other agreements on administrative assistance

Luxembourg is also a party to many other conventions in the field of administrative assistance, such as:

- the multilateral convention on mutual administrative assistance in tax matters[107] which covers exchange of information with respect to assessment and collection of all forms of compulsory payments to the general government or local authorities, save for customs duties, and assistance with collection and issuance of documents;[108]

- the Directive 2011/16/EU on administrative cooperation in the field of taxation, as amended, provides for the exchange of information in three forms fully compliant with the OECD standards, i.e. spontaneous, automatic and on request, regarding taxes of any kind (apart from VAT, customs duties, excise duties and compulsory social contributions, all of which are already covered by other European legislation on administrative cooperation);

- the mutual assistance in the field of recovery of tax and similar claims has been modernised and extended by Council Directive 2010/24/EU and the implementing Regulation (EU) No 1189/2011 and it determines that Member States, such as Luxembourg, must provide assistance for the recovery of any claims relating to taxes, duties and other measures levied in another EU country, including fees and surcharges relating to such claims;

[105] This is confirmed by new protocols to DTTs or new DTTs (not yet in force) signed by Luxembourg with Estonia, Ireland, Lithuania, Singapore, Tunisia and United States.

[106] This is the case of the Luxembourg DTTs with Azerbaijan, Denmark, Finland, France, Japan, Kazakhstan, Morocco, Norway, Sweden and Turkey. Differently, the DTT with Mexico includes an assistance of collection provision that provides that Luxembourg should assist Mexico in the collection of any Mexican taxes but only in as much as required to prevent treaty abuse.

[107] Convention between the Member States of the Council of Europe and the Member Countries of the OECD on Mutual Administrative Assistance in Tax Matters, as amended.

[108] Luxembourg's first information exchange thereunder is scheduled for September 2017.

- the Benelux mutual assistance treaty (1952) is a treaty between Belgium, the Netherlands and Luxembourg concerning the recovery of fiscal debts which came into force on 8 November 1956. It is one of the earliest examples of multilateral cooperation and assistance in the field of tax recovery. Its scope is quite broad as it covers any kind of taxes (i.e. direct and indirect taxes) and fees levied by the State or by the local authorities within the Benelux;

- the Savings Directive (2003/48) as implemented by Luxembourg as of 1 January 2015 (and by the other Member States, save for Austria) provides for an automatic exchange of information on interest paid by paying agents established in their territories to individuals resident in other Member States;

- EU mutual assistance in exchange of information, recovery and joint-audits in the field of indirect taxes, i.e. VAT and excise duties, is quite extensive; and

- the Luxembourg-United States FATCA Model 1A Agreement, which is in force as of 29 July 2015, provides for automatic exchange of information for tax purposes between the Luxembourg tax administration and the US Internal Revenue Service regarding certain tax information about US or Luxembourg reportable account holders, as the case may be.