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ATOZ ALERT

Upcoming measure denying the tax deduction of interest and royalties to entities in blacklisted jurisdictions

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Yesterday, the Luxembourg Government adopted a draft law amending the Luxembourg income tax law so as to deny, in Luxembourg, the deduction of interest and royalty expenses directed to entities or persons located in non-cooperative jurisdictions. This measure follows the recommendations made by the EU Council and happens a few weeks after the Cayman Islands were added to the EU blacklist. Since the draft law has not yet been published, the details of the measure and its date of application remain to be confirmed.

Background

On 18 February 2020, the EU Council updated the EU list of non-cooperative tax jurisdictions by adding Cayman Islands, Palau, Panama and Seychelles. The EU Council regularly reviews and updates the list, taking into consideration the evolving deadlines for jurisdictions to deliver on their commitments and the evolution of the listing criteria that the EU uses to establish the list.

In parallel, the EU Council produced a guidance on further coordination of national defensive measures in the tax area towards non-cooperative jurisdictions in December 2019 and invited EU Member States to apply one of the following legislative defensive measures in taxation vis-à-vis the listed jurisdictions as of 1 January 2021, with the aim of encouraging those jurisdictions' compliance with the Code of Conduct screening criteria on fair taxation and transparency:

- non-deductibility of costs;
- CFC rules;
- withholding tax measures;
- limitation of the participation exemption on profit distributions.

The Luxembourg Government decided to introduce the first of these measures, i.e. the non-deductibility of costs.

The measure in brief and its impact

The draft law amends the Luxembourg income tax law so as to deny the deduction of interest and royalty expenses paid or due to associated enterprises located in a non-cooperative jurisdiction at the level of Luxembourg taxpayers.

The Luxembourg draft law has not yet been published. Therefore, it remains to be confirmed as from when this new measure will enter into force (as from the publication of the law once adopted or will the draft law provide a specific date such as 1 January 2021 in accordance with the EU Council target date?).

Several other aspects will also need to be clarified:

- What happens if a jurisdiction (such as the Cayman Islands) is removed from the blacklist within the course of a specific tax year?
- If a jurisdiction is removed from the list, will it still impact all payments made or cost recorded in the course of that tax year? Or is only the listing or non-listing at the time of the payment/expense key?

Finally, since the EU blacklist evolves over time and as the Cayman Islands have already adopted some measures which could be assessed as sufficient from an EU point of view, it is possible that the Cayman Islands will be removed from the list before year-end, potentially before the measure enters into force.

Therefore, the analysis of the impact of this new measure on financing and IP structures with entities located in non-cooperative jurisdictions still depends on a number of evolving factors which remain to be clarified. Awaiting these clarifications, Luxembourg taxpayers with investments into and from non-cooperative jurisdictions such as the Cayman Islands should seek advice from their tax adviser in order to analyse the potential impact of the new provisions on their investments and take action, if necessary.

Do you have further questions?

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