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The amended Luxembourg tax consolidation regime: improvements still needed

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The 2021 budget law dated 19 December 2020 introduced a new provision dealing with the tax consolidation regime with effect as from tax year 2020. The amendments to the regime aim at reflecting the recent decision of the Court of Justice of the European Union ("CJEU") regarding the consequences of the change from a "vertical" to a "horizontal" tax consolidation (see "The modification of a vertical tax consolidation group into a horizontal tax consolidation group does not end the tax consolidation regime" in ATOZ Insights - July 2020). The new provision confirms that such change will not entail any negative tax consequences for the members of the tax consolidated group, provided that certain conditions are met.

Background

On 14 May 2020, the CJEU ruled on the Luxembourg tax consolidation regime and took a very positive decision for Luxembourg corporate taxpayers. The CJEU answered the question whether the strict separation of vertical and horizontal tax consolidations was in line with EU law. In other words, is it EU-compliant to be required to end the vertical tax consolidation before being able to benefit from a horizontal tax consolidation?

In this respect, the CJEU decided that the freedom of establishment should be interpreted as prohibiting a legislation of a Member State which has the effect to force a parent company with its seat in another Member State to dissolve an existing vertical tax consolidation between one of its resident subsidiaries and a certain number of its resident sub-subsidiaries, in order to allow this subsidiary to proceed with a horizontal tax consolidation with other resident subsidiaries of said parent company, when the resident integrating subsidiary remains the same and the dissolution of the vertical tax consolidation before the end of the minimum period of consolidation, provided for by national law, implies the rectification, on an individual basis, of the taxation of the companies concerned.

The CJEU concludes that since a non-resident parent company without a permanent establishment in Luxembourg can only consolidate its Luxembourg resident subsidiaries at the cost of dissolving an existing vertical consolidation, cross-border situations are disadvantaged compared to purely domestic situations. According to the CJEU, such a de facto obligation constitutes an unjustified restriction on the freedom of establishment.

As a result, EU law precludes that when a vertical consolidation is modified into a horizontal consolidation (i.e., addition of sister companies of the integrating company into the consolidated group) the vertical consolidated group must be dissolved with the consequence of retroactive taxation of each member of the group on an individual basis, in case the minimum period of five years has not yet been reached.

The new Luxembourg rule applicable to tax consolidations

The budget law did not amend article 164bis of the LITL, which is the article of reference for the tax consolidation regime. Instead, the new rule is included in a standalone provision of the 2021 Budget law. According to this provision, the change from a "vertical" to a "horizontal" tax consolidation will not entail any negative tax consequences for the members of the consolidated group, provided that certain conditions are met.
The new provision states that when the change from a "vertical" to a "horizontal" tax consolidation results in the dissolution of an existing vertical consolidated group, the change in the tax consolidation regime is made exceptionally without entailing tax consequences for the members of the dissolved integrated group if the following conditions are simultaneously met:

- the integrating parent company of the dissolved consolidated group becomes the integrating subsidiary company of the new consolidated group;
- the change of regime takes place for the tax year 2022 at the latest;
- the change of regime extends the scope of the dissolved consolidated group; and
- the members of the new consolidated group are bound for a period that must cover at least five financial years. For those who were already part of the dissolved consolidated group, the minimum five- year period is made as if the change of regime had not taken place.

Comments on the new Luxembourg rule

Introduction of a temporal limit in contradiction with the CJEU case law

According to the new Luxembourg rule, the period which the change of form from a vertical to a horizontal consolidation can be made within, without the consequences generally provided for in the event of dissolution of a consolidated group before the minimum period of five years has elapsed, expires with the taxation year 2022.

According to the comments on the draft budget law, *"it is considered that this period is sufficient to allow a consolidated group taking the form of a 'vertical consolidation' to verify whether, in its concrete case, it is judicious to change the regime and constitute a consolidated group taking the form of a 'horizontal consolidation', in order to enlarge the scope of the existing consolidated group"*. Furthermore, it is specified that, *"After this period, the general principles governing the dissolution of a consolidated group apply"*.

It is obvious that such comments ignore, on the one hand, the reality of groups of companies and their needs and, on the other hand, the very conclusions of the CJEU case law which are at the origin of the new provision.

Ignorance of the reality of groups of companies and their needs

Considering that a period expiring on 31 December 2022 is sufficient to allow a consolidated group taking the form of a "vertical consolidation" to verify whether, in its concrete case, it is appropriate to enlarge the scope of the existing consolidated group and apply for a "horizontal consolidation", the legislator ignored, for example, the following realities:

- The extension of a vertical consolidation after 31 December 2022 with a sister company of the integrating company incorporated after 31 December 2022;
- The extension of a vertical consolidation after 31 December 2022 with a sister company of the integrating company acquired by the joint parent company after 31 December 2022;

- The consolidation of a group as a vertical consolidation after 31 December 2022 and its subsequent extension;
- A change in the commercial policy of a group after 31 December 2022 which would justify an extension of the vertical consolidation only after 31 December 2022.

This is even more true as a consolidated group cannot even foresee a future extension by applying for a horizontal consolidation before 31 December 2022 without extending the scope of the consolidated group. Indeed, under the new provision, one condition to make the change in neutrality is that the change extends effectively the scope of the consolidated group.

Ignorance of the conclusions of the CJEU case law which justify the adoption of the new rule

As explained above, the CJEU considers that since a non-resident parent company without a permanent establishment in Luxembourg can only consolidate its resident subsidiaries at the cost of the dissolution of an existing vertical consolidation, cross-border situations are disadvantaged compared to purely domestic situations. Such a de facto obligation therefore constitutes an unjustified restriction on the freedom of establishment.

As the new rule introduces an option expiring with the taxation year 2022, as from 2023, the change of form of a consolidated group from a vertical to a horizontal form will be subject to the same rules as prior to the introduction of this new provision (i.e., article 164bis of the LITL). The commentaries on the draft budget law stating that a non-resident parent company will now be able to, like a resident parent company, freely decide whether to include its resident subsidiaries or sub-subsidiaries, including its domestic permanent establishments, within the scope of an existing tax consolidation is therefore inaccurate. Once the deadline set out in the budget law has passed, a non-resident parent company will no longer be able to freely decide whether to include its resident subsidiaries or sub-subsidiaries, including its domestic permanent establishments, within the scope of the tax consolidation.

According to the commentaries on the draft budget law, "general principles governing the dissolution of a consolidated group will thus apply to individual members" as from 1 January 2023. This statement is not correct either. Article 164bis of the LITL does not provide, in itself, for the dissolution of a consolidated group when modified from a vertical form to a horizontal one. Besides, article 164bis of the LITL interpreted in such way, driving to the dissolution of the group with retroactive taxation of its members on an individual basis, is considered as contrary to the freedom of establishment by the CJEU.

What is next?

The Luxembourg tax consolidation saga is not over yet! As from 2023, it is likely that consolidated groups taking the form of a vertical consolidation will ask for modifications into a horizontal consolidation based on the case law of the CJEU, while the tax authorities will refuse the neutrality of such transformations. We will thus be back to square one...

New amendments to the tax consolidation regime would thus be welcome in the interest of legal certainty.

In this respect, any amendments to the rules applicable to tax consolidations should also provide an opportunity to examine the effect of certain transactions or restructurings carried out by groups of companies which have adopted the tax consolidation regime. In view of the constant evolution of the structure of groups of companies, it would be appropriate for the Luxembourg legislator to expressly confirm, for the sake of legal certainty, the effects of transactions such as mergers, demergers and liquidations on consolidated groups. Finally, it would be also important to clarify the effect of Brexit on existing tax consolidation groups with a UK non-integrating parent company since, under the tax consolidation regime in force, non-integrating companies have to be resident in either the EU or in an EEA country, which is no longer the case of the UK since Brexit.

Luxembourg taxpayers having a tax consolidation group should seek advice from their tax adviser in order to analyse the potential impact of the new rule, notably if they plan to extend the scope of their existing tax consolidation. When requesting the application of the tax consolidation regime for the first time, consideration should also be given to the fact that, if possible, horizontal tax consolidation should be preferred over the vertical one.

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