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EXTENDED ANALYSIS ON CURRENT TAX TOPICS - JUNE 2026

Form over substance: Why the Luxembourg Tribunal's share premium ruling cannot stand

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On 25 March 2026, the Luxembourg Administrative Tribunal (the “**Tribunal**”) ruled that a repayment of share premium without a simultaneous reduction of share capital constitutes taxable income from capital under Article 97 (1) No. 1 of the Luxembourg Income Tax Law (“**LITL**”) which is, in principle, subject to Luxembourg withholding tax (the “**Decision**”).

However, the Decision is flawed as it prioritises legal form over economic substance and has already been appealed to the Administrative Court.

This article analyses the Decision and provides a comprehensive technical framework for the tax treatment of share premium and other capital repayments under Luxembourg law.

01 INTRODUCTION

The repayment of share capital, share premium and other contributions is a common business transaction for Luxembourg companies. However, under certain conditions, such repayments may be reclassified as income from capital under Article 97 (1) No. 1 of the Luxembourg Income Tax Law (“LITL”) (which includes dividends and other distributions). This would trigger a 15% Luxembourg withholding tax¹, unless a reduced rate or exemption applies under Luxembourg domestic tax law or an applicable tax treaty.²

Article 97 (3) b) of the LITL provides that allocations made in consideration of a reduction in share capital are not treated as income from capital provided that the company has not capitalised reserves and has no distributable reserves at the time of distribution.

In the Decision, the Tribunal ruled on the tax treatment of a share premium repayment carried out without a simultaneous reduction in share capital, as defined by Luxembourg company law. The Tribunal held that such a repayment does not fall within the scope of Article 97 (3) b) of the LITL. Therefore, the repayment of share premium was treated as income from capital under Article 97 (1) No. 1 of the LITL.

Although the facts of the case were specific to this instance, the Decision raised concerns in the Luxembourg market because the repayment of capital — including share capital, share premium and contributions to equity account 115 — is a common business transaction. This created significant legal uncertainty. The purpose of this publication is therefore to clarify the tax implications of repaying capital and help restore legal certainty.

02 FACT PATTERN OF THE CASE

A Luxembourg public limited liability company (“**LuxCo**”) created a share premium reserve in connection with its listing on the Frankfurt stock exchange. Subsequently, LuxCo used (part of) this share premium on several occasions to offset accounting losses, a common practice for listed companies to present a more favourable balance sheet.

After several profitable years, LuxCo accumulated reserves which were converted back into share premium, reinstating the original position (crucially, the amount converted did not exceed the amount previously used to offset losses).

On 10 April 2019, LuxCo's ordinary general meeting resolved to distribute funds to shareholders from the share premium account, without carrying out a formal share capital reduction under the Luxembourg Company Law of 10 August 1915 (the “**Company Law**”).

¹ Article 146 (1) No. 1 of the LITL in connection with Article 148 (1) of the LITL.

² Article 147 of the LITL or a clause drafted along the lines of Article 10 (2) of the OECD Model.

03 DECISION OF THE LUXEMBOURG TAX AUTHORITIES

On 20 December 2018, LuxCo filed a request for advance certainty with the Luxembourg tax authorities (the “**LTA**”), seeking confirmation that the proposed share premium repayment would qualify as an allocation within the meaning of Article 97 (3) b) of the LITL, rather than as taxable income from capital under Article 97 (1) No. 1 of the LITL. The LTA rejected the request on 20 March 2019.

Following the share premium repayment, the LTA issued the final withholding tax assessment on 24 July 2019. The LTA treated the payments as income from capital and subjected them to Luxembourg withholding tax under Article 146 (1) No. 1 of the LITL. This is subject to any applicable reduction or exemption under Article 147 of the LITL or an applicable tax treaty.

On 29 July 2019, LuxCo filed a complaint with the LTA challenging the withholding tax assessment. However, the LTA did not respond to this.

04 DECISION OF THE ADMINISTRATIVE TRIBUNAL

Following the LTA's silence on LuxCo's reclamation, LuxCo lodged an appeal with the Tribunal on 28 July 2021.

In its Decision of 25 March 2026, the Tribunal carefully analysed Article 97 (3) b) of the LITL, which specifically refers to a reduction in “share capital”. The Tribunal correctly observed that, while forming part of a company's equity, share premium is legally distinct from share capital under Luxembourg Company Law. As the repayment was carried out without a formal reduction in share capital, the Tribunal concluded that Article 97 (3) b) of the LITL did not apply.

The Tribunal also relied on an extract from the 1967 parliamentary preparatory works on the LITL (the “**Preparatory Works**”), which states that “repayments not taking the form of a regular share capital reduction remain taxable in all circumstances”. Based on this, the Tribunal held that the share premium repayment fell within the scope of Article 97 (1) No. 1 of the LITL. The Tribunal interpreted this provision as broadly covering any allocation to shareholders charged against invested net assets, unless it falls within the exhaustive exceptions set out in Article 97 (3) of the LITL.

As the disputed share premium repayment was made at the expense of LuxCo's net assets, according to the Tribunal it did not affect the substance of the participation. Therefore, it did not qualify for the specific exclusion set out in Article 97 (3) b) of the LITL. Instead, it constituted “other income” arising from the participation and was subject to withholding tax under Article 146 of the LITL.

The Tribunal drew a conceptual distinction between a product representing a flow derived from a participation, which does not affect its legal substance, and restitution of capital, which directly affects the substance of participation, notably by reducing share capital.

In the case of a share premium repayment made outside of a formal reduction in share capital:

- shareholders' rights remain unchanged;
- the participation is neither cancelled nor reduced;
- any decrease in value is merely a fluctuation during the holding period.

Furthermore, the Tribunal assumes that repayment of share premium does not adjust acquisition costs, thus confirming its classification as a taxable income rather than a tax-neutral restitution of capital. However, as analysed in Section 5.5, this should not be the case.

The Tribunal expressly rejected LuxCo's reliance on German legislation, case law and doctrine, ruling that these sources have no legal value under Luxembourg domestic law. This argument may be accepted, given that the German legislation referred to was specific to Germany and has not been implemented in Luxembourg tax law. It further held that "economic common sense", as a subjective notion, cannot replace or override statutory provisions.

Finally, the Tribunal deemed it unnecessary to categorise the distribution as a repayment of share premium, a dividend or a profit share, as all such allocations are covered by Article 97 (1) No. 1 of the LITL in its view.

Consequently, the Tribunal upheld the State's position that the repayment of share premium is income under Article 97 (1) No. 1 of the LITL and is therefore subject to Luxembourg withholding tax.

05 TAX ANALYSIS

5.1. Overview

Luxembourg companies can be financed through a variety of equity and debt instruments. Generally speaking, debt financing offers greater flexibility in terms of cash repatriation (i.e. interest payments and principal repayment) and involves fewer formalities than equity financing. In contrast, equity funding is more formalistic, requires more extensive procedures for issuance and repayment, and dividend distributions are subject to legal and timing restrictions. For these reasons, debt has traditionally been the more attractive financing option.

The Decision raises a fundamental question that arises whenever a company repays capital to its shareholders, whether in the form of share capital, share premium, or contributions to account 115. Treating a share premium repayment as taxable income rather than a tax-neutral return of invested capital creates a significant disincentive for equity funding.

This section provides a detailed technical analysis of the tax treatment of capital repayments under Luxembourg law, covering the classification of income from capital, the withholding tax regime, the anti-abuse purpose of Article 97 (3) b), the tax treatment at the level of the shareholder, and the relevant Preparatory Works.

5.2. Income from capital

Individuals and companies that are resident in Luxembourg are subject to income tax on their worldwide income.³ The LITL defines eight categories of taxable income.⁴ One of these is "income from capital", which covers income derived from specified capital investments.

Non-resident individuals and companies that realise income from Luxembourg sources, as defined in Article 156 of the LITL — including, among others, income from capital, as defined in Article 97 (1) No. 1 of the LITL, derived from Luxembourg companies — are subject to Luxembourg (corporate) income tax.⁵

³ Luxembourg resident individuals are subject to income tax on their worldwide income (Article 2 (2) of the LITL), Luxembourg companies are subject to corporate income tax on their worldwide income (Article 159 (2) of the LITL).

⁴ Article 10 of the LITL.

⁵ Non-resident individuals (Article 2 (3) of the LITL) and non-resident corporate taxpayers (Article 160 of the LITL) are subject to tax on their income from Luxembourg sources as defined in Article 156 of the LITL.

Article 97 (1) No. 1 of the LITL broadly defines income from capital to include dividends, profit shares and other income received in respect of a shareholding. In other words, any profits generated by a company and distributed to its shareholders should be subject to Luxembourg (corporate) income tax. This provision is designed to capture the economic yield derived from a participation (i.e. profits distributed by a company to its shareholders in any form). However, it does not extend to the repayment of capital⁶, unless Article 97 (3) b) of the LITL applies, resulting in the reclassification of a capital repayment as a dividend payment.

In the Decision, the Tribunal inverted this framework. Rather than treating Article 97 (3) b) of the LITL as an anti-abuse provision resulting in the exceptional reclassification of capital repayments as income from capital, the Tribunal treated it as an exhaustive exception. This means that if the repayment does not fall within its scope, it must automatically be taxable under Article 97 (1) No. 1 of the LITL. As analysed in detail below, this misreading extends the scope of Article 97 (1) No. 1 of the LITL beyond the intention of the legislature and contradicts the economic approach that underpins Luxembourg tax law.

5.3. Luxembourg withholding tax

Income from capital within the meaning of Article 97 (1) No. 1 of the LITL which is paid by a Luxembourg company is subject to Luxembourg withholding tax at a rate of 15%.⁷

However, Article 147 of the LITL provides for a withholding tax exemption in the case of certain corporate shareholders, subject to certain conditions. Furthermore, reduced or zero withholding tax rates may be claimed in accordance with tax treaties concluded by Luxembourg.⁸

5.4. Considerations regarding Article 97 (3) b) of the LITL

At first glance, Article 97 (3) of the LITL seems to define certain payments that should not be classified as income from capital. However, closer analysis of Article 97 (3) b) of the LITL reveals that it is not a general exception, but an anti-abuse provision designed to prevent shareholders from replacing taxable dividend distributions with tax-neutral capital repayments. This should prevent the deferral of income realisation and the associated taxation at the level of the shareholder.

According to Article 97 (3) b) of the LITL, capital repayments may be reclassified as income from capital in the following cases:

- First, when a company converts reserves (i.e. profits) into share capital. In these circumstances, the amount of the converted share capital is deemed to have been paid first. Any subsequent repayment of share capital (up to the amount of the converted reserves) is reclassified as capital income under Article 97 (1) No. 1 of the LITL and is subject to Luxembourg withholding tax. This prevents companies from “shielding” profits from taxation by converting them into share capital, which can then be repaid tax-free.
- Second, allocations that are the consideration for a reduction in share capital should remain taxable if such a reduction is not motivated by genuine economic reasons. According to the Preparatory Works, if a company has distributable reserves, a reduction in share capital is generally not considered to be justified by genuine economic reasons. Instead, up to the amount of distributable reserves, the redemption of share capital should be deemed a distribution of profits. This prevents companies from indirectly distributing profits through a capital reduction (which is generally not taxable income) rather than through an ordinary dividend (which is taxable income).

The following case studies illustrate both rules:

Case study: Conversion of reserves into share capital

A Luxembourg company (“**LuxCo**”) has a share capital of EUR 1.1m. End of 2025, LuxCo has distributable reserves amounting to EUR 2m corresponding to the profits realised in previous years. LuxCo converts these reserves into share capital. In June 2026, LuxCo declares a repayment of share capital amounting to EUR 1m.

⁶ Such repayments represent a return of the shareholder's original investment, not a distribution of profits.

⁷ Article 146 (1) No. 1 of the LITL in connection with Article 148 (1) of the LITL.

⁸ Provisions drafted along the lines of Article 10 (2) of the OECD Model.

In this case, the share capital that has been created through the conversion of distributable reserves is deemed to be repaid first. According to Article 97 (3) b) of the LITL, the entire amount of the formal repayment of capital is deemed to be a distribution of profits that falls within the scope of Article 97 (1) No. 1 of the LITL.

Case study: Repayment of capital when a company has distributable reserves

Based on the previous case study, it is assumed that LuxCo has share capital of EUR 1.1 m and distributable reserves of EUR 2m in 2025. In June 2026, LuxCo declares a share capital repayment of EUR 1m.

According to Article 97 (3) b) of the LITL, the formal declaration of a capital repayment should be treated as a distribution of profits up to the amount of the distributable reserves. Hence, the entire amount of the capital repayment should be reclassified into income from capital within the meaning of Article 97 (1) No. 1 of the LITL.

These examples demonstrate that the taxable event under Article 97 (3) b) of the LITL is not the repayment of capital itself, but rather the substitution of a capital repayment for a dividend distribution for tax purposes. Where no such substitution occurs (i.e. where the company has no distributable reserves and the capital was not created through the capitalisation of reserves), a genuine repayment of capital should be tax-neutral. This is confirmed by the Preparatory Works, which explicitly link the provision to preventing abuse rather than creating a general taxable category for all capital repayments.

5.5. Tax treatment at the level of the shareholder

In general, a genuine repayment of capital (whether share capital, share premium or contributions to account 115) reduces the shareholder's acquisition cost or book value of the participation. Consequently, the capital gain upon future disposal is calculated as the difference between the sale price and the reduced cost base.

Conversely, if a repayment of capital is reclassified as income from capital under Article 97 (1) No. 1 of the LITL, the acquisition cost or book value of the investment should not be reduced. Instead, the repayment would be treated as a taxable distribution, and the original cost basis would remain intact for future capital gains calculations.

The tax consequences for shareholders depend on their status:

- Luxembourg corporate shareholders may benefit from the participation exemption regime under Article 166 of the LITL, provided certain conditions are met. Furthermore, deemed dividend income from Luxembourg subsidiaries may be exempt from withholding tax under Article 147 of the LITL, provided certain conditions are met.
- Luxembourg resident individuals may benefit from a 50% tax exemption under Article 115, No. 15a of the LITL, provided the participation meets the necessary criteria. They may also credit the 15% withholding tax against their personal income tax liability.
- Non-resident shareholders are generally subject to a final withholding tax at the rate of 15%, unless an exemption or reduced rate applies under domestic law or an applicable tax treaty.

The Tribunal erred in assuming that a standard repayment of capital would not reduce the acquisition costs or book value of the participation where Article 97 (3) b) of the LITL does not apply. This assumption stems directly from its conclusion that such repayments constitute income from capital. However, as demonstrated above, a genuine repayment of capital is tax-neutral and reduces the cost base.

A more specific question arises when shares are transferred to a new shareholder. In these circumstances, the price paid by the new shareholder will often differ from the amount originally contributed by the initial shareholder. It is important to distinguish between the capital contributed to the Luxembourg company and the acquisition cost borne by the shareholder. Although the new shareholder should step into the initial shareholder's legal position with regard to the company's capital, income from capital may nevertheless arise at the level of the shareholder when the repayment of capital exceeds the acquisition costs. This situation may theoretically occur if a new shareholder acquires a participation for an amount that is lower than the initial capital investment.

Therefore, in such particular case, even if a repayment of capital is not treated as profit distribution at company level (i.e. if there is no conversion of reserves into capital or no distributable reserves), it may still be treated as income from capital at shareholder level if it constitutes an economic yield derived from a participation in the hands of the shareholder (i.e. the repayment exceeds the acquisition

costs). In this scenario, the Luxembourg company should not levy Luxembourg withholding tax; instead, the shareholder may have to declare the income for tax purposes in their residence state.

Case study: Transfer of shares and subsequent capital repayment

LuxCo, a Luxembourg company, has share capital and share premium amounting to EUR 1m.

A shareholder transferred a 20% stake in LuxCo, representing EUR 200,000 of its capital, to a third-party investor for EUR 150,000.

In this scenario, the investor's acquisition costs (EUR 150,000) are lower than their proportional share of LuxCo's capital (EUR 200,000).

Consequently, while LuxCo may repay up to EUR 200,000 of capital without triggering income tax at company level (assuming there are no distributable reserves or capitalised reserves), any amount exceeding the investor's acquisition costs of EUR 150,000 would constitute income tax at shareholder level and should be declared as such in the shareholder's state of residence.

5.6. Analysis of the Preparatory Works

5.6.1. Opening comments

The Tribunal's conclusion that the share premium repayment constitutes income from capital is based largely on selected extracts from the Preparatory Works. However, as will be demonstrated below, the Tribunal's interpretation of these materials is both selective and incomplete. A comprehensive analysis of the Preparatory Works as a whole reveals that:

- Article 97 (1) No. 1 of the LITL was intended to capture the economic yield of a participation, not the return of the shareholder's original investment.
- Article 97 (3)(b) of the LITL serves as an anti-abuse provision, not an exhaustive exception that automatically renders every other capital repayment taxable.

The following subsections examine the relevant passages of the Preparatory Works.

5.6.2. Income within the meaning of Article 97 (1) No. 1 of the LITL

The Tribunal relied on an extract from the Preparatory Works stating that “any allocation to shareholders charged against the invested net assets is taxable as income from capital.” However, this statement must be read in its proper context.

A few paragraphs earlier in the Preparatory Works, the term “shareholder” is clearly defined as a “capitalist” who is only taxed on amounts allocated as income derived from the participation (i.e. remuneration for capital provided to or retained by the company).⁹ Similarly, the Preparatory Works emphasise that taxable income consists of “dividends” and “similar distributions”, which are always charged against the company's invested net assets. This formulation links taxable income to the distribution of profits generated by the company, whether the distribution is a regular one or hidden.

The Preparatory Works further confirm that the taxable event under Article 97 (1) No. 1 of the LITL is not merely the receipt of funds, but rather the classification of those funds as a yield from participation.¹⁰

Income from participation should therefore be understood as the return generated by investments in movable capital, regardless of its form¹¹, and encompasses several distinct categories of income. The Preparatory Works provide various examples of such returns, all of

⁹ “Dans ces sociétés le sociétaire est considéré en conséquence, par le n°1 de l'article 114, comme capitaliste imposable uniquement du chef des sommes a lui allouées en rémunération des capitaux mis ou laissés à la disposition de la société.”

¹⁰ Example: “Ne sont pas des revenus de capitaux les parts de bénéfice de l'associé commandité de la société en commandite par actions, lorsque ces parts ne constituent pas la rémunération de la participation au capital-actions.”

¹¹ “Le produit de la participation peut affecter une forme différente des formes usuelles précitées. C'est pour cette raison que le texte englobe de façon formelle les autres produits.”

which either increase the shareholder's assets or stem from profit distributions. None of these examples resemble a mere repayment of a capital contribution.

Importantly, the notion of “other income” under Article 97 (1) No. 1 of the LITL does not encompass all payments made by a company to its shareholders. Instead, it is limited to distributions that represent the economic return on the investment, as opposed to the repayment of the initial investment to its contributor.¹² While the Preparatory Works acknowledge that the yield from a participation can manifest in ways other than traditional dividends, this statement clarifies the rationale behind the statutory inclusion of “other income”.¹³ However, it is not intended to transform the repayment of capital contributions into taxable income.

For the purposes of Article 97 (1) No. 1 of the LITL, the term of “allocation” should be understood as income derived from a participation only insofar as it compensates shareholders for their invested capital¹⁴. This allocation should increase the shareholders' assets rather than repay their initial investment.

Against this background, the repayment of share capital or other capital contributions should not, in principle, constitute a return on capital, but rather the return of the invested capital itself, which affects the substance of the investment. Contrary to the Tribunal's general assertion that share premium repayment does not affect the acquisition price of the participation, repayment of capital to the contributing shareholder should reduce the acquisition cost (or book value) of the shareholding. This would directly impact the computation of future capital gains, for example.

Consequently, repayment of share capital or capital contributions should be excluded from the definition of “income derived from participation” and, therefore, from the scope of Article 97 (1) No. 1 of the LITL. The legislator expressly articulates this distinction in the Preparatory Works, emphasising that “with regard to income from capital, it must be strictly distinguished between capital and income”¹⁵.

5.6.3. Scope and purpose of Article 97 (3) b) of the LITL

The Preparatory Works also provide useful guidance on the scope and purpose of Article 97 (3) b) of the LITL which is not a general exception to income from capital, but rather an anti-abuse provision targeting specific abusive arrangements.

The Preparatory Works relating to Article 97 (3) b) of the LITL are based on two key premises.

- First, “the fact that an allocation is made by drawing on accounts other than profits (e.g. share capital, share premium or account 115) does not prevent the taxation of that allocation”.¹⁶
- Second, the mere designation of an allocation as a “repayment” or “amortisation” of capital does not, in itself, make it non-taxable.¹⁷ Conversely, a repayment of capital is not automatically taxable either.

Taken together, these elements demonstrate that the Preparatory Works reject a purely formalistic or accounting-based approach. Instead, they require an assessment of the economic nature of the transaction. Accordingly, the decisive criterion is the economic substance of the transaction — namely, whether the allocation corresponds to a genuine repayment of contributed capital, or whether it disguises a distribution of profits or reserves.

The Preparatory Works state that Article 97 (3) b) of the LITL “formally establishes the tax exemption for share capital reductions carried

¹² “La désignation du produit est indifférente. Le produit peut consister en une distribution de marchandises à ses sociétaires par une société qui fait usuellement le commerce de ces marchandises, ou même en l'allocation d'éléments désaffectés de l'actif net investi. Un produit peut consister aussi en une prestation gratuite de la société au profit d'un sociétaire. Les “autres produits” comprennent aussi les distributions occultes, c'est-à-dire les avantages alloués sous une forme telle qu'ils n'apparaissent pas ouvertement comme distributions.”

¹³ “Le produit de la participation peut affecter une forme différente des formes usuelles précitées. C'est pour cette raison que le texte englobe de façon formelle les autres produits.”

¹⁴ “L'article 114 concerne les revenus de capitaux. Les revenus de capitaux sont en principe les produits des placements de toute nature de capitaux mobiliers.”

¹⁵ “Le sort du capital est considéré séparément de celui du produit.” Also in this sense “A l'endroit des revenus de capitaux, par contre, la distinction entre capital et revenu doit être observée le plus strictement possible parce que, d'une part, il est de la nature économique du capital mobilier de produire des revenus sans que, de ce fait, le fonds soit soumis à dépérissement et parce que, d'autre part, la prise en considération des fluctuations de valeur des placements mobiliers présupposerait l'existence d'une comptabilité encombrante dont on ne saurait imposer la tenue aux simples particuliers.”

¹⁶ “Le fait qu'une allocation est faite moyennant prélèvement sur des comptes autres que le bénéfice n'écarte pas l'imposabilité de ladite allocation.”

¹⁷ “Ainsi, lorsqu'une allocation se présente sous la désignation d'un remboursement ou d'un amortissement du capital, elle n'est pas pour autant à considérer comme allocation non imposable”.

out by a company for economic reasons” provided that such capital has been contributed by the shareholder(s) and has not been constituted through the capitalisation of reserves.¹⁸

However, genuine capital repayments do not require an exemption because they are not income in the first place. A reclassification of a capital repayment into income from capital only applies if it replaces dividend distributions through (i) the capitalisation of reserves or (ii) the repayment of capital while the company has distributable reserves. This confirms that Article 97(3) b) functions as an anti-abuse rule rather than a limitative exception that automatically renders every other capital repayment taxable.

5.6.4. Considerations regarding the Tribunal’s Decision

The Tribunal relied heavily on the statement that “the only case in which the repayment of capital does not constitute a taxable advantage for the shareholder is where such repayment constitutes the counterpart of a reduction of share capital”. However, this statement must be read in conjunction with the preceding premises, namely that:

- (i) the fact that an allocation is made by drawing on accounts other than profits (e.g. share capital, share premium or equity account 115) does not preclude its taxation; and
- (ii) the mere designation of an allocation as a “repayment” or “amortisation” of capital does not, in itself, render it non-taxable.

The Tribunal also stated that “it is still necessary that the reduction of share capital is not carried out, in the presence of distributable reserves or profits, for the sole purpose of avoiding the taxation of distributions”.

Taking the statement relied upon by the Tribunal at face value would contradict the aforementioned principles, resulting in a “form over substance” approach. The Tribunal’s conclusion implies that the tax treatment of an economic transaction (in this case, the repayment of share premium) can change depending solely on whether a share capital reduction is performed simultaneously or not. This would conflict with the fundamental principles underlying Luxembourg income tax law, such as the economic approach (*wirtschaftliche Betrachtungsweise*), the principle of economic ownership (*wirtschaftliches Eigentum*) and the substance over form principle.

By elevating the formal distinction between “share capital” and “share premium” to a decisive factor, the Tribunal disregarded the economic reality of the transaction: the repayment represented a return of the shareholder’s original investment, not a distribution of profits. The absence of a formal share capital reduction does not transform a genuine return of capital into taxable income. To hold otherwise is to prioritise legal form over economic substance; a result that the legislator explicitly sought to avoid.

5.7. Application to the case at hand

The case raises a question that goes beyond the mere application of Articles 97 (1) No. 1 and 97 (3) b) of the LITL.

More specifically, the question is whether absorbing accounting losses through share premium (as a balance sheet presentation measure) and then recreating that share premium once the company became profitable constitutes capitalising profits within the meaning of Article 97 (3) b) of the LITL, or whether the economic approach would result in disregarding the share premium transactions (up to the amount initially absorbed) for Luxembourg tax purposes.

However, the Tribunal did not analyse this question, as it concluded that repayment of share premium without simultaneous reduction of share capital would automatically result in classification as income from capital based on the general rules.

As analysed above, the repayment of share premium (even without simultaneous repayment of share capital) should not, in principle, be classified as income from capital unless (i) reserves have been capitalised (up to the amount of capitalised reserves) or (ii) there are distributable reserves available at the time of distribution (up to the amount of distributable reserves).

¹⁸ “Le texte inséré sub b consacre, d’une façon formelle, l’immunisation des remboursements par réduction de capital social opérés pour des raisons économiques par une société de capitaux. Il faut évidemment qu’il s’agisse d’une réduction du capital social dans les formes à ce prévues par les lois concernant les sociétés de capitaux. Il faut, d’autre part, qu’il s’agisse du capital social constitué par les apports des sociétaires, et non pas du capital provenant éventuellement de l’incorporation de réserves en exemption de l’impôt sur le revenu”.

Therefore, it must be determined whether the absorption and recreation of the share premium should be disregarded for Luxembourg tax purposes, or whether the latter should be classified as the capitalisation of reserves within the meaning of Article 97 (3) b) of the LITL.

Although this was not clear from the description of the facts, it is assumed that the amount of share premium recreated from reserves corresponds to the amount previously used to offset accounting losses. Furthermore, it is assumed that the company had no distributable reserves when the share premium was repaid to the shareholders.¹⁹

As the LITL does not include any specific rules dealing with these specific circumstances, the analysis must be based on general Luxembourg tax principles. Here, the economic approach should be considered which, broadly speaking, is the substance over form principle under Luxembourg tax law. This principle states that a transaction's economic reality takes precedence over its legal form.

In this case, LuxCo should have prepared a tax balance sheet for Luxembourg tax purposes, retaining the share premium and tax losses even after the share premium was used to offset accounting losses.

Once the share premium had been recreated for accounting purposes after LuxCo became profitable again, the tax balance sheet would not have changed, and the absorption and recreation of the share premium would have been a non-event for Luxembourg tax purposes. Based on this, the repayment of part of the share premium should not be considered as a repayment of capitalised reserves from a Luxembourg tax perspective.

Consequently, the repayment of share premium should not be classified as income from capital within the meaning of Article 97 (1) No. 1 of the LITL (assuming that LuxCo did not have distributable reserves at the moment of the share premium repayment). As such, the repayment of share premium should not be subject to Luxembourg withholding tax.

¹⁹ If LuxCo had distributable reserves at the moment of the distribution, Article 97 (3) b) of the LITL would require a reclassification of the share premium repayment into income from capital up to the amount of distributable reserves.

06 CONCLUSION

In its Decision of 25 March 2026, the Tribunal adopted a strict and formalistic interpretation of Article 97 of the LITL. In the absence of a simultaneous reduction in share capital, the Tribunal treated the repayment of share premium as taxable income from a participation.

The Decision focused on a single statement in the Preparatory Works which stated that repayments not taking the form of regular share capital reductions are “taxable in all circumstances” while disregarding the surrounding context. Based on this extract, the Tribunal analysed whether share premium constitutes share capital. It concluded that it does not, and therefore held that Article 97 (3) b) of the LITL (which refers only to share capital) did not apply.

The Tribunal then attempted to define the scope of Article 97 (1) No. 1 of the LITL by contrasting it with any payment not included in Article 97 (3) b) of the LITL. This effectively treated the latter as an exhaustive exception, rather than the anti-abuse provision it was intended to be. Article 97 (3) b) of the LITL was designed to prevent taxable distributions of reserves from being replaced by non-taxable repayments of capital, rather than rendering every capital repayment outside its scope automatically taxable.

However, repayments of capital, whether in the form of share capital, share premium, or contributions to account 115, are not, in principle, income from capital. Such repayments represent the return of invested capital, not income generated by the investment. Where a company has no distributable reserves and the repaid capital was not created through the capitalisation of reserves, the repayment should remain tax-neutral. This is confirmed by the Preparatory Works, which emphasise that tax treatment must be determined by the economic substance of the transaction rather than its legal form.

In this case, the issue extends beyond the mere application of Articles 97(1) No. 1 and 97(3) b) of the LITL. This is because the share premium was initially used to offset accounting losses, but was then reinstated following profitable years. Taking an economic approach into account, and bearing in mind that a tax balance sheet should have been prepared for tax purposes (meaning this transaction would be a non-event), the repayment should not have been classified as income from capital (in the absence of distributable reserves).

Ultimately, the Decision has created significant legal uncertainty surrounding a common business transaction, which will persist until the Administrative Court clarifies the basic mechanism of Article 97 (3) b) of the LITL. In the meantime, companies should exercise caution and carefully analyse the specific facts and circumstances of any proposed capital repayment.

Prior results do not guarantee similar outcome. This publication was not designed to provide tax or legal advice and it does not substitute for the consultation with a tax or legal expert.



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