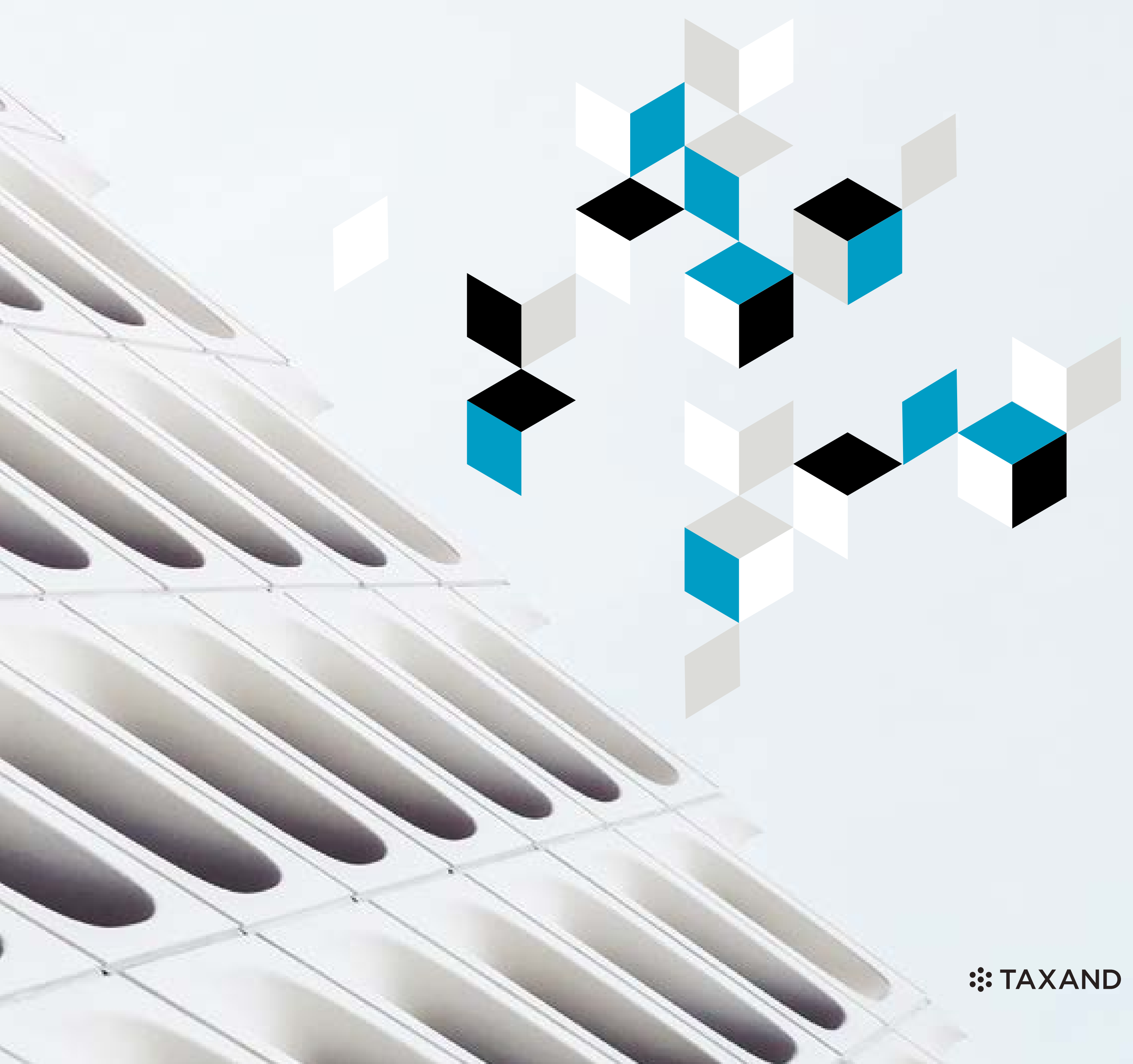
ATOZ

TAX ADVISERS LUXEMBOURG

INSIGHTS

DECEMBER 2023



TAXAND

CONTENTS

04 2024 Tax Forecast

10 Administrative Court clarifies the tax treatment of an interest-free loan (IFL) and overturns the decision of the Tribunal

14 Unconstitutionality of the minimum net wealth tax regime for companies holding predominantly financial assets: Consequences

19 Analysis of the last provisions introduced by the government in the law transposing Pillar Two

25 EU Commission's Initiatives in Direct Tax Matters: State of play

33 EU Commission Releases Proposal for a Council Directive on BEFIT: A Critical Analysis

39 The EU Commission's Directive Proposal on Transfer Pricing: A Trojan Horse?

47 Online incorporation of Luxembourg entities - the dream comes true but patience is still required!

49 Contact us

EDITORIAL

Greetings!

The end of 2023 has been marked by the legislative elections and the formation of a new government in Luxembourg. Time has now come to provide you with a few insights on what has happened in the Grand-Duchy and at European level in the past few months.

In addition to **tax measures** that have just been passed and will be applicable as from the fiscal year **2024**, the new **coalition agreement** announced several tax measures for the coming years. These are described in our 2024 tax forecast.

On 23 November 2022, the Luxembourg Administrative Court gave its decision in a case concerning an **interest-free loan** which was granted by a Luxembourg company to its wholly-owned Luxembourg subsidiary. In our dedicated article, we analyse the decision of the Administrative Court according to which **an interest-free loan qualifies as a debt instrument**.

Also from a case law perspective, on 10 November 2023, the Constitutional Court concluded that the **minimum net wealth tax** regime for companies holding predominantly financial assets is **unconstitutional in certain cases**. In our article, we analyse the facts leading up to the reference for a preliminary ruling as well as the Court's reasoning and the consequences of this ruling.

On 20 December, the law transposing the so-called **Pillar 2** directive was passed. However, before being passed, a few **amendements** to the initial draft law were made in order to introduce additional clarification in line with the **OECD guidance** and address **Luxembourg-specific points**. In our article, we describe selected amendments proposed by the government.

In view of the upcoming change in the presidency of the Council of the EU, we provide an overview of the **state of play** of various (new) EU direct tax initiatives such as the "**BEFIT**", "**HOT**" and "**TP**" directive proposals, as well as the "**Unshell**" proposal, the initiative aiming to tackle the role of so-called "enablers" called the "**SAFE**" proposal and also the "**DEBRA**" proposal to address Debt-Equity bias. The so-called "**FASTER**" proposal is moving forward quickly and the "**DAC8**" was formally adopted.

We also describe, in more detail, the implications and provide a critical analysis of the "**BEFIT**" and "**TP**" directive proposals adopted by the EU Commission on 12 September 2023.

Finally, a law on the use of digital tools and processes in company law and implementation of the digitalisation of the notarial profession was passed in June 2023. In our article, we present the main measures of this law and the current status of implementation by notaries.

We hope you enjoy reading our Insights.

The ATOZ Editorial team

Copyright © ATOZ 2023

2024 Tax Forecast

OUR INSIGHTS AT A GLANCE

- Various tax measures such as the major reform of the current investment tax credit framework and the adjustment of income tax scales will be applicable as from tax year 2024.
- In the 2023-2028 coalition agreement of the recently elected Luxembourg government, various measures related to income taxes, subscription tax, housing, the modernisation of tax administration and the tax procedure were announced.
- The new double tax treaty between Luxembourg and the UK as well as the new protocol to the double tax treaty between Luxembourg and Germany are on the way to be soon applicable.
- We provide hereafter an overview of the main changes to be introduced.

Luxembourg Income Tax Measures

- **Investment tax credit regime to be modernised as from 2024**

On 19 December 2023, the law introducing a major reform of the current investment tax credit ("**ITC**") framework was passed and will be applicable with effect as from tax year 2024. The law not only implements the investment tax credit modifications agreed upon in the tripartite agreement of 28 September 2022, but also completely reforms the current regime.

First, it increases the rates of the global investment tax credit. Further, it replaces the current additional investment tax credit by an additional tax credit for investments and operating expenses linked to the digital transformation and the ecological and energy transition and introduces a new system to certify the nature and reality of such investments and operating expenses.

The reform of the ITC regime is a positive initiative to accelerate the digital transformation as well as the ecological and energy transition of Luxembourg businesses and strengthen their competitiveness. However, since the new procedure of certification (which is only applicable to benefit from the new additional ITC) seems heavy, it remains to be seen how it will work in practice, given the related additional administrative burden for both taxpayers and the administration.

Read more about this new law in our previous Alert: Luxembourg Parliament adopts law modernising investment tax credit regime as from 2024

- **Individual taxation and tax brackets**

Given the difficult economic situation and the polycrisis context, the coalition agreement for the period 2023-2028 dated 16 November 2023 (hereafter referred to as the "**Coalition Agreement**") provides for a set of tax measures in order to strengthen the purchasing power of households.

To that aim, on 20 December 2023, a tax law was passed in order to adjust the income tax scale by 4 index brackets as from 1 January 2024. The tax relief provided for by the new law is in line with the Tripartite Agreement dated 3 March 2023, which had already provided for an adjustment of the tax scale by 2.5 index brackets implemented by a law dated 5 July 2023, which 1.5 additional brackets have now been added to. The law also reviews the tax scale for class 1A - which applies to single parents, widows and widowers - to ease the tax burden on single earners.

In practice, the law provides for an adaptation of tax brackets of 10.38% compared to the rate applicable since 2017.

Copyright © ATOZ 2023

According to the Luxembourg government, taking into consideration the economic tax credit (*crédit d'impôt conjoncture* or "**CIC**") applicable in 2023, the law involves the following tax reductions:

Class 1:

From this income*	Up to this income*	Rate
€0	€12,438	0%
€12,438	€14,508	8%
€14,508	€16,578	9%
€16,578	€18,648	10%
€18,648	€20,718	11%
€20,718	€22,788	12%
€22,788	€24,939	14%
€24,939	€27,090	16%
€27,090	€29,241	18%
€29,241	€31,392	20%
€31,392	€33,543	22%
€33,543	€35,694	24%
€35,694	€37,845	26%
€37,845	€39,996	28%
€39,996	€42,147	30%
€42,147	€44,298	32%
€44,298	€46,449	34%
€46,449	€48,600	36%
€48,600	€50,751	38%
€50,751	€110,403	39%
€110,403	€165,600	40%
€165,600	€220,788	41%
€220,788		42%

*adjusted taxable income

Employed taxpayers in tax class 1

Annual salary:

Gross annual salary	Adjusted annual taxable income	Tax due for 2023	Tax due for 2023* with eco-nomic tax rate	Tax due for 2024	Impact in €	Impact in %	Impact with the 2023 CIC applied
€37,000	€31,891	€3,046	€2,787	€2,598	-€448	-14.7	-€189
€45,000	€39,008	€5,066	€4,689	€4,369	-€697	-13.8	-€320
€50,000	€43,455	€6,586	€6,135	€5,710	-€876	-13.3	-€425
€60,000	€52,350	€10,023	€9,495	€8,928	-€1,095	-10.9	-€567
€75,000	€65,692	€15,210	€14,682	€14,115	-€1,095	-7.2	-€567
€100,000	€87,930	€23,887	€23,359	€22,793	-€1,094	-4.6	-€566
€125,000	€110,168	€32,666	€32,090	€31,470	-€1,196	-3.7	-€620
€150,000	€132,526	€41,606	€41,030	€40,408	-€1,198	-2.9	-€662

*not including the employment fund

Copyright © ATOZ 2023

Employed taxpayers in tax class 1A

Annual salary:

Gross annual salary	Adjusted annual taxable income	Tax due for 2023	Tax due for 2023* with eco-nomic tax rate	Tax due for 2024	**Impact in €**	**Impact in %**	Impact with the 2023 CIC applied
€37,000	€31,891	€1,650	€1,391	€1,050	**-€600**	**-36.4**	-€341
€45,000	€39,008	€4,109	€3,732	€2,990	**-€1,119**	**-27.2**	-€742
€50,000	€43,455	€5,844	€5,393	€4,684	**-€1,160**	**-19.8**	-€709
€60,000	€52,350	€9,315	€8,787	€8,155	**-€1,160**	**-12.5**	-€632
€75,000	€65,692	€14,502	€13,974	€13,342	**-€1,160**	**-8**	-€632
€100,000	€87,930	€23,180	€22,652	€22,019	**-€1,161**	**-5**	-€633
€125,000	€110,168	€31,959	€31,383	€30,697	**-€1,262**	**-3.9**	-€686
€150,000	€132,526	€40,899	€40,323	€39,634	**-€1,265**	**-3.1**	-€689

*not including the employment fund

***Collective taxpayers in tax class 2** - each earning a salary (split 2/3 and 1/3)*

Annual salary:

Gross annual salary	Adjusted annual taxable income	Tax due for 2023	Tax due for 2023* with eco-nomic tax rate	Tax due for 2024	**Impact in €**	**Impact in %**	Impact with the 2023 CIC applied
€50,000	€37,935	€1,470	€1,212	€1,184	**-€286**	**-19.5**	-€28
€75,000	€60,173	€5,252	€4,718	€4,468	**-€784**	**-14.9**	-€250
€90,000	€73,515	€8,747	€8,064	€7,523	**-€1,224**	**-14.0**	-€541
€100,000	€82,410	€11,586	€10,854	€10,019	**-€1,567**	**-13.5**	-€835
€125,000	€104,648	€20,007	€19,151	€17,818	**-€2,189**	**-10.9**	-€1,333
€150,000	€126,885	€28,685	€27,706	€26,496	**-€2,189**	**-7.6**	-€1,210
€175,000	€149,123	€37,362	€36,281	€35,173	**-€2,189**	**-5.9**	-€1,108

*not including the employment fund

Copyright © ATOZ 2023

The forecast impact of adapting the tax scale by 4 index brackets on budgetary revenue is estimated at EUR 480 million. This corresponds to an additional "tax waste" of EUR 180 million compared to the adaptation of 2.5 index brackets, retained in the Tripartite Agreement.

In the Coalition Agreement of the recently elected Luxembourg government, it was announced that in case the government manages to keep its finances healthy, it will also commit to catching up with the four missing index brackets in the tax scale over the next five years.

The government finally commits to carrying out a major tax reform over the coming years in order to implement a single tax scale. This project was introduced by the former government but never materialised, first delayed due to the pandemic and ultimately shelved when inflation and the energy crisis hit. Now, the new government says it plans to present a bill establishing the single tax by 2026. The new government opposes, however, the idea of increasing the maximum tax rates for the highest income brackets.

- **More to come in the following years**

The Coalition Agreement includes other tax measures, which the government intends to introduce in the course of the upcoming five years, but the date as from which they will be introduced remains to be confirmed.

Announced reforms in relation to the Luxembourg **income taxes** are the following:

- Revision of corporate income tax and municipal business tax rates in the medium term so as to bring them in line with the average tax rate applicable in OECD countries;
- Introduction of a tax allowance up to a certain income level for people entering the working life;
- Clarification and simplification of the tax treatment of benefits in kind granted by companies to their employees;
- Introduction of a tax scheme to encourage investment by individuals in young innovative companies in the field of the dual sustainable and digital transition;
- Strengthening of the participatory bonus scheme (*prime participative*) and the impatriate regime to support the recruitment and retention of talents;
- Incentives for employee participation in the capital of companies employing them.

The government also announced that the possibility of reducing the **subscription tax** for actively managed UCITS-ETF funds will be analysed and, to strengthen the competitiveness of the financial centre, the legal framework applicable to Funds will be adapted on an ongoing basis. In the same spirit, the government will analyse the impact of a subscription tax reduction for investment funds investing in sustainable economic activities and will assess whether further subscription tax reductions would increase investments in these activities.

Among the measures listed in the coalition agreement, several tax measures target the **housing and construction** crises in Luxembourg. Several of these are limited measures designed to stimulate the construction market in the short term, such as:

- A reduction of the capital gains tax;
- An accelerated depreciation rate for rental housing;
- An increase in the "Bëllegen Akt" tax credit, which will benefit buyers looking to purchase their main residence. This may also apply to individuals looking to invest in rental property;
- A higher deduction for annual interest for owners taking out property loans will be permitted when filing tax returns in order to facilitate their credit without harming purchasing power;
- An increase of the net income exemption to 90% for investors renting through social rental management organisations.

The Coalition Agreement is also targeting unoccupied housing units, planning to introduce a register to list empty homes and planning to revise taxes both for empty units and land. For these purposes, the government could be willing to bring forward the draft law n°8082 already presented in 2022 by the previous government with the aim of carrying out a reform of the Luxembourg property tax that would come into force in 2026. The three major axes of this draft law were based on a modernisation of the property tax and

Copyright © ATOZ 2023

the introduction of two new taxes encouraging property owners to mobilise building land (tax on the mobilisation of land) and uninhabited dwellings (tax on the non-occupation of housing) to combat the increasing housing shortage in Luxembourg. However, while the Council of State agreed with the objectives of the reform, the Council of State raised several concerns regarding the proposed legislative framework and expressed 17 formal objections to the draft law. According to the Council of State, some aspects of the measures proposed were not in line with the Luxembourg Constitution because:

- Some do not meet the criteria of clarity and accessibility required by the Luxembourg Constitution to achieve legal certainty;
- Some others go against the principle of equal treatment;
- Some are not in line with the principle of proportionality; and
- Some go against the right to an effective remedy and a fair trial.

Whether the government proposes a new draft law or redrafts the one currently on the table in order to address the Council of State's concerns, we can still expect such reform to come into force in 2026, as initially announced. Read more about the reform in our previous article: "The Luxembourg property tax reform: too slow to address efficiently the housing challenges!".

The government is also committed to creating tax incentives to enable companies to create and make available, on favourable terms, housing for their employees. The government will also analyse the introduction of a tax exemption for premiums paid by companies for rental housing purposes. To that aim, the premium to be exempted will be capped and will be reserved for young employees whose level of income does not exceed a certain threshold to be determined.

As part of a cross-policy to modernise **tax administrations**, the government also announced that they will adapt their organic laws on an ad hoc basis and make them more accessible, with the aim of strengthening the relation of trust between taxpayers and the tax authorities. Finally, tax legislation and **administrative procedures** will be simplified to ensure efficient processes. On 28 March 2023, a draft law as well as drafts of Grand-Ducal Regulations were presented by the previous government in order to amend the Luxembourg tax procedure. Some proposed provisions are positive as they would bring more certainty for taxpayers. Unfortunately, it seemed that the main purpose of the changes to be introduced was mainly to reduce the duties of the tax authorities or to relieve the tax authorities' congestion rather than to increase the tax certainty for taxpayers. This is also the conclusion reached by the Council of State in its opinion on the draft law released on 11 July 2023. It remains to be seen how this draft law will evolve over the legislative process. Nevertheless, we hope that the new government will take this opportunity to address the current needs of modernisation of the Luxembourg tax procedure. Read more about the current draft law in our previous article: "Direct tax procedure: Commentary on upcoming amendments".

The government will continue its efforts to digitise tax administrations. Similarly, digital exchanges with the tax authorities will be encouraged and administrative procedures will be digitalised, also using artificial intelligence.

Double tax treaties ("DTT")

- **DTT between Luxembourg and the UK**

On 18 September 2023, Luxembourg ratified the law approving the new DTT with the UK, as published in the Official Journal on 4 October 2023. The new DTT entered into force in respect of both contracting parties on 22 November 2023, in accordance with Article 29 of the DTT which states that: "*The Contracting States shall notify each other in writing, through diplomatic channels, that the procedures required by its law for the entry into force of this Convention have been satisfied. This Convention shall enter into force on the date of receipt of the later notification*".

As a result, the new provisions of the DTT between Luxembourg and the UK become applicable as follows:

In Luxembourg, it would apply:

- in respect of taxes withheld at source, to income

Copyright © ATOZ 2023

derived on or after 1 January 2024; and
- in respect of other taxes on income, and taxes on capital, to taxes chargeable for any taxable year beginning on or after 1 January 2024.

In the UK, the DTT would apply:
- in respect of taxes withheld at source, to income derived from 1 January 2024;
- in respect of income and capital gains tax, to any year of assessment from 6 April 2024; and
- for corporation tax (including corporation tax on capital gains), for any financial year beginning on or after 1 April 2024.

In the UK, whilst for corporation taxpayers the earliest the new treaty could apply is therefore 1 April 2024, in reality it could be the year after. A number of companies and groups have financial years starting 1 January and for these the DTT would only apply from 1 January 2025.

Once in force and effective, the new treaty will replace the old DTT as amended by the 1978, 1983 and 2009 protocols.

- **DTT between Luxembourg and Germany**

On 14 December 2023, the Luxembourg Parliament voted the law ratifying the protocol (the "2023 Protocol") to the Germany - Luxembourg double tax treaty ("**DTT**") signed on 6 July 2023. The 2023 Protocol introduces both amendments to the DTT and amendments to the protocol to the DTT signed in 2012 (the "**2012 Protocol**") currently in force.

The 2023 Protocol mainly (i) extends the tolerance threshold for cross-border workers from 19 to 34 days under the DTT, (ii) incorporates into the DTT the options taken by the two countries to implement the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**MLI**"), (iii) amends the provisions applicable to treaty benefits for investment funds and (iv) adapts the current provisions of the DTT in order to take into account some recent German tax law changes (e.g. dealing with Real Estate Investment Trusts, "**REITs**"). For more details on the implications of the 2023 Protocol, please read our previous publication on the topic: "Luxembourg and Germany sign amending protocol to their tax treaty" in our Insights of August 2023."

On 8 December 2023, Germany ratified the 2023 Protocol by way of publication in the Official Gazette (Bundesgesetzblatt) of 13 December 2023.

As a result, provided Luxembourg and Germany exchange their respective instruments of ratification before year-end, the 2023 Protocol will enter into force and should thus generally become applicable as from 1 January 2024. If Luxembourg and Germany do not manage to finalise the ratification process and exchange the instruments of ratification prior to the end of 2023, the new Protocol will not enter into force and will thus not become applicable as from 1 January 2024.

Our authors

OLIVIER REMACLE
Partner
olivier.remacle@atoz.lu

MARIE BENTLEY
Chief Knowledge Officer
marie.bentley@atoz.lu

Copyright © ATOZ 2023

Administrative Court clarifies the tax treatment of an interest-free loan (IFL) and overturns the decision of the Tribunal

OUR INSIGHTS AT A GLANCE

- On 23 November 2023, the Luxembourg Administrative Court held its decision in a case concerning an interest-free loan which was granted by a Luxembourg company to its wholly-owned Luxembourg subsidiary.
- The decision overturns the decision of the Administrative Tribunal of 23 September 2022 which classified the interest-free loan as a hidden capital contribution (rather than a debt instrument).
- The Court held that the classification of the interest-free loan (as equity or debt) must follow an overall assessment of all relevant criteria.
- In the present case, most of the relevant features of the interest-free loan were debt features. Therefore, the Court classified the loan as a debt instrument.
- Hereafter, we analyse the grounds on which the Administrative Court considered that the interest-free loan qualifies as a debt instrument.

On 23 November 2023, the Luxembourg Administrative Court (Cour Administrative, the "**Court**", which is the instance of appeal Court) held its decision (the "**Decision**") in a case concerning an interest-free loan ("**IFL**") which was granted by a Luxembourg company to its wholly-owned Luxembourg subsidiary.

The Decision overturns the decision of the Administrative Tribunal of 23 September 2022 which confirmed the position of the Luxembourg tax authorities ("**LTA**") that classified the IFL as a hidden capital contribution (rather than a debt instrument).

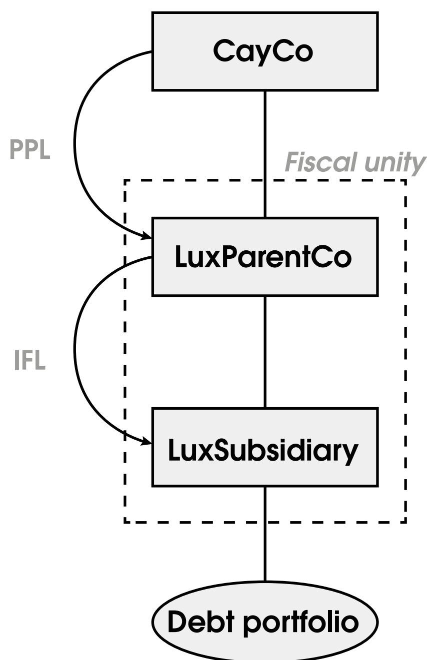
In our ATOZ Report (released in March 2023) we carefully analysed the classification and tax treatment of the IFL and reached the same conclusions as the Court. Considering the widespread use of IFLs to finance Luxembourg companies, the importance of the Decision cannot be overstated. Indeed, over the last year, some Luxembourg tax advisers became extremely concerned when considering the implementation of IFLs. As such, the Decision of the Court contributes to much needed legal certainty.

Background

The case involved a company resident in the Cayman Islands ("**CayCo**") that invested, as from 2016, via a Luxembourg investment platform into (distressed) debt owed by third parties. CayCo financed its Luxembourg subsidiary ("**LuxParentCo**") by a mixture of equity and a profit-participating loan ("**PPL**"). LuxParentCo used the funds received to finance its Luxembourg subsidiary ("**LuxSubsidiary**", the taxpayer) by a mixture of equity and (mainly) an IFL. In the Decision, it is stated that the IFL-to-Equity ratio was approximately 90:10 in 2016. LuxSubsidiary (the borrower) invested the funds received from LuxParentCo (the lender) mainly into distressed debt instruments.

Copyright © ATOZ 2023

The following chart depicts the investment structure:



The IFL granted by LuxParentCo to LuxSubsidiary was formalised on 19 December 2016, whereas the funds had already been transferred on 29 April 2016.

LuxParentCo and LuxSubsidiary are Luxembourg companies that are subject to corporate income tax ("**CIT**"), municipal business tax ("**MBT**") and net wealth tax ("**NWT**").

In its 2016 corporate tax return, LuxSubsidiary performed a downward adjustment in relation to the IFL in order to account for deemed interest expenses that would have been due at arm's length. The downward adjustment was made in accordance with Article 56 of the Luxembourg income tax law ("**LITL**").

There are no indications that LuxParentCo realised any taxable income in 2016. However, LuxParentCo recognised deemed interest income in its corporate tax return (corresponding to the amount of the deemed interest expenses reflected in the 2016 corporate tax return of LuxSubsidiary). The upward adjustment was performed in accordance with Article 56 of the LITL.

The investments of LuxSubsidiary should be taxable assets for NWT purposes, whereas the IFL should be a deductible liability that reduces the company's unitary value if the IFL is classified as a debt instrument for tax purposes.

As from 2017, LuxParentCo and LuxSubsidiary formed a fiscal unity. Accordingly, the taxable income of both companies was aggregated at the level of LuxParentCo which reported the consolidated taxable income in its corporate tax return.

In 2017, no tax adjustments (upward or downward adjustments) were made in respect of the IFL. The absence of tax adjustments in the 2017 corporate tax returns has been viewed by the LTA as an implicit acknowledgement that the IFL is not a debt instrument but a hidden capital contribution.

While the LTA may, for consistency purposes, require the same tax adjustments as in the fiscal year 2017 to be made onwards, the deemed interest income and expenses would fully offset each other in the tax base of the fiscal unity. Thus, the recognition of deemed interest income and expenses would be merely a theoretical exercise without any practical implications in terms of tax liabilities. Therefore, the LTA should not attribute too much importance to the approach taken by the taxpayers as from 2017 as it is no indication for the classification of the IFL by the taxpayers.

Decision of the Court

- **Overview**

According to the Court, the intention of the Luxembourg legislator (expressed in the parliamentary documents on the LITL) requires that the classification of a financing instrument follows the economic approach ("*wirtschaftliche Betrachtungsweise*"). This approach involves, for tax purposes, the economic reality prevailing over the legal form (also referred to as the "substance over form" principle).

Hence, it is necessary to analyse all relevant features of a financing instrument to determine the overall character of the instrument as either debt or equity. In this respect, the

Copyright © ATOZ 2023

parliamentary document of the LITL indicates that it is necessary to carry out an overall analysis of the transaction rather than focusing on one or a few characteristics of the loan agreement under review.

- **Circumstances assessment**

The Court held, in respect to the circumstances of the case, that contrary to the position of the tax authorities:
- No useful conclusion can be drawn from the fact that the actual date on which the funds were made available differs from the date on which the IFL agreement was formalised.
- The allocation of the funds lent is relevant. Here, the loan received was not allocated to long-term fixed assets. Therefore, it does not constitute an indication of the existence of a disguised shareholding in the form of a loan.
- The debt/equity ratio must be assessed considering the debt/equity ratio requirements at the time the funds were made available.

- **Assessment of the features of the IFL**

The Court noted that the loan agreement did not allow the lender to participate in the borrower's profits or liquidation proceeds and did not grant voting rights to the lender, which are all important equity features.

In addition, the Court considered in favour of a debt qualification of the IFL that:
- The IFL did not provide for an option of the borrower to unilaterally convert the loan into capital (according to the loan agreement, the lender had the right to require a conversion of the IFL at its sole discretion into capital).
- While the IFL agreement provides for the possibility of repayment of the loan in cash or in kind (this possibility is subject to the lender's acceptance and to agreement between the lender and the borrower on a method of valuation of the asset used for a repayment in kind), a repayment in kind may only be made with assets owned by the borrower (not with shares of the borrower).
- The IFL did not contain a stapling clause that would prevent the lender from transferring its rights and obligations arising from the IFL. On the contrary, the lender may freely assign its rights and obligations, whereas the borrower needs the consent of the lender to transfer its rights and obligations.
- The loan agreement provided for a ten-year maturity of the IFL and an obligation to repay the loan at maturity. However, a maturity of (only) ten years is not long enough to be an indication of the lender's intention to behave as an equity investor.
- The IFL contained a limited recourse clause, which, according to the Court, transferred risks to the lender but did not annul ex ante the borrower's repayment obligation. Consequently, it does not give rise to a presumption of the existence of a disguised participation in the form of a loan.

The Court further considered the following elements:
- Debt instruments frequently provide for a remuneration in the form of interest. Hence, the interest-free element of the loan is an equity feature.
- The IFL agreement does not provide for a guarantee in favour of the lender and subordinates repayment of the loan amount in the event of the borrower's bankruptcy to prior re-payment of any debt owed by it to a bank. However, third-party creditors (in particular a bank) requiring preferred creditor status in relation to the borrower's intra-group creditors is common in practice and cannot be taken as a conclusive equity feature.

As a last important element, the Court reiterated that the borrower made only very limited use of the credit facility and that the loan was repaid on 31 December 2018. Thus, in accordance with the principle of substance over form, and

Copyright © ATOZ 2023

with the hindsight inherent in the analysis carried out by the Court (after the end of the relevant transactions), the Court concludes that the IFL was indeed executed by the parties as a loan that was even repaid well before the contractually agreed maturity.

- **Classification of the IFL**

As the majority of the IFL's relevant features are debt features, the Court concluded that the IFL should be classified as a debt instrument.

Conclusion

The Court held that the classification of the IFL (as equity or debt) must follow an overall assessment of all relevant criteria. In the present case, most of the relevant features of the IFL were debt features. Therefore, the Court classified the loan as a debt instrument.

As the subject matter of the court case was the classification of the IFL as debt or equity and the Court is limited by the grounds on which it has been involved, it could not itself review the downward (and upward) adjustment in principle (i.e. notional interest) and the arm's length nature of the notional interest rate declared by the borrower. However, the Court stated that it is led to hold that it was wrong to recharacterise the IFL as equity and to refuse to admit the amount put forward as notional interest.

Hence, the Court re-established long-standing principles with respect to the classification of financial instruments as debt or equity (i.e. economic approach, substance over form). This contributes to much needed legal certainty regarding this fundamental tax question. Ultimately, considering the widespread use of IFLs to finance Luxembourg companies, the importance of this decision cannot be overstated.

Our authors

OLIVER R. HOOR
Partner, Head of Transfer Pricing & the German Desk
oliver.hoor@atoz.lu

MARIE BENTLEY
Chief Knowledge Officer
marie.bentley@atoz.lu

Copyright © ATOZ 2023

Unconstitutionality of the minimum net wealth tax regime for companies holding predominantly financial assets: consequences

OUR INSIGHTS AT A GLANCE

- On 10 November 2023, the Constitutional Court concluded that the minimum net wealth tax regime for companies holding predominantly financial assets is unconstitutional.
- Pending a potential legislative reform, taxpayers subject to minimum net wealth tax applicable to companies considered as SOPARFIs for minimum net wealth tax purposes should be subject to the minimum net wealth tax applicable to Non-SOPARFIs whenever this is more favourable.
- The facts leading up to the reference for a preliminary ruling, as well as the Court's reasoning and the consequences of such ruling, are analysed hereafter.

On 10 November 2023, the Constitutional Court (the "**Court**") concluded that the minimum net wealth tax regime ("**minimum NWT**") for companies holding predominantly financial assets is unconstitutional (n° 00185).

As a consequence, a legislative reform of the minimum NWT is possibly to be expected.

Pending the potential reform, taxpayers subject to minimum NWT applicable to companies considered as SOPARFIs for minimum NWT purposes should be subject to the minimum NWT applicable to Non-SOPARFIs whenever this is more favourable.

The facts leading up to the reference for a preliminary ruling, as well as the Court's reasoning and the consequences of such ruling, are analysed below.

Background

The minimum NWT provides that Luxembourg resident companies are, in principle, subject to a minimum NWT which is generally determined according to the nature and size of their balance sheet.

For purposes of determining the amount of minimum NWT due, the Luxembourg NWT law makes a distinction between, on the one hand, companies whose accounts 23, 41, 50 and 51 of the Luxembourg standard chart of accounts (i.e. financial assets, amounts owed by affiliated companies, transferable securities and cash at bank, hereafter referred to as the "**qualifying assets**") exceed both (i) 90% of their total balance sheets and (ii) a threshold of EUR 350,000 ("**SOPARFIs**"), and, on the other hand, the other companies ("**Non-SOPARFIs**"). Usually, holding companies meet the conditions to be treated as SOPARFIs for NWT purposes.

A fixed amount of minimum NWT of EUR 4,815 applies to "SOPARFIs". For the socalled "Non-SOPARFI" companies, the amount of minimum NWT is progressive and can range from EUR 535 to EUR 32,100 depending on the value of their total balance sheets.

In the case leading to the reference for a preliminary ruling, a corporate taxpayer, treated as a SOPARFI under NWT legislation, considered they were discriminated because the NWT provision which sets a minimum wealth tax of EUR 1,605 for a Non-SOPARFI with a total balance sheet greater than EUR 350,000 and less than or equal to EUR 2,000,000 is more favourable than the minimum flatrate tax of EUR 4,815 provided for a SOPARFI with a total balance sheet of more than EUR 350,000.

As a result, the taxpayer decided to appeal against the tax assessments before the Administrative Tribunal on the basis of the differential treatment between companies of equal size solely due to the criterion of the composition

Copyright © ATOZ 2023

of their balance sheet. In a judgement dated 18 April 2023 (n° 45910), the Administrative Tribunal referred the question of whether the difference in treatment between SOPARFIs and Non-SOPARFIs with regard to minimum NWT complies with article 10bis of the Luxembourg Constitution (i.e. the principle of equality before the law) to the Court.

Ruling of the Constitutional Court

On 10 November 2023, the Court concluded that the minimum NWT applicable to SOPARFIs (§8, (2), (a) VStG) is contrary to article 10bis, §1 of the Constitution (article 15 of the new Constitution applicable as from 1 July 2023).

In the opinion of the Court, the question of the differential treatment raised to its attention by the Administrative Tribunal is not solely based on the 90% threshold, since this is not the cause of the difference in tax regime for taxpayers (i.e. application of either the progressive or flatrate amount of minimum NWT). What distinguishes taxpayers exceeding the 90% threshold is the condition related to the threshold of EUR 350,000 because it is only when accounts 23, 41, 50 and 51 of the standard chart of accounts exceed the 90% threshold in relation to their total balance sheets that taxpayers are distinguished by the addition of the condition relating to the EUR 350,000 threshold.

The Court ruled that the minimum NWT provisions result in a differential treatment between taxpayers in comparable situations. The Court recalled that the legislator may, without violating article 10bis, §1 of the Constitution (i.e. the constitutional principle of equality), subject certain categories of persons to different legal regimes, provided that the difference instituted arises from objective disparities, that it is rationally justified, appropriate and proportionate to its aim.

In the case at hand, the Court noted that no justification could be provided by the government representative or inferred from the parliamentary documents for the differential treatment established and is thus to be regarded as not being rationally justified a priori, to the extent the threshold of EUR 350,000 is concerned.

Furthermore, the Court recalled that the principle of equality before the law is applied in tax matters through the principle of contribution according to the taxpayer's ability to pay. According to the Court, distinguishing between the taxpayers considered as SOPARFIs and Non-SOPARFIs by adding a second criterion based on the threshold of EUR 350,000 fails to take account of the taxpayers' ability to pay.

- **Critical analysis of the reasoning of the Court**

This ruling and the reasoning of the Court raises questions, notably due to a very light and lacunar motivation.

The preliminary ruling referred to by the Administrative Tribunal raised a question related to differential treatment between companies with balance sheets of equal size, and thus comparable, but falling under the scope of the minimum NWT of SOPARFIs or Non-SOPARFIs, the latter being more favourable, solely based on the criterion of the nature of their balance sheets (i.e. the 90% threshold). However, the Court considered, without explaining why it decided to change the comparability criteria to perform its analysis, that companies in a comparable situation were the ones reaching the 90% threshold but treated as SOPARFIs or Non-SOPARFIs whether or not the EUR 350,000 threshold was reached.

As a result, whilst seemingly not calling into question the difference made between SOPARFIs and Non-SOPARFIs based on the 90% threshold criteria (which was at the origin of the question raised by the Administrative Tribunal), the Court found that the additional condition relating to the EUR 350,000 threshold is the criteria making a distinction between taxpayers (and not the 90% threshold criteria).

This change in the comparability criteria between companies is not neutral. Indeed, the taxpayer initially compared companies with a total balance sheet between EUR 350,000 and EUR 2,000,000 on the basis that they reached the 90% threshold, and were thus subject to a minimum NWT of EUR 4,815, or not, thus being subject to a minimum NWT of EUR 1,605. Differently, the Court compared companies reaching the 90% threshold based on the fact that they

Copyright © ATOZ 2023

reached the EUR 350,000 threshold, and were thus subject to the minimum NWT of EUR 4,815, or not, thus being subject to a minimum NWT of EUR 535 if their total balance sheet was equal to or below EUR 350,000 or EUR 1,605 if the value of their total balance sheet was between EUR 350,000 and approximately EUR 389,000 depending on the percentage of qualifying assets they held (between 100% and 90%, in a manner that is inversely proportional)[1].

According to the Court, no justification was given by the State counsel or could be inferred from the parliamentary documents for the reference to this EUR 350,000 threshold as a criterion distinguishing taxpayers and thus the distinction made between taxpayers based on this threshold is to be looked at as not legally justified *a priori*.

This statement is surprising as in the parliamentary documents related to the law that introduced as from 2015 the EUR 350,000 criterion, it is stated that, "*In the absence of this criterion, small and medium-sized companies that are newly created or in liquidation regularly find themselves in the scope of the minimum IRC* tax [Author's note: the minimum corporate income tax has meanwhile been abolished and replaced by the minimum NWT] *of EUR 3,000* [Author's note: meanwhile increased to EUR 4,815] *because their total financial assets exceed 90% of the balance sheet total. This bill therefore proposes to refine the eligibility criteria to the EUR 3,000 tax rate by excluding entities whose total financial assets are less than or equal to EUR 350,000"*[2] (unofficial translation). It can thus be rather clearly inferred from this that the aim of the legislator was to exclude small and medium entities from the scope of the flat tax rate applicable to SOPARFIs, notably because of their more reduced ability to pay.

The Court finally added that in distinguishing entities that are a priori SOPARFIs (because they reach the 90% threshold) based on the EUR 350,000 threshold, the legal provision disregards the ability to pay taxes of targeted taxpayers.

Again, this conclusion seems counter-intuitive. We have indeed seen that the Court compared companies reaching the 90% threshold, and are thus either subject to the minimum NWT of EUR 4,815 if they reach the EUR 350,000 threshold or subject to a minimum NWT of EUR 535 or EUR 1,605 if the value of their total balance sheets is equal to or below EUR 350,000. Yet, if the ability to pay taxes is not taken into consideration in the same way as it is provided for Non-SOPARFIs (i.e. not based on a progressive scale), the EUR 350,000 threshold makes a distinction between small and medium entities and larger entities, the former paying a lower amount of minimum NWT and the latter paying more (i.e. the flat rate of EUR 4,815). Therefore, to a certain extent, the ability to pay taxes of entities is taken into account, and based on the parliamentary documents, this seems to have been the intention of the legislator.

Consequently, it is not clear without further explanations in the ruling why the Court considers that the EUR 350,000 criterion fails to take account of the taxpayer's ability to pay[3]. Indeed, the fact that the legislator decided to treat a taxpayer that is a priori a SOPARFI because it reaches the 90% threshold of qualifying assets, but is a small company because the value of these assets does not reach the threshold of EUR 350,000, in the same way as a small Non-SOPARFI (total balance sheet below a certain amount), precisely takes into consideration the taxpayers's ability to pay and thus seems to be justified.

The Court concluded that the legal provision applicable to SOPARFIs and providing for a flat tax of EUR 4,815 is unconstitutional because the EUR 350,000 threshold it

[1] All the other entities with a total balance sheet higher than approx. EUR 389,000 and reaching the 90% threshold are indeed subject to the minimum NWT due by SOPARFIs (because 90% of approx. EUR 389,000 = EUR 350,001).

[2] Projet de loi concernant le budget des recettes et des dépenses de l'Etat pour l'exercice 2015, Commentaire des articles, n°6720, session ordinaire 2014-2015, p. 72 : " En l'absence de ce critère, les petites et moyennes entreprises qui viennent d'être constituées ou qui sont en liquidation tombent régulièrement sous l'I.R.C. minimum de EUR 3,000 parce que le total de leurs actifs financiers dépasse 90% du total du bilan. Le présent projet de loi propose dès lors d'affiner le critère de l'assujettissement au tarif de EUR 3,000 en excluant les collectivités, dont la somme des actifs financiers est inférieure ou égale à 350.000 euros ".

[3] " En distinguant les contribuables visés aux points a) et b) par l'ajout d'un second critère au point a) reposant sur le dépassement de la somme de 350.000 euros par les comptes 23, 41, 50 et 51 du plan comptable normalisé, ladite disposition méconnaît la faculté contributive des contribuables y visés ".

Copyright © ATOZ 2023

refers to is not rationally justified. As a result, according to the Court, pending a legal reform, taxpayers subject to minimum NWT applicable to companies considered as SOPARFIs for minimum NWT purposes should be subject to the minimum NWT applicable to Non-SOPARFIs whenever this is more favourable. In practice, entities concerned are only the ones that are a priori SOPARFIs because they reach the 90% threshold and have a total balance sheet between EUR 350,000 and EUR 2,000,000.

- **Transposition of the issue to other cases**

Since the Court did not clearly answer the point raised by the Administrative Tribunal, the question remains open as to whether the 90% threshold criteria which differentiates taxpayers with a total balance sheet of the same value is legally justified. In other words, the questions as to whether these two categories of taxpayers are in comparable situations and, if they are in a comparable situation, as to whether the different treatment applied to them is legally justified have not been resolved.

As a consequence, given that it is not clear whether the 90% threshold raises an issue from a constitutional point of view, the argument of the taxpayer leading to the preliminary ruling request of the Administrative Tribunal could be transposed to other cases. Such argument could be transposed notably to the case of Non-SOPARFIs with a total balance sheet above EUR 2,000,000 compared to SOPARFIs with the same amount of total balance sheet because the minimum NWT payable by the Non-SOPARFIs would in such case be (much) higher according to the progressive scale than the minimum NWT payable by the SOPARFIs, while it could still be argued that both taxpayers are in a comparable situation.

Consequences of the unconstitutionality of the minimum net wealth tax regime

In light of this decision, taxpayers subject to minimum NWT applicable to SOPARFIs should be subject to the minimum NWT applicable to Non-SOPARFIs whenever this is more favourable.

- **Effect of the ruling on cases pending before a court or in which appeals are still possible**

According to the recently introduced[4] article 95*ter*, §6 of the Constitution (article 112, §8 of the new Constitution applicable as from 1 July 2023), "*the provisions of laws declared to be unconstitutional by a ruling of the Constitutional Court cease to have legal effect on the day following the publication of that ruling in the form laid down for the law, unless the Constitutional Court has ordered another period. The Constitutional Court shall determine the conditions and limits under which the effects that the provision has produced may be called into question*" (unofficial translation[5]).

In the present case, the ruling was published in the Official Journal of the Grand-Duchy of Luxembourg on 20 November 2023 and contains no indication of the Court's intention to defer its effects. Consequently, the ruling has had legal effect as from 21 November 2023.

This new provision of the Constitution confers general and absolute effect (*erga omnes*) to the rulings of the Constitutional Court. This means that the tax authorities on the one hand and the administrative courts on the other are bound to respect the consequences of the preliminary ruling given by the Constitutional Court.

The parliamentary documents in relation to this new provision of the Constitution state that "*there can be no*

[4] Loi du 15 mai 2020 portant révision de l'article 95ter de la Constitution, Journal officiel du Grand-Duché de Luxembourg, 15 mai 2020 (entered into force on 19 May 2020).

[5] " Les dispositions des lois déclarées non conformes à la Constitution par un arrêt de la Cour Constitutionnelle cessent d'avoir un effet juridique le lendemain de la publication de cet arrêt dans les formes prévues pour la loi, à moins que la Cour Constitutionnelle n'ait ordonné un autre délai. La Cour Constitutionnelle détermine les conditions et limites dans lesquelles les effets que la disposition a produits sont susceptibles d'être remis en cause ".

Copyright © ATOZ 2023

retroactive effect on fixed legal situations, but the ruling may have an effect on cases pending before a court or in which appeals are still possible"[6]. As a result, an analysis of the practical consequences of this ruling on taxpayers should be made on a case-by-case basis.

- **Which (potential) legislative reform is to be expected?**

By describing the effects of its ruling "pending a legal reform to come"[7], the Court seems to invite the legislator to modify the legal provision at stake, but the legislator is, in theory, not obliged to reform the minimum NWT regime. Various scenarios are possible.

First, as the rulings of the Constitutional Court now have a general and absolute effect, the tax authorities and administrative courts are bound to respect the consequences of such ruling (see above). Therefore, if the legal provision is not modified, it should not have any material adverse consequences for taxpayers.

Second, the legislator could simply remove the EUR 350,000 threshold (which is considered as being problematic according to the Court). As a result, a SOPARFI subject to the flat tax would be an entity meeting the 90% threshold only. Nevertheless, the impact of such modification would be to increase the minimum NWT due by entities that are currently not considered as being SOPARFIs because they do not reach the EUR 350,000 threshold and are thus currently paying either EUR 535 or EUR 1,605 minimum NWT depending on the value of their total balance sheets.

In this case, the decision of the Court would result in an increase of the tax bill for "smaller" taxpayers with a lower ability to pay taxes (i.e. with a total balance sheet below approximately EUR 389,000), which seems to contradict the reasons why this threshold was originally introduced in 2015 (see above). Such modification of the law would, in addition, have a very different result compared to the one prescribed by the ruling itself. Indeed, according to the ruling, only entities that are *a priori* SOPARFIs because they reach the 90% threshold and have a total balance sheet between EUR 350,000 and EUR 2,000,000 are affected by the unconstitutionality and should thus benefit from the most favourable of the two minimum NWT rates.

Finally, the legislator could also modify the provision differently and take the opportunity of a debate over the minimum NWT to analyse its effects on the competitiveness of Luxembourg and, as a result, potentially abolish the minimum NWT regime.

Our teams will continue to monitor closely further developments related to this topic. Please do not hesitate to contact us if you have any questions about the impact of this ruling on your company. In light of this decision, actions to be taken should be analysed on a case-by-case basis.

Our authors

JAMAL AFAKIR
Partner, Head of International & Corporate Tax
jamal.afakir@atoz.lu

MARIE BENTLEY
Chief Knowledge Officer
marie.bentley@atoz.lu

[6] Procès-verbal de la réunion du 23 mai 2019 de la Commission des Institutions et de la Révision constitutionnelle, session ordinaire 2018-2019, p. 3.
[7] "En attendant une réforme législative à intervenir et en vue de garder le système opérationnel, il y a lieu d'appliquer au contribuable visé par l'alinéa 2, du paragraphe 8 VStG tombant a priori sous le point a) l'impôt sur la fortune minimum visé par le point b) chaque fois que celui-ci est plus favorable."

Copyright © ATOZ 2023

Analysis of the last provisions introduced by the government in the law transposing Pillar Two

OUR INSIGHTS AT A GLANCE

- On 4 August 2023, the Luxembourg government released the text of the draft law transposing the Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union. This Directive implements the Global Anti-Base Erosion rules, also called "Pillar Two", agreed upon by the OECD.
- On 13 November 2023, the Luxembourg parliament published amendments proposed by the government to the draft Law.
- These amendments provide for additional guidance and clarification, as well as additional complementary rules in line with OECD guidance on Pillar Two but unfortunately, do not address all the clarification needed.
- On 20 December 2023, the law including all amendments proposed by the government was passed.
- In compliance with the Directive, most of the provisions of the new law are expected to come into effect for fiscal years beginning on or after 31 December 2023, while others will come into effect for fiscal years beginning on or after 31 December 2024.
- In this article, we desribe selected amendments proposed by the government

On 13 November 2023, the Luxembourg parliament published proposed amendments by the government to the law (the "**Law**") transposing the Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise ("**MNE**") groups and largescale domestic groups in the Union (the "**Directive**"). This Directive implements the Global Anti-Base Erosion ("**GloBE**") rules, also called "Pillar Two", agreed upon by the OECD/G20 Inclusive Framework on BEPS in the Statement to Address the Tax Challenges Arising from the Digitalisation of the Economy and the Detailed Implementation Plan, on 8 October 2021[8].

The Law initially, presented to Parliament on 4 August 2023 as a draft, was largely in line with the Directive. However, additional guidance and clarification, as well as additional complementary rules (in line with OECD guidance), were still required to address important Luxembourg-specific points[9]. The amendments proposed by the government aimed at addressing these points but unfortunately, do not address all the clarification needed.

On 12 December 2023, the Council of State provided its opinion on the draft law as amended and raised two formal oppositions. On 20 December 2023, the law including all amendments proposed by the government was passed.

In this article, we go through selected amendments proposed by the government. To know more about the initial draft law, please read our previous article on this topic.

Relevance of OECD Guidance

In line with Recital 24 of the Directive, the Law acknowledges the GloBE rules published by the OECD on 20 December 2021 (the "**OECD Model Rules**") and related administrative guidance as sources of illustration and interpretation, even where such guidance was issued after the Directive. However, initially, the draft law only considered "a number of guidelines and solutions identified at OECD level after the date of adoption of Directive". In this respect, explicit reference was, for example, made to OECD guidance published on 14 March 2022, 15 December 2022 and 2 February 2023 only.

Consequently, the 13 July 2023 OECD guidance were not

[8] For more details about the GloBE Rules at OECD and European Union levels, read one of our previous articles.
[9] For more details about the the Draft Law and the issues it raised, read our previous article.

Copyright © ATOZ 2023

explicitly mentioned in the initial draft law. In addition, part of the 2 February 2023 OECD guidance had not been taken into consideration either in practice.

The draft law was thus amended with the aim to reflect these additional OECD guidance and to equip the Luxembourg Pillar Two rules with more flexibility, safe harbours and transitional rules to mitigate unnecessary adverse consequences for Luxembourg taxpayers.

This was key for Luxembourg as the OECD guidance notably include important safe harbour rules through which alternative calculation rules make it possible to determine in a simplified manner the amount of top-up tax due in respect of constituent entities located in jurisdictions meeting the conditions to benefit from these safe harbour regimes.

Scope and carve-outs of the Draft Law

- **Annual group turnover of at least EUR 750 million**

The new rules will apply to "constituent entities[10]" located in Luxembourg belonging to MNEs or large-scale domestic groups with a combined annual turnover equal to or above EUR 750 million in at least two of the four fiscal years preceding the tested fiscal year, as per the consolidated financial statements of the group parent entity. A "group" is defined by the Law as a group of entities linked by virtue of their ownership or control structure and included in the consolidated financial statements of the ultimate parent entity (extending also to entities that are excluded from consolidation based on size, materiality or on the grounds that the entity is held for sale). A group could also be a main entity and one or more permanent establishments, provided that such group is not part of another group based on the above consolidation threshold.

- Deemed consolidation – legal uncertainty remains

Entities that do not prepare consolidated accounts on a line-by-line basis may nevertheless be considered to form a group with their subsidiaries and therefore be in the scope of Pillar Two (e.g. if they are not required to prepare accounts at all or they do not prepare accounts under an acceptable accounting standard).

Previous OECD guidance already clarified that certain investment entities (e.g. under IFRS 10) that are exempt from line-by-line consolidation and that are merely required to fair value their investments (including where majority stakes are held in subsidiary companies) do not fall within the deemed consolidation rule, i.e. such entities do not qualify as parent entities of a group.

The Law and the related parliamentary documents unfortunately remain silent on this particular topic. In order to have legal certainty and in light of the large number of Luxembourg investment fund vehicles concerned, it would have been particularly wise to clarify whether Luxembourg-specific exemptions from consolidation vehicles companies or for most investment funds based on the respective special laws such as for reserved alternative investment funds, specialised investment funds or companies in risk capital ("**SICAR**") are consolidation exemptions comparable to the IFRS 10 investment entity exception.

New qualified domestic top-up tax (QDMTT)

The Law provides for the introduction of three new taxes in Luxembourg law. The first two are based on the application of two interdependent rules, namely the income inclusion rule ("**IIR**[11]") and the undertaxed payments rule ("**UTPR**[12]"). Under the IIR, the minimum tax is paid at the level of the parent entity in proportion to its ownership interests in entities that have low-taxed income. The UTPR is designed to operate as a backstop to the IIR. A qualified domestic top-up tax ("**QDMTT**[13]") will also be implemented, allowing Luxembourg to tax Luxembourgish low-taxed entities and

[10] A "constituent entity" as defined by the Draft Law means an entity or permanent establishment that is part of an MNE group or a large-scale domestic group.
[11] Règle d'inclusion du revenu ("RIR") as per the wording used in the Draft Law drafted in French.
[12] Règles des bénéfices insuffisament imposés ("RBII") as per the wording used in the Draft Law drafted in French.
[13] Impot national complémentaire qualifié as per the wording used in the Draft Law drafted in French.

Copyright © ATOZ 2023

prevent the application of the IIR and UTPR rules by other jurisdictions with respect to these entities[14].

- **Safe harbour for the IIR and the UTPR rules in case of foreign QDMTT**

As allowed by the Directive, Luxembourg chose to implement a domestic top-up tax through the Law. It allows Luxembourg to collect a top-up tax for low-taxed Luxembourg entities in priority to any other jurisdiction applying an IIR or a UTPR for those entities. According to the Directive, when this election is exercised, the parent entity applying the IIR will be obliged to give credit for the QDMTT tax when calculating the top-up tax in respect of the relevant jurisdiction.

To avoid increased compliance costs for MNE groups and administrative burdens for tax authorities, the OECD provided, however, for a QDMTT Safe Harbour in its 13 July 2023 guidance. The QDMTT Safe Harbour is intended to provide a practical solution which excludes the application of the GloBE Rules (i.e. the QDMTT to be credited against the top-up tax) in other jurisdictions by deeming the top-up tax payable under the GloBE Rules to be zero.

The initial draft law provided for a safe harbour for the IIR and the UTPR rules, where a low-taxed constituent entity has been subject, in its jurisdiction, to a QDMTT which is calculated in accordance with the UPE's qualifying financial accounting standard or International Financial Reporting Standards IFRS or IFRS adopted by the European Union under Regulation (EC) No 1606/2002. Under the draft law, if the foreign QDMTT met this condition, no top-up tax would have been be calculated in accordance with the draft law for the foreign constituent entities located in the jurisdiction which applies this QDMTT and therefore no top-up tax would have be allocated to the parent entities and constituent entities located in Luxembourg for the purposes of the application of the IIR and the UTPR. As such, the initial Luxembourg safe harbour rules diverged from the 13 July 2023 OECD guidance.

The draft law was thus amended to make this safe harbour regime compliant with the 13 July 2023 OECD guidance on QDMTT by completing it. As per the Law, it is now provided that if the QDMTT of a jurisdiction meets the condition to qualify for the QDMTT Safe Harbour in the context of a peer review process at the level of the OECD's Inclusive Framework, the reporting constituent entity may exercise an option under which no top up tax is to be calculated in accordance with the Law in respect of that tax year for the constituent entities of the MNE group or large domestic group located in the jurisdiction that applies that QDMTT.

The Law now specifies that, in order to benefit from the QDMTT Safe Harbour, the QDMTT of a jurisdiction must be considered “eligible for the QDMTT Safe Harbour in the context of a peer review procedure at the level of the Inclusive Framework of the OECD”. The Inclusive Framework will rely on the peer review process to determine whether a QDMTT meets three standards (i.e. QDMTT Accounting Standard, Consistency Standard and an Administration Standard) and thereby qualifies for the safe harbour.

The wording of the Law implies the verification that the QDMTT of the jurisdiction concerned can validly be considered to meet the standards developed by the OECD. The exercise of the option implies then that the constituent entities located in Luxembourg no longer have to carry out the calculations necessary to determine the amount of the top up tax in accordance to the Law in respect of the constituent entities belonging to the same group and which are located in the jurisdiction for which the benefit of the safe harbour regime is invoked.

- **National QDMTT**

As permitted by the Pillar Two Directive, Luxembourg has chosen to implement a national QDMTT. This choice must be welcomed insofar as it is intended to allow Luxembourg to collect an additional tax for low-taxed Luxembourg entities as a priority compared to any other jurisdiction applying a top-up tax according to an IIR or an UTPR for these entities.

For the purposes of calculating the national QDMTT, the Law confirm now that the eligible profit or loss can

[14] For more details about the IIR and the UTPR, read our previous article.

Copyright © ATOZ 2023

be determined in accordance with an eligible financial accounting standard applicable in Luxembourg, if certain conditions are met. The admissible financial accounting standards applicable in Luxembourg are those based on Luxembourg accounting principles, hereinafter "Lux GAAP", and those based on international financial reporting standards, hereinafter "IFRS".

As indicated in the administrative instructions of July 2023, in the event of multiple admissible financial accounting standards applicable in a jurisdiction, such as for example for Luxembourg with Lux GAAP and IFRS, Luxembourg must explicitly provide which financial accounting standard is to be applied for the purposes of calculating the QDMTT.

Therefore, the Law provides that if the financial statements of all constituent entities of the MNE group or large national group that are located in Luxembourg are prepare on the basis of the Lux GAAP for legal filing and publication purposes in Luxembourg, and that these financial statements are based on the same fiscal year as that on which the consolidated financial statements of the MNE group or large national group are based, the profit or loss used to calculate the QDMTT of those constituent entities, shall be determined on the basis financial statements prepared in Lux GAAP.

According to the Law, to the extent that the constituent entities of the MNE group or the large national group located in Luxembourg prepare, for the purposes of legal filing and publication in Luxembourg, their financial statements in accordance with more than one standard of admissible financial accounting applicable in Luxembourg, namely the hypothesis where some constituent entities prepare their financial statements in Lux GAAP and others in IFRS, the admissible financial accounting standard to be used, for the purposes of calculating the QDMTT, for all the Luxembourg constituent entities of this group, is in principle the one based on IFRS.

Finally, the Law provides that where at least one of the constituent entities of the MNE group or large national group located in Luxembourg prepares its financial statements for legal filing and publication in Luxembourg in a qualifying financial accounting standard other than that applicable to Luxembourg (i.e. Lux GAAP or IFRS), or when the financial statements of the constituent entities of the group which are located in Luxembourg are based on a tax year diverging from that used to prepare the consolidated financial statements of the same group, the profit or loss used for the purposes of calculating the QDMTT is to be determined in accordance with the general provisions of Pillar Two.

In line with the 13 July 2023 OECD guidance on QDMTT, the Law also excludes investment entities and insurance investment entities from the regime of the QDMTT in order to ensure the tax neutrality of Luxembourg investment vehicles.

Lack of alignment between the Luxembourg participation exemption and Pillar Two

In order to enable the comparability of the effective tax rate ("**ETR**") determined for each jurisdiction in which the group's constituent entities are located, the Law contains detailed rules determining the qualifying income or loss of a constituent entity (denominator of the ETR computation) which differ in certain respects from the rules of ordinary Luxembourg tax law.

The starting point is the net financial accounting result according to the accounting standard used for group consolidation purposes at the UPE level, before any consolidation adjustments for intra-group transactions. The financial accounting net income or loss is then subject to a series of adjustments designed in particular to take account of any discrepancies between the accounting rules and the tax rules generally accepted by OECD member countries.

In that respect, there is an exclusion for dividend income or other distributions received or accrued in respect of an ownership interest, except for ownership interests held by the group in an entity, that carries rights to less than 10 % of the profits, capital or reserves, or voting rights of that entity at the date of the distribution or disposition (a "**Portfolio Shareholding**") and that has been economically

Copyright © ATOZ 2023

owned by the constituent entity that receives or accrues the dividend or other distribution for less than one year at the date of the distribution. This means that only dividends received or accrued in respect of Portfolio Shareholdings of less than one year are included in the qualifying income or loss. It is also specified in the commentary to the articles that for reasons of simplicity, the Law does not prohibit the inclusion of expenses relating to excluded dividends.

In addition, there is an exclusion for gains and losses from shareholdings provided that an ownership interest of at least 10% is held in an entity (irrespective of the holding period).

These rules are not aligned with the Luxembourg participation exemption regime since Luxembourg companies may also rely on the acquisition cost criterion (i.e. EUR 1.2m for dividends and liquidation proceeds and EUR 6 m for capital gains) to exempt dividend income or capital gains. Similarly, companies relying on the commitment-based 12-month holding period could face a divergence with the Pillar Two rules.

Therefore, it would have been desirable to enable an opting-out from the Luxembourg participation exemption regime (as is already possible in other jurisdictions) in order to align the Luxembourg tax result with the GloBE income. Such optionality will be key to keep Luxembourg's competitiveness in an international environment by allowing Luxembourg taxpayers to mitigate adverse tax consequences as well as an increased administrative burden as a result of timing and/or permanent differences.

The Law does not address this issue. However, the Law addresses the need for symmetry in the numerator and denominator of the ETR computation where losses in respect of equity investments are taken into account for local tax purposes but not under the GloBE Rules. For that purpose, in accordance with the 2 February 2023 OECD guidance, the Law provides that an MNE Group can elect to include gains, profits, and losses from equity investments in the computation of GloBE income or loss and to take into account the corresponding current and deferred tax expenses or benefits. The 2 February 2023 OECD guidance specifically allowed for the so-called "equity gain or loss inclusion election" to mitigate such mismatches. This is notably relevant as the Luxembourg participation exemption regime allows for a deduction of write-downs in value on qualifying shares (subject to certain recapture rules) while such losses are only deductible for Portfolio Shareholdings under Pillar Two.

In addition, following its amendment, the Law addresses the issue raised by insurance companies and other stakeholders according to which the requirements to differentiate short-term Portfolio Shareholdings from other (long-term) Portfolio Shareholdings are burdensome. As a matter of administrative simplification, an election to include all dividends received by the constituent entity with respect to Portfolio Shareholdings, regardless of whether these are short-term Portfolio Shareholdings, notwithstanding the adjustment for excluded dividends that would apply in the absence of the election, is therefore proposed. This means that in this situation, after the election, all dividends on Portfolio Shareholdings of the electing constituent entities will be included in the computation of the entities' GloBE income or loss.

Finally, the Law precises that financial instruments issued by a constituent entity and held by another constituent entity of the same group of MNEs or large national group is to be qualified uniformly by each of these constituent entities. In the event that the qualification, under the applicable accounting standard, differs between the issuing constituent entity and the holding constituent entity, the qualification adopted by the issuing entity shall be used for the purposes of the Law. This has been added to avoid asymmetrical treatment of the accounting classification of a financial instrument that would be used to artificially increase the effective tax rate, in line with the 2 February 2023 OECD guidance.

Excess Negative Tax Carry-forward

In the 2 February 2023 OECD guidance, it was agreed by the Inclusive Framework that jurisdictions should adopt the

Copyright © ATOZ 2023

administrative procedure described therein, for the determination of a jurisdiction's total adjusted covered taxes for a tax year, in order to resolve issues relating to timing differences.

The administrative procedure describes the method by which an MNE group defers any excess negative tax expense determined for a tax year and reduces the Adjusted Covered Taxes in a subsequent tax year(s) in which the MNE group has GloBE income for a given tax year in that jurisdiction. The administrative procedure is optional or mandatory depending on the case.

This procedure, which was not initially included in the draft law, does however grant taxpayers the option of not being subject to additional taxation, for example if losses under Luxembourg law are higher than GloBE losses and could therefore trigger, a priori, additional taxation for the year in question. This option was finally introduced in the Law.

Deferred tax amounts

The amendments made to the initial draft law clarify, to a certain degree, which deferred taxes may be taken into account in determining the adjusted amount of tax concerned in accordance with the 2 February 2023 OECD guidance. However, all uncertainties with regard to deferred tax amounts and some clarifications would still be welcomed.

Next Steps

According to the Law and in compliance with the Directive, the IIR and QDMTT are expected to come into effect for fiscal years beginning on or after 31 December 2023, while the UTPR will come into effect for fiscal years beginning on or after 31 December 2024.

Our authors

ANDREAS MEDLER
Partner
andreas.medler@atoz.lu

MARIE BENTLEY
Chief Knowledge Officer
marie.bentley@atoz.lu

Copyright © ATOZ 2023

EU Commission's Initiatives in Direct Tax Matters: State of Play

OUR INSIGHTS AT A GLANCE

- This edition of ATOZ Insights illustrates, once again, the busy and challenging times facing EU governments, tax authorities and taxpayers.
- In September 2023, three new directive proposals were released by the European Commission: (1) the Business in Europe: Framework for Income Taxation ("BEFIT") directive proposal, (2) the Head Office Tax System for mall and medium enterprises ("SMEs") ("HOT") directive proposal and (3) the transfer pricing directive proposal. Lively discussions can be expected in relation to these proposals and their outcome is unclear at this stage.
- In October 2023, the 8th Directive on Administrative Cooperation in tax matters, called "DAC8", was formally adopted, which mainly introduces new reporting obligations for crypto-asset service providers and will become applicable as of 1 January 2026.
- The Unshell directive proposal, published two years ago, is still subject to ongoing discussions and, despite various alternative propositions, no agreement can be found between Member States on this controversial proposal.
- Given the remaining uncertainty on the Unshell directive proposal, the related initiative on "enablers" of tax evasion and aggressive tax planning, called "SAFE", is still on hold.
- The examination of the Debt-Equity Bias Reduction Allowance ("DEBRA") directive proposal is also still on hold and this situation is expected to remain unchanged in the coming months.
- Finally, as opposed to other ongoing proposals, the proposed directive on Faster and Safer Relief of Excess Withholding Taxes, called "FASTER", is moving forward rather quickly.

The European Commission keeps proposing changes to the EU corporate tax rules with tight timelines and keeps increasing reporting obligations. This leaves very little time for all parties involved in the process of implementation, interpretation and application of the new rules.

In September 2023, three new directive proposals were released by the European Commission: (1) the Business in Europe: Framework for Income Taxation ("**BEFIT**") directive proposal (the "**BEFIT Proposal**"), (2) the Head Office Tax ("**HOT**") System for SMEs directive proposal ("**HOT Proposal**") and (3) the transfer pricing directive proposal (the "**TP Proposal**"). While past initiatives were generally motivated by a need to fight tax avoidance and aggressive tax planning, this time the European Commission justifies its actions by a need to simplify the corporate tax system and reduce compliance costs.

In October 2023, the 8th Directive on Administrative Cooperation in tax matters ("**DAC8**") was formally adopted. It mainly introduces new reporting obligations for crypto-asset service providers which will become applicable as of 1 January 2026.

Because of the challenges of a constantly evolving tax system, we are seeing more and more EU Member States raising their voices and taking a more critical position towards the measures proposed by the Commission. The discussions on the Unshell directive proposal, still going on two years after the release of this proposal, illustrate this quite well.

In this article, we provide with an overview of the state of play of all these EU direct tax initiatives of the European Commission and also update you on the initiative on "enablers" of tax evasion and aggressive tax planning,

Copyright © ATOZ 2023

called "**SAFE**", the Debt-Equity Bias Reduction Allowance ("**DEBRA**") directive proposal and the Proposal for a Council Directive on Faster and Safer Relief of Excess Withholding Taxes ("**FASTER**"), and assess their chances of success in the near future.

The BEFIT Proposal

On 12 September, the EU Commission adopted a key package of initiatives containing notably the BEFIT Proposal. The BEFIT Proposal aims to introduce a common set of rules for EU companies to calculate their taxable base while ensuring a more effective allocation of profits between EU countries, based on a formula. The BEFIT Proposal replaces and thus repeals the EU Commission's proposal for a common corporate tax base ("**CCTB**") and the proposal for a common consolidated corporate tax base ("**CCCTB**") that have never reached consensus.

To find out more about the BEFIT Proposal and our critical analysis on this proposal, please refer to our dedicated article in these ATOZ Insights.

The HOT Proposal

On 12 September 2023, the European Commission launched new initiatives to support the needs of Europe's small and mediumsized enterprises ("**SMEs**") in the current economic environment. One of these initiatives is the HOT Proposal establishing a HOT System for SMEs.

The HOT Proposal introduces an optional regime according to which standalone SMEs that operate exclusively through permanent establishments ("**PE**") in one or more Member State(s) would have the possibility to handle their tax obligations through a single tax administration (i.e. the tax administration of the head office jurisdiction), instead of having to comply with the tax system(s) of each of the jurisdictions in which they operate crossborder via a PE.

The aim of the optional HOT regime is to (1) encourage crossborder expansion of SMEs by simplifying the tax rules which they are subject to when they operate through Pes, as well as (2) reduce the related tax compliance burden and costs. We present its main aspects hereafter.
Inscope SMEs are defined as those which:

- are established under the law of an EU Member State and take one of the forms listed in Annexes I and II of the HOT Proposal;
- are resident for tax purposes in an EU Member State in accordance with the tax laws of that Member State, including its bilateral conventions for the avoidance of double taxation;
- are subject, directly or at the level of their owners, to a tax on profits listed in Annexes III and IV of the HOT proposal, or to any other tax with similar characteristics;
- qualify as micro, small and mediumsized (SMEs), as defined in Directive 2013/34/EU16;
- operate in other Member States exclusively through one or more PEs; and
- are not part of a consolidated group for financial accounting purposes in accordance with Directive 2013/34/EU and constitute an autonomous enterprise that fulfils either of the following conditions: (1) it is not an associated enterprise within the meaning of Article 2(13) of Directive 2013/34/EU; (2) it is not a linked enterprise within the meaning of Article 3(3) of Commission Recommendation 2003/361/EC.

Inscope SMEs are only eligible for the HOT simplification regime under the conditions that, over the last two tax years:

- the joint turnover of the EU PEs has not exceeded twice the turnover generated by the head office;
- the SME has been tax resident in the head office's member state; and
- the SME has been qualifying as micro, small and mediumsized (SME), as defined in Directive 2013/34/EU16.

Under the HOT Proposal, the option would be valid for five years, unless the head office residence changes or the joint turnover of the PEs becomes at least triple the head office's turnover, in which case the HOT rules would immediately cease to apply. The aim of the eligibility and termination provisions is to discourage companies to transfer their head office to a low-tax jurisdiction.

Copyright © ATOZ 2023

If an SME reaches a degree of expansion which is such that it no longer meets the eligibility requirements, it will be able to continue to apply the HOT rules until the end of the five-year period.

At the end of each five-year period, SMEs will be entitled to renew their choice for another five years without limit, as long as they continue to meet the eligibility requirements.

Under the HOT simplification regime:

- SMEs would compute their taxable results based solely on the tax rules of the Member State of their Head Office while the applicable tax rate(s) would remain that/those of the Member State(s) where the PE(s) is/are located.
- SMEs would file one single tax return with the tax administration of their Head Office, which would then share this return with the other Member States where the SME is operating.
- The Member State of the Head Office would also subsequently transfer any resulting tax revenues to the countries where the PE(s) is/are located.

Based on the current version of the HOT Proposal, Member States should transpose the provisions of the proposal into domestic law by 31 December 2025 and the new rules would apply as from 1 January 2026.

The deadline to give feedback to the European Commission on this HOT Proposal is currently set for 3 January 2024.

On 17 November 2023, the draft report of the European Parliament was released, in which the rapporteur in charge of the HOT Proposal suggested several amendments to the proposal, including among others:
(i) a quicker application of the optional regime by EU Member States (as from 2025 instead of 2026);
(ii) a limitation of the requirements so as to broaden the scope of application of the regime;
(iii) a granting of the benefits of the regime for an indefinite period of time (instead of being granted for a period of five fiscal years); and
(iv) a shortening of the deadlines for applications from SMEs and for the tax authorities to exchange information.

The draft report was discussed on 4 December 2023 by the members of the European Parliament ("**MEPs**") of the Committee on Economic and Monetary Affairs ("**ECON Committee**"), during which it was pointed out that the deadlines for tax administrations should be reasonable, and that the link with double tax treaties should be further discussed. The draft report is currently scheduled to be voted upon by the ECON Committee on 22 February 2024. However, it should be kept in mind that the opinion of the European Parliament is not binding, so the Council has no obligation to take these suggestions of amendments into account.

Like other recent directive proposals, the HOT Proposal is expected to give rise to discussions among the EU Member States. In this respect, in a press release of 26 October 2023, while expressing its support towards the HOT proposal for reducing the administrative costs of SMEs, the Finnish government has already indicated that it is questionable whether, in practice, the administrative burden would really be reduced for both enterprises and the tax administration. It indicated further that the implementation deadlines are challenging, given the concurrent developments in the international corporate taxation environment (Finland probably refers to, amongst others, the Pillar Two directive, which EU Member States have to implement before the end of 2023 and the upcoming changes which will have to be implemented subsequently under Pillar One).

Thus, it will first be necessary to await the reactions of other EU jurisdictions in order to be able to assess the chances of success of this new proposal. However, in the context of always increasing compliance and reporting requirements, this initiative has the potential of generating positive reactions. Still, one should keep in mind its limited scope of application: the HOT rules would only apply to standalone SMEs with PEs and not to groups of SMEs with subsidiaries. As such, many companies operating crossborder within the EU would not be able to benefit from the simplification system.

The TP Proposal

On 12 September 2023, the European Commission released

Copyright © ATOZ 2023

the TP Proposal as part of the package that includes the directive proposal on BEFIT. The TP Proposal aims at integrating key transfer pricing principles into EU law with the objective of putting forward common approaches for Member States. If adopted, the new rules would apply as from 1 January 2026.

To find out more about the TP Proposal and our critical analysis on this proposal, please refer to our dedicated article in these ATOZ Insights.

On 14 November 2023, the draft report of the European Parliament was released, in which the rapporteur in charge of the TP Proposal fully subscribed to the objectives of the directive but made several suggestions, including, among others, (i) a shortening of the entry into force of the directive, as most Member States have already introduced the arm's length principle in domestic legislation and (ii) the inclusion of a sunset clause in the proposal according to which the directive should first cease to apply for the companies in scope of the BEFIT directive, known as the BEFIT groups, as of 2035 and, going further, for all multinational groups operating in the EU as of 2040, except for their transactions with third countries. Here again, it should be kept in mind that the opinion of the European Parliament is not binding, so the Council has no obligation to take these suggestions of amendments into account.

The chances of success of this TP Proposal will mainly depend on what will happen in the next few months.

Indeed, the current draft of the TP Proposal is reportedly not at all acceptable to many Member States and thus the EU Commission is already working on a new draft. In this line, in its 26 October 2023 press release, the Finnish government publicly raised some concerns regarding the TP Proposal, which, in the same way as the BEFIT proposal, can be seen as problematic from the point of view of the distribution of fiscal powers given the relatively farreaching harmonisation which would be introduced by these proposals (i.e. the authority in tax matters should remain at national level and should not be transferred to the EU).

However, it has been reported to us that the TP Proposal is a priority for the Belgian Presidency of the Council of the EU starting on 1 January 2024.

The Directive on Administrative Cooperation ("DAC")

At the ECOFIN Council of 17 October, the EU Finance Ministers formally adopted the 9th Directive on administrative cooperation in tax matters ("**DAC8**"), which was published in the Official Journal of the European Union on 24 October 2023. It mainly introduces new reporting obligations for cryptoasset service providers and automatic exchange of information on advance crossborder rulings for individuals. It further extends the list of income subject to mandatory exchange of information between EU Member States and amends the rules related to reportable crossborder arrangements ("**DAC6**"). The amendments introduced by DAC8 will become applicable as of 1 January 2026.

For a presentation of the new rules to be introduced, please read our ATOZ Alert dated 18 October 2023.

While the 8th version of the DAC has just been adopted, additional amendments of the DAC can be expected in the near future. However, as opposed to previous revisions, this time the aim will not be to introduce additional reporting requirements but to improve the existing ones. In its Communication of 17 October 2023, the European Commission indicated that it will proceed to the evaluation of the DAC in 2024 in order to look at "*the potential rationalisation of the reporting obligations arising from the Directive, to inform potential proposals to reduce the reporting burden*".

On 17 October 2023, a new initiative was launched: "Administrative burden – rationalisation of reporting requirements" with a public consultation running until 1 December 2023 in order to gather views of stakeholders on areas where inefficient reporting requirements originating from EU law are particularly problematic. The intention of the Commission is to rationalise reporting requirements by removing redundant, duplicating or obsolete obligations, inefficient frequency or timing and inadequate methods of collection accumulated over the years, without undermining

Copyright © ATOZ 2023

the policy objectives. As a first step, the Commission wants to identify the most inefficient and burdensome reporting requirements for businesses and Member States and look for ways to rationalise them (e.g. by changing the frequency of reporting), modernise them (e.g. by introducing digitalisation) or optimise them (e.g. by applying the 'once only' principle that implies that businesses will not have to provide the same data for different obligations, or replacing when possible 27 different points of entry with one at EU level).

The Unshell Proposal

On 22 December 2021, the European Commission submitted a proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU (the "**Unshell Proposal**"). The objective of the proposal is to prevent tax avoidance and evasion through actions by undertakings without minimal substance. The proposal aims to fight against the misuse of shell entities for improper tax purposes and to ensure that shell companies in the EU that have no or minimal economic activity are unable to benefit from certain tax advantages. For more details on the Unshell Proposal, please read the article "The new Directive proposal to fight against the misuse of shell entities" in our April 2022 ATOZ Insights.

Many aspects of the Unshell Proposal remain under discussion such as the scope, excluded entities, the criteria of minimum substance, tax consequences, the links with the domestic anti-abuse legislation, rebuttal of the presumption and the reduction of administrative burden, the tax residency certificate and the exchange of information. Despite discussions ongoing for two years now, no agreement has been reached on all these controversial points.

In order to try to move forward, the Spanish Presidency recently suggested a new two-step approach. Under this approach:

- In the first step, the proposal would be amended so as to introduce only an obligation to automatically exchange information on entities identified as shell entities, based on a number of agreed hallmarks. Thus, the proposal would become a simple amendment of the directive on administrative cooperation (DAC) and the tax consequences of the shell entity qualification would no longer be part of the proposal. Instead, domestic tax consequences would apply to entities considered shell entities.
- In the second step, best practices would be exchanged about the use of the information received to apply tax consequences among the Member States and it would be determined if tax consequences should be introduced at EU level for entities considered as shell entities by means of a new EU legislative initiative.

During a meeting of the Working Party on Tax Questions (High Level) which took place on 4 October 2023, the majority of the EU Member States expressed their support to this new two-step approach. However, several delegations considered that the main pending issues would not be solved, and a number of delegations considered that it may require further analysis. Some Member States also opposed to this new approach because it would create an additional and disproportionate administrative burden on companies and tax administrations. During the meeting, the Commission suggested an alternative way forward that could be based on a minimum standard approach and a toolbox of consequences. Taking into account that more technical work would have to be done regarding the two-step approach, the Spanish Presidency submitted a proposal to the 23 November 2023 Working Party on Tax Questions (High Level) based on the suggestions made by the Commission in order to check whether this could be an acceptable alternative way forward. However, there was no agreement on this new proposal within reach that would be acceptable for each Member State, so further discussions will be needed in order to find, if ever, compromise solutions on outstanding issues.

In its recently released 2024 working programme, the European Commission stresses that it is imperative that agreement is reached on pending proposals, including on the Unshell Proposal. The working programme of the Belgian Presidency (which will take over the Presidency of the Council of the EU as of 1 January 2024) announces that "the Presidency will support the implementation of the Unshell Directive" but does not mention this proposal as a priority. Thus, uncertainty remains, and we recommend taxpayers to adopt a "wait and see" strategy before taking

Copyright © ATOZ 2023

any definitive action.

The SAFE initiative on "enablers" of tax evasion and aggressive tax planning

When the Unshell Proposal was adopted, the Commission announced that it would propose a follow-up initiative to respond to the challenges linked to non-EU shell entities. This follow-up initiative was started on 6 July 2022, when the EU Commission launched a public consultation regarding a proposal for a Council Directive to tackle the role of tax advisers and other professionals rendering tax advice (collectively referred to as "enablers"): Securing the Activity Framework of Enablers, "**SAFE**". While the European Commission initially planned to adopt the SAFE directive proposal on 7 June 2023, despite the text of the proposal being technically ready, in the end the Commission decided to indefinitely postpone its release due to the uncertain future of the Unshell Proposal.

Since then, the situation has not evolved and there is a big question mark as to whether this proposal will ever be released. The recently released 2024 working programme of the European Commission does not even refer to the SAFE initiative. Thus, there is still too much uncertainty regarding the proposal and its potential content to assess its chances of success. In addition, should the SAFE initiative finally move forward, it can be expected that it will give rise to controversial discussions amongst the EU Members States, considering that Member States already have a very comprehensive toolbox to tackle tax evasion and aggressive tax planning. To find out more on the SAFE initiative, you can read the article "SAFE - The new EU initiative targeting tax advisers" in our December 2022 ATOZ Insights.

The Debt-Equity Bias Reduction Allowance (DEBRA) directive proposal

On 11 May 2022, the European Commission released a directive proposal to address Debt-Equity bias. The proposal is one of the targeted measures announced by the European Commission in May 2021 in its Communication to promote productive investment and entrepreneurship and ensure effective taxation in the EU. The proposal lays down rules on the deduction, for corporate income tax purposes, of an allowance on increases in equity and additional rules on the limitation of the tax deductibility of exceeding borrowing costs (for a presentation of the DEBRA proposal, please read the article "European Commission releases DEBRA Directive Proposal" in our July 2022 ATOZ Insights).

As mentioned in our previous article "EU Commission's initiatives in direct tax matters: state of play" released in our April 2023 ATOZ Insights, by the end of 2022, it was decided to suspend the examination of the DEBRA proposal in order to, if appropriate, reassess it within a broader context only after other proposals in the area of corporate income taxation announced by the Commission have been put forward. Since then, no development occurred, with the exception of the approval by the European Parliament of its report dated 19 January 2023. Neither the 2024 working programme of the European Commission nor the ECOFIN report to the European Council on tax issues refers to the DEBRA proposal, and it can be expected that the project will be kept on hold in the coming months given that whether the DEBRA proposal will be kept or totally abandoned will depend on the outcome of the discussions on the BEFIT directive proposal, which just started.

The FASTER directive proposal

On 19 June 2023, the European Commission published the proposal for a Council Directive on Faster and Safer Relief of Excess Withholding Taxes (hereafter the "**FASTER Proposal**"). With this new initiative, the Commission aims to tackle the current particularly burdensome withholding tax ("**WHT**") refund procedures - which differ between Member States - for cross-border investors in the EU and, at the same time, the risks of tax abuse related to refund procedures revealed notably by the Cum/Ex and Cum/Cum scandals. For a presentation of the FASTER proposal, please read our ATOZ Alert of 21 June 2023 "European Commission releases FASTER Directive Proposal".

On 19 September 2023, the FASTER Proposal was discussed by members of the European Parliament and experts during a hearing organised by the FISC subcommittee of

Copyright © ATOZ 2023

the European Parliament. Views were exchanged on topics such as the potential effect of the proposal on Cum/Ex and Cum/Cum scandals, the definition of beneficial ownership, the interaction with third countries and the cost of registers. On 9 October 2023, the European Parliament released its non-binding draft opinion on the FASTER Proposal, which was discussed on 7 November 2023 and is planned to be voted upon during the ECON committee on 23 January 2024. While the report welcomes the effort to introduce a common EU-wide system for WHT on dividend or interest payments, it also proposes several amendments[15].

Since the release of the FASTER Proposal, the Spanish Presidency of the Council of the EU has been giving this legislative proposal a high level of priority and the EU Council has been very active[16] on discussing and analysing the proposal. Based on the [ECOFIN report to the European Council on tax issues] which was approved on 8 December 2023, four compromise texts of the FASTER Proposal (unreleased) were discussed. However, during the technical analysis of the proposal, it appeared quickly that the initial text proposed by the Commission had to be adjusted[17] in order to have a chance to be agreed upon at EU Council level. In addition, during the discussions, some EU Member States with comprehensive relief-at-source systems for WHT already in place complained about the administrative burden created by the proposal, without any real added value for them (given their already well-functioning system). As a reaction, and to make sure that the proposal can still move forward, the Spanish Presidency suggested to exempt jurisdictions which have already a comprehensive relief-at-source system for WHT in place from certain provisions of the FASTER Proposal, provided their system meets certain requirements. Finally, another topic raised by one delegation was that the establishment of the financial intermediary register and reporting obligations should be voluntary for Member States.

During the last meeting of the Working Party on Tax Questions (High Level) on 23 November 2023, it became clear that substantial progress had been made and, in particular, the provision regarding the electronic tax residence certificate was broadly supported. Nevertheless, further technical work is still required before the FASTER Proposal can be submitted to the Council for approval of a general approach. This is why the proposal was not discussed at the ECOFIN meeting of 8 December 2023 in the end, as originally expected by the Council, and one will have to await 2024 to see further developments in the legislative procedure related to this file. In this respect, it has been reported to us that the FASTER Proposal is a priority for the Belgian Presidency of the Council of the EU starting on 1 January 2024.

Implications

Over the past few months, the ongoing initiatives of the European Commission in corporate tax matters have evolved and new initiatives have been launched. Three new directive proposals were released (i.e. the BEFIT, HOT and TP Proposals). While past and ongoing initiatives (such as ATAD, DAC6 and the Unshell Proposal) were generally motivated by a need to fight tax avoidance and aggressive tax planning, we now see the European Commission justifying its most recent actions (the BEFIT, HOT and TP Proposals) by a need to simplify the corporate tax system and reduce compliance costs. However, it is questionable whether constantly redoing the corporate tax system will

[15] Including changes aimed (1) to equip the tax administration with tools to deal with the relief/refund procedures and train the relevant staff supervising such tools, (2) to ensure the protection of the processing of personal data, (3) to examine possible measures to facilitate the refund procedure for small investors without the involvement of certified financial intermediaries, (4) to ensure more clarity in the registration of financial intermediaries from third countries and (5) to clarify the interaction between the tax consequences resulting from the Unshell Proposal and the issuing of an electronic tax residency certificate under the FASTER Proposal.
[16] Meetings of the Working Party on Tax Questions (Direct Taxation and High Level) took place on 12 July, 7 September, 28 September, 18 October, 6 November, 17 November and 23 November 2023.
[17] The Spanish Presidency made a number of amendments to the text and, most notably, (i) adapted the rules applicable to the issuing of digital tax residence certificates, (ii) included provisions that would allow certified financial intermediaries to assume the position of non-certified intermediaries, in order to facilitate the application of the relief and complete the information that has to be reported to the tax administrations, (iii) strengthened the scope of information to be reported by certified financial intermediaries and specified a number of other related provisions, (iv) clarified the conditions under which EU Member States may reject the requests for quick refunds, in order to reduce the possibilities for fraudulent claims, (v) added special provisions that govern the cases related to indirect investments and (vi) further specified the provisions on late payment interest, liability, personal data protection and evaluation of the future directive.

Copyright © ATOZ 2023

really bring more simplicity. In addition, the current discussion on the Unshell Proposal also seems to be moving towards a direction including additional burdensome administrative reporting.

Given this issue, we see more and more Member States raising their voices to express their concerns regarding some of the proposals, the administrative burden introduced by all the recent new directives and the fast pace at which various new corporate tax measures have to be implemented. In this context, the Commission has already announced its will to review the DAC in order to reduce the administrative burden and rationalise the reporting requirements. The discussions on the Unshell Proposal, still ongoing two years after the release of the directive proposal, illustrate the concerns of Member States quite well and, as of today, nobody knows whether the EU Member States will ever manage to reach an agreement on this proposal. Controversial discussions can also be expected in the review process of the more recent BEFIT, HOT and TP Proposals and their outcome is unclear at this stage.

The Programme of the Belgian Presidency remains cautious and does not commit to obtaining an agreement on all these proposals or even to announce a certain proposal as being a priority for the Presidency. However, it has been reported to us that the TP Proposal and the FASTER Proposal will be the effective priorities of the incoming Belgian Presidency.

Finally, more is yet to come for corporate entities given the ongoing work on Pillar One and following the release of the text of the Multilateral Convention to Implement Amount A. Pillar one aims to provide for the reallocation of a share of the residual profits of the largest and most profitable multinational enterprises (i.e. with revenues exceeding EUR 20 billion and a profitability greater than 10%) to end market jurisdictions where goods or services are used or consumed. During an ECOFIN meeting which took place on 9 November 2023, EU Member States approved statements which confirm the Council and the Commission's political support of the Two-Pillar solution. The European Commission expressed its support of the ambition to have the Pillar One agreement in force as soon as possible and called on Member States to swiftly sign and ratify the Multilateral Convention.

Our author

KEITH O'DONNELL
Managing Partner
keith.odonnell@atoz.lu

Copyright © ATOZ 2023

EU Commission Releases Proposal for a Council Directive on BEFIT: A Critical Analysis

OUR INSIGHTS AT A GLANCE

- On 12 September 2023, the EU Commission adopted the BEFIT directive proposal aiming to "introduce a common set of rules for EU companies to calculate their taxable base while ensuring a more effective allocation of profits between EU countries, based on a formula".
- BEFIT strongly resembles the previous (now replaced) Common Consolidated Corporate Tax Base proposal.
- If adopted by the EU Council, the BEFIT proposal would enter into force on 1 July 2028.
- This article analyses the directive proposal and considers its numerous issues.

Introduction

On 12 September 2023, the EU Commission adopted a Directive Proposal on "Business in Europe: Framework for Income Taxation" ("**BEFIT**" or the "**Directive Proposal**"). BEFIT aims to "*introduce a common set of rules for EU companies to calculate their taxable base while ensuring a more effective allocation of profits between EU countries, based on a formula*".

The Directive Proposal on BEFIT replaces – and thus repeals – the EU Commission's proposal for a common corporate tax base ("**CCTB**") and the proposal for a common consolidated corporate tax base ("**CCCTB**") that have never reached consensus. However, BEFIT strongly resembles the previous CCCTB proposal.

The Directive Proposal on BEFIT establishes a common set of rules to determine the tax base of companies subject to corporate income taxation in a Member State which are part of groups which prepare consolidated financial statements. Moreover, BEFIT would require the aggregated tax base of the members of the BEFIT group to be allocated based on formulary apportionment. If adopted by the EU Council, the BEFIT proposal would enter into force on 1 July 2028.

This article analyses the Directive Proposal and considers its numerous issues.

The BEFIT system

Scope of the BEFIT group

The BEFIT rules would be mandatory:
- for companies resident for tax purposes in a Member State, including their permanent establishments located in other Member States, and
- for permanent establishments located in Member States of entities resident for tax purposes in a third country ("**third-country entities**")

if they belong to a domestic group or to a multinational enterprise group ("**MNE group**") which (i) prepares consolidated financial statements and (ii) had annual combined revenues of EUR 750 million or more in at least two of the last four fiscal years.

The ultimate parent entity ("**UPE**") of the group must further hold at least 75% of the ownership rights or have 75% profit entitlement for an entity to be part of the BEFIT group.

While the mandatory scope of BEFIT comprises similar groups to Pillar 2 (i.e. groups with annual combined revenues of at least EUR 750 million), it would be limited to the so-called "**BEFIT group members**" (i.e. the EU subset group of entities that meets a 75% ownership threshold, assessed on a yearly basis).

This Directive Proposal would not apply to companies or

Copyright © ATOZ 2023

permanent establishments with a UPE outside the EU where the combined revenues of the group in the EU either do not exceed 5% of the total revenues for the group based on its consolidated financial statements or the amount of EUR 50 million in at least two of the last four fiscal years. Thus, non-EU MNE groups with limited anchorage in the EU would be out of scope of the Directive Proposal.

Computation of the tax base

Under the Directive Proposal, BEFIT group members would need to calculate their tax base in accordance with a common set of rules. Like in Pillar 2, the starting point will be the accounting result from the financial accounts, which must be determined under one single accounting standard for the BEFIT group. To this aim, the financial accounts of each BEFIT group member will have to be reconciled, in principle, with the accounting standard of the UPE.

For simplification purposes, adjustments under BEFIT would be kept to a minimum, rather than putting together a detailed corporate tax framework. Hence, BEFIT would require fewer and different tax adjustments (i.e. dividends and capital gains exclusion) compared to Pillar 2 which has a different purpose, namely to calculate the appropriate qualifying income when determining the level of tax due. The scope of the exclusion of dividends and capital gains under BEFIT is also different to the Luxembourg participation exemption.

Aggregation of the BEFIT group's tax base

The preliminary tax results of all BEFIT group members would need to be aggregated into a single "pool" at EU group level, which will be the "**BEFIT tax base**".

If the BEFIT tax base were positive in a given year, the profit would be allocated to the BEFIT group members according to an allocation key (i.e. formulary apportionment).

If the BEFIT tax base were negative, the loss would be carried forward and may offset against the next positive BEFIT tax base at EU group level.

The aggregation of the preliminary tax results of all BEFIT group members to obtain the BEFIT tax base would have the following consequences:

- Cross-border loss relief allowing the BEFIT groups to set off losses across borders;
- No withholding taxes on transactions such as interest and royalty payments within the BEFIT group, as long as the beneficial owner of the payment is a BEFIT group member;
- Facilitation of transfer pricing compliance: the arm's length principle would be replaced by formulary apportionment (even though transactions would still need to adhere to the arm's length standard). The arm's length principle would only be relevant for transactions with non-EU members of the group.

The Directive Proposal would lead to a drastic change of the corporate tax system which would obviously raise concerns with respect to public finances as it seems to be impossible to predict the exact impact on the budget of EU Member States. Most likely, corporate tax revenues would change significantly, be it on the upside or the downside.

Formulary apportionment

Once the BEFIT tax base is determined, the (positive) aggregated tax base would be allocated to each member of the BEFIT group based on a transition allocation rule. According to this rule each member of the BEFIT group would have a percentage of the aggregated tax base calculated on the basis of the average of the taxable results in the previous three fiscal years.

For each fiscal year between 1 July 2028 and 30 June 2035 at the latest (the "**transition period**"), the BEFIT tax base would be allocated to the BEFIT group members in accordance with the following baseline allocation percentage:

$$\text{Baseline allocation} = \frac{\textit{Taxable result of a BEFIT group member}}{\textit{Total taxable result of the BEFIT group}} * 100$$

According to the EU Commission, the transitional allocation rule should "*pave the way for a permanent allocation method that can be based on a formulary apportionment*".

In designing a permanent allocation method, the transitional

Copyright © ATOZ 2023

solution would make it possible to take into account more recent County-by-Country Reporting ("**CbCR**") data and information gathered from the first years of the application of BEFIT.

It would also allow for a more thorough assessment of the impact that the implementation of the OECD/G20 Inclusive Framework Two-Pillar Approach is expected to have on national and BEFIT tax bases. In addition, the Commission announced that, if appropriate, it may propose a Directive whereby the aggregated tax base will be allocated based on a factor-based formula.

Upon allocation, each BEFIT group member would have a part of the BEFIT group's profit. On this part, the group member will have to apply additional adjustments in its tax assessment. These would mostly include technical corrections that are necessary for the coherence of the system (for example, the deduction of pre-BEFIT losses).

Finally, to ensure Member States' competence in tax rate policies, the Directive Proposal would allow Member States to introduce further deductions, tax incentives or base increases, to the extent they comply with the EU Directive on Minimum Tax/Pillar 2.

A critical review of the BEFIT initiative

The BEFIT initiative raises a number of concerns that are addressed in this section.

National sovereignty of EU Member States at stake

The corporate tax laws of EU Member States vary from one state to another against the backdrop of the structure and focus of the respective economy. Notably, EU Member States have the freedom to adopt different tax policy choices with a view to set the right incentives for their economies.

The EU Member States' national sovereignty over tax matters is a fundamental principle of the EU. Therefore, when it comes to important decisions in the field of taxation, unanimous agreement by all countries is required.

While there have been several attempts by the EU Commission to move to qualified majority voting (where measures can be approved by a minimum number of EU countries, representing a minimum share of the EU population), such attempts have failed so far.

In the author's view, moving to qualified majority voting in taxation would undermine the competitiveness of the EU as it would diminish the pressure on national authorities to pursue efficient and competitive tax policies, and result in higher taxation across the EU.

The BEFIT initiative would undermine national sovereignty over tax matters through the backdoor as it would largely replace domestic tax laws with an EU corporate tax system over which individual Member States would have only very limited control.

Absence of a need for BEFIT

Since the time of the CCCTB proposal, the European and international tax landscape has undergone a dramatic transformation. Following the OECD Base Erosion and Profit Shifting ("**BEPS**") Project, the EU Commission adopted several EU Directives that aimed to tackle perceived tax evasion and tax avoidance.

The two Anti-Tax Avoidance Directives ("**ATAD**" and "**ATAD II**") provided for a number of strict anti-abuse provisions that had to be transposed into the domestic tax laws of EU Member States. Tax transparency has been elevated to a new level through the various amendments of the Directive on Administrative Cooperation ("**DAC**" 1 - 8). The EU Commission further released a draft Directive regarding the misuse of EU shell entities[18] ("**ATAD III**", also referred to as the "**Unshell Directive**").

Other important changes to the international tax landscape have been advanced by the OECD. The Multilateral Instrument ("**MLI**") resulted in the implementation of various anti-abuse provisions such as the Principal Purposes Test ("**PPT**") in covered bilateral tax treaties. In 2017 and

[18] Shell entities are entities lacking a minimum level of substance for tax purposes.

Copyright © ATOZ 2023

2020, the OECD Transfer Pricing Guidelines were revised in accordance with the guidance developed as part of the OECD's (follow-up) work on BEPS Actions 8 – 10 and 13.

Hence, the corporate tax laws of EU Member States have already been significantly amended, and tax authorities of EU Member States have a comprehensive arsenal of anti-abuse rules that allow them to tackle any kind of abusive situation (as well as reporting requirements that should allow them to be aware of any residual abuse).

Absence of a legal basis for BEFIT

The purported legal basis of the BEFIT initiative is Article 115 of the Treaty on the Functioning of the EU ("**TFEU**") which stipulates that legal measures under that provision shall be vested the legal form of a Directive. However, the EU Commission only has a legal basis in Article 115 of the TFEU to the extent the Directive Proposal (i) is imperative for the functioning of the internal market and (ii) adheres to the principles of subsidiarity and proportionality.

As regards the need of BEFIT for the functioning of the internal market, the EU Commission claims that the complexity of 27 tax systems would be a serious impediment to businesses that undermines the competitiveness of the internal market which can only be tackled by laying down legislation at EU level.

However, it is more than questionable that this initiative, which would result in extreme complexity and legal uncertainty for years to come, is required for the functioning of the internal market, and all the more since the tax laws of EU Member States have already been significantly amended over the last few decades. Furthermore, differences in tax systems are consistent with the Member States' sovereignty in tax matters which cannot be undermined through invoking Article 115 of the TFEU.

Even if it could be established that some tax law changes would be imperative for the functioning of the internal market, the BEFIT initiative aiming at the implementation of a European corporate tax system should be inconsistent with both the principle of subsidiarity and the principle of proportionality. In the author's view, the Commission should have no authority to intervene.

However, it comes as no surprise that the explanatory memorandum of the Directive Proposal reaches the conclusion that BEFIT is in line with the principle of subsidiarity and the principle of proportionality.

Tax treaty override

Bilateral tax treaties concluded between EU Member States allocate an unlimited primary taxing right over business profits to the residence state of a company. Other EU Member States may only tax (part of) the business profits of the company to the extent it has a permanent establishment in their territory and business profits are attributable to such permanent establishment.

Prices charged for the transfer of goods and services between associated enterprises (which are transfer prices) must comply with the arm's length principle. Otherwise, the tax authorities of the contracting states may perform tax adjustments with a view to restate arm's length conditions.

Formulary apportionment as proposed under BEFIT would be inconsistent with the tax treaty obligations of EU Member States, undermine the arm's length principle and represent tax treaty override.

While legitimate EU law prevails over domestic tax laws and tax treaties in a mere EU context, one should keep in mind that the tax treaties concluded by EU Member States are generally based on the OECD Model. The concepts and principles included in the OECD Model have been developed over time and agreed upon at global level by OECD countries (all EU Member States belong to the OECD).

Overwriting these fundamental tax principles with regard to transactions between EU companies by BEFIT would eliminate the great accomplishments of bilateral tax treaties and not be an improvement (as suggested by the EU Commission).

Continued chronic legal uncertainty

The implementation of BEFIT has the potential to result

Copyright © ATOZ 2023

in years (and likely more than a decade) of chronic legal uncertainty. While the numerous tax law changes over the last few years already resulted in significant legal uncertainty (ATAD 1, ATAD 2, DAC6, etc.), a large part of existing domestic tax laws has a long history including extensive guidance and established case law.

Replacing these domestic tax systems by a new set of rules that might be interpreted differently in EU Member States would be an adventure for taxpayers and EU Member States alike. Considering that it may take up to ten years until the Court of Justice of the European Union ("**CJEU**") may take a decision (a case must go through the courts of the Member State before it can be referred to the CJEU), it would take a very long time before the new rules would be settled.

This would mean that taxpayers and tax authorities would need to dedicate a lot more resources on ensuring compliance and settling the disputes resulting from the legal uncertainty.

Complexity and costs

While the EU Commission claims that the objective of BEFIT is to decrease complexity, compliance costs and legal uncertainty, the opposite seems to be the case. Introducing a new corporate tax system that would operate in parallel to the existing 27 corporate tax systems would be a significant burden on the part of the taxpayers and the tax administrations.

The interaction of BEFIT and the minimum tax rules (Pillar II) would increase complexity to an unprecedented level, the results of which cannot be reliably anticipated. This would obviously result in significant compliance costs and make the EU a less attractive place to do business.

According to the explanatory memorandum of the Proposal Directive, "*the costs of the proposal cannot be determined with any precision because the BEFIT proposal does not have a precedent and there is no dedicated data that can be used reliably for concrete estimates*". However, BEFIT would entail (i) ongoing operational costs, (ii) short-term (one-off) adjustment costs related to updating IT systems and (iii) the training of staff and tax administrations to adjust to the new system.

Unpredictable impact on public finances

BEFIT would require (i) the determination of the tax base according to a new set of rules, (ii) the aggregation of the tax bases of the members of the BEFIT group and (iii) the allocation of part of the aggregate tax base to individual members based on formulary apportionment. During a transition period, the allocation would be based on the average of the taxable results of the previous three fiscal years. Thereafter, a new allocation key should be developed for formulary apportionment.

Hence, the arm's length principle would be replaced by formulary apportionment (although transactions would still need to adhere to the arm's length standard). However, with regard to transactions with non-EU members of the group, the arm's length principle would need to be strictly applied.

Such a drastic change of the corporate tax system would obviously raise concerns with respect to public finances as it seems to be impossible to predict the exact impact on the budget of EU Member States. Most likely, corporate tax revenues would change significantly, be it on the upside or the downside.

In addition, it should not be forgotten that such a fundamental change of the corporate tax system may create unintended incentives for multinational groups to reduce their economic activity in a Member State or the EU altogether. For example, multinational groups might consider shifting shared service centres and production to jurisdictions with low salary costs.

Conclusion and outlook

The BEFIT initiative aims at the adoption of a common set of rules for EU companies to calculate their corporate tax base and the allocation of profits between EU Member States based on formulary apportionment.

According to the explanatory memorandum, "*the idea to develop a common corporate tax framework in support of the internal market has always been part of the Union's*

Copyright © ATOZ 2023

history and first appeared in policy documents of the European Economic Community as early as the 1960s". Hence, it can be assumed that it was always part of an (hidden) agenda to move towards a European corporate tax system.

While the explanatory memorandum complains that "*businesses have to comply with (up to) 27 different national tax systems, making it difficult and costly for companies to do business across the Union*", complexity and compliance costs did not seem to be a major concern for the EU Commission when adopting countless tax initiatives over the last decade.

More truth about the real motive for the BEFIT initiative might be found in the following statement: "*In 2020, the Council, Parliament and the Commission agreed that a common corporate tax base could be the basis for a new own resource that the Commission will propose*". Could the real intention be to create a new source of own tax revenue for the EU in addition to contributions by EU Member States?

Ultimately, it remains to be seen whether the governments of EU Member States will unanimously give up their sovereignty in tax matters or if BEFIT will share the fate of the previous CCTB and CCCTB initiatives.

Our authors

OLIVER R. HOOR
Partner, Head of Transfer Pricing & the German Desk
oliver.hoor@atoz.lu

MARIE BENTLEY
Chief Knowledge Officer
marie.bentley@atoz.lu

Copyright © ATOZ 2023

The EU Commission's Directive Proposal on Transfer Pricing: A Trojan Horse?

OUR INSIGHTS AT A GLANCE

- On 12 September 2023, the EU Commission adopted a Directive Proposal on Transfer Pricing. This proposal is part of the package known as "Business in Europe: Framework for Income Taxation" or "BEFIT".
- The Directive Proposal aims at integrating the arm's length principle and some fundamental transfer pricing principles included in the OECD transfer pricing Guidelines into EU law.
- This article provides an overview of the directive proposal and analyses its numerous issues.

On 12 September 2023, the EU Commission adopted a Directive Proposal on Transfer Pricing (the "**Directive Proposal**"). This proposal is part of the package known as "Business in Europe: Framework for Income Taxation" or "**BEFIT**".

While the Directive Proposal would integrate key transfer pricing principles into EU Law, BEFIT aims to introduce a common set of rules for EU companies to calculate their taxable base that would be aggregated at BEFIT group level and subsequently re-allocated to the individual companies based on formulary apportionment.

The Directive Proposal aims at integrating the arm's length principle and some fundamental transfer pricing principles included in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the "**OECD TP Guidelines**") into EU law. It would further create a new procedure for ensuring corresponding adjustments, require certain transfer pricing documentation, clarify the role and status of the OECD TP Guidelines and create the possibility to establish common binding rules on specific transactions. If adopted by the EU Council, the Directive Proposal would enter into force on 1 July 2026.

This article provides an overview of the Directive Proposal and analyses its numerous issues.

Content of the Directive Proposal

- **Overview**

According to Article 1 of the Directive Proposal, the Directive Proposal lays down rules to harmonise transfer pricing rules of EU Member States and to ensure a common application of the arm's length principle within the EU.

The transfer pricing rules would apply to taxpayers that are registered (or subject to tax) in one or more Member States, including permanent establishments in one or more Member States.[19]

- **Transposing general OECD TP guidance into EU Law**

Overview

The OECD TP Guidelines reflect the consensus of OECD member countries towards the application of the arm's length principle as provided in Article 9 (1) of the OECD Model Tax Convention ("**OECD-MC**"). The arm's length principle is the international transfer pricing standard that OECD member countries have agreed should be used for

[19] Article 2 of the Directive Proposal.

Copyright © ATOZ 2023

tax purposes by MNE groups and tax administrations.

The arm's length principle requires that, for tax purposes, the terms and conditions agreed to between related parties in their commercial or financial relations correspond to those that one would have expected in transactions between unrelated parties. When the terms and conditions agreed upon in controlled transactions differ from the arm's length standard, tax administrations may, for tax purposes, perform transfer pricing adjustments.

General definitions

Article 3 of the Directive Proposal includes a number of definitions of basic terms such as the "arm's length principle", "arm's length range", "primary adjustment", "corresponding adjustment", "comparable uncontrolled price method", "resale price method", "cost plus method", "transactional net margin method", "profit split method" and "controlled transaction".

All these definitions are consistent with the definitions that can be found in the Glossary of the OECD TP Guidelines.

Application of the arm's length principle

Article 4 of the Directive Proposal advocates the application of the arm's length principle in case of commercial or financial cross-border transactions with associated enterprises. When such transactions do not adhere to the arm's length principle, EU Member States should perform transfer pricing adjustments to restate arm's length conditions.

These basic rules are consistent with the guidance provided in Chapter I of the OECD TP Guidelines (see section B. thereof).

It is interesting to note that the related BEFIT initiative would rely on formulary apportionment to allocate profits among EU members of a multinational group. Here, the OECD TP Guidelines state that formulary apportionment should not be confused with the transactional profit methods discussed in Part III of Chapter II of the OECD TP Guidelines, and formulary apportionment should not be the standard to be applied for the allocation of profits among different members of a multinational group (see Chapter I, section C.).

Hence, the BEFIT initiative would be inconsistent with the OECD TP Guidelines that the Directive Proposal claims to foster.

Associated enterprises

Article 5 of the Directive Proposal defines what is to be understood as an "associated enterprise". Accordingly, associated enterprise means a person who is related to another person in any of the following ways:

(i) A person participates in the management of another person by being in a position to exercise a significant influence over such other person;
(ii) A person participates in the control of another person through a holding that exceeds 25% of the voting rights;
(iii) A person participates in the capital of another person through a right of ownership that, directly or indirectly, exceeds 25% of the capital; or
(iv) A person is entitled to 25% or more of the profits of another person.

This guidance is largely consistent with the definition of "associated enterprises" in the OECD TP Guidelines, albeit the OECD TP Guidelines do not determine any shareholding threshold. It is questionable whether a threshold of 25% as mentioned in the Directive Proposal is appropriate to classify transactions as controlled transactions since the other shareholders should generally have no interest in shifting advantages to a 25% shareholder.

Furthermore, "permanent establishments" are treated as associated enterprises to ensure equal treatment. Thus, the internal dealings between the head office and a permanent establishment should be determined in accordance with the arm's length principle. This principle is consistent with the guidance provided in the 2010 OECD report on the Attribution of Profits to Permanent Establishments (released on 22 July 2010).

Identification of commercial and financial relations

Article 8 of the Directive Proposal states that Member

Copyright © ATOZ 2023

States shall ensure that the application of the arm's length principle starts with the identification and accurate delineation of, on the one hand, the commercial and financial relations of the associated enterprises and, on the other, the actual transaction or transaction between the associated enterprises.

This is consistent with the guidance provided in Chapter I of the OECD TP Guidelines (see Section D. thereof).

Transfer pricing methods

Article 9 of the Directive Proposal reminds us that the arm's length price charged in a controlled transaction between associated enterprises may be determined based on:

a) the comparable uncontrolled price method,
b) the resale price method,
c) the cost-plus method,
d) the transactional price method, or
e) the profit split method.

Moreover, EU Member States should allow the application of any other valuation methods and techniques if none of the aforementioned methods are appropriate or workable in the circumstances of the case, and such other method provides for a more reliable estimate of the arm's length result than the standard methods.

This is consistent with the guidance provided in Chapter II of the OECD TP Guidelines.

The most appropriate transfer pricing method

Article 10 of the Directive Proposal provides that the arm's length price should be determined using the most appropriate transfer pricing method for the circumstances of the case. Here, the respective strengths and weaknesses of the transfer pricing methods and other aspects should be considered.

This is consistent with the guidance provided in Chapter II of the OECD TP Guidelines (see Section A. thereof).

Comparability analysis

According to Article 11 of the Directive Proposal, EU Member States shall evaluate whether a controlled transaction produces an arm's length result by comparing the conditions of the controlled transaction with the conditions that would have been set had the associated enterprises been independent and had they undertaken a comparable transaction under comparable circumstances (i.e. the comparability analysis).

Here, the Directive Proposal points to the comparability factors such as (i) the contractual terms of the transaction, (ii) the functions performed by each of the parties to the transaction (taking into account assets used and risks assumed), (iii) the characteristics of the property transferred or the services provided, (iv) the economic circumstances of the parties and the market in which the parties operate and (v) the business strategies pursued by the parties.

An uncontrolled transaction is deemed to be comparable to a controlled transaction if either of the following conditions is met:

(i) None of the differences (if any) between the transactions being compared or between the enterprises undertaking the transactions could materially affect the price in the open market; or
(ii) Reasonably accurate adjustments can be made to eliminate the material effects of such differences.

These basic principles are consistent with the guidance provided in Chapters I and III of the OECD TP Guidelines (see, in particular, Paragraph 1.36 in Chapter I and Section A.6 in Chapter III).

Determination of the arm's length range

According to Article 12 of the Directive Proposal, when the application of the transfer pricing methods produces a range of values, the arm's length range is determined using the interquartile range of the results of the uncontrolled comparables.

More precisely, the interquartile range is the range from the

Copyright © ATOZ 2023

25th to the 75th percentile of the results derived from the uncontrolled comparables.

While no tax adjustments should be made by EU Member States when a result falls within the interquartile range (unless it can be proven that a specific different positioning in the range is justified by the facts and circumstances of the specific case), if the results of a controlled transaction fall outside the arm's length range, an adjustment should be made to the median of all the results (unless it is proven that any other point of the range determines an arm's length price taking into consideration the circumstances of the specific case).

This is consistent with the guidance provided in Chapter III of the OECD TP Guidelines (see Section A.7 thereof).

Compensating adjustments

Article 7 of the Directive Proposal states that compensating adjustments in the form of year-end adjustments initiated by the taxpayer should be accepted if certain conditions are met.

This is consistent with the guidance provided in Chapter III of the OECD TP Guidelines (see Section A.3.2. thereof).

- **Corresponding adjustments**

Article 6 of the Directive Proposal

According to Article 6 of the Directive Proposal, when a primary adjustment is made, EU Member States shall ensure that a corresponding adjustment is made to prevent double taxation if the following conditions are met:

(i) The EU Member State that was requested to perform the corresponding adjustment agrees that the primary adjustment is consistent with the arm's length principle both in principle and as regards the amount;
(ii) The primary adjustment results in the taxation of an amount of profits in another jurisdiction on which the associated enterprise in the EU Member State that was requested to perform the corresponding adjustment has already been subject to tax in such EU Member State;
(iii) Where a third country jurisdiction is involved, a tax treaty is in force to prevent economic double taxation.

The Directive Proposal would set out a "fast-track" procedure. Under this procedure, the request introduced by the taxpayer must indicate all factual and legal circumstances necessary to evaluate, under the arm's length principle, the primary adjustment performed in the other jurisdiction and provide a certificate (or equivalent document) attesting the definitive nature of the primary adjustment abroad. After filing the request, EU Member States will have to declare the request (in)admissible within 30 days.

When double taxation arises from a primary adjustment made in another EU Member State, EU Member States would have to conclude the procedure within 180 days from the receipt of the taxpayer's request with a reasoned act of acceptance or rejection. If the corresponding adjustment is not granted under this fast-track procedure, it would not prevent the taxpayer from pursuing a mutual agreement procedure.

The Directive Proposal also lays down that EU Member States should grant corresponding adjustments as a result of joint audits or other forms of international administrative cooperation such as multilateral risk assessment programs like the European Trust and Cooperation Approach ("**ETACA**") and the International Compliance Assurance Programme ("**ICAP**") when the relevant tax administrations agree on the determination of the arm's length price and the primary and corresponding adjustments are granted symmetrically for the same amount in all the relevant jurisdictions.

Existing legal remedies

European companies may already rely on existing remedies provided in tax treaties (concluded by their residence state, the "mutual agreement procedure" or "**MAP**" that may provide an arbitration clause) and, in an EU context, on the EU Arbitration Convention, and EU Directive 2017/1852.

This raises the question of whether another procedure to claim corresponding adjustments would advance legal certainty for businesses in a meaningful manner.

Copyright © ATOZ 2023

After all, one of the conditions for a corresponding adjustment is that the EU Member State that was requested to perform the corresponding adjustment agrees that the primary adjustment is consistent with the arm's length principle both in principle and as regards the amount. However, this is frequently the key issue when it comes to disputes in transfer pricing matters as tax authorities have no incentive to agree to tax adjustments to their disadvantage.

- **Transfer pricing documentation**

According to Article 13 of the Directive Proposal, EU Member States shall ensure that a taxpayer has sufficient information and analyses available to verify that the conditions of controlled transactions are consistent with the arm's length principle and should at least encompass the following elements:

- the identification of the commercial or financial relations;
- the transfer pricing method and its selection;
- the comparability analysis; and
- the determination of the arm's length range.

Article 13 (2) of the Directive Proposal states that the Commission shall be empowered to adopt delegated acts, in accordance with Article 18 of the Directive Proposal, in order to further supplement the rules mentioned above.

According to Article 18 of the Directive Proposal, the power to adopt the delegated act referred to in Article 13 shall be conferred on the EU Commission subject to the conditions laid down in Article 18 of the Directive Proposal.

Hence, Article 18 of the Directive Proposal seems to suggest that additional powers regarding transfer pricing documentation requirements would be shifted from EU Member States to the EU Commission.

Chapter V of the OECD TP Guidelines is dedicated to providing guidance in regard to transfer pricing documentation. In the 2017 Revision of the OECD Guidelines, Chapter V was replaced by new guidance on transfer pricing documentation that was developed by the OECD as part of their work on Action 13 (Transfer Pricing Documentation) of the Base Erosion and Profit Shifting ("**BEPS**") Project.

The guidance sets out a three-tiered approach towards transfer pricing documentation that includes a master file, a local file and a country-by-country report (all three reports are collectively referred to as the country-by-country reporting package).

Considering the above, it is questionable whether additional transfer pricing documentation requirements may be necessary.

- **Development of binding EU transfer pricing rules**

According to Article 14 of the Directive Proposal, the EU Council may lay down further rules, consistent with the OECD TP Guidelines, on how the arm's length principle and the other provisions laid down in Chapter II of the Directive Proposal are to be applied in specific transactions to ensure more tax certainty and mitigate the risk of double taxation.

More precisely, these specific transactions or dealings that might be governed by additional guidance from the EU Council are the following:

(a) Transfer of intangible assets or rights in intangible assets between associated enterprises, including hard-to-value intangibles;
(b) The provision of services between associated enterprises, including the provision of marketing and distribution services;
(c) Cost contribution arrangements between associated enterprises;
(d) Transactions between associated enterprises in the context of business restructurings;
(e) Financial transactions;
(f) Dealings between the head office and its permanent establishments.

It is interesting to note that the OECD TP Guidelines already include specific guidance on all these topics (but not for guidance on dealings between the head office and its permanent establishments which have been extensively covered in a 2010 report on the Attribution of Profits to Permanent Establishments, released on 22 July 2010).

Copyright © ATOZ 2023

With the latest release of the OECD TP Guidelines back in January 2022, the guidance included in the OECD TP Guidelines is consistent with all post-BEPS transfer pricing standards:

- Chapter VI of the OECD TP Guidelines provides guidance on the transfer of intangible assets or rights in intangible assets between associated enterprises, including hard-to-value intangibles;
- Chapter VII of the OECD TP Guidelines provides guidance on the provision of services between associated enterprises, including the provision of marketing and distribution services;
- Chapter VIII of the OECD TP Guidelines provides guidance on cost contribution arrangements between associated enterprises;
- Chapter IX of the OECD TP Guidelines provides guidance on transactions between associated enterprises in the context of business restructurings;
- Chapter X of the OECD TP Guidelines provides guidance on financial transactions.

The question arises as to why the EU Council would release competing guidance to the explicit OECD TP Guidelines which are the result of years, if not decades, of negotiations between OECD Member States (and the EU Commission takes part in the work of the OECD) considering that such competing guidance would need to be consistent with the OECD TP Guidelines. Notably, any competing guidance may create legal uncertainty for businesses.

A critical review of the Directive Proposal

The Directive Proposal raises several concerns that are addressed in this section.

- **National sovereignty of EU Member States at stake**

The corporate tax laws of EU Member States vary from one State to another against the backdrop of the structure and focus of the respective economy. EU Member States have the freedom to adopt different tax policy choices with a view to set the right incentives for their economies. However, the interpretation of the arm's length principle is (at least in theory) not subject to much variation as most, if not all, of the EU Member States adhere to the OECD TP Guidelines.

The EU Member States' national sovereignty over tax matters (including transfer pricing) is a fundamental principle of the EU. Therefore, when it comes to important decisions in the field of taxation (and transfer pricing), unanimous agreement by all EU Member States is required.

While there have been several attempts by the EU Commission to move to qualified majority voting (where measures can be approved by a minimum number of EU countries, representing a minimum share of the EU population), such attempts have failed so far.

In the author's view, moving to qualified majority voting in taxation would undermine the competitiveness of the EU as it would diminish the pressure on national authorities to pursue efficient and competitive tax policies, and result in higher taxation across the EU.

The Directive Proposal would undermine national sovereignty over (transfer pricing) tax matters through the backdoor as it would largely replace domestic tax laws with EU transfer pricing rules over which individual EU Member States would have very limited control. Instead, the adoption of the Directive Proposal would elevate the EU Commission to the authoritative instance regarding the interpretation of the arm's length principle. EU Member States would further have limited control over future transfer pricing developments initiated by the EU Commission (e.g. adoption of additional transfer pricing rules to be applied in specific transactions).

- **Absence of a need for the Directive Proposal**

The Directive Proposal would introduce some of the fundamental principles included in the OECD TP Guidelines into EU Law. However, all but four EU Member States[20] are member states of the OECD and should adhere to

[20] Malta, Cyprus, Bulgaria and Romania are not members of the OECD.

Copyright © ATOZ 2023

the organisation's TP Guidelines (the four EU Member States that are not members of the OECD should likely accept transfer pricing that is consistent with the OECD TP Guidelines).

The latest revision of the OECD TP Guidelines was released on 20 January 2022 and now includes a new chapter, Chapter X, with transfer pricing guidance on financial transactions which was drafted as follow-up work on the OECD BEPS Project.

The 2017 revision of the OECD TP Guidelines resulted in some major changes including the replacement of the chapters on (i) transfer pricing documentation and (ii) transfer pricing aspects of intangibles. All these changes followed the work of the OECD on the BEPS Project from September 2013 until October 2015.

Notably, 4 of the 15 Actions of the BEPS Action Plan focused on transfer pricing and related documentation requirements:

- Action 8 focusing on intangibles,
- Action 9 focusing on risk and capital,
- Action 10 focusing on other high-risk transactions, and
- Action 13 focusing on transfer pricing documentation.

The stated purpose of the work of the OECD was to ensure that transfer pricing outcomes are in line with "value creation". The 2017 Revision of the OECD Guidelines reflects the wording provided in the Final Report on Actions 8 – 10 (Aligning Transfer Pricing Outcome with Value Creation) and the Final Report on Action 13 (Transfer Pricing Documentation) which were released in October 2015.

Consequently, the current version of the OECD TP Guidelines is consistent with all post-BEPS transfer pricing standards and should be followed by OECD member states (and beyond). How could there be a need for additional transfer pricing guidance?

- **Absence of a legal basis for the Directive Proposal**

The EU Commission only has a legal basis in Article 115 of the TFEU to the extent the Directive Proposal (i) is imperative for the functioning of the internal market and (ii) adheres to the principles of subsidiarity and proportionality.

As regards the need of the Directive Proposal for the functioning of the internal market, the EU Commission claims that the cross-border nature of transfer pricing requires legislation at EU level as individual uncoordinated action by EU Member States would only add to the current fragmentation of the legal framework for transfer pricing.

This is an interesting conclusion considering that the interpretation and application of the arm's length principle has been detailed in the comprehensive OECD TP Guidelines (and other reports) which is the result of thorough negotiations between OECD member states (and the EU Commission which takes part in the work of the OECD).

However, it is more than questionable that this initiative, which would merely implement some of the fundamental principles included in the OECD TP Guidelines into EU Law, would be necessary for the functioning of the single market.

Furthermore, the implementation of a new procedure for corresponding adjustments, in addition to the existing three instruments, may likely fall short of its objective for the same reason the other instruments may not efficiently ensure corresponding adjustments in a timely manner, in particular, as the EU Member State that was requested to perform the corresponding adjustment must agree that the primary adjustment is consistent with the arm's length principle both in principle and as regards the amount.

It is further not clear how the development of binding EU rules on topics that have already been covered in comprehensive OECD guidance (that should not be contradicted by potential new EU transfer pricing rules) could improve the situation.

Member States have sovereignty in tax matters which cannot be undermined through invoking Article 115 of the TFEU. In the author's view, the EU Commission should have no authority to intervene in transfer pricing matters.

However, it comes as no surprise that the explanatory

Copyright © ATOZ 2023

memorandum of the Directive Proposal reaches the conclusion that this initiative is compliant with both the principle of subsidiarity and the principle of proportionality.

Conclusion and outlook

The promise of the Directive Proposal on transfer pricing is fewer disputes, faster dispute resolution, a harmonised transfer pricing landscape and more legal certainty for businesses in the EU. However, as it stands, it might be (mis)used by the EU Commission to become the authoritative instance for the interpretation of the arm's length principle and the OECD TP Guidelines in the EU.

While this largely failed during several of the EU Commission's State Aid investigations that concerned transfer pricing (for example, the FIAT and Amazon State Aid cases), this Directive Proposal could be used by the EU Commission to strip sovereignty in tax matters from the tax authorities of EU Member States.

Instead, a measured approach to achieve the purported purpose of the Directive Proposal would be to reinforce that EU Member States should adhere to the OECD TP Guidelines and to emphasise, and potentially revise, the existing legal remedies to corresponding adjustments with a view to improve their effectiveness.

On 17 October 2023, the Swedish Ministry of Finance published its position on the Directive Proposal. After an overall assessment, the Swedish government is opposed to the proposal and believes that it has clear shortcomings in accuracy and proportionality based on the stated purpose. The Swedish government believes that the differences in EU Member States' interpretation and application of the arm's length principle are overestimated and that the disputes that arise regarding transfer pricing are more often due to States making different assessments regarding the facts and circumstances of the specific cases.

Ultimately, it remains to be seen whether all governments of EU Member States will agree unanimously to this initiative of the EU Commission. While it seems unlikely given the obvious shortcomings of the Directive Proposal, time will tell.

Our author

OLIVER R. HOOR
Partner, Head of Transfer Pricing & the German Desk
oliver.hoor@atoz.lu

Copyright © ATOZ 2023

Online incorporation of Luxembourg entities - the dream comes true but patience is still required!

OUR INSIGHTS AT A GLANCE

- On 15 June 2023, the Luxembourg Parliament adopted the law on the use of digital tools and processes in company law and implementation of the digitalisation of the notarial profession.
- The law creates the possibility for certain Luxembourg companies to be incorporated online by way of an electronical notarial deed.
- This notably entails a review of the probative value of electronic deeds, the exchange of information between European registers, the implementation of the notarial platform for the digitawlisation of the notarial profession, etc..
- However, this new process is not yet operational.
- In this article, we describe the implications of this new process to come.

On 15 June 2023, the Luxembourg Parliament adopted the law on the use of digital tools and processes in company law and implementation of the digitalisation of the notarial profession (the "**Law**"). The Law implements EU Directive 2019/1151 of 20 June 2019 as regards the use of digital tools and processes in company law.

This article will focus on the main measures of the Law and the current status of implementation by notaries.

The Law creates the possibility for Luxembourg private limited liability companies (*société à responsabilité limitée* "**SARL**"), joint stock companies (*société anonyme* "**SA**") and partnerships limited by shares (*société en commandite par actions* "**SCA**") to be incorporated online by way of an electronical notarial deed. There will be no obligations for the founders to be physically present or represented by their proxyholders at the notary offices.

The electronic notarial deeds need to respect the following criteria to be valid and have the same value as paper deeds:

- The signatory must be duly identified. To achieve this, the electronic signature used must be uniquely linked to the signatory, enable the signatory to be identified and have been created using electronic signature creation data that the signatory can, with a high level of confidence, use under his or her exclusive control.
- The integrity of the content of the document must be guaranteed by being able to detect any subsequent modifications or revisions made to the document.
- The technical process used must enable the authentic instrument or deed to be represented in a way that is intelligible to humans. The notarial electronic deed will need to be signed by the notary by means of a qualified electronic signature process within the meaning of the eIDAS Regulation[21].

Online incorporation may be refused by the notary in case (i) all or part of the share capital is paid in kind, (ii) they have reason to suspect falsification or usurpation of identity or (iii) of non-compliance with the rules relating to the legal capacity of a party or the power of representation of a company by a party to the deed. In these cases, the

[21] Regulation (EU) 910/2014 of the European Parliament and the Council of 23 July 2014 on electronic identification and trust services for electronic transactions in the internal market and repealing Directive 1999/93/EC. "**Qualified electronic signature**" means an advanced electronic signature that is created by a qualified electronic signature creation device, and which is based on a qualified certificate for electronic signatures.

Copyright © ATOZ 2023

Luxembourg notary may require that the party be physically present or represented by a proxyholder to draw up and sign the deed.

Notaries will remain legally responsible for checking the accuracy of the identity of the appearing parties to the deed and for the statement they certify. In this respect, the notary may require the persons using the platform to use a qualified electronic signature within the meaning of the eIDAS Regulation.

The *Chambre des Notaires* has created a dedicated platform on their website (notariat.lu) called "company creation request" where it will be possible to register all the information on the company to be set up. The data will then be transmitted directly to the notary chosen.

The online incorporation process can be summarised as follows:

- Click on the tab "company creation request";
- Complete the general information on the company: (i) name, (ii) legal form, (iii) corporate object, (iv) address, (v) share capital and (vi) accounting year;
- Relationship – in this section, you will have to enter the details of the directors, shareholders and auditor;
- Your information – in this section, you will have to insert your details and also the notary with whom you wish to work;
- Submission of the application;
- The notary selected will contact you in order to finalise the incorporation.

Templates of standard articles of incorporations are now available on the Chambre des Notaires website and, if they are used, the notary will have maximum five days to proceed with the incorporation. It is worth highlighting that the templates available are basic and will probably rarely be used.

The Law seems to introduce the possibility to proceed with an incorporation in cash without a blocking certificate from the bank anymore. Instead, a proof of payment could be provided online. This would constitute a major improvement to facilitate the incorporation process and reduce the administrative burden, notably considering the current hardship of opening bank accounts for companies in Luxembourg. Furthermore, in case the share capital is paid in cash, such payment can be made online in an account opened with a bank operating in the EU[22] in the name of the company to be incorporated.

Unfortunately, as of today, the platform is not yet operational and the Chambre des Notaires has not yet confirmed its launching date. As a result, as of today, physical meetings are still required.

While the Law represents a major change, some adjustments are already needed, notably regarding the limitation of the number of words for the corporate object of the company. Nevertheless, the Law is only the beginning of the digitalisation in Luxembourg considering the revision of Directive 2019/1151/EU was announced in the 2023 Commission work programme to further expand and upgrade its scope and adapt it to recent technical, economic and social changes. We can thus expect new developments in this area in the next few months.

Our authors

GAELLE BERNARD
Partner
gaelle.bernard@atoz-services.lu

RICHARD FAUVEL
Principal
richard.fauvel@atoz-services.lu

[22] A credit institution within the meaning of article 4(1)(1) of Regulation (EU) nr. 575/2013 established in a Member State.

Copyright © ATOZ 2023

CONTACT US

NORBERT BECKER
Chairman
Phone +352 26 940 400
Mobile +352 661 830 400
norbert.becker@atoz.lu

FATAH BOUDJELIDA
Managing Partner-Operations
Phone +352 26 940 283
Mobile +352 661 830 283
fatah.boudjelida@atoz.lu

KEITH O'DONNELL
Managing Partner
Phone +352 26 940 257
Mobile +352 661 830 203
keith.odonnell@atoz.lu

JAMAL AFAKIR
Partner, Head of International & Corporate Tax
Phone +352 26 940 640
Mobile +352 661 830 640
jamal.afakir@atoz.lu

OLIVER R. HOOR
Partner, Head of Transfer Pricing & the German Desk
Phone +352 26 940 646
Mobile +352 661 830 600
oliver.hoor@atoz.lu

THIBAUT BOULANGE
Partner, Head of Indirect Tax
Phone +352 26 940 270
Mobile +352 661 830 182
thibaut.boulange@atoz.lu

PETYA DIMITROVA
Partner
Phone +352 26 940 224
Mobile +352 661 830 224
petya.dimitrova@atoz.lu

ANTOINE DUPUIS
Partner
Phone +352 26 940 207
Mobile +352 661 830 601
antoine.dupuis@atoz.lu

HUGUES HENAFF
Partner
Phone +352 26 940 516
Mobile +352 661 830 516
hugues.henaff@atoz.lu

CHRISTINA LEOMY-VOIGT
Partner
Phone +352 26 940 203
Mobile +352 661 830 104
christina.leomy-voigt@atoz.lu

ANDREAS MEDLER
Partner
Phone +352 26 940 237
Mobile +352 661 830 038
andreas.medler@atoz.lu

OLIVIER REMACLE
Partner
Phone +352 26 940 239
Mobile +352 661 830 230
olivier.remacle@atoz.lu

Copyright © ATOZ 2023

CONTACT US

ATOZ TAX ADVISERS

ROMAIN TIFFON
Partner
Phone +352 26 940 245
Mobile +352 661 830 245
romain.tiffon@atoz.lu

MARIE BENTLEY
Chief Knowledge Officer
Phone +352 26 940 903
Mobile +352 661 830 048
marie.bentley@atoz.lu

HOLLY WHATLING
Marketing Director
Phone +352 26 940 916
Mobile +352 661 830 131
holly.whatling@atoz.lu

ATOZ SERVICES

JEAN-MICHEL CHAMONARD
Managing Partner
Phone +352 26 9467 772
Mobile +352 661 830 233
jean-michel.chamonard@atoz-services.lu

EMILIE BRUGUIERE
Partner, Head of Direct Tax Compliance
Phone +352 26 9467 305
Mobile +352 661 830 305
emilie.bruguiere@atoz-services.lu

MIREILLE RODIUS
Partner, Head of VAT Compliance
Phone +352 26 9467 305
Mobile +352 661 830 305
mireille.rodius@atoz-services.lu

CHAFAI BAIHAT
Partner
Phone +352 26 9467 305
Mobile +352 661 830 305
chafai.baihat@atoz-services.lu

GAELLE BERNARD
Partner
Phone +352 26 9467 703
Mobile +352 661 830 134
gaelle.bernard@atoz-services.lu

NICOLAS CUISSET
Partner
Phone +352 26 9467 305
Mobile +352 661 830 305
nicolas.cuisset@atoz-services.lu

CHRISTOPHE DARCHE
Partner
Phone +352 26 9467 588
Mobile +352 661 830 588
christophe.darche@atoz-services.lu

JEREMIE SCHAEFFER
Partner
Phone +352 26 9467 517
Mobile +352 661 830 517
jeremie.schaeffer@atoz-services.lu

Copyright © ATOZ 2023

CONTACT US

GILLES STURBOIS
Partner
Phone +352 26 9467 209
Mobile +352 661 830 067
gilles.sturbois@atoz-services.lu

GAEL TOUTAIN
Partner
Phone +352 26 9467 306
Mobile +352 661 830 306
gael.toutain@atoz-services.lu

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.

ATOZ

TAX ADVISERS LUXEMBOURG

Aerogolf Center 1B, Heienhaff | L-1736 Senningerberg
Phone (+352) 26 940-1

www.atoz.lu