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Luxembourg: Law & Practice

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Loyens & Loeff

LUXEMBOURG

Law and Practice

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Contents

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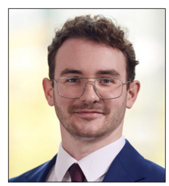

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LOYENS & LOEFF
Law & Tax

1. Types of Business Entities, Their Residence and Basic Tax Treatment

1.1 Corporate Structures and Tax Treatment

Luxembourg has several forms of entities with separate legal personality. Businesses generally incorporate an entity with limited liability set up in one of the following forms:

- a public limited company (*société anonyme*, SA);
- a private limited company (*société à rèsponsable limitée*, SARL); or
- a partnership limited by shares (*société en commandite par actions*, SCA).

A SARL is likely the most popular corporate form to conduct a business through. Both a SARL and an SA are incorporated through a deed before a Luxembourg notary and are governed by a board of managers/directors (an SA can also be governed using a two-tier structure with a management board and a supervisory board). The minimum capitalisation requirement amounts to EUR12,000 for a SARL and EUR30,000 for an SA. In contrast to an SA, shares in a SARL cannot be publicly traded and a SARL is limited to a maximum of 100 shareholders.

An SCA is a partnership limited by shares. It is created through a notarial deed and has characteristics of both a limited partnership and a public limited company. There must be at least one general partner and one limited partner. In contrast to a limited partnership, the shares of an SCA can be freely transferred to individuals who are not shareholders, unless stated otherwise in the articles of association.

These corporate forms are considered opaque from a Luxembourg tax perspective and are fully subject to corporate income tax (CIT) and municipal business tax (MBT) at an aggregate tax rate of 23.87% (in Luxembourg City), and net wealth tax (NWT).

Fully taxable Luxembourg corporate entities that are part of the same group are eligible for group taxation (fiscal unity). Under this regime, each entity's taxable income is determined on a standalone basis, with the taxable results of all participants ultimately added together. As a result, intra-group transactions remain fully recognised.

Less common corporate entities are:

- the simplified joint stock company (*société par actions simplifiée*, SAS);
- the simplified private limited liability company (*société à responsabilité limitée simplifiée*, or SARL-S);
- the European company (*Societas Europaea*, SE);
- the co-operative company (*société cooperative*, SCOP); and
- the European co-operative company (*société coopérative européenne*, or SE SCOP).

1.2 Transparent Entities

Luxembourg has several forms of transparent entities, some with legal personality:

- a general partnership (*société en nom collectif*, SNC);
- a limited partnership (*société en commandite simple*, SCS);
- a special limited partnership (*société en commandite speciale*, SCSp); and
- a civil company (*société civil*, SC).

The two most common forms are the SCS and the SCSp. Both can be established through a partnership agreement or through a notarial deed. There must be at least one general partner and one limited partner. There is no limitation on the number of partners. A general partner has unlimited, joint, and several liability for all the partnership's obligations. A limited partner is in principle only liable up to the amounts pledged as a contribution to the partnership. The difference between the two forms of partnership is that an SCS has legal personality while an SCSp does not. An SCSp is commonly used in the private equity and alternative investment fund sectors.

Subject to the so-called reverse hybrid rules, an SCS and SCSp are considered tax transparent entities. The partners of the partnership are considered to (indirectly) hold the assets of the partnership, and taxation should occur at the level of the partners, irrespective of whether the partnership distributes income.

If a partnership is engaged in, or deemed to be engaged in, a commercial activity (in Luxembourg), Luxembourg MBT is levied at the level of the partnership.

1.3 Determining Residence of Incorporated Businesses

Corporate entities are deemed to be residents of Luxembourg for tax purposes if their legal seat or central administration is located in Luxembourg. This means that both collective entities registered in Luxembourg, and those registered abroad but with their central administration or registered office in Luxembourg, are considered tax residents.

The central administration of an entity is in Luxembourg if the entity's affairs are managed there. This is determined based on facts through a substance-over-form analysis. Generally, the location of the entity's central accounting and archives, as well as where the shareholders' and board meetings are held, are considered important factors in this determination.

A company established under Luxembourg law is by definition a Luxembourg tax resident, irrespective of its substance (physical and economical footprint) in Luxembourg.

Transparent entities are not considered Luxembourg tax residents.

1.4 Tax Rates

For the year 2025, the applicable CIT rate amounts to:

- 14%, if the corporation's taxable worldwide income is EUR175,000 or less;
- EUR24,500 plus 30% of income on the portion exceeding EUR175,000, if the taxable income is between EUR175,000 and EUR200,000; or
- 16%, if the taxable income is more than EUR200,000.

Additionally, a solidarity surcharge of 7% is levied as a contribution to the unemployment fund.

A local MBT on profits from trade or business is levied by the different municipalities. The rate varies depending on the municipality, but is often 6.75% (eg, in Luxembourg City).

The aggregate effective tax rate on income for a company located in Luxembourg City is generally 23.87%.

Luxembourg corporate resident taxpayers are subject to NWT levied on the fair market value of the taxable net wealth on 1 January of each year. The rates as from fiscal year 2025 are:

- 0.5% on taxable net wealth up to EUR500 million; and
- 0.05% on the portion of taxable net wealth in excess of EUR500 million.

NWT is levied on the net wealth of the company (ie, non-exempt assets minus deductible liabilities, in both cases valued at their fair market value, unless a specific provision prescribes a different valuation). A minimum NWT is applicable, which is levied if it is higher than the NWT liability determined on the basis of the taxable net wealth of the entity. The minimum tax depends on the total balance sheet of the resident corporate taxpayer and ranges from EUR535 to EUR4,815.

Business Through a Transparent Entity

Businesses in Luxembourg that are operated by resident individuals, either directly or via a transparent entity, are liable to pay progressive income tax. The tax rate applicable for 2025 depends on the tax class of the individual. The tax brackets range from 8% to 42%. Additionally, there is a 7% unemployment fund contribution, which increases to 9% on taxable income above EUR150,000 or EUR300,000 (in the case of joint taxation). Therefore, the highest possible marginal tax rate reaches up to 45.78%.

2. Key General Features of the Tax Regime Applicable to Incorporated Businesses

2.1 Calculation for Taxable Profits

Resident corporate entities of Luxembourg are taxed annually on their global income, while non-resident entities are only taxed on certain types of income originating in Luxembourg.

Typically, each category of income is determined and taxed separately. However, all income generated by corporations and commercial partnerships is considered business income.

The business profit of an entity is generally defined as the increase in its net assets over the fiscal year, adjusted for capital contributions, repayments, and distributed profits. This is based on the entity's annual accounts (in Luxembourg GAAP), meaning that the taxable profit usually aligns with the financial result and is determined on an accrual basis, unless specific tax rules or a special tax regime apply.

A fiscal balance sheet is prepared for this purpose, where the accounting values of assets and liabilities are replaced by their tax values if they differ. Generally, all business-related expenses of a commercially active company are deductible unless they relate to exempt income. Some expenses are explicitly classified as deductible (eg, non-creditable foreign taxes and value-added tax, real estate tax and capital duty, depreciation and amortisation), while others are explicitly non-deductible (eg, CIT, MBT, NWT, directors' fees for supervisory services, fines, non-qualifying gifts and profit distributions).

For MBT purposes, profits and losses from a foreign permanent establishment (PE) or those already taxed at the level of a commercial partnership (of which the taxpayer is a member) are not considered.

2.2 Special Incentives for Technology Investments

Investment Tax Credit

Luxembourg tax law provides for two types of investment tax credits. First, a company carrying out a digital transformation or ecological/energy transition project can benefit from an investment tax credit that is calculated based on investments and operating expenses incurred as part of that project. To be eligible, the project needs to comply with at least one of the objectives listed in the law.

The rate of the tax credit is 18% for investments and operating expenses, except for investments in tangible depreciable assets, which benefit from a rate of 6%, in addition to the 12% rate applicable to the overall investment tax credit (effectively reaching 18%).

Secondly, a company that makes investments during an operating year may qualify for a 12% overall investment tax credit. The tax credit for overall investment is based on the acquisition price or production costs of qualifying assets acquired. The qualifying investments encompass investments in tangible depreciable assets, as well as investments in sanitary and central heating installations in hotel buildings and buildings used for social activities. The rate is increased to 14% for investments that qualify for special depreciation. The credit for the acquisition of software is capped at 10% of the CIT due for the fiscal year in which the acquisition was made.

IP Regime

In 2018, Luxembourg adopted a new intellectual property (IP) regime that aligns with the guidelines set out by the OECD in its Base Erosion and Profit Shifting (BEPS) Action Plan 5. It adopted a nexus approach to ensure that only the R&D activities that have a direct connection with the Luxembourg taxpayer can benefit from the tax regime. This new regime came into effect on 1 January 2018.

Under the IP regime, net income from qualifying IP assets that meet the eligibility criteria may benefit from an 80% exemption from CIT and MBT, and a 100% exemption from NWT. The eligible assets should have been established, developed, or enhanced after 31 December 2007. These assets include patents, utility models, supplementary protection certificates for a patent on medicine and plant protection, plant variety certificates, extensions of a complementary protection certificate for paediatric use, orphan drug designations, and software protected by copyrights.

Income that qualifies for the IP regime include:

- income derived from the use of, or a concession to use, a qualifying asset;
- income related to a qualifying asset that is embedded in the sales price of products or services directly related to the eligible IP asset;
- capital gains derived from the sale of a qualifying asset; and
- the indemnities received based on an arbitration ruling or a court decision concerning a qualifying asset.

The part of the IP income that benefits from the favourable tax treatment is determined by a ratio that considers the research and development (R&D) costs. This ratio is the eligible R&D costs divided by the total R&D expenses. Luxembourg permits a 30% uplift of the eligible R&D costs, provided that the resulting ratio does not surpass the total expenditure. To be eligible, expenses must be incurred as part of an R&D

activity. These activities can be carried out by the taxpayer or outsourced.

2.3 Other Special Incentives

Holding Regime

Proceeds derived by a Luxembourg taxable resident company from shares in a subsidiary company (such as dividends, liquidation distributions, capital gains and foreign exchange results) are subject to CIT and MBT, unless the domestic participation exemption applies. Pursuant to this exemption, dividends (including liquidation distributions) and capital gains received by a Luxembourg company are exempt from CIT and MBT provided that, at the time of the received distribution:

- a minimum participation of 10% or with an acquisition price of at least EUR1.2 million (EUR6 million for capital gains) is held;
- the participation is held in (i) a capital company that is fully subject to Luxembourg CIT or a comparable foreign tax (ie, a tax rate of at least 8.5% and a comparable tax base) or (ii) an EU entity qualifying under the EU Parent-Subsidiary Directive; and
- on the date on which the dividend is received (or capital gain is realised), the company has held (or commits itself to hold) a qualifying participation continuously for at least 12 months.

Once the minimum threshold and holding period are met, newly acquired shares of a qualifying participation immediately qualify for the participation exemption.

A taxpayer may opt to waive the participation exemption for participations which qualify on the basis of the acquisition price being above EUR1.2 million (EUR6 million for capital gains). The waiver option is intended to allow taxpayers who are in scope of the so-called Pillar Two Rules to avoid a mismatch between the exclusion of income under the Pillar Two Rules and the Luxembourg domestic participation exemption. Such mismatch may potentially give rise to (cash) top-up taxes, which may be avoided (eg, if tax losses carried forward would be utilised to offset the otherwise exempt income).

Meeting the EUR1.2 million acquisition price threshold also makes a participation exempt from NWT.

Costs and losses related to an exempt participation, such as financing expenses and impairments, are tax deductible to the extent that the related costs and/or losses exceed the amount of exempt income in a given year. At the time of sale of the exempt participation, any appreciation in value is taxable up to the historical acquisition price (ie, recaptured), which would otherwise be an exempt capital gain.

2.4 Basic Rules on Loss Relief

The taxpayer that generated losses can carry them forward and offset them against the taxable income (on the condition that they result from acceptable accounts) for a maximum of 17 consecutive years. Losses generated before 2017 can be carried forward indefinitely. Usage of tax losses follows the *"first-in, first-out"* principle. Tax losses cannot be carried back.

The deductibility of the tax losses can be denied by the Luxembourg tax authority if a change in the taxpayer's control and activity (which has generated the tax losses) has the purposes of circumventing the personal nature of the right to carry forward tax losses and avoiding taxation of subsequently realised profits.

In case of a fiscal unity, pre-fiscal unity losses can only be used to offset income in relation to the entity that sustained such tax losses.

2.5 Imposed Limits on Deduction of Interest

Luxembourg applies the interest deduction limitation rule (IDLR) in accordance with the EU anti-tax avoidance directive. Subject to certain exclusions that are discussed below, the IDLR limits the deduction of the net amount of interest expenses and economically equivalent expenses (ie, the excess, if any, of such expenses over interest and economically equivalent income) in a taxable year to the higher of:

- 30% of EBITDA for tax purposes; or
- EUR3 million.

The IDLR does not distinguish between third-party and related-party interest. However, the rule contains a grandfathering rule pursuant to which interest and economically equivalent expenses incurred in respect of loans that were concluded prior to 17 June 2016 and were not modified after such date fall outside the scope of the earning stripping rules. Furthermore, taxpayers that qualify as *"financial undertakings"* or *"standalone entities"* within the meaning of the IDLR are excluded from their scope. Moreover, in case the ratio of equity to assets of a taxpayer is equal to or higher than such ratio for the consolidated group to which it belongs, such taxpayer is excluded from the scope of the rules.

The EBITDA is calculated on a Luxembourg tax basis, which means that dividends that qualify for the participation exemption are not included in the EBITDA. Any interest that is not deductible pursuant to the IDLR can be carried forward indefinitely. In addition, any unused deduction capacity can be carried forward for five years. Luxembourg taxpayers that have opted for the fiscal unity regime can decide whether the IDLR applies at the level of each Luxembourg taxpayer on a standalone basis or at fiscal unity level.

2.6 Basic Rules on Consolidated Tax Grouping

The fiscal unity regime allows certain group companies to consolidate their results for CIT and MBT purposes, provided a joint written request is submitted before the end of the financial year for which the application is sought. This regime permits both horizontal and vertical integration, or a mix of both.

Vertical fiscal unity is available to a Luxembourg parent company or a Luxembourg Permanent Establishment (PE) of a foreign company that is subject to a tax comparable to the Luxembourg corporate tax, as well as to qualified subsidiaries. Horizontal fiscal unity is available to Luxembourg subsidiaries of a non-integrating parent company.

A non-integrating parent can be a Luxembourg parent company or a Luxembourg PE of a foreign company fully subject to a tax comparable to the domestic corporate tax, or a capital company resident in the European Economic Area (EEA) subject to a tax comparable to the Luxembourg corporate tax, or a PE of such an entity in the EEA. The non-integrating parent is not part of the fiscal unity itself. The consolidation occurs at the level of the integrating subsidiary.

A consolidated tax grouping in Luxembourg is possible if the following conditions are met:

- the qualified subsidiaries and the integrating subsidiary must be either a Luxembourg-resident fully taxable company or a local PE of a

non-resident capital company fully subject to a tax comparable to the domestic tax;
- Luxembourg subsidiaries can be included when they are controlled, directly or indirectly, by the group parent or the non-integrating parent company for at least 95% of their capital since the beginning of the fiscal year for which the option is exercised:
- the book year must coincide for all companies included in the fiscal unity; and
- the request for a fiscal unity is filed jointly by all the intended parties.

Taxable income and losses of each company pertaining to the fiscal unity are determined individually (as if they were not integrated) and then aggregated at the level of the group parent or the integrating subsidiary with adjustments to eliminate double taxation and double deduction of the same items of income or expenses. The tax due on such aggregated result is then levied from the group parent or the integrating subsidiary.

Inter-corporate dividends paid within the fiscal unity regime are fully exempt and do not need to be adjusted when determining the profit of the group, as the requirements for the application of the participation exemption regime are less strict than the requirements for the application of the fiscal unity regime. Losses generated prior to the fiscal unity can only be used to offset the income of the group up to the taxable income of the integrated subsidiary that generated them. Once the regime ends, losses generated during the tax unity have to be left at the level of the group parent or the integrating subsidiary.

2.7 Capital Gains Taxation

Capital gains derived by a Luxembourg taxable resident company are subject to CIT and MBT, unless the domestic participation exemption applies (see **2.3 Other Special Incentives**).

2.8 Other Taxes Payable by an Incorporated Business

VAT

As a member of the European Union, Luxembourg adheres to the EU VAT Directive 2006/112/EC and has a standard 17% VAT rate. Luxembourg also applies lower rates (3%, 8%, and 14%) to a variety of goods and services.

Unlike other member states, Luxembourg has not adopted the *"use and enjoyment"* rule, which requires non-registered holding companies to pay VAT on services received from non-EU suppliers without the ability to recover it.

Following rulings from the Court of Justice of the European Union (CJEU), Luxembourg has strictly confined the VAT exemption for an *"independent group of persons"* (cost-sharing) to taxable entities carrying out activities of public interest. In response to the near elimination of the cost-sharing exemption for the financial, fund, and insurance sectors, Luxembourg has introduced the VAT grouping mechanism, based on Article 11 of the EU VAT Directive 2006/112/EC.

Recently, the CJEU ruled that a member of the board of directors of a public limited company incorporated under Luxembourg law carries out an economic activity within the meaning of Directive 2006/112/EC (VAT Directive), but does not carry out that economic activity independently, insofar as the person concerned does not act on his/her own behalf or under his/her own responsibility and does not bear the economic risk associated with the activity. As a result, directors' fees, subject to the above reservations, are not subject to VAT.

Customs/Excise Duties

Besides VAT, goods imported into the EU may also be liable for customs or import tariffs. The rates applied can differ based on the type and amount of the products.

In Luxembourg, items such as electricity, mineral oils, manufactured tobacco, and alcohol are subject to excise duties.

Capital Duty or Registration Tax

A registration tax of EUR75 is levied in several instances, such as for the incorporation of a company, when the legal seat or effective management of a foreign company is transferred to Luxembourg, or when a local branch of a foreign company is established.

Depending on the assets or documents registered, other registration duties or stamp duties may be applicable.

Real Estate Taxation

An annual real estate tax is imposed on the unitary value of properties in Luxembourg, with the rate varying based on the property's classification and location. The unitary value, determined by the Luxembourg tax authority, typically does not surpass 10% of the property's market value.

Sales and transfers of real estate are subject to a registration duty of 6% and a transcription tax of 1% (plus a city surtax). Contributions of real estate are also subject to a registration tax of 1.1% (if contributed in exchange for shares) or 7% if contributed in exchange for other than shares.

2.9 Incorporated Businesses and Notable Taxes

Pillar Two

Luxembourg has implemented the EU Directive on a global minimum income tax (Pillar Two), which imposes a minimum effective tax rate of 15% on multinational groups and large-scale domestic groups that have had consolidated revenues exceeding EUR750 million in at least two out of the previous four years. Pillar Two includes three related tax measures: the income inclusion rule (IIR), the undertaxed profits rule (UTPR) and the qualified domestic top-up tax (QDMTT). In Luxembourg, the IIR and a QDMTT apply as from fiscal years starting on or after 31 December 2023, with the UTPR applying a year later. Luxembourg has implemented the transitional *"CbCR Safe Harbours"*, which apply for the first three years that a group is considered in scope, beginning on or after 31 December 2026 and ending before 1 July 2028 (eg, fiscal years 2024, 2025 and 2026 if the fiscal year aligns with the calendar year).

Luxembourg parent entities may be subject to top-up tax under the IIR, to the extent that the group does not meet the 15% minimum tax rate in a jurisdiction where the Luxembourg parent holds a subsidiary, as determined under the Pillar Two rules.

Under the UTPR, Luxembourg entities are subject to top-up tax in cases where a parent entity of the group is in a jurisdiction that has not implemented Pillar Two. The top-up tax due under the UTPR would be the sum of the difference of the effective tax rate for all jurisdictions where the group is active and the minimum tax rate of 15%, and is allocated between all entities of the group that are located in jurisdictions that have implemented a UTPR, using an allocation key based on tangible assets and the number of employees.

The starting point for the Pillar Two calculations is the *"standalone pre-consolidation"* financial statements of the group, in the accounting standard used for consolidation.

Furthermore, all Luxembourg entities of an in-scope group are subject to the Luxembourg QDMTT, under which top-up tax may be levied if Luxembourg as a jurisdiction of the group does not meet the 15% minimum tax rate. Provided that all Luxembourg entities of a group apply Luxembourg GAAP and apply the same fiscal year as the consolidating entity, the calculations for the QDMTT may be performed based on Luxembourg GAAP accounts, rather than the accounting standard used for consolidation purposes by the group.

The currency applied for QDMTT purposes is either the euro or the currency used for group consolidation purposes. If the QDMTT is determined on the basis of the accounting standard used for consolidation purposes, the currency used in the consolidated financial statements shall be used. If the QDMTT is based on a Luxembourg domestic accounting standard (ie, Luxembourg GAAP or IFRS), and all Luxembourg entities of the group apply the euro as their functional currency, the euro shall be applied for QDMTT purposes. If there are Luxembourg entities that apply a non-euro currency as their functional currency, a five-year election is provided to the group on whether to apply the euro or the currency used for consolidation for the purposes of the QDMTT.

The Pillar Two rules further place new compliance obligations on Luxembourg resident entities. All Luxembourg entities that are part of an in-scope group would have to register with the Luxembourg tax authority within 15 months after the end of a relevant fiscal year (18 months for the transition year). Further, a Pillar Two information return would have to be filed; such information return can be filed by a designated group entity in any qualifying jurisdiction (ie, a jurisdiction that has implemented the Pillar Two rules). Luxembourg entities would have to notify the Luxembourg tax authority about such designated reporting entity. Finally, to the extent that the IIR, UTPR and QDMTT apply, Pillar Two tax returns would have to be filed. For such purposes, a Luxembourg entity of the group can also be designated as the filing entity.

Payment of top-up tax is due within a month of the filing deadline.

NWT

Luxembourg corporate resident taxpayers are subject to NWT levied on the fair market value of the taxable net wealth on 1 January of each year. The rates for fiscal year 2024 are:

- 0.5% on taxable net wealth up to EUR500 million; and
- 0.05% on the portion of taxable net wealth in excess of EUR500 million.

The unitary value is typically determined using accounting book values and adjusted as needed. For real estate in Luxembourg, the unitary value is based on cadastral values.

Assets that yield exempt or partially exempt income (like exempt participations and qualifying intellectual property rights) are generally also exempt from NWT. Assets allocated to a foreign permanent establishment and foreign real estate are usually exempt due to tax treaties Luxembourg has signed.

Liabilities are generally deductible unless they relate to exempt assets. Provisions for uncertain liabilities (like provisions for risks) are not deductible. NWT is not deductible for income tax purposes and is generally not creditable in foreign jurisdictions. Net wealth tax is considered *"covered tax"* for Pillar Two purposes.

In the company's first year of existence, NWT is not due as the assets as of 1 January are considered to be nil. A minimum NWT applies and depends on the resident corporate taxpayer's balance sheet total and ranges from EUR535 to EUR4,815.

The NWT liability can be decreased by adopting an NWT reserve. This decrease is limited to the amount of CIT (not including MBT) that the entity is liable to pay. It is further required that the established reserve be five times the requested NWT reduction. This reserve must be maintained for a minimum of five years. If not adhered to, the granted NWT reduction will be reclaimed in its entirety.

3. Division of Tax Base Between Corporations and Non-Corporate Businesses

3.1 Closely Held Local Businesses

It is more common for local businesses to operate in a corporate form, usually a SARL.

3.2 Individual Rates and Corporate Rates

Corporate entities are subject to an aggregate tax rate of 23.87% (in Luxembourg City), which is lower than the maximum tax rate of 45.78% applicable to individuals. Dividend income is taxed according to the progressive tax rate of the recipient individual, however half of the dividends distributed from a regularly taxed EU entity, or a regularly taxed entity resident in a jurisdiction with which Luxembourg has concluded a tax treaty are exempted.

3.3 Accumulating Earnings for Investment Purposes

Luxembourg enforces controlled foreign company (CFC) rules based on so-called Model B per the EU anti-tax avoidance directive from 2016 (ATAD 1).

A CFC is an entity or a permanent establishment of an entity that fulfils the following conditions:

- a Luxembourg taxpayer, either alone or in conjunction with one or more associated enterprises, holds a direct or indirect stake of more than 50% in the voting rights, capital, or profit entitlement of such an entity; and
- the entity or permanent establishment is subject to an effective tax rate that is less than 50% of the Luxembourg CIT rate (ie, for 2024, an effective rate lower than 8.5%) that would be applicable if the entity or permanent establishment were located in Luxembourg.

Luxembourg corporate taxpayers are taxed on the undistributed net income of a CFC, proportionate to their ownership or control of the entity (held directly and/or indirectly), provided that such income is associated with significant functions performed by the Luxembourg corporate taxpayer and only if the CFC in question was essentially established to gain a tax advantage. This CFC income is only subject to CIT, augmented by the solidarity surtax (resulting in a combined effective CIT rate of 17.12%), but it is not subject to MBT.

3.4 Sales of Shares by Individuals in Closely Held Corporations

Dividends

In general, dividends received by individuals residing in Luxembourg are fully subject to personal income tax but may qualify for a 50% exemption under certain circumstances.

Dividends fall under the 50% exemption if they are derived from a shareholding that qualifies as:

- a Luxembourg resident entity that is fully subject to Luxembourg income taxes;
- a non-resident capital company that is subject to an income tax in its country of residence (and that is a country with which Luxembourg has concluded a double tax treaty) that is comparable to the Luxembourg CIT (ie, a minimum 8% CIT rate on a comparable tax basis); or
- an entity resident in an EU member state as defined in Article 2 of the Parent-Subsidiary Directive.

Dividends further benefit from a EUR1,500 annual deduction (double in the case of joint taxation).

Capital Gains

Capital gains earned by Luxembourg resident individuals from the sale of shares are subject to personal income tax in the following manner:

- If the shares are sold less than six months after acquisition, they are taxed at the normal progressive income tax rate.
- If the shares are sold more than six months after acquisition:
  - (a) the capital gain is fully tax-exempt if the shares represent less than a 10% shareholding; or
  - (b) the capital gain is taxed at 50% of the applicable personal income tax rate if the shares represent more than 10%.

3.5 Sales of Shares by Individuals in Publicly Traded Corporations

Individuals are taxed on dividends from and gains on the sale of shares in publicly traded companies under the same rules applicable in relation to non-listed companies.

Dividends

In general, dividends received by individuals residing in Luxembourg are fully subject to personal income tax but may qualify for a 50% exemption under certain circumstances.

Dividends fall under the 50% exemption if they are derived from a shareholding that qualifies as:

- a Luxembourg resident entity that is fully subject to Luxembourg income taxes;
- a non-resident capital company that is subject to an income tax in its country of residence (and that is a country with which Luxembourg has concluded a double tax treaty) that is comparable to the Luxembourg CIT (ie, a minimum 8% CIT rate on a comparable tax basis); or
- an entity resident in a member state of the EU as defined in Article 2 of the Parent-Subsidiary Directive.

Dividends further benefit from a EUR1,500 annual deduction (double in the case of joint taxation).

Capital Gains

Capital gains earned by Luxembourg resident individuals from the sale of shares are subject to personal income tax in the following manner:

- If the shares are sold less than six months after acquisition, they are taxed at the progressive personal income tax rate.
- If the shares are sold more than six months after acquisition:
  - (a) the capital gain is fully tax-exempt if the shares represent less than a 10% shareholding; or
  - (b) the capital gain is taxed at 50% of the applicable personal income tax rate if the shares represent more than 10%.

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

Luxembourg imposes a 15% withholding tax on dividends (and hidden distributions), unless a tax treaty limits the amount Luxembourg can levy.

A domestic exemption for withholding tax on dividends applies in case:

- the recipient is a company that is:
  - (a) a Luxembourg resident entity;
  - (b) an entity which is covered by Article 2 of the Parent-Subsidiary Directive; or
  - (c) a capital company subject in its country of residence to income tax comparable with the Luxembourg CIT rate (ie, subject to a CIT rate of at least 8% on a similar taxable basis) and is resident in a country with which Luxembourg has concluded a double tax treaty; and
- the recipient holds, or commits itself to hold, a participation of at least 10% in the share capital of the Luxembourg company paying the dividend or, an acquisition price of at least EUR1,200,000 for an uninterrupted period of at least 12 months.

No withholding tax is levied on arm's length interest payments made to corporate entities, except for profit-sharing interest which, under certain circumstances, is subject to 15% withholding tax (subject to reduction under tax treaties).

Interest payments made to Luxembourg resident individuals by a Luxembourg *"paying agent"* are subject to 20% Luxembourg withholding tax. The 20% withholding tax operates as a full discharge of personal income tax for Luxembourg resident individuals acting in the context of the management of their private wealth.

Luxembourg does not apply any withholding tax on arm's length royalty payments or on distributions of liquidation proceeds.

4.2 Primary Tax Treaty Countries

Luxembourg has currently 92 tax treaties in force, and most are based on the OECD Model Convention.

On 7 June 2017, Luxembourg signed the Multilateral Convention (MLI) to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS), also known as the MLI. The MLI came into effect in Luxembourg on 1 August 2019. However, due to the necessary national ratification process, as well as the schedule outlined in the MLI, the widespread effects varied in terms of timing. Nevertheless, for many of Luxembourg's treaties, the principal purpose test (PPT) entered into force on 1 January 2020.

4.3 Use of Treaty Country Entities by Non-Treaty Country Residents

It is uncommon for Luxembourg to challenge the use of treaties. However, national law contains a general anti-abuse rule, as well as the EU Parent Subsidiary Directive anti-abuse rule, under which tax benefits can be denied if the main purpose of an arrangement is to obtain a tax benefit.

The domestic general anti-abuse rule, amended on 1 January 2019 to align the provision with the wording of the general anti-abuse rule in ATAD 1, includes the concept of *"non-genuine arrangement"*. A transaction will be disregarded or requalified if the following elements are met: the use of one or more legal form(s) or institution(s) of law; (ii) the main purpose, or one of the main purposes, of such use of legal form(s) or institution(s) of law is to avoid or reduce a tax liability in a manner that goes against the object or purpose of the tax law; and (iii) such use of legal form(s) or institution(s) of law is non-genuine.

Since 1 January 2020, the PPT entered into force for tax treaties concluded by Luxembourg. Tax benefits can be denied under this rule, if it can be reasonably concluded that obtaining the treaty benefit was one of the principal purposes of an arrangement or transaction that directly or indirectly caused the benefit.

4.4 Transfer Pricing Issues

In 2014, the arm's length principle, which was already in practice, was officially incorporated into Luxembourg tax law. In 2016, a new article was introduced that outlined the main principles for conducting a transfer pricing functional analysis. This analysis focuses on the commercial and financial relations between affiliated companies and the economically significant circumstances of these relations.

The law also includes a requirement for taxpayers to provide transfer pricing documentation at the request of the tax authority. This documentation should validate the arm's length nature of transactions between related parties. Therefore, the taxpayer carries the initial burden of proof.

At the end of 2016, the Luxembourg tax authority issued guidance that clearly states the criteria for determining arm's length remuneration on intra-group financing transactions. The Circular applies to group companies whose main activity, aside from holding activities, involves intra-group financing transactions. These transactions are defined as the provision of loans or advances to associated companies, financed by any means. While the guidance does not address other intra-group situations, its principles should be largely applicable to those transactions.

Among other things, the guidance outlines the main substantive requirements that a group financing company established in Luxembourg must meet to enter into an advance pricing agreement with the tax authority. In this context, and among other substance requirements, the financing company should have adequate capital to handle the functions performed and the risks assumed in relation to its financing activity.

4.5 Related-Party Limited Risk Distribution Arrangements

The arm's length principle applies to related-party limited risk distribution arrangements.

4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards

The Luxembourg tax authority applies the arm's length principle in line with the OECD standards.

4.7 International Transfer Pricing Disputes

Generally, the tax treaties concluded by Luxembourg contain an article on the mutual agreement procedure. This article establishes a mutual agreement procedure for the settlement of difficulties arising from the application of the Convention. The Luxembourg tax authority issued guidance on 11 March 2011 concerning the modalities for the implementation of the mutual agreement procedure and specified which information and documents need to be included for such a procedure.

5. Key Features of Taxation of Non-Local Corporations

5.1 Compensating Adjustments When Transfer Pricing Claims Are Settled

Upward and downward adjustments of taxable income are in principle allowed in Luxembourg.

If a foreign tax authority unilaterally makes an adjustment of the taxable income, resulting in an increase of the taxable income, the taxpayer may initiate a mutual agreement procedure (MAP) before the directorate or the economic division of the Luxembourg tax authority, provided that the applicable double tax treaty contains a MAP article.

The Luxembourg tax authority will verify the request and assess whether the taxpayer's objection appears to be well-founded. If the request is well-founded, the Luxembourg tax authority will try to provide a solution unilaterally, or if it is unable to provide such a unilateral solution, the Luxemburg tax authority is obliged to contact the competent authority in the other state to resolve the case by mutual agreement.

The Director of the Luxembourg tax authority issued an update on the guidance on MAPs filed under a bilateral tax treaty concluded by Luxembourg.

5.2 Taxation Differences Between Local Branches and Local Subsidiaries of Non-Local Corporations

In Luxembourg, local branches of non-local corporations are treated the same as Luxembourg resident companies for CIT purposes. A branch is subject to MBT if it conducts a commercial activity in the territory of Luxembourg.

5.3 Capital Gains of Non-Residents

Non-residents are subject to taxation of the income generated in Luxembourg. Gains realised on the alienation of a substantial interest in a Luxembourg company (more than 10% shareholding) by non-residents are taxable, if the gain is realised within a period of six months following the acquisition of the shares. The foregoing may equally apply to distributions received upon liquidation and proceeds from a redemption of shares.

Non-resident capital gains tax will also be levied in case where the shareholder has been a Luxembourg resident for more than 15 years and became a non-resident less than five years prior to selling the participation in the Luxembourg company.

5.4 Change of Control Provisions

No provisions in Luxembourg tax law address the change of control of resident companies.

However, a change in control can have consequences for the carry-forward of losses if the change of the taxpayer's control and activity (which has generated the tax losses), has the purposes of circumventing the personal nature of the right to carry forward tax losses and avoiding taxation of subsequently realised profits.

5.5 Formulas Used to Determine Income of Foreign-Owned Local Affiliates

No provisions in Luxembourg tax law, other than the general arm's length principle for transactions between related parties, are used to determine the income of foreign-owned local affiliates selling goods or providing services.

5.6 Deductions for Payments by Local Affiliates

The deduction of expenses incurred by a non-local affiliate is only possible when:

- the expenses are charged to the Luxembourg company;
- the charge is beneficial to the business; and
- the expense adheres to the arm's length principle.

5.7 Constraints on Related-Party Borrowing

Related-party borrowings paid by foreign-owned Luxembourg subsidiaries to foreign companies are subject to the arm's length principle and the IDLR.

6. Key Features of Taxation of Foreign Income of Local Corporations

6.1 Foreign Income of Local Corporations

Resident taxpayers in Luxembourg are subject to tax on their worldwide income. Foreign income is therefore subject to tax in Luxembourg, unless a double tax treaty restricts the taxation rights of Luxembourg.

If double taxation of the same income is not prevented, Luxembourg allows a credit for foreign tax paid, limited to the tax amount the taxpayer is required to pay under Luxembourg tax law. However, it is required that the foreign tax correspond to Luxembourg CIT.

6.2 Non-Deductible Local Expenses

Costs directly and economically related to tax-exempt participations (eg, impairments or interest expenses on a loan financing an exempt participation) are only deductible to the extent that the expenses exceed the exempt income. Any deductible expenses on an exempt participation are subject to *"recapture"* upon a sale of the participation, up to the historical acquisition cost.

6.3 Taxation on Dividends From Foreign Subsidiaries

Dividends received by a Luxembourg tax resident are subject to CIT and MBT, unless the participation exemption applies (see **2.3 Other Special Incentives**).

6.4 Use of Intangibles by Non-Local Subsidiaries

A foreign subsidiary that uses intangibles developed by a Luxembourg resident company should compensate the latter in line with the arm's length principle.

The income derived by a Luxembourg resident company from intangibles is subject to Luxembourg taxation.

Under the IP regime, net income from qualifying IP assets that meet the eligibility criteria may benefit from an 80% exemption from CIT and MBT and a 100% exemption from NWT. The eligible assets should have been established, developed, or enhanced after 31 December 2007. These assets include patents, utility models, supplementary protection certificates for a patent on medicine and plant protection, plant variety certificates, extensions of a complementary protection certificate for paediatric use, orphan drug designations, and software protected by copyrights.

Income that qualifies for the IP regime includes:

- income derived from the use of, or a concession to use, a qualifying asset;
- income related to a qualifying asset that is embedded in the sales price of products or services directly related to the eligible IP asset;
- capital gains derived from the sale of a qualifying asset; and
- the indemnities received based on an arbitration ruling or a court decision concerning a qualifying asset.

6.5 Taxation of Income of Non-Local Subsidiaries Under Controlled Foreign Corporation-Type Rules

ATAD 1 introduced a CFC rule into Luxembourg domestic tax law. Under this rule, if a CFC is essentially established to obtain a tax advantage, Luxembourg corporate taxpayers are taxed on the undistributed net income of the CFC. This is proportional to their ownership or control of the foreign branch or subsidiary (held directly and indirectly), but only if such income is associated with significant functions performed by the Luxembourg corporate taxpayer (see **3.3 Accumulating Earnings for Investment Purposes**).

The Luxembourg tax authority has issued administrative guidance requiring Luxembourg resident taxpayers to annually document the functions and risks undertaken by the foreign entities in relation to any CFC income. If a Luxembourg company can demonstrate, through sufficient documentation of its activities or functions, that it does not perform significant functions related to the CFC's activities, the CFC rules should not result in a negative tax impact.

However, if the foreign entities' accounting profits are less than EUR750,000 or their accounting profits constitute less than 10% of their operating costs for a given year, the CFC rule does not apply.

6.6 Rules Related to the Substance of Non-Local Affiliates

The general anti-abuse rule in Luxembourg domestic law also applies to the substance of non-local affiliates.

The domestic general anti-abuse rule, amended on 1 January 2019 to align the provision with the wording of the general anti-abuse rule in ATAD 1, includes the concept of *"non-genuine arrangement"*. A transaction will be disregarded or requalified if the following elements are met: the use of one or more legal form(s) or institution(s) of law; (ii) the main purpose, or one of the main purposes, of such use of legal form(s) or institution(s) of law is to avoid or reduce a tax liability in a manner that goes against the object or purpose of the tax law; and (iii) such use of legal form(s) or institution(s) of law is non-genuine.

Since 1 January 2020, the PPT entered into force for the tax treaties concluded by Luxembourg. Tax benefits can be denied under this rule if it can be reasonably concluded that obtaining the treaty benefit was one of the principal purposes of an arrangement or transaction that directly or indirectly caused the benefit.

6.7 Taxation on Gain on the Sale of Shares in Non-Local Affiliates

Capital gains derived by a Luxembourg taxable resident company from shares in a subsidiary company are subject to CIT and MBT, unless the domestic participation exemption applies (see **2.3 Other Special Incentives**).

7. Anti-Avoidance

7.1 Overarching Anti-Avoidance Provisions

Luxembourg's domestic tax law contains several anti-abuse measures with a general anti-abuse provision, that has been amended in light of ATAD 1.

Furthermore, the substance-over-form is a principle underlying Luxembourg tax law. This principle dictates that the tax treatment of a structure or transaction is not bound to its legal classification, and taxation is determined solely based on the substance of the structure or transaction.

This approach has been used for the evaluation of a debt/equity instrument which has been confirmed by parliamentary history and Luxemburg case law.

Furthermore, the domestic general anti-abuse rule, amended on 1 January 2019 to align the provision with the wording of the general anti-abuse rule in ATAD 1, includes the concept of *"non-genuine arrangement"*. A transaction will be disregarded or requalified if the following elements are met: (i) the use of one or more legal form(s) or institution(s) of law; (ii) the main purpose, or one of the main purposes, of such use of legal form(s) or institution(s) of law is to avoid or reduce a tax liability in a manner that goes against the object or purpose of the tax law; and (iii) such use of legal form(s) or institution(s) of law is non-genuine.

Since 1 January 2020, the PPT entered into force for the tax treaties concluded by Luxembourg. Tax benefits can be denied under this rule if it can be reasonably concluded that obtaining the treaty benefit was one of the principal purposes of an arrangement or transaction that directly or indirectly caused the benefit.

8. Audit Cycles

8.1 Regular Routine Audit Cycle

For CIT, MBT and NWT, a tax return needs to be filed every year and will be used to determine the taxable income and tax liability. The Luxembourg tax authority will usually issue *"preliminary"* tax assessment based on the tax return filed. A five-year limitation period applies for the Luxembourg tax authority to issue a revised tax assessment if it disagrees with the *"preliminary"* tax assessment. An exception to the five-year limitation period applies if the tax return is found to be incomplete or incorrect, irrespective of an intent of fraud.

The Luxembourg tax authority has dedicated departments that have the competence to conduct on-site tax audits. The *Service de révision* is responsible for periodically auditing the accounts and other accounting documents of taxpayers subject to audit and drawing up audit reports proposing any resulting changes to taxation.

9. BEPS

9.1 Recommended Changes

Most of the BEPS-recommended action points have been implemented in Luxembourg via the transposition of related European directives (ATAD 1 and 2):

- Action 2 – anti-hybrid rules;

- Action 3 – CFC;
- Action 4 – interest deduction limitation rules;
- Action 5 – IP box;
- Action 6 – treaty abuse;
- Action 8-10 – transfer pricing;
- Action 13 – country-by-country reporting (CbCR); and
- Action 15 – multilateral instrument.

9.2 Government Attitudes

Luxembourg is fully committed to combating detrimental tax competition and supports the BEPS initiative (which led to ATAD 1 and 2 and the MLI).

In its effort to back tax developments, Luxembourg transposed the Pillar Two Directive on minimum taxation for corporations in December 2023. Pillar Two is implemented in Luxembourg, with the IIR and Luxembourg QDMTT applying for fiscal years starting on or after 31 December 2023, and the UTPR applying for fiscal years starting on or after 31 December 2024.

The Luxembourg legislature has also tried to implement most of the OECD Pillar Two administrative guidance released up to autumn of 2024, and it has also confirmed in parliamentary documents the intention to (i) treat existing and additional OECD guidance as a relevant source of interpretation of the rules, and (ii) implement (if appropriate) additional OECD guidance that may require a change of law.

In particular, a recent amendment law which includes additional clarifications for the fund industry and clarifications on the Luxembourg QDMTT was passed in December 2024.

9.3 Profile of International Tax

For many years, Luxembourg has been known as a key European jurisdiction for cross-border investment structures for large multinational corporations worldwide, as well as for the largest collective investment structures, both regulated and unregulated, such as undertakings for collective investment in transferable securities and alternative investment funds.

9.4 Competitive Tax Policy Objective

Luxembourg continues to stay competitive with other EU member states in terms of taxation, fully committing to all fair taxation initiatives.

9.5 Features of the Competitive Tax System

Taxpayers can obtain advance tax confirmations.

9.6 Proposals for Dealing With Hybrid Instruments

Luxembourg has transposed the hybrid mismatch rules from ATAD 2. The purpose of the hybrid mismatch rules is to neutralise the tax effects of hybrid mismatches by limiting the deduction of payments or by including the payments in the taxable income of a Luxembourg corporate taxpayer. The rules target double deduction and deduction-non-inclusion outcomes.

The hybrid mismatches covered by the rules include (i) payments on hybrid financial instruments, (ii) payments to or by hybrid entities, (iii) payments to or by hybrid permanent establishments, (iv) payments by dual resident entities and (v) payments made on a non-hybrid instrument that directly or indirectly finance a payment that leads to a hybrid mismatch (*"imported mismatches"*). Exceptions may apply, depending on the specific facts and circumstances.

If certain conditions regarding hybrid mismatches are met, Luxembourg transparent vehicles (eg, limited partnerships) may constitute so-called reverse hybrid entities and become (fully or partially) subject to Luxembourg CIT.

9.7 Territorial Tax Regime

Luxembourg does not have a territorial tax regime, but taxes residents on their worldwide income (subject to limitations in any applicable double tax treaty).

9.8 Controlled Foreign Corporation Proposals

There is no applicable information in this jurisdiction.

9.9 Anti-Avoidance Rules

Luxembourg is Europe's main hub for investment funds. Its success is partially due to the vast amount of tax treaties that the country has signed.

As part of the MLI, the PPT came into effect in Luxembourg on 1 January 2020. This general anti-abuse rule could have an effect on certain investment structures.

9.10 Transfer Pricing Changes

Luxembourg legislation on transfer pricing, including the arm's length principle, has been aligned with the OECD standard. The transposition of the BEPS project mainly affected intra-group transactions.

9.11 Transparency and Country-by-Country Reporting

Luxembourg tax legislation and regulations will continue to combat tax avoidance and improve transparency.

9.12 Taxation of Digital Economy Businesses

Luxembourg has not made any standalone changes or proposals in relation to the taxation of transactions effected or profits generated by digital economy businesses operating largely from outside its territory, nor are any such proposals being discussed.

9.13 Digital Taxation

Digital taxation in Luxembourg is expected to align with EU proposals on the topic. Luxembourg has implemented the EU Directive (DAC 7) concerning platform operators, which enacts transparency rules for digital platforms.

9.14 Taxation of Offshore IP

Luxembourg has not introduced any provisions dealing with the taxation of offshore intellectual property that is deployed within its territory.

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