ATOZ
TAX ADVISERS

INSIGHTS

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TAXAND

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EDITORIAL

Greetings!

As spring is upon us, the time has come to present our latest edition of our Insights, highlighting recent developments from the Grand Duchy, at European level, and in the Middle East over the past few months.

In this edition, we explore a diverse range of key topics that have shaped the tax landscape.

Focusing first on Luxembourg, we provide a comprehensive overview of the newly introduced impatriate tax regime, outlining its key features, conditions of eligibility, and the potential tax benefits available to individuals relocating to the jurisdiction.

We also examine the recent decision of the Administrative Court concerning the tax reclassification of interest-free shareholder loans, with particular attention to the Court's analysis of the 85/15 debt-to-equity ratio practice and the implications arising therefrom.

Staying in Luxembourg, we address key amendments introduced by the new circular revising the rules for determining arm's length remuneration for upstream loans granted to both individual and corporate shareholders, as well as the updated circular concerning the issuance of residence certificates for Luxembourg undertakings for collective investment in the context of double tax treaties.

At European level, we analyse the recent decision of the Court of Justice of the European Union in the *Nordcurrent* case, which provides clarification on the application of the general anti-abuse rule under the Parent-Subsidiary Directive to national participation exemptions and its implications for Luxembourg companies.

Concerning VAT, we assess the practical impacts for the financial sector of the new Council Directive on VAT in the Digital Age (ViDA), which notably generalises electronic invoicing and digital reporting.

From the Middle East, we outline the newly published corporate tax guidance published by the United Arab Emirates Ministry of Finance, focusing on interest deduction limitation rules.

We hope you enjoy reading our Insights.

The ATOZ Editorial team

New Luxembourg impatriate regime: Analysis and comments

OUR INSIGHTS AT A GLANCE

- On 20 December 2024, Luxembourg passed a law reforming the tax regime for skilled workers considered as 'impatriates'.
- The prior regime was not perceived as competitive enough because it was rather complex to navigate through the conditions to benefit from it and the outcomes it produced.
- This reform aims at strengthening the attractiveness of Luxembourg for talent and highly specialised profiles, and takes into account attractive regimes set up in other countries in the European Union.
- While most conditions for benefiting from the new regime are identical to those applicable under the previous regime, certain conditions evolved with the reform.
- We analyse and comment hereafter on the implications of this new impatriate regime.

In order to modernise its tax regime and make it simpler and more attractive, Luxembourg has recently amended its tax regime for skilled workers considered as 'impatriates'. The aim of this reform, introduced by a law dated 20 December 2024[1] (the "**Law**") is to continue to attract to and retain talent in Luxembourg, and to strengthen the competitiveness of Luxembourg companies.

With effect from tax year 2021, the tax regime of impatriates, previously governed by the circular L.I.R. – n° 95/2 dated 27 January 2014 (the "**2014 Circular**") was, for the first time, incorporated into the Luxembourg income tax law ("**LITL**"). According to Article 115 of the LITL, impatriate premiums granted by an employer to employees qualifying as impatriates, benefited from a 50% exemption under certain conditions, and certain costs incurred in moving highly qualified workers and borne by the employer were tax-exempt. The prior regime was not perceived as being competitive enough because it was rather complex to navigate through the conditions to benefit from it and the outcomes it produced. With effect from tax year 2025, the Law repeals and replaces that partial exemption of the gross annual remuneration paid in the form of a bonus by employers to impatriates and the exemption of certain costs borne by the employer and generated by the expatriate's move to Luxembourg.

The new impatriate regime, inspired by the Italian and French regimes, is far easier to understand in terms of both the conditions to benefit from it and the outcome it produces. It provides for an exemption of 50% of the gross annual remuneration, including benefits in kind, paid to the impatriate, capped at EUR 400,000 per annum. This measure aims at strengthening the attractiveness of Luxembourg for talent and highly specialized profiles, and takes into account attractive regimes set up in other countries in the European Union.

Taxpayers in scope of the impatriate regime

For the purposes of the new regime, 'impatriate' means:

- an employee who, usually working abroad, is seconded from an undertaking of an international group located outside the Grand Duchy of Luxembourg in order to carry out an activity as an employee in a Luxembourg local undertaking belonging to the same international group; or
- an employee directly recruited abroad by a Luxembourg

[1] Loi du 20 décembre 2024 portant modification de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu, *Mémorial A589*, https://legilux.public.lu/eli/etat/leg/loi/2024/12/20/a589/jo

local undertaking or by an undertaking established in another State party to the Agreement on the European Economic Area, in order to work as an employee in the Luxembourg undertaking.

This regime will not apply to employees hired on the basis of a contract of secondment by a temporary employment agency or within the framework of labour lending.

The conditions to qualify as an impatriate can only be met at one point in time. Therefore, once an employee qualifies as an impatriate upon their arrival in Luxembourg (i.e., year N), they remain an impatriate for the purposes of the regime throughout the entire period of application of this regime. The status is not lost in the year following the employee's arrival in Luxembourg (i.e., year N+1) merely because they are no longer 'directly recruited' that year, for example. For the same reason, the qualification of an employee as impatriate should not be lost because the regime is not effectively applied to that employee as from the moment where the said employee relocates to Luxembourg or due to a potential change of employer.

Conditions for benefiting from the exemption

Most conditions for benefitting from the new regime are identical to those applicable under the previous regime and already described in the 2014 Circular.

To qualify, the following conditions must be met:

- The impatriate is an individual whose tax domicile or habitual residence is in the Grand Duchy of Luxembourg. The impatriate must be resident for tax purposes in Luxembourg, in accordance with the LITL.
- During the five tax years preceding the year in which the impatriate took up employment in the Grand Duchy of Luxembourg, the impatriate has neither been domiciled for tax purposes in the Grand Duchy of Luxembourg, nor lived at a distance of less than 150 km from the border, nor been subject to personal income tax in the Grand Duchy of Luxembourg on professional income.
- The impatriate carries out the professional activity qualifying for the exemption for at least 75% of their working time. The previous regime required that the impatriate was employed for a job that was their main professional occupation. However, to assess the 75% threshold, it remains unclear what type of activities (e.g., volunteering, non-remunerated mandates, etc.) fall within the scope of the "working time" and whether this threshold must be assessed annually, monthly or even weekly.
- Like under the previous regime, the impatriate earns a fixed annual remuneration of at least EUR 75,000. The fixed remuneration to be taken into consideration being the gross amount, before incorporation of benefits in cash and in kind;
- The impatriate does not replace another employee not considered as an impatriate meeting all the criteria to benefit from the regime;
- In the case of a secondment,
  - (i) the seconded impatriate has a seniority within the international group of at least five years or has acquired at least five years of specialised professional experience in the sector concerned,
  - (ii) an employment relationship exists between the seconding company and the employee during the period of secondment,
  - (iii) the temporary assignment of the seconded employee provides for a right for the employee to return to the seconding establishment at the end of the period of secondment, and
  - (iv) a contract relating to the secondment of the employee is concluded between the seconding company and the local company;
- In the case of direct recruitment, the impatriate must have in-depth specialisation in the sector concerned; and
- the number of impatriates entitled to the exemption does not exceed 30% of the total workforce of the local company in which the impatriate works. Part-time employees, including impatriates, are counted in proportion to their workload.

The previous version stated that this last condition was not required for entities that have been in existence for less than 10 years. Now, according to the Law, this condition is not required for companies that have been in existence for less than 10 years **on the 1st of January of the calendar year concerned**. The parliamentary documents of the Law do not explain why this reference to the 1st of January was added.

Literally interpreted, this exception applies to companies "in existence" on 1st January. Thus, it would not apply to companies incorporated after the 1st of January of the calendar year concerned because they would not have been in existence, for less than 10 years, **on the 1st of January** of the calendar year. On that date, they do not exist at all. However, such a reading seems contrary to the presumed objective of the exemption, as it would require the application of the 30% threshold for the first year of incorporation of a company and not for the following years. This condition should thus be read, *a contrario*, as meaning that the 30% threshold requirement is required for entities that have been in existence for 10 years on the 1st of January of the calendar year.

The impatriate regime is no longer applicable when one of the aforementioned conditions related to the impatriate, their employment, or their employer ceases to be met. It is interesting to note in this respect that the Law does not provide, contrary to what has been provided for the young employee bonus exemption, any restrictions that would prevent an employee qualifying as an impatriate from changing employers, whether within the same group or not.

Period of application of the regime

Employees who have benefitted from the previous impatriate regime, applicable up to and including 2024, remain subject to this previous version of the impatriate regime as long as the conditions for its application are met, unless the employee expressly asks for the application of the new impatriate regime as from 2025.

The choice to apply the new impatriate regime needs to be communicated to the Luxembourg tax authorities and is irrevocable.

The impatriate regime is applicable during the entire secondment of the impatriate to Luxembourg, respectively the entire time the impatriate is working for the local company, but only until the end of the 8th tax year following the year during which the impatriate started to work in the Grand Duchy of Luxembourg. This therefore means that the impatriate may benefit from the new regime the year in which individual relocates to Luxembourg and the full eight fiscal years thereafter.

Declaration to be performed by the employers

According to the Law, each year, by 31 January at the latest, employers must provide the tax authorities with a list of the names of their employees who are eligible for the impatriate regime during the tax year in question.

In this regard, a newsletter issued by the tax authorities on 24 January 2025 provides that "*no later than 31 January of tax year N, employers are required to provide the RTS office responsible for employer verification with a list of the names of their employees who benefited from the tax regime for impatriates during the period from 1 January to 31 December of tax year N-1.*"

However, this newsletter states conditions that are not in the Law and therefore are *contra legem*. It is also surprising that this "clarification" would be needed in 2025 while this employer's declaration was already required, under the same terms, under the 2014 Circular and under the previous regime.

This newsletter seems to imply that the employer declaration is a condition for the application of the regime but that is not what the Law provides. According to the Law, the employer's declaration is not a condition for the application of the impatriate regime. It rather seems to be a modality allowing the tax authorities to issue the withholding tax forms (*la fiche de retenue d'impôt*). Indeed, the following sentence of the paragraph of the legal provision establishing this employer's declaration specifies that when the employer is a foreign company with no withholding tax obligation on salaries in Luxembourg (for example, if the company has no permanent establishment in Luxembourg), the employee is taxable by means of a tax return only and the employer is not required to pay the withholding tax on the payroll.

Our authors

ROMAIN TIFFON
Partner
romain.tiffon@atoz.lu

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

Luxembourg Administrative Court upholds reclassification of interest-free shareholder loans to equity and rejection of Malaysian branch as permanent establishment

OUR INSIGHTS AT A GLANCE

- On 17 April 2025, the Luxembourg Administrative Court issued a ruling in a case challenging the tax reclassification of intragroup loans as hidden capital contributions and the denial of recognition of a permanent establishment in Malaysia.
- With respect to the tax reclassification of the loans, our article highlights the criteria which, in view of all relevant circumstances and in light of the broader context of the transactions, support the Court's conclusion that said loans must be viewed, in their entirety and for tax purposes, as hidden capital contributions.
- With respect to the existence of a permanent establishment, our article outlines the elements that led the Court to find that the taxpayer failed to demonstrate the existence of a fixed place of business.
- Hereafter, we analyse the decision of the Court, with particular attention to the Court's analysis of the 85/15 debt-to-equity ratio practice and the implications arising therefrom.

On 17 April 2025, the Luxembourg Administrative Court (the "**Court**") issued its ruling No. 50602C (the "**Ruling**") in a case challenging the tax reclassification of intragroup loans as hidden capital contributions ("**HCC**") and the denial of recognition of a permanent establishment ("**PE**") in Malaysia. This Ruling follows the judgment No. 47267 rendered by the Administrative Tribunal (the "**Tribunal**") on 8 May 2024, which upheld the initial decision of the Luxembourg tax authorities (the "**LTA**") on these contested points.

In this article, we analyse the Ruling and the lessons we can learn from this decision.

Facts and issues at stake

A Luxembourg company (hereafter referred to as "**LuxCo**") incorporated in October 2014 acquired participations in companies (C) and (CC). These acquisitions became effective in April 2015. To finance these participations, LuxCo obtained two interest-free shareholder loans ("**SHLs**" or "**IFLs**") from company (E), another group entity (indirect shareholder), on 31 December 2015.

LuxCo submitted a request for an advance ruling to the LTA in August 2015 in which it stated its intention to establish a branch in Malaysia to which it would allocate its participations in companies (C) and (CC). LuxCo requested confirmation (i) of the recognition of this branch as a PE and, (ii) of the exemption of these participations from Luxembourg net wealth tax ("**NWT**"), as well as of the income generated by these participations from Luxembourg corporate income tax ("**CIT**") and municipal business tax ("**MBT**"). In August 2016, the LTA rejected the ruling request, stating that the proposed structure lacked economic substance and constituted an abuse of law within the meaning of § 6 of the Tax Adaptation Law (*StAnpG*).

Notwithstanding this refusal, LuxCo, in its 2015 tax return, treated the branch as a PE, allocated the two participations to said PE, and sought to treat the assets and related income as tax exempt in Luxembourg in accordance with the applicable double tax treaty. Furthermore, LuxCo classified the IFLs as debt instruments.

Subsequently, in 2020, the LTA issued tax assessments deviating from the 2015 tax return, following the non-recognition of the Malaysian PE and the reclassification of the SHLs as HCC (i.e., equity). Consequently, LuxCo was regarded as holding two participations that did not fulfil the conditions for the participation exemption and was not entitled to deduct the IFLs from its net wealth tax basis.

On 8 May 2024, the Tribunal released its judgment which upheld the initial decision of the LTA.

On appeal, the Court was called upon to rule on:
(i) the proper tax qualification of the SHLs at issue, and specifically, whether they should be treated as debt instruments or reclassified as equity, i.e., HCC;
(ii) the tax treatment of the Malaysian branch, in particular, whether it constituted a PE; and
(iii) whether the overall structure gave rise to an abuse of law within the meaning of § 6 *StAnpG*.

Regarding the tax qualification of the SHLs

Conclusion of the Court

The Court opens its analysis by clarifying the legal basis underpinning the reclassification. It confirms that the tax qualification of a financial instrument does not depend solely on its accounting or legal form but must be assessed in light of the principle of economic reality (substance over form approach). Under this fundamental principle of tax law, facts and legal acts must be interpreted and assessed based on their economic substance. Legal characterisations advanced by the parties are taken into account only insofar as they reflect the parties' actual intent.

The Court recalls the criteria which must be considered for the purpose of determining whether a financial instrument should be classified as debt or equity. These include, first, contractual features such as the stipulation of an interest rate and repayment terms; second, economic indicators such as the use of the funds, the existence of guarantees, and the ratio between the company's equity and the amount of funds made available. Additionally, the Court refers to further indicia identified by case law, including voting rights granted to the lender, participation in profits and losses, entitlement to liquidation proceeds, a high degree of subordination, long maturity, convertibility into equity at the company's discretion, repayment in shares, and stapling clauses.

In the case at hand, in addition to the **absence of interest**, the Court specifically examined and considered the following criteria:

- **The allocation of funds**

Funds were used to finance participations considered as long-term assets ("*immobilisations à longue durée*"). The Court noted that their classification in LuxCo's balance sheet as "Non-current assets" supported this long-term intention. The Court also considered the nature of the underlying project (a gas pipeline project) financed through these participations, deeming it a durable investment due to its complexity and scale. Additionally, the Court noted that LuxCo had no other significant assets or activities, besides acquiring and managing these participations, thereby reinforcing their characterisation as long-term assets.

The Court further highlighted LuxCo's significant influence over the acquired entities (via board representation) and the similarity of the corporate names of the involved entities as additional indications of a long-term intention.

The Court rejected LuxCo's argument that the qualification of the asset should depend solely on the financing instrument's maturity, stating that a global analysis is required. Although the loans had a formal 10-year maturity, the group's strategy, consisting in the almost automatic refinancing of LuxCo, implied a *de facto* longer duration.

- **The debt-to-equity ratio**

A manifest disproportion existed between the loaned funds and LuxCo's equity (a very high debt-to-equity ratio). Aligning with its previous jurisprudence, the Court reiterated that this criterion must be assessed at the time the funds were made available. However, the Court rejected the arguments based on purported market practice or transfer pricing reports suggesting an 85 percent debt to 15 percent equity norm as indicative of an arm's length structure, stating that such practice lacks legally binding force and that the provided transfer pricing report was inconclusive.

The Court also rejected LuxCo's claim for a partial reclassification of the contested loans as equity, holding that, as a matter of principle, the nature of the instruments cannot be hybrid but must be regarded entirely either as debt or as equity.

- **The absence of guarantees**

The absence of guarantees for the lender (E) increases the lender's risk akin to that of a shareholder.

Firstly, the Court found that despite the absence of a formal limited recourse clause, a *de facto* limitation existed. This was evidenced by a letter from the lender stating it would not demand repayment unless LuxCo's funds permitted repayment without affecting its ability to meet its other financial liabilities.

Secondly, while conceding LuxCo's argument that intragroup loans might plausibly be less guaranteed, the Court found the assertion that pledging shares was impossible to be unfounded. It noted that the lender was an indirect shareholder, such that pledging LuxCo's shares would not have been impossible. The Court further questioned why other forms of guarantees would not have been reasonably conceivable.

With respect to the overall assessment process, the Court emphasised that the determination of a financial instrument's qualification cannot be based solely on the presence of a majority of debt-like features, especially where such features result from the absence of explicit contractual provisions.

In the case at hand, while acknowledging that certain indicators typically point to a debt classification (such as the absence of profit participation, liquidation proceeds entitlements, or voting rights), the Court made clear that this is not an arithmetic exercise. Instead, it upheld a substance over form approach, concluding that the overall economic analysis, particularly the fact that the financing conditions could only be explained by the existence of an indirect shareholding relationship with the lender, prevailed over formal characteristics in determining the true nature of the transaction.

The Court therefore concluded that the loans were properly qualified by the Tribunal as HCC based on economic reality.

Analysis of the Ruling

- **Hidden capital contribution concept**

Luxembourg tax law does not provide for a definition of HCC. The concept of HCC derives from and has been shaped by the German case law made by both the German Reich Tax Court and the German Federal Tax Court. In accordance with relevant Luxembourg case law, HCCs bear the following characteristics:

- a shareholder or a related party of the shareholder;
- grants an advantage to a company that may be reflected in the balance sheet;
- the advantage is motivated by the shareholding relationship; and
- the contribution is not a regular contribution (pursuant to Luxembourg commercial law).

As a principle, contributions increase the net equity of a company which is reflected in the receiving company's (tax) balance sheet. The object of a HCC must, therefore, directly relate to balance sheet items, i.e., an increase in assets or a reduction in liabilities. Accordingly, only advantages that may be contributed within the framework of regular contributions may be classified as HCC. This is a reason why services provided to a company for no consideration cannot be qualified as HCC. Examples of free services include interest-free loans and royalty-free licenses (here, the advantage corresponds to the arm's length remuneration). Such advantages do not qualify as assets and may, therefore, not be reflected in the company's balance sheet.

Consequently, only assets – and not their use – may be the object of a contribution although the company's net equity should be "indirectly" increased as a result of reduced business expenses.

In the case at hand, the Court does not refer to a waiver of the IFL by company (E), the lender. As such, LuxCo's liabilities were not reduced, and its net equity remained unchanged.

The question arises whether the absence of an arm's length remuneration could give rise to the classification as a HCC. However, given that the advantage granted through the IFL (i.e., the advantage of the zero interest rate) neither results in an increase of assets nor a decrease of liabilities, the advantage shifted to LuxCo cannot be classified as a HCC.

- **Hidden capital concept**

The freedom of shareholders in the financing of companies is limited by the concept of hidden capital under which shareholder loans may be reclassified into equity based on their economic substance. Consequently, the question arises whether the IFL could be reclassified into equity for tax purposes, based on the concept of hidden capital.

The concept of hidden capital would result in a requalification of debt into equity. This may, for example, affect the NWT position of the company. Moreover, when the concept of hidden capital applies, interest payments on the shareholder loans are reclassified into hidden dividend distributions that are not deductible for tax purposes and, in principle, subject to Luxembourg dividend withholding tax.

The IFL might be reclassified into hidden capital if it was necessary for company (E), that is not a direct shareholder, to finance LuxCo with additional equity rather than by means of a debt instrument. The Court reiterated that this criterion must be assessed based on the requirements existing at the time the funds were made available (i.e., 2015 in the case at hand).

Thin capitalisation rules are not formally embodied in Luxembourg law. According to long-standing administrative practice, a debt-to-equity ratio of 85%/15% has been considered acceptable for the financing of participations. It is also worthwhile mentioning that, according to this practice, share capital, share premium, equity account 115 (special reserve account without issuance of shares), and interest-free debt should be treated as equity for the determination of the debt-to-equity ratio.

However, according to the Court, with regard to the assertion made by LuxCo that it was 'market practice' to allow 85% of the investment to be financed by debt and 15% by equity, it should be emphasised that such a practice is not legally binding.

According to the Court, LuxCo was therefore wrong to claim that the adequacy of its financing structure has been established in accordance with the arm's length principle. Indeed, according to the Court, the relevant question was what debt-to-equity ratio would have been applied if the financing transactions had taken place between third parties and not within entities of the same group.

To the best of our knowledge, it is the first time the Court rules on the debt-to-equity ratio of 85%/15% practice. Absent any legally binding rule on this ratio, it is however not surprising that the Court, that has to apply the law, disregards this practice for the benefit of the arm's length principle formally introduced[2] in article 56 of the Income Tax Law ("**ITL**") as from 2015. The Court does not expressly refer to this article to justify its position. Thus, the question of whether the Court's conclusion would have been the same had the IFL been granted before 2015, when the arm's length principle was not then incorporated in the ITL, seems to remain open.

In the absence of specific thin capitalisation rules in Luxembourg tax laws, chapter X of the OECD Guidelines (Guidance on Financial Transactions), released on 11 February 2020, is now generally relevant. Accordingly, the debt-to-equity ratio of a Luxembourg company is in principle subject to a debt capacity analysis (i.e., in the context of a transfer pricing analysis).

So far, the debt-to-equity ratio of 85%/15% has not been systematically challenged, although the LTA have requested debt-capacity analyses in certain cases. Nonetheless, taking into consideration the new orientation resulting from this case law and in order to mitigate any potential risks, a debt-capacity report confirming the debt-to-equity ratio of a company is now highly recommended in any case. Before this case law, the need for a debt capacity analysis was analysed on a case-by-case basis but was already strongly

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[2] https://wdocs-pub.chd.lu/docs/exped/189/337/138386.pdf

recommended for companies having a ratio with debt financing exceeding 85% and for high-risk investments, for example, that would proportionally require more equity funding due to the higher downside risks.

Regarding the existence of a PE in Malaysia

The Court examined this question based on Article 5 of the Luxembourg-Malaysia double tax treaty (the "**DTT**"), interpreted in light of the OECD Model Convention commentary. The existence of a PE in Malaysia is subject to the fulfilment of the following criteria: (i) the existence of a place of business, i.e., a tangible place of business which may take the form of a branch or office; (ii) the fixed nature of this place of business, implying that it is established in a specific location and possesses a certain degree of permanence; and (iii) the conduct of all or part of the enterprise's business through that place of business. In addition to these general conditions, the analysis must further assess (iv) whether the activity carried out goes beyond being merely preparatory or auxiliary in nature.

In the case at hand, the Court found that LuxCo failed to prove the existence of a fixed place of business due to several elements:

- Lack of clear identification of the precise office address, with contradictory information provided by LuxCo over time. While plausibly within a larger complex, the specific location needed to be identifiable.
- Serious doubts about the reality of services and effective activity, evidenced by: a Service Level Agreement ("**SLA**") concluded retroactively; a history of services within the group that were not actually rendered, despite being recorded; lack of proof of payment of SLA fees; lack of documentation showing actual tasks performed by alleged personnel; the Malaysian bank account only being opened late in 2020, not in 2015; and the significant involvement of a group employee located outside Malaysia in signing documents and acting as contact point, undermining the plausibility of effective management from Malaysia by the alleged local manager.
- Limited value of the letters confirming the existence of a PE from the Malaysian tax authorities, which were dated after the relevant tax year (2015) and did not detail the criteria used or explicitly confirm the PE's existence for 2015.

The Court confirmed the analysis of the Tribunal in that the evidence did not support the existence of a fixed place of business functioning as a PE in Malaysia.

Regarding the existence of an abuse of law

The Court upheld the judgment under appeal, albeit on partially different grounds with respect to the issue of abuse of law. Indeed, it finds that the question of abuse of law was irrelevant in the case at hand.

The Court reasoned that, having confirmed both the requalification of the loans and the absence of a PE in Malaysia, the right to tax remained with Luxembourg. LuxCo failed to meet the burden of proof to demonstrate the facts that would justify a different tax treatment. Therefore, the tax treatment applied by the LTA was justified based on these findings alone, without recourse to the concept of abuse of law.

Our authors

ROMAIN TIFFON
Partner
romain.tiffon@atoz.lu

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

Updated circular on residence certificates for Luxembourg UCIs

OUR INSIGHTS AT A GLANCE

- On 24 December 2024, the Luxembourg tax authorities issued a new circular which provides updated administrative guidance on the issuance of tax residence certificates for Luxembourg undertakings for collective investment, considering the developments in Luxembourg's double tax treaty network.
- The new circular supersedes two earlier versions while broadly maintaining the interpretations and procedural approach previously adopted.
- The new circular clarifies which DTTs currently in force do or do not apply to SICAVs, SICAFs, FCPs and other transparent entities based on a series of conditions listed in the article. As far as FCPs and other tax transparent entities are concerned, certain recent DTTs include specific provisions. The Luxembourg tax authorities will issue a tax residence certificate upon request for these DTTs. In all other situations, Luxembourg FCPs will not be able to obtain a tax residence certificate.
- We provide hereafter an overview of the guidance set out in the circular, while specifically highlighting the updates that have been introduced compared to the previous version.

On 24 December 2024, the Luxembourg tax authorities ("**LTA**") issued a new circular L.G. - A N°61 (the "**Circular**") which provides updated administrative guidance on the issuance of tax residence certificates for Luxembourg undertakings for collective investment ("**UCIs**"), considering the developments in Luxembourg's double tax treaty ("**DTT**") network. The Circular repeals and replaces circular L.G. - A N°61 dated 8 December 2017 (the "**2017 Circular**"), which itself replaced circular L.G. - A N°61 dated 12 February 2015.

The Circular sets out an updated list of jurisdictions with which DTTs are applicable — or not applicable — to corporate UCIs (i.e., an investment company with variable capital (*société d'investissement à capital variable*, or "**SICAV**") or with fixed capital (*société d'investissement à capital fixe*, or "**SICAF**")), reflecting the entry into force of new DTTs as well as amendments to existing DTTs since the release of the 2017 Circular.

The Circular remains unchanged with respect to contractual vehicles without legal personality (*fonds commun de placement*, or "**FCP**") or other tax-transparent entities, such as limited partnerships or special limited partnerships, which is particularly noteworthy given that several recently ratified DTTs incorporate specific provisions governing the tax treatment of FCPs (see *infra*). This article provides an overview of the guidance set out in the Circular, while specifically highlighting the updates that have been introduced compared to the 2017 Circular.

Background and scope of the Circular

Luxembourg UCIs may perform different types of investments in many different countries. The return on these various investments may be subject to withholding tax in the country of source. The DTTs concluded by Luxembourg provide, among others, reduced withholding tax rates. The question arises as to whether, and if so, under which conditions, Luxembourg UCIs may benefit from these reduced rates. Obtaining a tax residence certificate from the jurisdiction of establishment of the fund is very often one of the requirements.

Back in 2015, the LTA released a first circular aiming to confirm under which conditions Luxembourg UCIs may obtain a tax residence certificate and clarifying the position of the LTA and the foreign authorities towards DTT benefits for Luxembourg UCIs. The 2015 circular initially covered UCIs both within the meaning of the law of 17 December 2010 relating to undertakings for collective investment, as amended ("**UCI Law**"), and within the meaning of the law of 13 February 2007 relating to specialised investment funds ("**SIF Law**"). The 2017 Circular extended its scope to include Reserved Alternative Investment Funds ("**RAIFs**"), provided they are taxed in the same way as specialised investment funds ("**SIFs**").

Consistent with the scope defined under the 2017 Circular, the new Circular remains applicable to the following categories of UCIs:

(i) UCIs within the meaning of the UCI Law which encompasses UCIs in transferable securities and UCIs subject to Part II of the UCI Law;
(ii) SIFs within the meaning of the SIF Law; and
(iii) RAIFs within the meaning of the law of 23 July 2016 on reserved alternative investment funds ("**RAIF Law**"), in as far as they comply with risk diversification rules (i.e., RAIF-SIF). The Circular does not apply to RAIFs investing solely in risk capital as per Article 48 of the RAIF Law (i.e., RAIF-SICAR). Nevertheless, they are subject to Luxembourg corporate income tax and thus can obtain tax residence certificates in the same way as any other fully taxable Luxembourg company or SICAR.

Tax residence certificate in a DTT context

The Circular indicates which DTTs currently apply to SICAVs, SICAFs, FCPs and other transparent entities and which DTTs do not apply, according to the LTA.

(i) *Tax residence of SICAVs and SICAFs*

The Circular reiterates that UCIs established in the form of a SICAV or SICAF are deemed Luxembourg tax residents where either their registered office or central administration is located in Luxembourg, pursuant to Article 159 of the Luxembourg Income Tax Law. The Circular confirms that certain UCIs benefit from an exemption from corporate income tax under Luxembourg domestic law. Nevertheless, the LTA considers such entities to be tax resident for treaty purposes. However, this position is not universally accepted by Luxembourg's treaty partners.

The (non-)applicability of a DTT may arise from one of the following scenarios:
- a clear provision in the DTT;
- an agreement between Luxembourg and the other contracting State; or
- an interpretation by the LTA or the tax authorities of the other contracting State.

The Circular clarifies which DTTs currently in force do or do not apply based on the above. For the DTTs which do apply, the LTA will issue a tax residence certificate upon request.

- **Updates brought by the Circular**

Countries granting DTT access to corporate UCIs

The following jurisdictions have been added to the list of countries granting DTT access to corporate UCIs by virtue of a clear wording within the relevant DTT:
- Botswana,
- Cyprus,
- Ethiopia,
- France,
- Hungary,
- Kosovo,
- North Macedonia (replacing Macedonia as indicated in the 2017 Circular),
- Rwanda, and
- United Kingdom.

For these newly indicated countries, the respective DTTs contain a positive provision expressly granting the benefit of the DTTs to UCIs.

Countries not granting DTT access to corporate UCIs

The following jurisdiction has been added to the list of countries not granting DTT access to UCIs in accordance with a specific DTT provision:
- Senegal.

From ATOZ's perspective, the rationale for its inclusion remains unclear, as the relevant DTT does not, based on our reading, appear to contain any provision addressing this matter.

The following jurisdictions have been removed from the list of countries not granting DTT access to UCIs:
- France,
- Hungary, and
- the United Kingdom.

(ii) *Tax residence of FCPs and other transparent entities*

The Circular clarifies that UCIs structured as FCPs generally cannot benefit from the provisions of DTTs since they have no legal personality and are seen as tax transparent from a Luxembourg tax point of view. As such, an FCP is typically not considered a resident of the contracting state where it is established.

However, irrespective of practical constraints, unitholders of an FCP who are tax residents in Luxembourg may personally claim DTT benefits. Despite the tax transparency of FCPs, the Circular indicates that certain DTTs allow FCPs to benefit from treaty provisions, particularly when a treaty treats the FCP or other tax-transparent entities as individuals residing in the contracting state and as the beneficial owners of the income they receive.

In all other situations, Luxembourg FCPs will not be able to obtain a tax residence certificate.

- **No updates brought by the Circular**

The Circular does not amend the 2017 Circular with respect to FCPs and other transparent entities. However, from ATOZ's perspective, this seems inconsistent, as several DTTs concluded or amended since 2017 include provisions specifically addressing FCPs. This is notably the case for:
- Ethiopia[3];
- Hungary[4]; and
- Kosovo[5].

With respect to Germany, similarly to the 2017 Circular, the new Circular provides a confirmation that FCPs are indeed covered by the new Protocol. As a reminder, the Protocol[6] expressly carves out UCIs set up in the form of a partnership. It was ATOZ's view that, although FCPs are tax transparent for Luxembourg tax purposes, an FCP does not constitute a partnership and should therefore fall within the scope of the new UCI definition. The Circular appears to confirm this interpretation.

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[3] The Protocol to the DTT with Ethiopia provides that "A collective investment vehicle which is established in a Contracting State and that is not treated as a body corporate for tax purposes in this Contracting State shall be considered as an individual who is resident of the Contracting State in which it is established and as the beneficial owner of the income it receives."

[4] The Protocol to the DTT with Hungary provides that "It is understood that the term 'collective investment vehicle" means: (…) (b) in the case of Luxembourg, (…) (iv) a collective investment fund (fonds commun de placement) (…)".

[5] The Protocol to the DTT with Kosovo provides that "A collective investment vehicle which is established in a Contracting State and that is not treated as a body corporate for tax purposes in this Contracting State shall be considered as an individual who is resident of the Contracting State in which it is established and as the beneficial owner of the income it receives."

[6] The Protocol to the DTT with Germany provides that "the term "undertaking for collective investment" means (...) however, not an entity established as a partnership; (...)".

The table below summarises the treatment of Luxembourg SICAVs/SICAFs, FCPs and other tax-transparent entities with respect to tax residence under the relevant DTTs covered by the Circular.

DTT Benefits For Luxembourg UCIs

Covered by the 2024 Circular

		SICAVs/SICAFs				FCPs	
		Express Agreement	Provision in DTT	Interpretation	No clear position	Provision in DTT	No Provision in DTT
1	Armenia		DTT applicable				DTT not applicable
2	Andorra		DTT applicable			DTT applicable	
3	Austria		DTT applicable				DTT not applicable
4	Azerbaijan		DTT applicable				DTT not applicable
5	Bahrein		DTT applicable				DTT not applicable
6	Barbados		DTT applicable				DTT not applicable
7	Belgium	DTT not applicable					DTT not applicable
8	Botswana		new (DTT applicable)				DTT not applicable
9	Brazil	DTT not applicable					DTT not applicable
10	Brunei		DTT applicable			DTT applicable	
11	Bulgaria				No clear position		DTT not applicable
12	Canada			DTT not applicable			DTT not applicable
13	China		DTT applicable				DTT not applicable
14	Croatia		DTT applicable			DTT applicable	
15	Cyprus		new (DTT applicable)				DTT not applicable
16	Czech Republic		DTT applicable				DTT not applicable
17	Denmark	DTT applicable					DTT not applicable
18	Estonia		DTT applicable			DTT applicable	
19	Ethiopia		new (DTT applicable)			ATOZ's position (DTT applicable)	
20	Finland			DTT applicable			DTT not applicable
21	France		new (DTT applicable)				DTT not applicable
22	Georgia		DTT applicable				DTT not applicable
23	Germany		new DTT (DTT applicable)			new DTT (DTT applicable)	
24	Greece				No clear position		DTT not applicable
25	Guernsey		DTT applicable			DTT applicable	
26	Hong Kong		DTT applicable				DTT not applicable
27	Hungary		new (DTT applicable)			ATOZ's position (DTT applicable)	
28	Iceland			DTT not applicable			DTT not applicable
29	India			DTT not applicable			DTT not applicable
30	Indonesia	DTT applicable					DTT not applicable
31	Ireland	DTT applicable					DTT not applicable
32	Isle of Man		DTT applicable			DTT applicable	
33	Israel		DTT applicable				DTT not applicable
34	Italy				No clear position		DTT not applicable
35	Japan	DTT not applicable					DTT not applicable
36	Jersey		DTT applicable			DTT applicable	
37	Kazakhstan			DTT applicable			DTT not applicable
38	Kosovo		new (DTT applicable)			ATOZ's position (DTT applicable)	
39	South Korea				No clear position		DTT not applicable
40	Laos		DTT applicable				DTT not applicable
41	Latvia			DTT not applicable			DTT not applicable
42	Liechtenstein		DTT applicable				DTT not applicable
43	Lithuania			DTT not applicable			DTT not applicable
44	Macedonia (North)		DTT applicable				DTT not applicable
45	Malaysia		DTT applicable				DTT not applicable
46	Malta		DTT applicable				DTT not applicable
47	Mauritius		DTT not applicable				DTT not applicable
48	Mexico		DTT not applicable				DTT not applicable
49	Moldavia		DTT applicable				DTT not applicable
50	Monaco		DTT applicable				DTT not applicable
51	Morocco	DTT applicable					DTT not applicable
52	Netherlands	DTT not applicable					DTT not applicable
53	Norway	DTT not applicable					DTT not applicable
54	Panama		DTT applicable				DTT not applicable
55	Poland		DTT applicable				DTT not applicable
56	Portugal		DTT applicable				DTT not applicable
57	Qatar		DTT applicable				DTT not applicable
58	Romania		DTT applicable				DTT not applicable
59	Russia			DTT not applicable			DTT not applicable
60	Rwanda		new (DTT applicable)				DTT not applicable
61	San Marino		DTT applicable				DTT not applicable
62	Saudi Arabia		DTT applicable			DTT applicable	
63	Senegal		new (DTT not applicable)				DTT not applicable
64	Serbia		DTT applicable				DTT not applicable
65	Seychelles		DTT applicable			DTT applicable	
66	Singapore		DTT applicable				DTT not applicable
67	Slovak Republic			DTT applicable			DTT not applicable
68	Slovenia		DTT applicable				DTT not applicable
69	South Africa	DTT not applicable					DTT not applicable
70	Spain	UCITS only (DTT applicable)					DTT not applicable
71	Sri Lanka		DTT applicable				DTT not applicable
72	Sweden		DTT not applicable				DTT not applicable
73	Switzerland			DTT not applicable			DTT not applicable
74	Taiwan		DTT applicable				DTT not applicable
75	Tajikistan		DTT applicable			DTT applicable	
76	Thailand			DTT applicable			DTT not applicable
77	Trinidad & Tobago		DTT applicable				DTT not applicable
78	Tunisia		DTT applicable				DTT not applicable
79	Türkiye		DTT applicable				DTT not applicable
80	Ukraine			DTT not applicable			DTT not applicable
81	United Arab Emirates		DTT applicable				DTT not applicable
82	United Kingdom		new (DTT applicable)				DTT not applicable
83	United States		DTT not applicable				DTT not applicable
84	Uruguay		DTT applicable			DTT applicable	
85	Uzbekistan		DTT applicable				DTT not applicable
86	Vietnam		DTT applicable				DTT not applicable

DTT applicable
DTT not applicable
No clear position

(iii) *Application for residence certificates*

The following formal conditions apply to requests for tax residence certificates in a DTT context:

- The request has to be sent to the LTA *(Administration des Contributions Directes*, Tax Office 6);
- The request has to indicate the tax number of the company;
- Except for RAIFs, a certificate from the CSSF (Luxembourg Supervisory Authority of the Financial Sector) has to be filed together with the request, which confirms that the applicant is a SICAV/SICAF/FCP which is subject to CSSF supervision;
- For RAIFs, the request has to be made by either the company or by its depositary. It has to indicate the tax number, the date of incorporation as well as the legal seat of the company. The tax residence certificate will be sent automatically to the legal seat of the company. The tax office may require additional information or supporting documents considered as essential for the issue of the tax residence certificate (such as an income statement).

Tax residence certificate based on Luxembourg internal law

For SICAVs and SICAFs, a tax residence certificate can be established for Luxembourg internal law purposes each time the legal seat or the central administration of the SICAV/SICAF is located in Luxembourg. Such certificates can be established in any situation (whether there is an applicable DTT, a non-applicable DTT, or no DTT at all).

As far as this type of tax residence certificate is concerned, the formal requirements are much more burdensome:

- The request has to be sent to the LTA (*Administration des Contributions Directes*, Tax Office 6);
- The request has to indicate the tax number of the company;
- Except for RAIFs, a CSSF certificate has to be filed together with the request, confirming that the applicant is a SICAV/SICAF subject to CSSF supervision;
- As far as RAIFs are concerned, the request has to be made by either the company or by its depositary. It has to indicate the tax number, the date of incorporation as well as the legal seat of the company. The tax residence certificate will be sent automatically to the legal seat of the company. The tax office may require additional information or supporting documents considered as essential for the issue of the tax residence certificate (such as an income statement);
- Any request for a tax residence certificate based on internal law has to be "motivated", meaning that it will be necessary to explain why the certificate is needed, including an explicit reference to the applicable DTT or foreign local law provision to be applied;
- It is necessary to provide a detailed statement of the income for which the tax residence certificate is needed. In case the said income has not yet been received, the request has to indicate the investment strategy of the UCI. In addition, the UCI has to commit to provide a detailed income statement at the latest on 30 June of the year following the accounting year during which the income has been received.

Our authors

FANNY BUEB
Partner
fanny.bueb@atoz.lu

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

New circular on interest rates applicable to shareholders' current accounts

OUR INSIGHTS AT A GLANCE

- On 29 January 2025, the Luxembourg tax authorities issued a new circular concerning the interest rates applicable to current accounts of individual and corporate shareholders of Luxembourg entities subject to corporate income tax.
- The circular updates the rules for determining appropriate remuneration on upstream loans to individual shareholders while maintaining the existing framework for loans to corporate shareholders and related parties.
- In line with the previous circular, the underlying rationale of the circular is based on the application of the arm's length principle.
- Hereafter, we describe this new circular and analyse its consequences for Luxembourg taxpayers.

On 29 January 2025, the Luxembourg tax authorities ("**LTA**") issued a new circular n°164/1 ("**the Circular**") replacing the previous circular dated 23 March 1998 ("**the Previous Circular**"), concerning the interest rates applicable to current accounts of individual and corporate shareholders of Luxembourg entities subject to corporate income tax.

In practice, it is common for a shareholder to receive funds from the company in which they hold shares. These funds are classified as loans and recorded by the company as receivables under the shareholder's current account. The Circular provides clarification on the determination of appropriate remuneration for such upstream loans, i.e., funds lent by a company to its shareholders.

The Circular updates the rules for determining appropriate remuneration on upstream loans granted to individual shareholders (i), while maintaining the existing framework for loans to corporate shareholders (ii).

Individual shareholders

Under the Previous Circular, a fixed interest rate of 5% was required for loans granted to individual shareholders, with no option to demonstrate that such rate was inadequate. In practice, this fixed rate, unchanged since 1998, frequently exceeded prevailing market conditions.

To address this issue, the LTA now requires, in the Circular, that interest rates be determined in accordance with the arm's length principle as reflected in Article 164 (3) of the Income Tax Law ("**ITL**"). In particular, it mandates that an arm's length analysis be conducted to ensure that the terms of such loans reflect those which would be agreed between independent parties in an open market scenario. Where a shareholder benefits from conditions that would not be available to them as a non-shareholder, the transaction would not comply with the arm's length standard.

This new approach appears to align with recent case law. In its ruling n°48127C dated 21 September 2023, the Luxembourg Administrative Court ("**the Court**") held that the 5% interest rate was not legally binding and could not be automatically imposed on taxpayers. The Court clarified that the burden of proof lies with the LTA to demonstrate that the interest rate applied reflects an arm's length rate; mere reliance on the Circular is insufficient. Moreover, the Court accepted the use of the interest rate applicable to consumer credit as a valid comparable for determining an arm's length interest rate on current accounts. On 14 November 2023, in its ruling n°47754C, the Court reaffirmed this position, explicitly referencing the earlier case and denying the automatic application of the 5% rate by the LTA.

As a simplification measure, the Circular permits, in lieu of conducting a formal transfer pricing study, the use of the annual consumer credit rates as a reference point for determining the applicable interest rates, provided that such an approach is supported by relevant evidence. Specifically, it enables a reference to the monthly average rate of euro-denominated consumer credits of the relevant financial period, as published by the Luxembourg Central Bank. On 4 April 2025, the Luxembourg Central Bank published that, in February 2025, for new businesses, the interest rate on consumer loans that have an initial fixation period between 1 year and 5 years reached 4%, and 3.85% for loans that have a period over 5 years.

Consistent with the Previous Circular, the new Circular maintains the provisions regarding the methods for calculating interest, including in specific circumstances. It also reaffirms the applicability of the internal note L.I.R./N.S. – N° 164/1 of 9 June 1993, in relation to the criteria for assessing whether a shareholder current account qualifies as a debt instrument or a hidden dividend distribution. According to this internal note, the loan has to be analysed taking into account its economic features. As a reminder, in line with the principle of substance over form, the LTA are allowed to requalify a financial instrument if its economic features do not align with its legal classification.

Corporate shareholders

For corporate shareholders, the Circular does not alter the principles set forth in the Previous Circular. Interest rates on loans between related parties must continue to be assessed on a case-by-case basis, in accordance with the arm's length principle. The new Circular adds reference to articles 56 and 56*bis* ITL, which reflect the internationally recognised OECD Guidelines.

It reiterates that the rate will be influenced by various factors, including the currency involved, foreign exchange and hedging risks, the refinancing interest rate, and the maturity of the receivable.

While the Circular specifically addresses upstream loans, it does not cover downstream loans, i.e., loans granted by a shareholder to the company. However, for corporate shareholders, the arm's length principle remains fully applicable.

Our authors

ANTOINE DUPUIS
Partner
antoine.dupuis@atoz.lu

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

Nordcurrent (C-228/24): CJEU provides clarification on the application of the GAAR under the Parent-Subsidiary Directive to national participation exemptions

OUR INSIGHTS AT A GLANCE

- On 3 April 2025, the CJEU delivered its decision in the preliminary ruling procedure in the case Nordcurrent Group (C-228/24), providing further clarification on the interpretation of the general anti-abuse rule set out in the Parent-Subsidiary Directive.
- The case concerned whether the application of a national participation exemption regime may be denied in instances where an allegedly abusive practice is identified.
- The CJEU ruling in this case adds to the existing case law in this area on withholding tax exemptions, such as the Danish cases.
- Hereafter, we analyse the decision of the CJEU and its implications for Luxembourg taxpayers.

On 3 April 2025, the Court of Justice of the European Union ("**CJEU**") delivered its decision in the preliminary ruling procedure in the case Nordcurrent Group (C-228/24), providing further clarification on the interpretation of the general anti-abuse rule ("**GAAR**") set out in the Parent-Subsidiary Directive[7] ("**PSD**"). The case concerned whether the application of a national participation exemption regime may be denied in cases where an allegedly abusive practice is identified.

The CJEU's ruling in this case adds to the existing case law in this area on withholding tax exemptions, such as cases C-116/16 and C-117/16 dated 26 February 2019 ("**the Danish cases**"). However, the CJEU's ruling is the first judgment from the CJEU addressing abuse and the participation exemption and not a withholding tax exemption.

Significantly, the CJEU has ruled that Member States may deny the benefit of the participation exemption under the anti-abuse provision in the PSD.

In this article, we analyse this ruling and its practical implications for Luxembourg companies.

Facts and background

A Lithuanian video game development and publishing company (Nordcurrent UAB, the "**Parent Company**") established a subsidiary in the United Kingdom in 2009 (Nordcurrent Ltd, the "**UK Subsidiary**"), to handle sales and distribution activities. The UK Subsidiary operated as an intermediary with advertising and game distribution platforms and was subject to regular UK corporate income taxation.

Between 2017 and 2019, the group gradually relocated the operational functions and associated risks of the UK Subsidiary to the Lithuanian Parent Company. Subsequently, a decision was taken to wind up the UK Subsidiary in 2021.

In the course of 2018 and 2019, the Parent Company received dividends from the UK Subsidiary and applied the Lithuanian participation exemption regime to those distributions, in line with the PSD.

However, following an audit for the years 2018 and 2019, the Lithuanian tax authorities denied the exemption, asserting that, during those years, the UK Subsidiary constituted a

[7] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, as amended by Council Directive (EU) 2015/121 of 27 January 2015.

"non-genuine arrangement", lacking sufficient economic substance (namely, adequate human resources, own place of business, and tangible assets), and that the primary purpose of the structure was to obtain a tax advantage.

Nordcurrent UAB challenged the Lithuanian tax authority's decision before the Tax Disputes Commission of Lithuania, which is the referring court in the present case. In its assessment, the referring court found that the UK Subsidiary did not qualify as a conduit entity within the meaning established by the CJEU in the Danish cases. It emphasised that:

- the UK Subsidiary had historically generated income from activities carried out in its own name;
- the Lithuanian tax authorities had not called into question the reasons for the formation of the UK Subsidiary or its activity during periods other than 2018 and 2019;
- according to Nordcurrent UAB, there was no actual tax advantage, on the grounds that the UK Subsidiary was making a profit and that the corporate tax rate to which profits are subject in Lithuania (namely 15%) is lower than that applied in the UK (which is 24%).

These considerations ultimately led the referring court to submit a request for a preliminary ruling to the CJEU.

The qualification of arrangements as abusive is not limited to conduit companies

The CJEU first held that Member States may deny the benefits of national participation exemptions under the GAAR PSD if each of the elements of an abusive arrangement is met, namely:

- an arrangement or a series of arrangements,
- which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the PSD, and
- that are not genuine having regard to all relevant facts and circumstances.
  - An arrangement or a series of arrangements are to be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality[8].

The CJEU noted that abuse may also arise in cases where the distributing subsidiary is not a conduit company, and where the dividends are paid out of profits generated in the course of business activities carried out by the latter in its own name.

All facts and circumstances (including historical) must be taken into account

The CJEU ruled that the assessment under the GAAR PSD must take into account all facts and circumstances, including the history of the arrangement, and not only the situation at the time of the dividend distribution or the formation of the arrangement.

In that context, the CJEU noted that it cannot be ruled out that an arrangement, initially put into place for valid commercial reasons which reflect economic reality may, from a certain point onwards, be regarded as not genuine due to changes in circumstances. It is therefore inappropriate to limit the abuse assessment solely to the formation of the arrangement. Nevertheless, the circumstances existing at the time of that formation or, in any event, prior to the specific step in the arrangement at issue (in the present case, the payment of the dividends) must not be disregarded for the purposes of determining abuse (see paras. 36-38).

The GAAR PSD requires two distinct and cumulative conditions (a non-genuine arrangement and a tax advantage)

The CJEU emphasised that two cumulative elements (objective and subjective) must be fulfilled to deny the participation exemption under the GAAR PSD, namely (i) the existence of a non-genuine arrangement (ii) which was set up for the (principal) objective of obtaining a tax advantage that runs counter to the purpose of the PSD. The mere existence of an artificial arrangement is therefore insufficient in itself.

[8] Article 1(2) and (3) PSD.

According to the CJEU, where a parent company has received dividends from a subsidiary classified as a non-genuine arrangement, that classification alone is not sufficient to find that, by enjoying an exemption from corporation tax in respect of those dividends, the parent company obtained a tax advantage that defeats the object and purpose of the PSD.

It further noted that the existence of a tax advantage must not be assessed in isolation, but rather with reference to the overall tax effect arising from the non-genuine arrangement (see para. 52). The fact that the subsidiary is subject to a higher domestic tax rate may be relevant in determining whether the principal objective of the arrangement was indeed to obtain a tax advantage that defeats the object and purpose of the PSD.

Conclusion

Firstly, the CJEU confirms that Member States may deny the benefit of the participation exemption in accordance with the GAAR in the PSD. As the Luxembourg participation exemption already incorporates an anti-abuse provision similar to the GAAR under the PSD, this confirmation by the CJEU does not introduce any new implications for Luxembourg companies. The benefit of the Luxembourg participation exemption could already be denied in cases of abuses.

However, the CJEU clarifies how “all facts and circumstances” must be assessed when applying the GAAR PSD. This guidance, which is directly relevant for the Luxembourg participation exemption, stipulates that tax authorities cannot consider just the circumstances at the time of the dividend distribution when “having regard to all relevant facts and circumstances”. On the contrary, the CJEU emphasizes the obligation for tax authorities to conduct comprehensive and thorough assessments when evaluating the genuineness of cross-border corporate structures.

This positive clarification for taxpayers prevents tax authorities from disqualifying structures based on a perceived lack of valid commercial reasons or substance at a specific time or phase of an arrangement. Nevertheless, it also underscores the importance of legitimate commercial reasons that reflect economic reality for maintaining tax exemptions under the PSD.

The CJEU also provides taxpayers with more objective criteria to argue and demonstrate that their arrangements have legitimate business purposes and were not established solely to obtain a tax advantage.

The CJEU noted that the pursuit of a tax benefit that undermines the purpose of the PSD must be interpreted broadly, and the tax advantage covered by the PSD must not be construed as the tax exemption referred to in the PSD itself. To assess such tax benefit, the overall tax effect resulting from the formation of the arrangement in the Member State in question must be taken into consideration. To that aim, for example, a higher corporate income tax rate applied in the state of the subsidiary is an objective fact that can be used by the parent company to argue that the subsidiary was not used to pursue a tax benefit.

Our authors

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

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

VAT in the Digital Age (ViDA): Practical impacts for the financial sector

OUR INSIGHTS AT A GLANCE

- On 11 March 2025, the EU Member States reached a consensus leading to the adoption of Council Directive No. 2025/516 as regards VAT rules for the digital age, also called "ViDA Directive".
- The ViDA Directive just entered into force and EU Member States will be required to gradually implement the related measures in accordance with the EU calendar.
- This Directive foresees notably a generalisation of electronic invoicing and digital reporting. This will help suppliers and customers with their transaction invoicing, payment and VAT reporting.
- All companies, including actors of the financial sector, will be impacted by these measures and should get prepared ahead of their entry into force between 2030 and 2035.
- We summarize hereafter the set of measures introduced by the ViDA Directive and their related impacts for the financial sector.

Overview of the new relevant measures and practical impacts

The genesis of VAT in the Digital Age ("**ViDA**") stems from the desire to tackle the VAT losses suffered by EU Member States ("**EU MS**") linked to fraud, while also simplifying VAT reporting for businesses and decreasing the related costs by leveraging on IT technologies.

After years of discussions, the EU MS reached a consensus leading to the adoption of Council Directive No. 2025/516 as regards VAT rules for the digital age on 11 March 2025 (the so-called "**ViDA Directive**"). The ViDA Directive entered into force on 14 April 2025 requiring EU MS to transpose its provisions into their national law.

Aside from various measures for operational companies regarding certain supplies of goods, short-term accommodation and rental passenger transport, the ViDA Directive foresees a new pan-European regime applicable to electronic invoicing ("**e-invoicing**") and digital reporting.

This last set of measures is summarised hereafter with the related impacts for the financial sector (fund management companies, investment funds, holding/financing companies, banks, etc).

E-invoicing

- **What is e-invoicing?**

Under the ViDA Directive, e-invoicing does not refer to mere PDF, Excel, or Word format invoices communicated by electronic means. Instead, e-invoicing refers to invoices prepared and communicated by suppliers to customers in a standardised electronic format (e.g., XML or UBL). Under such a format, the relevant data with the invoice dates, suppliers, amounts, etc., are structured in a specific manner, thereby enabling their automatic treatment by an accounting / tax management software ("**ERP**"). The precise e-invoicing format and the related details will be further discussed in the coming months.

Invoices will be transmitted by suppliers through ERP systems, passing through a common interface (managed and supervised by a public body) before reaching the customer's own ERP.

- **What is the purpose of e-invoicing?**

E-invoicing aims at simplifying the invoicing process. It also seeks to secure transactions by ensuring data integrity, authenticity, and legal compliance.

Last but not least, e-invoicing aims at combatting VAT fraud and thus reducing the VAT gap for EU MS.

- **Which transactions are subject to e-invoicing?**

ViDA generalises the e-invoicing for all supplies of goods and services subject to VAT invoicing obligations (with limited exceptions). The supplies covered are typically services between two VAT taxable persons (e.g., a law firm invoicing an investment fund).

It is worth noting that, to date, the ViDA Directive does not specifically address e-invoicing for VAT exempt services (e.g., fund management, investment advice, negotiation services for share deals, etc). In a new system where accounting and invoicing will be digitalised as a whole, it is nonetheless predictable that the VAT exempt services could be *de facto* subject to the new e-invoicing format in order to be managed together with the VAT taxable supplies in ERP.

Explanatory notes from the European Commission are expected shortly and they will hopefully clarify this point.

- **Who is subject to the e-invoicing obligations?**

On the supplier side, this should mostly be those established in the EU territory. Nevertheless, areas of uncertainty remain for non-EU established companies providing services to EU clients, which may also fall within the scope of the ViDA Directive. Further clarifications are also expected on this topic.

On the customer side, EU VAT registered clients will be impacted and must ensure that their accounting / invoicing tools allow them to receive e-invoices from their suppliers.

- **When will the e-invoicing obligations enter into force?**

The EU MS can henceforth implement e-invoicing systems, and many countries have already started to do so (e.g., Belgium, France or Germany). However, they must ensure that their national e-invoicing process ultimately meets the ViDA Directive requirements.

The e-invoicing obligation will become effective:

- As from 1 July 2030 for cross-border supplies; and
- As from 1 January 2035 for domestic supplies.

E-invoicing constitutes the first set of measures for the VAT digitalisation of transactions. In parallel, the ViDA Directive also provides for digital reporting, where the data of e-invoices will be gathered before being transmitted not only between suppliers and customers but also to the tax authorities of EU MS.

Digital reporting

The ViDA calendar for digital reporting is similar to the one for e-invoicing. Digital reporting requires suppliers to declare transaction data to the tax authorities via ERP in near real time (generally within 10 days following completion of the transaction).

In practice, once the e-invoices are prepared in the ERP, modules of this tool will allow a transmission of the invoice data to the tax authorities' platforms. The latter will therefore have a direct and almost immediate view of the transactions performed.

At the same time, all this data will be shared on a centralised European system gathering various information (e.g., supplier VAT number, invoiced amounts, etc). VAT registered suppliers and clients will have access to this data for their respective transactions.

As a result, European Sales Listings will no longer be relevant and will therefore be abolished. Nevertheless, and as for now, VAT registered clients may still have to communicate in anticipation with their foreign EU suppliers for cross-border services that may be treated differently between two EU MS (e.g., financial services in share deals, fund management services, etc). This point could be critical as reporting mismatches should continue to generate questions from the VAT authorities in case the supplier declares services as being VAT taxable in the country of the client whereas the latter reports such services as VAT exempt.

What about Luxembourg?

Unlike its neighbouring countries, Luxembourg does not currently impose a general e-invoicing obligation nor a digital reporting system, and no official implementation calendar has been announced. For the time being, only B2G activities (i.e., transactions with public bodies) are subject to an e-invoicing obligation in Luxembourg.

Our insights

ViDA is very welcome as it will ease in the mid-term the operational management of invoices and the related VAT reporting.

Nevertheless, to ensure a smooth transition, companies must make sure that their ERP / accounting allows them to issue, receive and report invoices in compliance with the ViDA requirements.

Moreover, it will also be necessary to ensure that the VAT classification of the turnover and expenses is correct in the ERP, in particular as human intervention will decrease in terms of review for each transaction thanks to the automation of certain tasks. In this context, an overall review and some adjustments of the VAT codes may be needed in ERP regarding the VAT treatment of all expenses and incomes. Lastly, groups of companies will also have to concert with their affiliates to allow a smooth and consistent circulation of invoicing data, in particular when companies are established in several EU MS.

In addition, non-EU stakeholders may have to seek solutions internally (e.g., self-billing by EU based entities) or via external providers to handle the new e-invoicing requirements for their transactions with EU clients.

To conclude, even if the transition could be burdensome and technical, the ViDA Directive implementation will ultimately lead to significant cost and time savings in terms of VAT compliance thanks to technology.

Our authors

THIBAUT BOULANGE
Partner, Head of Indirect Tax
thibaut.boulange@atoz.lu

SILVIN LEIBENGUT
Principal
silvin.leibengut@atoz.lu

UAE Ministry of Finance publishes a new Corporate Tax Guide on Interest Deduction Limitation Rules

OUR INSIGHTS AT A GLANCE

- In April 2025, the Ministry of Finance of the United Arab Emirates released a new Corporate Tax Guide on Interest Deduction Limitation Rules.
- It provides general guidance on the deductibility of interest expenditure while calculating the Taxable Income of a Taxable Person in accordance with Federal Decree-Law No. 47 of 2022 on the taxation of corporations and businesses.
- The guidance provided by the Ministry of Finance explains the General Principles of Deductibility, as well as the Specific and General Interest Deduction Limitation Rules governing the deduction of Interest expenditure incurred on loans and preventing the misuse of debt financing to reduce the Taxable Income base.
- Hereafter, we describe key takeaways provided by the Guide.

The Ministry of Finance of the United Arab Emirates ("**UAE**") has recently released a new Corporate Tax Guide on Interest Deduction Limitation Rules (the "**IDLR Guide**"). The IDLR Guide is not a legally binding document, but it provides general guidance on the deductibility of Interest expenditure while calculating the Taxable Income[9] of a Taxable Person in accordance with Federal Decree-Law No. 47 of 2022 on the taxation of corporations and businesses ("**Corporate Tax Law**").

Under the Corporate Tax Law, there are three primary rules for limiting the Interest expenditures deduction:

(i) the General Principles of Deductibility: this includes the arm's length principle and is applied first;

(ii) the Specific Interest Deduction Limitation Rule: this rule is applied second, after the general principles;

(iii) the General Interest Deduction Limitation Rule: this rule is applied lastly.

Hereafter, we describe key takeaways provided by the IDLR Guide on the deductibility of Interest expenditures.

General Principles of Deductibility of Expenditure and Interest

Under the Corporate Tax Law, business expenditures are generally deductible when calculating the Taxable Income of a Taxable Person, provided that such expenditures are incurred wholly and exclusively for the purposes of the Taxable Person's Business and are not capital in nature. The definition of "expenditure" typically aligns with the accounting classification and measurement as per the Financial Statements prepared in accordance with IFRS (or IFRS for SMEs). Consequently, the Accounting Income figure serves as the initial basis for calculating the Taxable Income.

However, for Corporate Tax purposes, adjustments to the Accounting Income figure may be required, as some expenditures recognised for accounting purposes may not be deductible for determining the Taxable Income. This includes:

- Expenditures not incurred for the purposes of the Taxable Person's Business;

[9] All terms in capital letters that are not defined in this article shall be interpreted as defined under the UAE corporate tax laws.

- Interest expenditures in relation to Exempt Income; and
- Interest expenditures due to Connected Persons and/ or Related Parties.
  - Interest expenditures can only be deducted if the payment or benefit corresponds to the Market Value of the service or benefit provided by Connected Persons and if the payment is incurred solely for the Taxable Person's Business purposes. Additionally, transactions or arrangements with Related Parties must adhere to the arm's length standard.

To delineate the scope of the interest deduction limitation rules, the IDLR Guide references the comprehensive definition provided by the Corporate Tax Law, which encompasses:

- any amount accrued or paid for the use of money or credit;
- discounts and premiums;
- profit paid in respect of an Islamic financial instrument;
- other payments economically equivalent to Interest; and
- any other amounts incurred in connection with the raising of finance.

Specific Interest Deduction Limitation Rule

In addition to the General Principles of Deductibility of expenditure and Interest described above, the Corporate Tax Law stipulates a Specific Interest Deduction Limitation Rule aimed at preventing the erosion of the Corporate Tax base.

Under this Specific Interest Deduction Limitation Rule, any form of borrowings, line of credit, bonds or transactions analogous to a loan (defined in the IDLR Guide as 'Interest Expenditure Incurred on a Loan') obtained, directly or indirectly, from a Related Party in connection with any of the following transactions are not deductible:

- dividend or profit distribution to a Related Party;
- redemption, repurchase, reduction or return of share capital to a Related Party;
- capital contribution to a Related Party; and
- acquisition of ownership interest in a Person who is or becomes a Related Party after the acquisition.

However, this interest deduction limitation is subject to a main benefit test ("MBT") so that the limitation is applicable only if the main purpose of obtaining the loan and executing one of the aforementioned transactions is to obtain a Corporate Tax advantage.

- **Presumption of no Corporate Tax advantage for Non-Residents**

Under Corporate Tax Law, it is presumed that no Corporate Tax advantage exists if the related party is subject to Corporate Tax, or a comparable tax under the laws of a foreign jurisdiction, and the effective tax rate is at least 9% after adhering to the arm's length standard.

In instances where this presumption does not apply, the taxpayer retains the ability to demonstrate that the primary purpose of the transaction, as assessed under the MBT, is not to obtain a Corporate Tax advantage.

General Interest Deduction Limitation Rule

The Taxable Person's Net Interest Expenditure is governed by the General Interest Deduction Limitation Rule under the Corporate Tax Law. This rule is designed to prevent the misuse of debt financing to reduce the Taxable Income base.

Exceptions to the applicability of the General Interest Deduction Limitation Rule apply to Banks, Insurance Providers, natural persons undertaking Business or Business Activity in the UAE, and any other Person as may be determined by the Minister (none are currently specified). However, treasury companies, captive insurance companies or other non-regulated financial entities that carry out quasi-banking or insurance activities, as well as investment vehicles whether regulated (for example, by Securities and Commodities Authority ("SCA"), Dubai International Financial Centre ("DIFC") or Abu Dhabi Global Market ("ADGM")) or not, remain subject to the General Interest Deduction Limitation Rule.

When the Net Interest Expenditure exceeds United Arab Emirates Dirham ("AED") 12 million in a Tax Period, the amount of deductible Net Interest Expenditure is the greater of:

- 30% of EBITDA (earnings before the deduction of Interest, tax, depreciation and amortisation) for a Tax Period, calculated as the Taxable Income for the Tax Period with adjustments for (referred to as "**adjusted EBITDA**");
- or the *de minimis* threshold of AED 12 million, to be adjusted in proportion to the length of the Tax Period if it is shorter or longer than 12 months.

For this purpose, the IDLR Guide provides guidance on the computation of the Net Interest Expenditure. In summary, the Net Interest Expenditure is the difference between the amount of Interest expenditure incurred (including any carried forward Net Interest Expenditure) and the Interest income derived during a Tax Period.

The IDLR Guide further specifies that for a Taxable Person using the Cash Basis of Accounting, interest expenditure should be deducted, in accordance with the General and Specific Interest Deduction Limitation Rule, when calculating Taxable Income for the Tax Period in which the interest is received or paid, rather than when it becomes due.

As a grandfathering rule, the Net Interest Expenditure related to any debt instruments or liabilities with terms agreed upon before 9 December 2022 ("**pre-existing debt instruments or liabilities**") is not subject to the General Interest Deduction Limitation Rule. In the case of a loan facility concluded before that deadline, pre-existing debt instruments or liabilities include provisions for principal which had not been drawn down at that date. However, the Net Interest Expenditure attributable to this amount is excluded from the General Interest Deduction Limitation Rule only if the lender was legally obligated to disburse the funds upon the completion of specific deliverables or project phases agreed upon prior to 9 December 2022. If the obligation to disburse the funds is triggered merely at the borrower's request, the grandfathering rule does not apply.

Any non-deductible Net Interest Expenditure in a Tax Period, in application of the General Interest Deduction Limitation Rule, can be carried forward and used in the following ten Tax Periods, in a "first in, first out" principle basis.

- **Non-Resident Persons**

A juridical person classified as a Non-Resident Person is subject to Corporate Tax (i) on Taxable Income attributable to its Permanent Establishment in the UAE, (ii) on Taxable Income that is attributable to its nexus in the UAE, and (iii) on State Sourced Income that is not attributable to its Permanent Establishment in the UAE.

The General Interest Deduction Limitation Rule is applicable when determining the Taxable Income attributable to a Permanent Establishment or a nexus in the UAE but it does not apply when determining State Sourced Income.

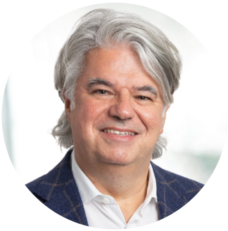
The General Interest Deduction Limitation Rule permits a Taxable Person, including a Non-Resident Person, to carry forward disallowed Net Interest Expenditure for deduction in the subsequent ten Tax Periods. However, if a Non-Resident Person's Permanent Establishment or nexus is disrupted, resulting in the cessation of their Taxable Presence in the UAE, the ability to carry forward is forfeited upon deregistration, even if the Non-Resident Person subsequently re-establishes another Permanent Establishment or nexus.

- **Small Business Relief**

A Resident Person who qualifies as a Taxable Person may opt for Small Business Relief if their Revenue is AED 3 million or less during the relevant Tax Period and all previous Tax Periods ending on or before 31 December 2026. Upon making this election, the Person is deemed to have no Taxable Income, thereby preventing the deduction or carry forward of any Net Interest Expenditure incurred during that Tax Period to subsequent periods.

However, if the Person had Net Interest Expenditure disallowed under the General Interest Deduction Limitation Rule in a prior Tax Period where Small Business Relief was not elected, the disallowed amount may still be carried forward to future Tax Periods where Small Business Relief is not elected. For the computation of ten Tax Periods during which Net Interest Expenditure can be carried forward, periods in which Small Business Relief is elected are excluded, as the previously disallowed expenditure cannot be utilised during these periods.

Our authors



OLIVIER REMACLE
Partner
Mobile +971 58 624 4378
olivier.remacle@atoz-me.ae

BARBARA SCHWARTZ
Principal
Mobile +971 54 291 6992
barbara.schwartz@atoz-me.ae

CONTACT US

ATOZ TAX ADVISERS

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

FANNY BUEB
Partner
Phone +352 26 940 206
Mobile +352 661 830 007
fanny.bueb@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

SAMANTHA HAUW
Partner
Phone +352 26 940 213
Mobile +352 661 830 018
samantha.hauw@atoz.lu

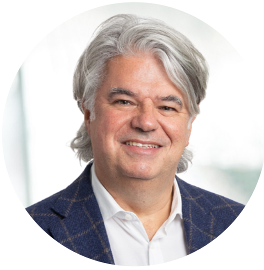
HUGUES HENAFF
Partner
Phone +352 26 940 516
Mobile +352 661 830 516
hugues.henaff@atoz.lu

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

CONTACT US

ATOZ TAX ADVISERS

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

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

MIKE VAN KAUVENBERGH
Director & Head of Consulting - ESG
Phone +352 26 940 518
Mobile +352 621 532 195
mvk@deveco.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

CONTACT US

ATOZ SERVICES

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

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

ATOZ FUND SERVICES

JEREMIE SCHAEFFER
Authorised Manager
Phone +352 26 9467 517
Mobile +352 661 830 517
jeremie.schaeffer@atoz-fundservices.lu

GAELLE BERNARD
Authorised Manager
Phone +352 26 9467 703
Mobile +352 661 830 134
gaelle.bernard@atoz-fundservices.lu

NICOLAS CUISSET
Authorised Manager
Phone +352 26 9467 305
Mobile +352 661 830 305
nicolas.cuisset@atoz-fundservices.lu

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ATOZ

TAX ADVISERS

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

www.atoz.lu

TAXAND