

## Luxembourg: Year-end tax considerations for 2020 and the start of 2021

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### Executive summary

For Luxembourg, tax year 2020 has been impacted by the provisions of the European Union (EU) Anti-Tax Avoidance Directive (ATAD) that were reflected for the first time in the 2019 tax returns. The year was also impacted by the entry into force of the provisions of Council Directive (EU) 2017/952 of 29 May 2017 amending the ATAD on hybrid mismatches with third countries (ATAD 2). With tax year 2020 ending soon, there are other Luxembourg corporate tax developments that may require action before year-end, while others may require attention early in 2021.

This Alert summarizes these developments that may require taxpayer action.

### Detailed discussion

#### Net wealth tax 2021

Net wealth tax is assessed on the latest annual accounts preceding 1 January 2021 (i.e., generally 31 December 2020). Net wealth tax is levied at a rate of 0.5% on an amount of taxable net wealth called the unitary value (corresponding basically to the sum of assets less liabilities and provisions at a given date as valued

according to the provisions of the Luxembourg Valuation Law) up to and including €500 million. If the unitary value exceeds this threshold, net wealth tax equals the sum of the following:

- ▶ €2.5 million (which corresponds to a rate of 0.5% applied to the amount of €500 million)
- ▶ 0.05% of the taxable amount exceeding €500 million

Resident companies must pay minimum net wealth tax equal to either of the following:

- ▶ €4,815 if the sum of financial assets, transferable securities, cash and receivables owed by affiliated companies exceeds 90% of their balance sheet and €350,000
- ▶ An amount ranging from €535 to €32,100, depending on their balance sheet total

It should be noted that certain assets are exempt for the computation of the unitary value, such as qualifying participations (at least 10% of the capital of qualifying domestic or foreign subsidiaries), qualifying intellectual property rights or assets for which the taxation right is allocated under the provisions of a double taxation treaty to another country (e.g., assets held through a foreign permanent establishment or real estate located abroad).

Taxpayers should review their net wealth tax exposure for 2021 and consider if they can possibly reduce net wealth tax 2021 (up to the amount of corporate income tax for 2020) by the creation of a net wealth tax reserve (equivalent to five times the reduction requested) that must be maintained for five years in the accounts.

## Fiscal unity

Groups with more than one company in Luxembourg should assess the benefits of entering into a fiscal unity. In addition, they should evaluate the impact of the interest limitation rules to determine if they should apply at fiscal unity level or rather on a stand-alone basis. Finally, existing vertical fiscal unities may consider the opportunity to request to form a horizontal fiscal unity, as per the Budget Law 2021, which may exceptionally occur without triggering any adverse tax consequences for the individual members of the vertical fiscal unity that is dissolved.

## Conditions for companies to form a fiscal unity

A Luxembourg company and its wholly-owned (at least 95% of the capital, which may be reduced to 75% in exceptional situations) Luxembourg subsidiaries may form, under certain conditions, a “vertical fiscal unity.” The fiscal unity allows the affiliated subsidiaries to combine their respective tax results with the tax result of the parent company of the consolidated group. To qualify for fiscal unity, the parent and its wholly-owned subsidiaries must be resident capital companies that are fully subject to tax. A permanent establishment of a nonresident capital company fully subject to a tax comparable to Luxembourg corporate income tax also qualifies as a parent company of the group.

Companies may also, upon conditions, form a “horizontal fiscal unity.” The horizontal fiscal unity can be formed by two or more Luxembourg-resident companies owned by the same nonresident parent, provided that the parent company is resident in a European Economic Area state and fully subject to a tax comparable to Luxembourg corporate income tax. In addition, a Luxembourg permanent establishment of a nonresident company, regardless of its tax residence, is allowed to be included in a fiscal unity, provided that this company is fully liable to a tax corresponding to Luxembourg corporate income tax.

Companies will have to apply the regime for at least five years or the benefits of the regime will be clawed back.

## New requests to apply fiscal unity as from financial year 2020

The application of the fiscal unity regime is subject to the filing of a common written request, to be introduced by all the companies that wish to become part of such fiscal unity, by 31 December 2020 (for companies with accounting periods corresponding to the calendar year).

## Interest limitation option for new fiscal unities

The interest limitation rules as introduced by the Luxembourg law of 21 December 2018 implementing the EU ATAD apply by default to newly formed fiscal unities, meaning that the rules apply to the fiscal unity as such rather than the individual members of a fiscal unity.<sup>1</sup> If the companies forming the fiscal unity wish to apply the interest limitation rules to each company individually, an “opt-out” must be included in the written request to form a fiscal unity.

It should be noted that the “all or nothing” principle applies, meaning that the application of the interest limitation rules on a stand-alone basis will concern all the companies belonging to the same fiscal unity, and not just some of them. Furthermore, regarding the option for the application of the interest limitation rules at the individual member’s level, this choice will be binding for the entire period of belonging to the fiscal unity.

As a result, companies forming a new fiscal unity that do not want to apply the interest limitation rule at the fiscal unity level would have to include the “opt-out” in the aforementioned request.

#### **Switch from a vertical to a horizontal fiscal unity**

In May 2020, the Court of Justice of the European Union (CJEU) concluded that the requirement to first dissolve an existing vertical fiscal unity before being able to form a horizontal fiscal unity and the resulting consequences, are not in line with EU law. In response to this decision, the Budget Law 2021 (not yet adopted at the date of this Tax Alert) foresees the possibility for a group of companies in a vertical fiscal unity to request to form a horizontal fiscal unity exceptionally without triggering any adverse tax consequences for the individual members of the vertical fiscal unity that is dissolved. This is however subject to the fulfillment of certain conditions.

Based on the general rules applying to fiscal unities, a written request to form a new horizontal fiscal unity must be sent to the relevant taxation office before the end of the accounting period for which the application of the new fiscal unity regime is requested.<sup>2</sup>

As a result, companies whose financial year corresponds to the calendar year and that wish to switch from a vertical fiscal unity to a horizontal fiscal unity for tax year 2020 would have to file their request to form a new horizontal fiscal unity before 31 December 2020.

#### **Application of functional currency**

Companies drawing up their annual accounts in a foreign currency are, under conditions, entitled to declare their taxable income by converting the amounts determined in such foreign currency into Euro at specific foreign exchange rates, rather than having to maintain a Euro-denominated tax balance sheet (functional currency method).

Companies incorporated during 2020 that wish to apply the functional currency method need to file a written request by the end of their first accounting year. As a result, companies incorporated in 2020 and whose financial year corresponds to the calendar would have to file such request by 31 December 2020.

#### **Expiry of 2016 rulings**

According to the provisions regulating the tax ruling practice, advance decisions relating to the application of Luxembourg tax provisions are valid and binding for the tax authorities for a period of five tax years. A taxpayer will thus be able to rely on the principles set forth in an advance decision which applied for the first time to tax year 2016 for the last time in the framework of its 2020 tax return. Given that the 2021 net wealth tax is generally assessed on the unitary value determined based on the annual accounts as at 31 December 2020, possible implications of the expiry of such advance decision should be assessed prior to year-end.

#### **Preparation for reporting under DAC6**

As the six-month deferral to Luxembourg’s Mandatory Disclosure Rules (MDR) Law, as enacted in July 2020, is about to elapse, Luxembourg intermediaries and relevant taxpayers should be prepared to fulfill their reporting requirements. The reporting deadline of 30 days with respect to reportable arrangements that are made available for implementation, that are ready for implementation or for which the first step of implementation has been made between 1 July 2020 and 31 December 2020 begins on 1 January 2021. A 30-day reporting deadline also applies for reportable arrangements that are made available for implementation, that are ready for implementation or for which the first step of implementation is made on or after 1 January 2021.

With respect to reports covering the transitional period, i.e., arrangements for which the first step was implemented between 25 June 2018 and 1 July 2020, the reporting deadline is set at 28 February 2021.

In the case of marketable arrangements, the periodic update report to be made by the intermediary every three months containing new reportable information shall be established for the first time by 30 April 2021 with respect to reportable arrangements that are made available for implementation, that are ready for implementation or for which the first step of implementation has been made between 1 July 2020 and 31 December 2020.

The submission of MDR reports should be done by using the XML schema as released by Luxembourg Tax Authorities via either manual entries of information on the MyGuichet platform and/or direct submissions of XML files. In both cases, authentication will be required to submit reports, which requires a number of administrative steps that may take a few weeks.<sup>3</sup>

### Transactions with non-cooperative jurisdictions for tax purposes

Luxembourg companies that have entered into transactions with related enterprises located in a country listed on the EU list of non-cooperative jurisdictions for tax purposes (the EU List) are required to report these in their 2020 tax return. For the disclosure requirement as mentioned above, Appendix I of the EU List as it stands at the end of the financial year concerned needs to be consulted. For Luxembourg companies whose financial year closes on 31 December 2020, the following jurisdictions are relevant: American Samoa, Anguilla, Barbados, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, the US Virgin Islands and Vanuatu.

Furthermore, a new law (not yet adopted at the date of this Tax Alert) is expected to deny, as from 1 January 2021, the deduction of interest and royalties owed by Luxembourg corporate taxpayers to associated enterprises that are corporations established in a country listed on the latest published EU List.<sup>4</sup>

Taxpayers should therefore assess if they have transactions with any of the above listed jurisdictions that could possibly be impacted by the forthcoming non-deductibility.

### Shareholder relationships with Gibraltar companies

Following the decision of the CJEU in the case of *GVC Services (Bulgaria) EOOD* (Case C-458/18), in which the CJEU confirmed that companies incorporated under Gibraltar law are not covered by the Directive on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (Parent Subsidiary Directive or PSD), the exemption provided for dividends and capital gains received by domestic permanent establishments of a company covered by article 2 of the PSD or derived by Luxembourg resident entities from a participation in a company covered by the same article will no longer apply where the company is incorporated under Gibraltar law as from 1 January 2021.

Correspondingly, the withholding tax exemption provided for dividends paid by a Luxembourg company to a company covered by article 2 of the PSD will no longer be granted where the beneficiary is a Gibraltar company, nor will a participation held in a Gibraltar company be considered a qualifying participation for the net wealth tax exemption given that such company is not covered by the PSD.<sup>5</sup>

### Analyzing exposure to Brexit

On 31 December 2020, the transition period with respect to the United Kingdom's (UK) exit from the EU comes to an end. As of 1 January 2021, the UK will thus no longer be part of the single market and the customs union and the relationship of EU Member States with the UK will change fundamentally.

This could have an impact on a number of tax provisions, such as the provisions with respect to corporate reorganizations (cross-border mergers or demergers, etc.) or the provisions on fiscal unity.

Taxpayers should thus analyze the impact of and prepare for Brexit.

## Endnotes

1. For a more detailed discussion, see EY Global Tax Alert: [Luxembourg reduces tax rates and allows interest limitation rules to apply to fiscal unities](#), dated 6 May 2020.
2. For a more detailed discussion, see EY Global Tax Alert: [Luxembourg Draft Budget Law 2021 - A look at the tax measures affecting companies](#), dated 16 October 2020.
3. For a more detailed discussion, see EY Global Tax Alert: [Luxembourg Tax Authorities publish XML schema and User Guide on submitting MDR reports](#), dated 23 October 2020.
4. For a more detailed discussion, see EY Global Tax Alert: [Luxembourg limits deduction of certain payments made to countries on the EU list of non-cooperative jurisdictions](#), dated 1 April 2020.
5. For a more detailed discussion, see EY Global Tax Alert: [Luxembourg Tax Authorities clarify application of EU Parent-Subsidiary Directive with respect to Gibraltar companies](#), dated 3 December 2020.

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For additional information with respect to this Alert, please contact the following:

### Ernst & Young Tax Advisory Services Sàrl, Luxembourg City

- |                                                                        |                                 |
|------------------------------------------------------------------------|---------------------------------|
| ▶ Bart Van Droogenbroek, <i>Tax Leader</i>                             | bart.van.droogenbroek@lu.ey.com |
| ▶ Marc Schmitz, <i>Tax Policy &amp; Controversy Leader</i>             | marc.schmitz@lu.ey.com          |
| ▶ Olivier Bertrand, <i>Private Equity Tax Leader</i>                   | olivier.bertrand@lu.ey.com      |
| ▶ Dietmar Klos, <i>Real Estate Sector Leader</i>                       | dietmar.klos@lu.ey.com          |
| ▶ Fernando Longares, <i>TMT &amp; Life Science Tax Leader</i>          | fernando.longares@lu.ey.com     |
| ▶ Christian Schlessler, <i>Commercial and Public Sector Tax Leader</i> | christian.schlessler@lu.ey.com  |
| ▶ Jacques Linon, <i>Banking &amp; Insurance Tax Leader</i>             | jacques.linon@lu.ey.com         |
| ▶ Vincent Rémy, <i>Wealth &amp; Asset Management Tax Leader</i>        | vincent.remy@lu.ey.com          |
| ▶ Nicolas Gillet, <i>Transfer Pricing Leader</i>                       | nicolas.gillet@lu.ey.com        |
| ▶ Elmar Schwickerath, <i>Global Compliance and Reporting Leader</i>    | elmar.schwickerath@lu.ey.com    |

### Ernst & Young LLP, Luxembourg Tax Desk, New York

- |                |                     |
|----------------|---------------------|
| ▶ Xavier Picha | xavier.picha@ey.com |
|----------------|---------------------|

### Ernst & Young LLP, Luxembourg Tax Desk, Chicago

- |                         |                           |
|-------------------------|---------------------------|
| ▶ Alexandre J. Pouchard | alexandre.pouchard@ey.com |
|-------------------------|---------------------------|

### Ernst & Young LLP, Luxembourg Tax Desk, San Jose

- |                         |                             |
|-------------------------|-----------------------------|
| ▶ Andres Ramirez-Gaston | andres.ramirezgaston@ey.com |
|-------------------------|-----------------------------|

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