

LUXEMBOURG PUBLISHES DRAFT RULES TO LIMIT DEDUCTIBILITY OF PAYMENTS TO BLACKLISTED COUNTRIES

On 5 December 2017, the Council of the European Union ("EU") approved and published conclusions on the EU list of non-cooperative countries and territories in tax matters (the "List"). The List is published in the Official Journal of the EU as Annex I to the said Council conclusions.

BACKGROUND

The EU list currently includes the Cayman Islands, American Samoa, Fiji, Guam, Oman, Palau, Panama, Samoa, Trinidad, Tobago, the US Virgin Islands, Vanuatu and the Seychelles.

It was agreed that the Member States shall implement defensive measures having a deterrent effect on the listed countries and territories.

KEY ELEMENTS

The non-deductibility of interest and royalties rule

On 30 March 2020, the Luxembourg Government submitted a bill to introduce a specific rule that would derogate to the operating expenses deductibility principle with regard to interest¹ and royalties² paid or due by a Luxembourg taxpayer to an entity located in a country or territory mentioned on the List.

Thus, interest or royalties paid or owed would not be deductible when the following conditions are simultaneously met:

1. the entity to which the interest or royalties are paid or due is established in a country or territory included on the List;
2. the entity to which the interest or royalties are paid or due is an affiliated undertaking within the meaning of Article 56 L.I.T.L.³; and
3. the entity to which the interest or royalties are paid or due is a corporation within the meaning of Article 159 L.I.T.L. (i.e. partnerships are excluded from the scope).

¹ The term "interest" refers to interest and arrears paid or owed which are linked to a debt obligation of any kind, whether or not secured by mortgage or with a right to participate in the debtor's profits. The term also includes interest and arrears on bonds or debentures, including premiums attached to such securities. Penalties for late payment are out of scope.

² The term "affiliated undertakings" refers to two undertakings which are related if one of them participates, directly or indirectly, in the management, control or capital of the other, or if the same persons participate, directly or indirectly, in the management, control or capital of both undertakings.

³ The term "affiliated undertakings" refers to two undertakings which are related if one of them participates directly or indirectly in the management, control or capital of the other, or if the same persons participate directly or indirectly in the management, control or capital of both undertakings.

Please note that the beneficial owner (i.e. the entity which actually benefits from the interest or royalties) must be taken into consideration if the entity to which the interest or royalties are paid or due is not the beneficial owner.

Nonetheless, the non-deductibility rule would not apply if the taxpayer provides evidence that these expenses are linked to a transaction which reflects economic reality. Mere evidence that the transaction is used for valid business motives is not sufficient. These business motives – considering all the relevant facts and circumstances – must not only be real, but must also present a sufficient economic advantage beyond any tax benefit obtained through the transaction. Thus, in the event that such evidence is provided by the taxpayer, the deduction would be allowed.

Entry into force

The Government shall add to these provisions a list ("**the Luxembourg List**"), with effect from 1 January 2021, the content of which will be determined in accordance with the EU List in its latest version. Thus, the countries and territories appearing on the latest published version of the EU List would be included on the Luxembourg List.

Subsequent updating of the Luxembourg List may be carried out, at most, once a year. Thus, the first update of the Luxembourg List shall be proposed by the Government during the second half of 2021, in the event that the EU List has been updated. Countries and territories which are newly included, or no longer included in the last updated EU List, would be added to, or removed from, the Luxembourg List.

The measure would be applied to interest and royalties paid or due from 1 January 2021.

Subsequent additions of countries and territories following an update shall be taken into account for interest or royalties paid or due from 1 January of the following year. On the other hand, with respect to withdrawal of countries and territories, interest or royalties paid or due would be out of scope of the non-deductibility rule from the date of publication of the updated EU List in the Official Journal of the EU.

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