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TAX ADVISERS LUXEMBOURG

ATOZ ALERT

Measure denying the tax deduction of interest and royalties due to entities in blacklisted jurisdictions passed by the Parliament

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Yesterday, the draft law which introduces a measure denying under certain conditions the corporate income tax deduction of interest and royalty expenses due to entities located in non-cooperative tax jurisdictions was passed by the Luxembourg Parliament. Since the legislative procedure took longer than initially expected and the draft law could not be passed prior to the end of 2020, the legislator decided to postpone the entry into force of the new measure from 1 January 2021 to 1 March 2021. The postponement of the entry into force of the measure means that its scope of application may evolve in the coming weeks following the update of the EU list of non-cooperative jurisdictions which is expected to take place next month.

Background

The list of non-cooperative tax jurisdictions is determined at EU level. It is a result of a thorough screening and dialogue process with non-EU countries to assess them against agreed criteria for good governance relating to tax transparency, fair taxation, the implementation of OECD BEPS measures and substance requirements for zero-tax countries. The list is updated twice a year, taking into consideration the evolving deadlines for jurisdictions to deliver on their commitments and the evolution of the listing criteria that the EU uses to establish the list. Given those regular updates, the scope of application of the new Luxembourg measure will constantly evolve over time.

As of 6 October 2020 (date of the latest update of the list), the list included the twelve following jurisdictions: American Samoa, Anguilla, Barbados, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, US Virgin Islands and Vanuatu.

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Presentation of the new measure

As from 1 March 2021, interest and royalties due to entities located in non-cooperative tax jurisdictions will no longer be tax deductible, if the following cumulative conditions are met:

- The beneficiary of the interest or royalty is a collective undertaking within the meaning of article 159 Income Tax Law, “ITL” (thus, excluding tax transparent entities); if the beneficiary is not the beneficial owner, then the beneficial owner has to be taken into account;
- The beneficiary of the interest or royalty is an associated enterprise within the meaning of article 56 ITL; and
- The collective undertaking which is the beneficiary of the interest or royalty is established in a country or territory which is on the EU list of non-cooperative tax countries and territories.

Interest and royalties remain tax deductible to the extent that the taxpayer can demonstrate that the operation to which the interest or royalties relate has been put in place for valid economic reasons which reflect economic reality.

Interest is defined as follows: "interest due relating to debt claims of every kind, whether or not secured by a mortgage and whether or not carrying a right to participate in the debtor's profits, and, in particular, interest from bonds or debentures, including premiums and prizes attaching to such securities. Penalties for late payments shall not be regarded as interest payments."

Royalty is defined as follows: "remuneration of any kind due as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."

These two definitions are largely inspired by the definitions included in the EU Interest and Royalty Directive and in the OECD Model Tax Convention.

Timing for application

The new measure will apply to interest and royalties due as from 1 March 2021 to entities located in jurisdictions considered as non-cooperative tax jurisdictions based on the latest EU list available as of 1 March 2021. Since an update of the list is expected to take place in the course of February 2021, the countries to be taken into account as from 1 March 2021 may no longer be the same as the twelve countries mentioned above and listed as of 6 October 2020.

As from 1 January of the following years, the same principle will apply, i.e. the measure will apply to interest and royalties due to countries listed as of the latest list available at that time and published in the Official Journal of the European Union.

What is the effect of a country being added or removed from the list?

- Countries added will be taken into account for interest and royalties due as from 1 January of the following year (i.e. there will be no retroactive nor immediate effect but only an impact as from the following calendar year);
- Countries removed will no longer be taken into account for interest and royalties due as from the date of the publication of the relevant EU list in the Official Journal (i.e. the removal will have an immediate effect).

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Implications

Luxembourg taxpayers with investments into and from non-cooperative jurisdictions should seek advice from their tax advisers in order to analyse the potential impact of the new provisions on their investments and take action, if necessary.

The evolution of the legislation of jurisdictions under the radar of the EU Council should also be closely monitored in order to anticipate an addition to or a removal from the EU list of non-cooperative tax jurisdictions in the future and thus a change in the scope of application of the new Luxembourg measure.

It is worth stressing that given the short timeframe between the expected publication of the non-cooperative tax jurisdiction list and the entry into force of this law, taxpayers will need to react quickly.

Do you have further questions?

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