



# Taxation of cross-border mergers and acquisitions

**Luxembourg**

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# Luxembourg

## Introduction

To strengthen Luxembourg's financial sector and attract more cross-border transactions, the Luxembourg legislator has passed several laws designed to simplify and facilitate the legal framework for cross-border mergers and acquisitions (M&A) involving Luxembourg entities and to create more flexible restructuring schemes.

Luxembourg companies may be involved in domestic and cross-border mergers and demergers in various ways. Luxembourg has implemented the European Union (EU) Merger Directive to create several possibilities for tax-neutral company reorganizations.

This report provides a general overview of tax and other issues relating to cross-border M&A in Luxembourg and clarifies the frameworks within which the different operations may take place. The following aspects are analyzed in particular:

- opportunities available to the acquirer when purchasing shares or assets
- choice of acquisition vehicles available to the acquirer
- questions relating to funding of the acquisition.

## Corporate law framework

Luxembourg corporate law has always been a strong support to the Luxembourg global pro-business approach. To the extent possible, corporate law rules are designed with a view to fulfilling entrepreneurs' goals and expectations. As a global financial center, Luxembourg is eager to facilitate cross-border transactions. In this respect, cross-border mergers have become strategic concerns for groups of companies over the years, either in terms of internal restructuring or in the context of acquisitions of new businesses. As a result, Luxembourg saw the need for a set of rules that would fulfill these objectives.

The law of 10 August 1915 on commercial companies was first amended by the law dated 23 March 2007, which provides the current framework and facilitates mergers and divisions of Luxembourg companies.

Since 2007, cross-border mergers involving Luxembourg companies without forming a European company (*societas Europaea*) were permitted under Luxembourg law.

At the time, Luxembourg law was ahead of most of other European jurisdictions, which did not foresee the benefits of a cross-border merger mechanism. In a nutshell, Luxembourg commercial companies were entitled to take part in cross-border mergers, either as absorbing or absorbed entities, to the extent that the legislation of the other jurisdiction did not prohibit such merger. However, the 2007 law did not provide a comprehensive legal framework.

This deficiency was resolved pursuant to the law of 10 June 2009, which transposed several EU directives relating to cross-border merger into Luxembourg law. True to its standard proactive and business-friendly approach, the Luxembourg legislator took the opportunity to exceed the minimum requirements set forth in the EU directives.

Any Luxembourg company can be merged into a foreign company where:

- The foreign company or economic interest group is formed in accordance with the law of a foreign state.
- The law governing the foreign entity allows cross-border mergers as a matter of principle.
- The foreign entity complies with the national provisions and formalities of the foreign state.

## Cross-border merger legal framework

As mentioned, the Luxembourg corporate law sets out a simplified framework for both domestic and cross-border mergers, easing restructuring and cooperation across borders on a European and international level. The Luxembourg cross-border legal framework is an example of the continuing modernization of Luxembourg company law. The framework is designed to make Luxembourg more competitive and enable domestic companies to benefit further from the single market and from the flexibility of the Luxembourg corporate law system.

### Scope

The scope of Luxembourg law is wider than that of Directive 2005/56/EC, in that it allows for cross-border mergers between all types of Luxembourg companies vested with

legal personality and EU companies, as well as non-EU companies, insofar as the law of the non-EU country does not prohibit such mergers. Where one merging company operates under an employee participation system and the company resulting from the merger must also operate under such a system and is a Luxembourg company, it can only take the form of a *société anonyme*.

Luxembourg has rejected the option that the national authorities could oppose a cross-border merger on public interest grounds, as suggested in article 4 (1) (b) of Directive 2005/56/EC.

Luxembourg includes undertakings for collective investment in transferable securities (UCITS) within the scope of the law, thus allowing for mergers among Luxembourg UCITS, unlike Directive 2005/56/EC, which explicitly excludes UCITS from its scope. Luxembourg also chose to apply the law to cooperative companies.

### **Procedural steps for cross-border merger**

The legal regime for cross-border mergers is the same as the regime applying to national mergers. This is an improvement, given that the EU directives set more stringent conditions for cross-border mergers.

Directive 2005/56/EC sets out 12 items to be included in the written 'common draft terms' of cross-border mergers that involve Luxembourg limited liability companies. The management of the merging companies must establish these draft terms. They include the same basic principles required in the common draft terms for mergers of Luxembourg companies and additional information for cross-border mergers and mergers resulting in the creation of a European company (EC).

The common draft terms of mergers must be published in the relevant national gazette at least 1 month before the general meeting of shareholders of the merging companies, which is convened to approve of the merger. The management of the merging companies must draw up a report explaining the economic and legal aspects of the merger and its impact on shareholders, employees and creditors.

For cross-border mergers, this report must be made available at least 1 month before the general meeting of shareholders of the merging companies. In the absence of unanimous approval of the merger by the shareholders of both companies, an independent expert appointed by the management of the merging companies must prepare a report on the proposed merger.

The expert and management's reports inform the decision of the general meetings of the merging companies on the proposed merger, which must be approved with the same quorums and majorities required for amending the companies' articles. The independent expert's report and

relevant documents are only necessary where they are required by the national law of the absorbed or absorbing company and where the absorbing company holds 90 percent or more but not all the shares and securities that confer rights to vote in the general meetings of the absorbed company.

### **Validity and effect of the merger**

In Luxembourg, the notary is the national authority in charge of verifying the legality of the merger and, in particular, in charge of ensuring that the merger proposal has been agreed on the same terms by each merging company.

The notary may be required to issue a certificate attesting to the legality of the merger.

The merger is effective in relation to third parties as of the publication of the deed of the general meeting approving it or, if no such meeting is required, on publication of the notary's certificate.

Once merged, the absorbed company ceases to exist and all its rights and obligations are transferred to the absorbing company. If the cross-border merger has taken place in accordance with the law, it cannot be declared null and void.

## **Asset purchase or share purchase**

### **Purchase of assets**

The purchase of an asset usually increases the cost base of the asset and is taxable in the hands of the seller. However, Luxembourg tax law differs in its treatment of transfers of 'private' and 'business' assets. For business assets (held by a company), a capital gain on disposal must be included in the business profit of the seller.

Capital gains realized on assets other than real estate or a substantial participation held as private property (i.e. not held by a company) are exempt unless they qualify as speculative gains under article 99bis of the Income Tax Law, that is, unless the gain is realized within the 6 months of the acquisition of the asset or the disposal precedes the asset's acquisition.

Liabilities associated with the transferred asset remain with the seller and are not transferred with the asset.

### **Purchase price**

When a Luxembourg entity directly acquires a business, the acquisition price of the assets normally represents the basis for their depreciation for Luxembourg tax purposes.

The (depreciated) acquisition cost determines gains or losses arising on a subsequent disposal. However, where a business is acquired from a related party at a price deemed not to be arm's length, a tax adjustment may be made.

## Goodwill

Under Luxembourg tax law, each asset transferred should be allocated its own distinct value, which forms the base cost for depreciation purposes. Where the total value exceeds the sum of the values attributed to each asset, the excess is deemed to constitute goodwill. In principle, goodwill is depreciable under Luxembourg tax law, and the normal practice is to write off goodwill over 10 years. However, Luxembourg companies may write off goodwill over a longer period, provided it does not exceed the useful economic life of the asset.

Financial fixed assets, such as participations, are not generally depreciable, even where there is a goodwill element in the purchase price. A deductible write-down in value is permitted following a prolonged reduction in the value of the participation.

## Depreciation

Fixed assets are, in principle, subject to an annual depreciation that should be deductible from the taxable income of the Luxembourg company. Generally, the straight-line method is used to compute the amount of depreciation. The declining-balance method may be used in certain cases but not for buildings and intangible assets.

With the approval of the tax administration, depreciation on the basis of asset use may be applied to assets whose annual use fluctuates widely. Extraordinary depreciation may also be permitted if there is excessive wear and tear or other sharp reductions in value of the assets. Buildings used for business purposes may be depreciated over their useful lives, but land may not be depreciated.

Apart from a few assets covered by administrative circulars, there are no specified rates of depreciation. The depreciation period should reflect the useful life of the asset. Rates commonly used in practice are as follows:

Buildings	1.5–5%
Machinery and equipment	10–20%
Vehicles	25%

Source: KPMG in Luxembourg, 2016

Reference is generally made to German rules for depreciation periods.

## Tax attributes

Losses that arise on the disposal of assets may offset other taxable income of the Luxembourg company. Losses that exceed taxable income may be carried forward indefinitely against future profits of the Luxembourg entity. However, any tax losses available for indefinite carry forward of the Luxembourg company selling the assets may not be transferred to the buyer of the assets.

## Value added tax

The normal valued added tax (VAT) rate is 17 percent. When assets are transferred individually, the transferred items within the scope of VAT are subject to the normal VAT rules for goods and services.

However, a merger or division generally is not subject to VAT because the transfer of all assets forming all or part of a business is not deemed to constitute a supply of goods for VAT purposes. There is deemed to be continuity between the transferee and the transferor.

## Stamp duty and stamp duty land tax

No stamp duty is generally payable on the transfer of assets. The transfer of immovable property is subject to registration duty of 6 percent of the value of the real estate, plus an additional transfer duty of 1 percent. For certain real estate in Luxembourg City, there is a supplementary municipal duty of 3 percent. A registration duty of 0.24 percent may apply on debt that is mentioned in notarized deeds or presented to certain Luxembourg public authorities.

No proportional registration duties apply to the transfer of other assets (e.g. shares in Luxembourg companies) where the transfer is subject to VAT.

## Purchase of shares

Generally, the purchase of a target company's shares should not affect the book values of its assets. The assets of the target company cannot be revalued to reflect fair market values.

The acquirer should record the participation acquired in its balance sheet at the acquisition price, plus costs directly connected with the acquisition.

## Tax indemnities and warranties

Since the purchaser is taking over all the liabilities, including contingent liabilities, the purchaser requires more extensive indemnities and warranties than in the case of an acquisition of assets. Due diligence of the target company's tax position is advisable, particularly when the amounts involved are significant.

In principle, indemnity payments received by a Luxembourg company pursuant to a warranty clause are subject to tax in the hands of the company. In principle, a Luxembourg company making such an indemnity payment may deduct it for tax purposes.

## Tax losses

Generally, tax losses may only be deducted by the company that originally incurred them. Hence, where a Luxembourg company is absorbed by an existing or a newly incorporated company, its tax loss carry forward may not

be transferred. However, it may be possible to disclose latent capital gains of the absorbed company to be offset by unused tax losses. Accordingly, the absorbing company may acquire assets on a stepped-up basis and benefit from higher depreciations.

As long as a Luxembourg company continues to exist following these types of restructuring, its tax losses may be carried forward in certain conditions. Conversely, where two or more Luxembourg companies are merged to create a new company, the tax loss carry forward of each disappearing entity is lost.

### Crystallization of tax charges

While there are no specific rules under Luxembourg tax law, a purchaser should perform a due diligence to assess the tax position and related risks of the target company.

### Pre-sale dividend

The treatment of pre-sale dividends (distributions by the subsidiary of retained earnings before disposal) may benefit from the participation exemption. When the subsidiary company distributes dividends to its parent company, any write-down in value of the participation held by the parent company in the subsidiary is not deductible to the extent of the amount of dividends distributed.

### Stamp duty

No stamp duty is payable on the transfer of shares in capital companies. Registration duty may be levied on the transfer of all or most of the shares in certain vehicles that hold only real estate. In some cases, the tax authorities may apply a look-through and consider that the real estate, rather than the company, has been transferred and levy duty accordingly. Special rules apply in the case of a transfer of partnership interests with underlying real estate.

### Tax clearances

Generally, the taxpayer can ensure the Luxembourg tax treatment of a restructuring by applying for a written advance tax clearance from the tax authorities.

## Choice of acquisition vehicle

Several potential acquisition vehicles are available to a foreign purchaser, and tax factors often influence the choice. Following the abolition of Luxembourg duty on capital contributions as of 1 January 2009, the incorporation of Luxembourg companies and subsequent increases in capital are no longer subject to capital duty.

### Local holding company

Instead of acquiring the assets and liabilities comprising a business, which is often not tax-efficient, purchasers may choose to set up a holding company to acquire the shares of the target company.

Two legal forms of limited liability company are widely used in Luxembourg:

- Public limited company (*société anonyme*): a joint stock company with freely transferable shares. As of 25 August 2007, the one-person public limited company (*société anonyme unipersonnelle*) was introduced to Luxembourg company law. The conditions are the same except that, at the organization level, the board of directors may be represented by one director and the general shareholders meeting may be attended by the sole shareholder.
- Limited liability company (*société à responsabilité limitée*): a private limited company with restrictions on the transfer of shares. The one-person limited liability company (*société à responsabilité limitée unipersonnelle*), introduced in 1992, also may have only one shareholder.

These companies are fully taxable corporations with equity investments, and they may benefit from the Luxembourg participation exemption regime unless they are subject to a specific tax regime.

Following the abolition of the 1929 holding regime, Luxembourg tax legislation provides for the private family asset holding company (*Société de gestion de patrimoine familiale* — SPF), an investment vehicle for individuals introduced by the law of 11 May 2007. This type of company is specially designed to meet the business needs of family-owned holding companies managing financial assets. The exclusive objectives of an SPF are the acquisition, holding, management and disposal of financial assets, to the exclusion of any commercial activity.

In addition, Luxembourg domestic law provides for other types of entities, including:

- partnership limited by shares
- *societas Europaea*
- partnership
- limited partnership
- special limited partnership
- joint venture
- cooperative society
- civil company
- economic interest grouping.

### Foreign parent company

The foreign purchaser may choose to make the acquisition itself, perhaps to shelter its own taxable profits with the financing costs. Generally, this should not trigger any adverse Luxembourg tax consequences. In principle, interest payments are not subject to Luxembourg withholding tax (WHT). Dividend

payments generally are subject to 15 percent Luxembourg dividend WHT, but an exemption is provided under domestic tax law if certain conditions are met. As of 1 January 2009, the scope of this WHT exemption is extended (subject to certain conditions) to parent companies resident in countries with which Luxembourg has concluded a tax treaty.

### **Non-resident intermediate holding company**

Where the foreign country taxes capital gains and dividends received from the Luxembourg target company, an intermediate holding company resident in another jurisdiction could be used for tax-deferral purposes, among other things. Luxembourg tax treaties often do not include extensive anti-treaty shopping rules. However, the implementation of measures against tax treaty abuse in Luxembourg's tax treaties should be closely monitored following the October 2015 release of the Organisation for Economic Co-operation and Development's (OECD) recommendations on the prevention of tax treaty abuses under Action 6 of the Action Plan on Base Erosion and Profit Shifting (BEPS) and the January 2016 release of the European Commission's Anti-Tax Avoidance Package.

### **Local branch**

As an alternative to the direct acquisition of the target's trade and assets, a foreign purchaser may structure the acquisition through a Luxembourg permanent establishment (PE). The income attributable to the PE is subject to Luxembourg taxation, but dividends and capital gains realized on disposal of a shareholding in a Luxembourg company may, under certain conditions, benefit from the Luxembourg participation exemption regime. The repatriation of profits to the foreign head office does not trigger additional taxes on branch profits.

### **Joint venture**

Whenever a joint venture takes a form in which the company is legally and fiscally recognized as an entity distinct from the participants, it is taxed according to the regime applicable to corporations (see earlier in this report).

In other cases, the income is taxable in the hands of the individual venturers under the rules applicable to partnerships (see earlier in this report), which is the case for European economic interest groupings (*Groupement européen d'Intérêt économique* — GEIE).

The profits are allocated on the basis of the joint venture agreement.

## **Choice of acquisition funding**

To fund an acquisition, the acquiring company may issue debt, equity or a combination of both. Below we discuss the tax aspects that should be considered when deciding the funding structure.

### **Debt**

Interest expenses incurred to fund the acquisition of assets generally are deductible as long as the arm's length principle is satisfied.

On an acquisition of shares, the interest deduction may be restricted or subject to clawback (i.e. a recapture provision that taxes part of the capital gain on a disposal of the shareholding) where the acquiring company benefits from the participation exemption. Expenses relating to a participation qualifying for the participation exemption are deductible only to the extent that they exceed exempt income (dividends) arising from the participation in a given year. Depending on the circumstances, there are several ways to achieve a deduction of interest even where the debt is used to finance participation.

No WHT is levied in Luxembourg on interest payments unless the loan is a direct profit-participating loan, bond and similar security. Further, where the recipient of the interest payments is an EU-resident or Luxembourg-resident individual, a 10 percent WHT may be due (Relibi).

### **Deductibility of interest**

Luxembourg tax law does not stipulate a specific debt-to-equity ratio. According to the Luxembourg administrative practice, a debt-to-equity ratio of 85:15 is required to finance shareholdings. Provided the shareholders give no guarantees, third-party debt is disregarded in this computation.

Where the required ratio is not met, the portion of interest paid in excess of the ratio could be regarded, for Luxembourg tax purposes, as a hidden profit distribution. In principle, a hidden profit distribution is not tax-deductible and is subject to 15 percent WHT, subject to relief under the domestic WHT exemption rules or a tax treaty.

### **Withholding tax on debt and methods to reduce or eliminate it**

Luxembourg domestic tax law does not levy WHT on arm's length interest payments, except for interest on profit-participating bonds and similar securities. In principle, interest payments on such financing instruments is subject to Luxembourg WHT of 15 percent where:

- The loan is structured in the form of a bond or similar security.
- In addition to the fixed interest, supplementary interest varying according to the amount of distributed profits is paid, unless the supplement is stipulated to vary inversely with the fixed interest.

It is possible to use profit-participating financing instruments that do not fall within the above scope, such that the interest payments are not subject to Luxembourg WHT.

## Checklist for debt funding

- In principle, interest payments are not subject to Luxembourg WHT.
- The maximum 85:15 debt-to-equity ratio must be respected when financing participations.

## Equity

As of 1 January 2016, the cumulative corporate tax (municipal business tax (MBT) plus corporate income tax (CIT)) for companies established in Luxembourg City amounts to 29.22 percent. As of 1 January 2016, the current minimum CIT (due by Luxembourg resident corporate taxpayers) has been abolished and replaced it by a minimum net wealth tax (NWT). Overall, the rules determining this minimum NWT are the same as those that were in force for determining minimum CIT, except for certain changes.

A minimum NWT equal to 3,210 euros (EUR) applies to companies that have aggregate financial assets (of the year concerned) exceeding 90 percent of their total balance sheet and EUR350,000.

For non-holding companies (which do not have aggregate financial assets exceeding 90 percent of their total balance sheet and EUR350,000), the minimum NWT ranges from EUR535, for a balance sheet total of less than EUR350,000, to EUR 32,100 if the total balance sheet exceeds EUR30 million. In addition, the new minimum NWT would not be seen as an advance payment against future NWT liabilities, as was the case for the minimum CIT.

Securitization vehicles, incorporated as corporations are subject to the minimum NWT (as they were to the minimum CIT), although they are generally not subject to NWT. Such vehicles include the SICAR (*Société d'Investissement à Capital à Risque*), the SEPCAV (*Société d'Epargne-Pension Capital Variable*) and the ASSEP (*Association d'Epargne-Pension*). Luxembourg permanent establishments of non-resident entities remain excluded from the minimum taxation.

Where the investor wants to fund the acquisition to the extent possible with debt, the Luxembourg tax law is flexible since it does not impose any strict debt-to-equity ratios on ordinary taxable companies. The tax authorities apply informal limits for the financing of an acquisition of a subsidiary (participation) by intragroup loans. In this situation, the tax authorities generally consider a ratio of 85:15 as being in line with the arm's length principle, which means that 85 percent of the purchase price of the participations held may be financed by an intragroup loan. Where interest rates exceed market rates, part of the interest may be treated as a hidden profit distribution. Dividends are subject to WHT at a rate of 15 percent unless

a tax treaty or the participation exemption regime applies (see later in this report). For purposes of determining the debt-to-equity ratio, based on the current administrative practice, an interest-free loan from shareholders may be assimilated to equity for ratio purposes, so it may be possible to structure funding with a 99:1 debt (interest-free/bearing)-to-equity ratio.

Scenario	Equals
Subscribed and paid-in capital	1
Interest-free shareholder loan	14
Total equity for debt-to-equity purposes	15
Maximum interest-bearing liabilities	85

Source: KPMG in Luxembourg, 2016

Such a funding structure should be analyzed case-by-case.

No WHT tax is levied on liquidation or partial liquidation proceeds.

## Share-for-share exchange

A share-for-share exchange is the contribution of shares by the shareholders of the target company to the acquiring company against allocation of shares in the acquiring company to the shareholders of the target company, or the 'exchange' of shares in the target company against shares in the acquiring company in the context of a merger/division at the level of the shareholder of the target.

In principle, a share-for-share exchange constitutes a taxable sale followed by an acquisition by the disposing shareholder. However, Luxembourg tax law provides for tax-neutral restructuring in the following circumstances.

Article 22bis of the Luxembourg income tax law (LIR) provides a limited list of share exchanges at book value that may be tax-neutral at the level of the Luxembourg shareholder (i.e. no realization of capital gains):

- transformation of the legal form of corporation to another legal form of corporation
- merger/demerger of resident companies or EU-resident companies (entities that are covered by Article 3 of the EU Directive 434/90) or capital companies or cooperative companies resident in a European Economic Area (EEA) state other than an EU member state fully subject to a tax corresponding to the Luxembourg corporate income tax
- exchange of shares (in an EU/EEA resident company or a capital company fully taxable subject to a comparable effective tax rate of 10.5 percent computed on a similar base as the Luxembourg rate), where the acquiring

company (being a EU-resident company or a capital company fully taxable subject to a comparable effective tax rate of 10.5 percent computed on a similar base as the Luxembourg one) obtains the majority of the voting rights in the acquired company or increases the majority of voting rights already held.

Where this provision does not apply:

- a participation exemption may apply for qualifying investments held by resident taxable companies and qualifying branches of non-resident companies (article 166 LIR) — an extensive exemption that covers capital gains triggered by a share-for-share exchange
- rollover relief may also apply where sales proceeds are invested in a qualifying asset or participation under certain conditions (article 54 LIR).

Where none of these relieving provisions can be applied, the share-for-share exchange is, in principle, fully taxable (specific structuring may be possible to achieve tax-neutrality, depending on the economic circumstances). However, where the shareholders are resident individuals, the gain is taxed in accordance with Luxembourg tax law only if the participation realized represented at least 10 percent of the shares of the target company. Such a gain may be taxable at half the normal rate.

Non-Luxembourg resident shareholders are taxed only where a participation representing at least 10 percent of the shares of the target company is sold within a period of 6 months following the acquisition of the shares, or where the foreign shareholder, having been a resident of Luxembourg for more than 15 years, disposed of the participation within 5 years since becoming non-resident. Most of Luxembourg's tax treaties provide for capital gains to be taxed in the state of residence of the entity or individual realizing the gain.

### **Transfer of the assets at book value**

Article 170, paragraph 2 LIR provides for the possibility of transferring assets at their book value or at a value between their book and market value. This allows for the transfer of assets without the realization and thus taxation of underlying capital gains. This provision does not give a definitive tax exemption of the capital gains attached to the transferred assets but merely allows a deferral until their subsequent realization.

The following conditions must be fulfilled:

- The absorbed and absorbing company must be resident in Luxembourg (within the meaning of article 159 LIR) and fully subject to Luxembourg corporate income tax.
- The shareholders of the absorbed company must receive, in consideration of the transfer of its shares,

shares of the absorbing company newly issued for this purpose. Where the absorbing company has a participation in the absorbed company, the participation must be canceled. The absorbed company must be dissolved.

- The parties must take steps to ensure that the capital gains (hidden reserves) ultimately will be taxable. Thus, the absorbing company must make an entry in its fiscal financial statements reflecting the book value of the assets transferred to it by the absorbed company.
- Where the absorbing company holds a participation in the absorbed company, the former must produce evidence to the tax administration to the effect that the merger is based on sound business principles.

Where the transfer is not made at book value, to the extent the value attributed to the assets exceeds their book value, this will create taxable income in the absorbed company (offering a useful way of absorbing losses of the absorbed company, which would otherwise disappear). The higher reported amount of the assets transferred in the balance sheet of the recipient company would result in a higher depreciation of the acquisition costs of the transferred assets.

### **Transfer of a business by the target company**

Contribution of the entire business of the target company or only an independent branch of activity can be made to an acquiring company in exchange for shares in the acquiring company (a share capital company). In this case, the target company remains in existence and, depending on the size of the companies involved, the company acquiring the business may become a subsidiary of the target company whose sole remaining activity is the holding of shares in the acquiring company.

Article 59 LIR applies where the target company transfers either all assets and liabilities or a branch of activity (the target company remaining in existence). Under this article, in principle, hidden reserves cannot be transferred to the acquiring company because the assets involved are revalued to market value, thus exposing any increase in value over book value to taxation at normal rates at the level of the target company. Thus, the minimum value at which the acquiring company may value the assets transferred is book value.

However, where both the target and acquiring companies are fully taxable companies that are resident in Luxembourg or in another EEA/EU member state, articles 59(3) and 59 bis (1) LIR provide that the assets may be transferred to the acquiring company at book value, market value or an intermediate value at the election of the target company,

thus deferring taxation. The maximum value at which the acquiring company may value the assets transferred is market value.

If the receiving company is resident in another EU member state, any Luxembourg-based assets must be transferred to a Luxembourg PE of that company to benefit from a tax-neutral treatment.

### **Anti-hybrid rule and general anti-abuse rule**

In line with the recent changes made to the EU Parent-Subsidiary Directive to combat abuse of law and intra-EU hybrids, profits deriving from a participation falling within the scope of the EU Parent-Subsidiary Directive are no longer tax-exempt in Luxembourg (based on article 166 (2) 1 LIR) to the extent that such distributions are deductible by the payer located in another EU member state or where the transaction is considered to be abusive.

The purpose of this provision is to avoid situations of double non-taxation deriving from abusive transactions or from mismatches in the tax treatment of profit distributions between member states.

### **Discounted securities**

The tax treatment of securities issued at a discount to third parties normally follows their accounting treatment under Luxembourg generally accepted accounting principles (GAAP). As a result, the issuer should be able to obtain a tax deduction for the discount accruing over the life of the security.

### **Deferred settlement**

Where acquisitions involve elements of deferred consideration (i.e. the amount of the consideration depends on the business's post-acquisition performance), such future consideration should be regarded as part of the sale price.

Where the sale price relates to shares disposed of, the deferred settlement may be eligible for the Luxembourg participation exemption regime as an element of a capital gain on shares.

## **Other considerations**

### **Concerns of the seller**

A sale of shares of a Luxembourg company may be tax-exempt, where the seller is either a Luxembourg corporation under the capital gains substantial participation exemption or a non-resident. Luxembourg usually loses the right to tax capital gains under tax treaties, and non-resident sellers who do not benefit from treaty protection when disposing of shares in a Luxembourg company are

not taxable in Luxembourg after a 6-month holding period has elapsed.

The sale of shares does not trigger registration or stamp duty (except in some cases where sellers hold Luxembourg real estate).

In an acquisition for cash of all the assets of a Luxembourg company, the seller is subject to Luxembourg corporation tax on any capital gains. Certain techniques are available to the seller to defer taxation, for example, by reinvesting the sale proceeds in fixed assets or by reducing the tax basis where the sale takes place in the course of the liquidation of the seller.

### **Company law and accounting**

#### *Merger*

Following the enactment into domestic law of the Third and Sixth EU Company Law Directives in 1987, mergers of two or more Luxembourg public limited companies (SA) can be effected only by absorption of an existing company or incorporation of a new entity. In both cases, the target companies of the merger are dissolved without liquidation, and all assets and liabilities are contributed to the absorbing or newly created entity.

The law of 23 March 2007, as further detailed by the law of 10 June 2009, amended Luxembourg company law to simplify the rules and conditions for mergers and divisions. This law allows a cross-border merger between any Luxembourg company with a legal personality and companies governed by a European or foreign law, where the national law of the relevant country does not oppose such merger (entities with legal personality are the *société anonyme*, *société en commandite par actions*, *société à responsabilité limitée*, *société en nom collectif*, *société en commandite simple*, *the société coopérative*, *société civile*, and *groupement d'intérêt économique*).

A merger can also occur where one or more of the companies or economic interest groupings that are acquired or will cease to exist are the subject of bankruptcy proceedings relating to litigation with creditors or a similar procedure, such as the suspension of payments, control of the management of the company, or proceedings instituting special management or supervision of one or more of such companies.

A merger is effected by the acquisition of one or more companies by another (merger by acquisition) or by the incorporation of a new company (merger by incorporation of a new company). In exchange, the shareholders receive shares and possibly a cash payment not exceeding 10 percent of the nominal value of the shares issued. In both cases, the target companies of the merger are dissolved without liquidation,

and all assets and liabilities are transferred to the absorbing or newly created entity.

#### *Division*

Luxembourg company law defines a division as an operation in which the company being divided, after dissolution but without going into liquidation, contributes its assets and liabilities to two or more pre-existing or newly formed companies (the recipient companies) in exchange for the issue of shares to shareholders, possibly with a cash payment not exceeding 10 percent of the nominal value of the shares issued.

The law of 23 March 2007 simplified the rules and conditions for mergers and divisions. This law allows a cross-border division between any Luxembourg company having a legal personality and a European or a foreign law-governed company where the national law of the relevant country agrees.

#### **Group relief/consolidation**

Under Luxembourg tax law,<sup>1</sup> resident companies may be authorized to file consolidated tax returns for corporate income tax and municipal business tax, but not for net wealth tax. An application must be made for a period of at least 5 years. Where a company leaves the group within 5 years, the overall group results will be adjusted where tax savings have been made through compensation for the losses of the departing company. Qualification for fiscal integration requires financial integration (i.e. 95 percent or, in some cases, 75 percent, of the shares in the subsidiary or the Luxembourg PE must be held directly or indirectly by the fully taxable resident capital company or by a Luxembourg PE of a non-resident capital company fully liable to a tax that corresponds to Luxembourg corporate income tax). An organizational or economic integration is not required.

If the participation is held indirectly, it is necessary for the companies through which the parent company or the Luxembourg PE holding 95 percent of the share capital of the subsidiary that is to be integrated for tax purposes to be capital companies fully liable to a tax that corresponds to Luxembourg corporate income tax; namely, a tax compulsorily levied by public authorities at a rate of at least 10.5 percent of a base calculated in accordance with rules and criteria similar to Luxembourg's. The 95 percent shareholding condition must be satisfied continuously from the beginning of the first accounting period for which tax consolidation is requested.

Losses incurred prior to a company's inclusion in a fiscal integration group cannot be offset against other group companies' profits on fiscal integration. Losses may continue to be carried forward by the company that realized them and set off against profits subsequently made by that company within the fiscal integration group.

In order to comply with EU law (and in particular with the ECJ decision of 12 June 2014, *SCA Group Holding*, C-40/13), the law of 18 December 2015 contains new measures that provide for the possibility to apply for a so-called 'horizontal' tax unity, whereby eligible sister companies can form a tax unity group (without their parent company). These provisions are applicable as of the fiscal year 2015.

Based on the law of 18 December 2015, the setting-up of a horizontal tax unity group is subject (among others) to the following conditions:

- The (non-integrated) parent company must be either a foreign company resident in an EEA country (or a PE located in a EEA country), or a company resident in Luxembourg or a Luxembourg PE of a foreign company.
- Each integrated subsidiary must be either a company resident in Luxembourg or a Luxembourg PE of a foreign company resident in an EEA country. They must be sister companies (as well as their respective subsidiaries) and must be held at least at 95 percent (directly or indirectly) by the same (non-integrated) parent company.
- One of the integrated subsidiaries will act as the parent company of the group for the purpose of the tax unity regime. It can be either a company resident in Luxembourg or a Luxembourg PE of a foreign company.
- The integrated subsidiaries and the (non-integrated) parent company must send a joint request to the tax authorities by the end of the first year during which the application of the tax unity regime is sought.

Eligible companies are free to decide to set-up either a vertical or a horizontal group (if all the conditions are met). However, once the initial choice is made, the companies are bound for a 5-year period.

In order to comply with EU law (and in particular with the ECJ decision of 6 September 2012, *Philips Electronics*, C-18/11), the law also foresees that a Luxembourg PE of a foreign company resident in an EEA country can now also be included as a subsidiary in the tax-consolidated group. Foreign subsidiaries remain out of the scope of the regime.

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<sup>1</sup> See below, however, regarding new provisions applicable as of 1 January 2015.

The General Tax Law has been modified in order to facilitate the recovery of tax claims within the tax unity group and thus ensure that each member of the tax-consolidated group can be held liable for the taxes due by the parent company of the group (in case of default of the latter).

## Transfer pricing

Except for intragroup financing activities, there are no transfer pricing rules in Luxembourg applicable to M&A operations. The OECD transfer pricing guidelines are generally followed in practice.

Where a business asset is sold to a non-resident related party, the Luxembourg tax authorities may reassess the transfer value of the assets where the value is below market value and results in a shift of taxable profits to the benefit of a non-resident taxpayer linked directly or indirectly to the transferor. This is simply an application of common transfer pricing rules.

Where transfer prices are exclusively motivated by a relationship between a Luxembourg undertaking and a non-resident taxpayer and motivated by sound business reasons, the Luxembourg tax authorities may reassess the undertaking's taxable profit (articles 56 and 164 LIR). Therefore, a shift of profits outside Luxembourg between related parties, for example, through excessive indebtedness, which implies excessive deductible expenses, may be challenged under common transfer pricing rules.

According to article 164 LIR, a hidden profit distribution arises when a direct or indirect shareholder receives proceeds or other advantages from a company that they would not have received in the absence of this relationship. No tax deduction is available at the company level for these expenses, and the proceeds or advantages are treated as dividends subject to dividend WHT, unless a tax treaty or the participation exemption applies.

The transfer pricing practice is still developing in Luxembourg. On 28 January 2011, the Luxembourg tax authorities issued Circular 164/2 on the tax treatment of intragroup financing companies. However, the circular's provisions do not apply to cross-border M&As.

## Dual residency

Cases of dual residency may be beneficial for tax purposes in a few specific cases. Tiebreaker clauses in tax treaties tend to have a direct impact for Luxembourg tax purposes.

## Foreign investments of a local target company

Luxembourg tax law includes no controlled foreign company legislation.

## Comparison of asset and share purchases

### Advantages of asset purchases

- Buyer may depreciate the purchase price of assets acquired, including goodwill.
- Possible to acquire only part of the business.
- Losses within the acquiring group may be absorbed by a profitable business acquired from the target company.
- Buyer generally is not liable for claims on or previous liabilities of the target company.

### Disadvantages of asset purchases

- The business is effectively being carried on by another entity, which may require renegotiation of trading and employment contracts, etc.
- Pre-acquisition losses incurred by the target company are not transferred with the business. They remain with the target company or are lost.
- Generally, there is a need to renegotiate supply, employment and technology agreements.
- An asset purchase could be more expensive than a share purchase where, from a tax perspective, it is unattractive for the seller.
- Accounting profits may be affected by the creation and depreciation of goodwill.
- Transfer registration duties are due on transfers of real estate.

### **Advantages of share purchases**

- Contractual continuity because the target company may remain active, with only the shareholders changing.
- Pre-acquisition tax losses incurred by the target company may be retained, despite the change of shareholder, if certain conditions are met.
- The acquiring group companies may use losses incurred by the target company following an acquisition under fiscal integration provisions (excluding losses incurred prior to the fiscal consolidation).
- Losses incurred by acquiring group companies within fiscal integration may be offset against profits of the target company.
- Registration duties on the transfer of real estate may be avoided.

### **Disadvantages of share purchases**

- Participation cannot be amortized.
- There is liability for claims on or previous liabilities of the target company.
- Where the participation exemption applies, direct funding costs related to the acquisition of the subsidiary may not be entirely deductible.

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