

# Luxembourg government issues a new draft law on limitation of interest and royalty payments

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On 30 March 2020, the Luxembourg government issued a draft law (the "**Draft Law**"), which should be applicable as of 1 January 2021, introducing new rules on the limitation of the deduction of interest and royalties paid by a Luxembourg entity to companies included in the EU list of non-cooperative territories and jurisdiction for tax purposes, effective as from 1 January 2021 and updated once a year.

## EU list of non-cooperative jurisdictions

The EU list of non-cooperative jurisdictions comprises, as of 27 February 2020, 13 jurisdictions (the "**Listed Jurisdictions**"). This list is updated twice a year but for the purpose of the application of the new rules to be implemented in Luxembourg domestic law, it should be updated only once a year further to the Government's proposal.

Considering the target date of application of the Draft Law is 1 January 2021, and the next review of the list of Listed Jurisdictions is foreseen to take place in October 2020, it is still uncertain which countries will be included in the final text of the law. The government will, before the draft undergoes a vote, add an annex which will specify which are the Listed Jurisdictions. This annex will be a transposition of the EU list of jurisdictions in force on the date the government introduces the annex.

As previously mentioned, and taking into account that the EU list may be altered in the course of the year, the legislator has foreseen yearly additions and removals from the list - proposals will be made by the government, also by means of transposition of the EU list in force at the given moment. These modifications will take effect, and apply to interests and royalties paid, as of 1 January of the year following such a proposal.

## Criteria for application of the new interest and royalty deduction limitation rules

Based on the Draft Law, the deduction for income tax purposes of the following charges will be

denied: any interests or royalties paid by a Luxembourg company to its effective beneficiary being a fully taxable entity in the sense of article 159 of Luxembourg Income Tax law ("LITL") and related party in the sense of article 56 LITL, established in a jurisdiction featured in the EU list of non-cooperative jurisdictions.

The deduction of interest or royalty payments will only be denied if it is allocated to a fully taxable corporate entity in the sense of article 159 LITL. As a consequence, interest and royalties payments to partnerships resident in a non-cooperative jurisdiction should not fall within the scope of the new rules if the effective beneficiary of such payments do not qualify as a fully taxable entity resident in a non-cooperative jurisdiction for tax purposes.

As an example, interest payments allocated by a Luxembourg company to a partnership established in a Listed Jurisdiction held by US or EU tax residents should remain deductible at the level of the Luxembourg company, provided that the other interest limitation deduction rules are not applicable.

The interest expenses targeted by the above mentioned new rules shall comprise interest paid and accrued in relation to all kinds of receivables, whether or not secured or profit participating. Premiums and other prizes attached to such receivables are to be included in the scope of the new interest deduction limitation rules; however, penalties for late payment of interest should be excluded.

For the purposes of the application of the new deduction limitation rules, "royalties" should comprise all kinds of remunerations paid or due in relation to the use or the right to use any copyrights on literary, artistic or scientific work including movies, patents, trademarks, drawings, models, maps, formulas, secret processes and information related to an experience acquired in the commercial, industrial or scientific domains.

The commentaries issued by the Luxembourg Government provide clarification regarding the scope of application of the deduction limitation rules. In fact, they outline that the interest and royalties targeted by the new rules should correspond to those listed in article 2 of the Interest and Royalties EU Directive (2003/49/CE of 3 June 2003) and in articles 11 and 12 of the OECD model convention.

### **Exclusion of the scope of application of the new rules**

The above mentioned rules should not be applicable if the relevant taxpayer can prove that interests and royalties have been paid in the context of an operation performed for valid economic reasons reflecting economic reality.

### **Adoption of the Draft Law**

At this stage, the Draft Law still needs to be reviewed by the Luxembourg Parliament and the

Council of State. A further update of this briefing will be available once the final version of the Draft Law is voted by the Luxembourg Parliament.

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