

Luxembourg published draft law denying tax deductions for interest and royalty payments to related entities in non-cooperative jurisdictions

Following our [news update last week](#), the Luxembourg government published on the 30th of March 2020 the draft law that denies tax deductions for interest and royalty payments to related entities residing in jurisdictions which are on the European Union's list of non-cooperative jurisdictions. If approved by parliament, the provisions of the draft law will apply from 1 January 2021.

As announced last week when it was adopted, the draft law will apply to interest and royalty payments by Luxembourg companies to related entities residing in jurisdictions which are on the EU-list of non-cooperative jurisdictions. However, the published draft law contains the following two provisions that will limit its application:

- Deduction should still be allowed if the Luxembourg taxpayer can prove that the payments are related to transactions which take place for valid economic reasons that reflect economic reality. Mere evidence that the transaction is used for valid business reasons is not sufficient (in practice, the application of this limitation should be confirmed in a ruling). Please note, in this case the payments could still be subject to other tax measures that could limit or refuse its deduction, such as the interest deduction limitation rule.
- Deductions will only be denied if the recipient is a corporate entity which is considered opaque from a Luxembourg tax perspective. Hence, interest and royalty payments to entities that are considered transparent from a Luxembourg tax perspective fall not within the scope. In that case the actual beneficial owner(s) of the payments (i.e. the participant(s) in the transparent entity) should be taken into account as the recipient.

The definition of related entities will be in line with the definition as defined for the purposes of the Luxembourg transfer price regime. This means, two entities will be deemed to be related entities if :

- one entity participates directly or indirectly in the management, control or capital of the another entity; or
- the same persons participate directly or indirectly in the management, control or capital of two entities.

Furthermore, the definitions of interest and royalties are in line with the definitions of the OECD Model Convention.

The draft law follows the guidance, provided by the EU Council in December 2019, in which all Member States were invited to apply defensive tax measures regarding jurisdictions on the EU-list of non-cooperative jurisdictions.

Last February the EU Council updated the EU-list of non-cooperative jurisdictions by adding the Cayman Islands, Palau, Panama and Seychelles. In addition to the four added jurisdictions, the EU-List includes American Samoa, Fiji, Guam, Oman, Samoa, Trinidad and Tobago, Vanuatu and the US Virgin Islands. The EU regularly updates and reviews the list and the next review will be in October 2020.

Since the Cayman Islands have already adopted some measures that should be considered sufficient from a EU point of view to not be considered a non-cooperative jurisdiction, it is expected that they will be removed from the EU-list during the next update in October 2020. In that case, structures involving deductible payments by Luxembourg companies to Cayman Islands resident entities should not be affected by the new draft law as it will only enter into force from 1 January 2021, however clients should obviously not rely on this and assume the Cayman Islands will still be on the list by January 2021 (and take defensive measures).

We will closely monitor future updates of the EU-list as it may have significant impact on Luxembourg investment structures.

Should you have any questions or require more information, please do not hesitate to contact us.



JOOST VAN DEN BERG

+31 (0) 20 - 763 09 16

j.vandenberg@hvkstevens.com



INAKKI HEGEMAN

+31 (0) 20 - 763 09 04

i.hegeman@hvkstevens.com