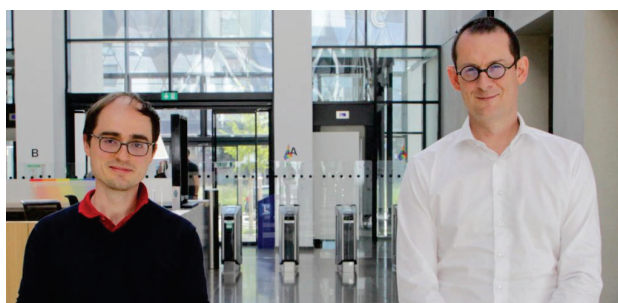


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# Interview with Bernard David and Pierre- Antoine Klethi

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*Paul Schonenberg : Please discuss between yourselves and share with our audience if there has been consistency with regards to the first perception and response by high level management to the challenges caused by this crisis and the first step responses?*

**Bernard David & Pierre-Antoine Klethi:**

All actions that we took as employers were aligned with government decisions.

First, the top management decided and took all the necessary steps to preserve our people's health and safety first, notably by monitoring COVID-19's impact on our

employees. As the crisis required our employees to work remotely almost overnight, robust technical support was necessary.

Regular communication was also key to ensure our people felt as supported and connected as possible to ease the constraints of the pandemic, such as feeling isolated. We also kept them regularly informed of how the company was tackling these unprecedented times. Middle management played a crucial role in ensuring that every individual was connected to a group.

Finally, as we had no clear view of how the pandemic would affect the business, various measures were taken to protect the company and preserve employment. Notably, we made sure that work would be well-allocated depending on how the demand of various service offerings evolved, through internal mobility, vacation, sick leave, extraordinary leave for family reasons, etc.

*Paul Schonenberg: Please compare, contrast and share your observations related to the good and bad experiences related to employee remote working?*

**Bernard David & Pierre-Antoine Klethi:**

From an employee perspective, remote working can offer great flexibility and a reduced commute, especially for cross-border workers who previously spent long periods in traffic jams. However, whether remote working is seen as a positive or negative experience depends on each employee's unique situation. For example, home working could be difficult for people who needed to care for children when schools were closed or those employees who live alone.

These differences are also reflected in employees' preferences regarding returning to the office when the spread of the virus was and is under control. Also, virtual communication—even over video—cannot fully replace physical interactions.

As an employer, remote working has its pros and cons. On the positive side, successful remote working requires employee empowerment, trust and agility; therefore, our people were well capable when our entire business went remote overnight. On the downside, remote working can put pressure on employees due to long hours and hyper-connectivity, blur the separation between professional and private life, involve a reduced corporate sense of belonging, and a lack of human relationships.

Overall, a return to the old ways of working in the office 100% of the time seems unlikely. The vast majority of people support a hybrid model and the past 15 months have shown on a large scale that it can work.

From a tax point of view, remote working created tax residency and permanent establishment risks. This was on top of cross-border workers' potential double taxation issues and possible change of social security state of affiliation. In general, we welcomed and relied upon OECD guidance from April 2020 regarding permanent establishment and tax residency issues for corporate and personal taxpayers.

However, the provisions of the amicable tax agreements between Luxembourg and its neighbors were urgently and retrospectively concluded and without exhaustively addressing cases.

This opens the floor to interpretation and unresolved questions: whether managing directors can benefit or not from these measures, which work patterns are in scope, how should ad hoc office workdays required by employers during COVID-19 be treated, etc. While highly appreciated, this generalist legal environment can support unpredictable and surprising positions by authorities. This was notably the case for Belgian resident managing directors, who were deemed out of scope of such an agreement during the summer of 2020.

Today, Luxembourg employers and employees are likely ready to take on the challenges of new ways of working. This should be possible through employers upgrading their existing homeworking policies to consider the different tax and social aspects of working from home and, in the long term, through Member States of the Greater Region developing adaptive tax and social environments.

We hope that the concerned EU Member States will consider exploring the full potential of article 16 of the EU Social Security Regulations . This will open the door to possible future bilateral agreements that allow sustainable homeworking in the employee's state of residence beyond the current thresholds.

***Paul Schonenberg: What are your observations both good and bad related to the government responses over the life of this crisis experience?***

**Bernard David & Pierre-Antoine Klethi:**

The COVID-19 pandemic has affected everyone: governments, businesses and individuals.

The **Luxembourg government** implemented several short-term measures for direct and indirect taxes. Remote-working cross-border employees were suddenly exposed to potential double taxation and/or a change in their social security state of affiliation if certain thresholds were exceeded. The Luxembourg government took immediate action to recognize the extraordinary nature of the crisis, which was globally acknowledged as “cas de force majeure” by the international tax business community and the EU social security authorities.

The European Commission issued practical guidance to ensure the free movement of critical workers, as well as helpful information for cross-border workers and posted workers affected by the restrictions on free movement taken by several EU Member States due to COVID-19. These pragmatic measures are currently still in force until the end of June 2021.

Strictly adhering to such a common and global mindset, Luxembourg was able to set up amicable mutual tax and bilateral social security tools. These aimed to shield cross-border staff from temporary double personal taxation and/or social security issues when forced to work from home, either due to decisions made by the Luxembourg government (their state of work) and/or their respective state of residence (Belgium, France or Germany). In fact, the International Monetary Fund stated that such an abrupt change of business environment was well managed by the Luxembourg government .

As an employer, we saw that the Luxembourg government's immediate responses focused on people's health and safety, clearly directing employers to take all required actions. The state provided substantial support to families needing to care for children at home while working remotely. While partial unemployment measures to preserve jobs were quickly available, they could have benefited from enhanced clarity on eligibility.

***Paul Schonenberg: How optimistic (or pessimistic) are you for the future, what do you consider the most serious issues to face and overcome?***

**Bernard David & Pierre-Antoine Klethi:**

On the talent side, we are quite optimistic. The sudden switch to home working exposed management and people to unprecedented challenges requiring agility, flexibility

and resilience. It unveiled a world of new opportunities; better work-life balance for some employees and new talent pools for employers. Overall, it has hugely accelerated the development of remote working, achieving in 15 months what would have normally taken a decade.

The flip side is that people and businesses have realized that more tasks could be done from abroad. Therefore, Luxembourg must reassess its attractiveness and develop new policies to improve the situation of people and businesses established in Luxembourg. While tax is not the only element to consider, it does play a clear role.

Ultimately, the main challenges of the world—such as the environment, social inequalities, and conflicts in various areas of the globe—remain unchanged. The COVID-19 crisis just delayed governments from (re)focusing their attention on these issues and sometimes exacerbated them, if we consider the disproportionate impact on some economic sectors and the uneven global vaccination rollout.

That said, there are reasons to be optimistic. The crisis fostered a feeling of everyone being in the same boat, which could help us build new bridges and work better together to tackle the big challenges of our lifetimes.

***Paul Schonenberg: How has the covid crisis impacted your professional world of Tax practices?***

**Bernard David & Pierre-Antoine Klethi:**

Notwithstanding initial fears, business activity has proven resilient, with clients continuing to seek advice for new deals or new funds. Moreover, the entry into force of some regulations required the review of numerous existing structures and the restructuring of some. These regulations include most of ATAD 2's anti-hybrid rules and DAC6, with Luxembourg implementing a sensible six-month delay regarding the latter. Of course, deteriorating public finances around the world will drive an increase in corporate taxation over the coming years.

Now that we seem to be exiting the crisis, new tax questions will arise on a more "local"/operational level. For example, the taxation of cross-border workers, as well as the risks of permanent establishments or permanent representatives in other jurisdictions due to employees working more frequently from home.

From a transfer pricing perspective, we have seen a trend in reviewing transfer pricing models for the use of losses (FY2020 and loss carried forward from previous years). There has been some interest in planning and reassessing over FY2020 and the first months of FY2021, rather than on classic rollovers of transfer pricing documentation.

However, we anticipate more documentation projects in the second half of FY2021, as multinational companies would need to adapt their legacy documentation to FY2020's specificities. Despite high anticipation by the tax community, the OECD guidance on the interaction between the COVID-19 crisis and transfer pricing was published very late in 2020.

***Paul Schonenberg: For what reasons and in what ways are you concerned over local and global efforts to increase taxes on companies and individuals?***

**Bernard David & Pierre-Antoine Klethi:**

An increase in taxes is inevitable to pay for the huge costs incurred during the crisis. This is especially true in countries with significantly higher public debt levels; Luxembourg was lucky to have a relatively low indebtedness at the beginning of the crisis.

However, there are two ways to raise taxes. The most efficient way is through neutral taxation, with moderate tax rates and a wide or large taxable basis. This is fair, transparent and does not trigger negative incentives for investors. The less efficient way is to rely on high tax rates with a narrow tax basis.

To be sustainable, the tax policy of the future must be as neutral as possible with a wide taxable basis, combined with direct public subsidies to ensure social fairness.

Luxembourg has borrowed proportionally less than most EU countries and has one of the smallest increases of debt-to-GDP ratios in the EU, with an increase of 2.8% between 2019 and 2020. However, its taxable basis has increased, due to the recent implementation of EU legislations like ATAD 1 and 2, and its nominal corporate tax rate is above the EU average.

Therefore, it is probably time for Luxembourg to consider a major post-COVID-19 tax reform, which could be structured around five building blocks.

The first building block would be to improve tax certainty. As this does not involve a tax cost, it may be the first thing to consider. Taxpayers value tax certainty more than ever,

and this has become a real differentiator.

The second building block is aimed at sustaining innovation and digital transformation. The best way to reach a balanced budget is to have high-performing corporations creating well-paid jobs that contribute to the national budget. To attract and keep those highly valuable players, we need to create a favorable environment, as these companies and individuals are highly mobile as demonstrated during the COVID-19 crisis.

The third building block would focus on the financing industry and, more specifically, on alternative investment companies. While Luxembourg is well-positioned today, this could change very quickly in a post-Brexit, post-COVID-19 and post-BEPS environment, with many other countries trying to attract these key players in the financing of the post-COVID-19 economy.

The fourth building block should be about talent attraction and retention, as there is a real battle to attract mobile talent. While tax is not the only stumbling block, the current personal tax environment must be rethought and improved. As property costs are very high in the Grand Duchy, we need clear and pragmatic tax rules that are preferable to those of neighboring countries.

The final building block would deal with behavioral taxes, such as environmental ones, which continue to be of growing importance in the EU and Luxembourg. However, the social acceptability of behavioral taxes must be tested, as lower-earning individuals are often hit harder by them.

Recently, the Luxembourg government announced the two-year postponement of the tax reform initially planned for 2021. Major tax reforms are currently being discussed at the EU and international levels, which would have to be implemented in Luxembourg. The need for clarity on these upcoming EU tax laws before implementing new local rules is understandable. However, companies have been waiting for meaningful tax reform for a long time already. Whether two more years is too long a wait remains to be seen.

As the European Commission highlights, the tax mix needs to be adapted to tackle the various challenges ahead. This would ensure that the economies of Luxembourg and the EU remain competitive, while making sure the tax system is fit for purpose and creates sustainable tax revenues for the government budget.

Global plans to introduce some kind of minimum taxation may help level the playing field. However, the current proposals miss a proper substance-based carve-out and fail to account for certain jurisdictions' need to offer tax incentives to balance certain constraints such as a very small size of the internal market.

Also, achieving a manageable system will be key. Excessive administrative complexity and compliance burdens kill activity and generate a high level of costs for public authorities.

Last but not least, higher corporate taxation often translates into higher prices for products and services to preserve businesses' operating margins, eventually landing end customers with larger bills. Therefore, the current trend is likely to create inflation with the related consequences, which must be anticipated. We can only hope this will remain under control and is not taken for granted, given today's global economy and tomorrow's very complex tax environment.

***Paul Schonenberg: What are the issues associated with a corporate global minimum tax as recently advocated by President Biden in the USA and endorsed by the Luxembourg Minister of Finance, Pierre Gramegna?***

**Bernard David & Pierre-Antoine Klethi:**

On 21 May 2021, the United States proposed a 15% global minimum corporate tax rate for the so-called OECD Pillar 2 to reach G7 and then G20 consensus. This minimum rate, which is currently under OECD/G20 negotiation, is one of the cornerstones of the future tax applying to certain large multinational companies with an annual group gross revenue of at least EUR750 million.

This move by the United States follows a national policy rationale, i.e., to convince Congress that the United States would remain competitive if the Biden tax agenda is adopted by increasing US corporate taxation and effective minimum taxation (GILTI). If the 15% OECD minimum taxation is adopted at the international level, this would reduce the taxation gap between the United States and the rest of the world.

Countries with tax rates lower than 15%, such as Ireland and Hungary, may oppose this proposal and instead seek a rate significantly lower and closer to their corporate income tax rate (e.g., 12.5% in Ireland).



From a business perspective, based on the OECD Pillar 2 blueprint published in October, the main issues that remain to be solved are:

- (i) A proper substance-based carve-out, so that the rules do not annihilate certain tax incentive regimes that comply with the BEPS Action 5 recommendations (concerning harmful tax practices);
- (ii) Effective simplification measures, to avoid computing an effective tax rate for every single jurisdiction where a multinational enterprise (MNE) group realizes revenue, and to limit the adjustments from the financial statements or to national tax bases; and
- (iii) A minimum effective tax rate that is not excessively high, to avoid harming economic recovery.

In addition, the specifics of developing countries may not have been sufficiently considered in the design of the future global minimum rules. The proposed rules tend to favor large, developed countries, despite the issue of base erosion mostly affecting developing countries in the first place. The interaction with territorial tax regimes will also be a point of attention.

In any case, taxpayers would need clear guidance on how the OECD Pillar 2 is applied, and only reasonable administrative costs should be incurred to comply. International coordination and cooperation are key to implement this set of new rules, to avoid unfair tax competition due to unilateral actions.

***Paul Schonenberg: What are the issues and impacts for Luxembourg associated with the EU efforts to impose taxes on global IT companies?***

**Bernard David & Pierre-Antoine Klethi:**

There are two elements to consider. First, the OECD's Pillar One proposal, which is a reallocation of taxing rights towards "market" jurisdictions, i.e., jurisdictions where companies generate profits remotely. Second, the EU's plans to levy its own resources, including digital, which are still unclear as formal announcements are expected around mid-July.

Luxembourg hosts various companies that form part of the so-called "digital economy". Therefore, it may lose tax income from a reform like Pillar One. However, the digital levy would amount to additional taxation rather than just shifting taxing rights; therefore, it should not have an immediate impact on Luxembourg's budget and competitiveness.

Luxembourg should, however, protect taxpayers that have invested in Luxembourg and created activity in the country. This would involve defending a level-playing field and rejecting proposals that fail to account for a digital activity's profitability, as these proposals may wipe out businesses with low profit margins entirely.

***Paul Schonenberg: What are the potential risk factors that these efforts to harmonize and increase corporate taxation will adversely impact on the attractiveness of Luxembourg as an international business location and what advice would you give the government to mitigate against disproportionate impact on the Luxembourg economy and the international companies domiciled here in Luxembourg?***

**Bernard David & Pierre-Antoine Klethi:**

A country's attractiveness, including Luxembourg's, is not solely based on its tax system. Instead, it is a combination of many factors such as political stability, legal and regulatory system, infrastructure, skilled workforce etc. Non-tax incentives aligned with EU and other international regulations may need to gain weight to attract and retain businesses. One example is the proposed global minimum effective tax rate, which is aimed at leveling taxation between countries to reduce tax competition and the "race to the bottom". Luxembourg's competitiveness depends on its ability to adapt its economy and policies as a whole to current and future challenges.

Focusing on tax, the Luxembourg corporate tax rate of 24.94% is one of the highest in Europe, above the OECD average of 23.51%. The Tax Foundation study "International tax competitiveness Index 2020" reveals that the Luxembourg tax system is one of the least competitive compared to the other countries analyzed (26th out of 36) due to the high tax burden on companies and individuals (20th out of 36).

Pillar One reforms will remove some taxing rights from Luxembourg and reallocate them to other jurisdictions, which will affect competitiveness. While a global minimum effective tax rate may help Luxembourg compete against territorial tax jurisdictions and low and no-tax jurisdictions, it also bears serious risks.

If and when Pillar Two is implemented, several groups will likely reconsider their holding and financing structures. Therefore, Luxembourg must consider the following:

- Improving legal certainty regarding existing legislation. Recent reforms, including anti-hybrid rules, the interest deduction limitation rule and DAC6, require greater clarity.
- Harnessing the flexibility that will remain under Pillar Two and other proposals, such as Business in Europe: Framework for Income Taxation (BEFIT), the European Commission's latest attempt to relaunch a common consolidated corporate tax base. It may be worth tackling incentives towards debt financing by introducing a notional interest deduction on equity (as proposed by the European Commission) and limiting the scope of dividend withholding.
- Certain industries may and/or should benefit from carve-outs. Regarding Pillar Two, investment and pension funds are notably due to remain out of scope —this must be confirmed in future draft laws.
- Helping businesses build substance which goes beyond tax. The excessive inflation of the housing market, infrastructure that cannot cope with peak hour traffic, and the relatively high cost of living all challenge Luxembourg's competitiveness compared to other jurisdictions.

Taxpayers are willing to pay their taxes, but they desperately need clarity from policymakers and tax authorities to understand how to easily apply increasingly complex tax rules. Double taxation continues to grow in the EU among Member States competing against each other, increasing the risks and costs of doing cross-border business. Legal certainty is a must-have.

Well-functioning tax administrations are key to reducing unnecessary administrative burdens and smoothing relationships between taxpayers and tax administrations. This requires implementing sufficient resources, harnessing the digital transformation of the economy, and constantly improving user experience and service delivery to taxpayers. Implementing a modern tax audit procedure in line with other major countries would improve the protection of taxpayer rights without damaging the oversight capabilities of the Luxembourg tax authorities.

***Paul Schonenberg: In addition to corporate taxation issues, personal taxation issues can likewise seriously negatively impact Luxembourg's attractiveness as a work location for the highly skilled business employees we need within the international business sector of the Luxembourg economy. Please assess the recent changes which have been initiated regarding pay and benefit taxation for employees and assess***

*the impact on these high skilled individuals and indicate the degree of increased risk concerning Luxembourg's ability to attract top talent.*

**Bernard David & Pierre-Antoine Klethi:**

The long-term stock option regime was completely abolished with effect of the tax 2021 year. This requires affected Luxembourg employers to rethink their remuneration strategies and refocus on the fundamental elements of the Luxembourg individual income tax law.

The inpatriate regime that was based on a 2014 tax circular has been codified with a few adjustments. The main difference is a change to the lump sum allowance for recurring expenses regarding the cost-of-living differential between home and host Member States. The new rule accounts for certain moving expenses for inpatriates and their families covered by the 2014 circular. This includes an exemption from individual income tax of up to 50% of the inpatriation premium for up to eight consecutive years following the first year of services in Luxembourg, if the premium amount does not exceed 30% of the inpatriate's annual remuneration.

However, the new regime would be limited to highly remunerated inpatriates that have a minimum annual remuneration of EUR100,000 (currently EUR50,000). Even if strengthening this regime's legal background is a positive move, its practical application and the transition from the old to the new could have been smoother.

As mentioned, the difficulty in finding some highly skilled people is challenging. While some measures have already been adopted, such as the "participation bonus", they are so restrictive in scope that they are unable to adequately tackle these challenges.

Looking toward future and long-term horizons, the recent measures seem insufficient to keep and attract key decision-makers and added-value generators to Luxembourg. The absence of a predictable tax environment for carry-holder individuals will need to be addressed.

A prudent pension approach would certainly require a revisit and boost to the second and third pension pillars' tax environments, based on the potential of salary sacrifices by employees being invested in specific pension schemes (comparable to 401K/IRA). to get augmented future pension rights, subject to upfront taxation at a preferential rate.

To address the tax and social security issues faced by cross-border workers, we need to think bigger—at the scale of the Greater Region. Finding solutions to reduce cross-border commutes would reduce pressure on Luxembourg's infrastructures, improve the protection of the environment, boost employees' productivity, and possibly incentivize neighboring countries to refrain from supporting measures that would excessively damage Luxembourg's competitiveness.