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Luxembourg Tax Alert

Luxembourg 2019 budget in force as of 1 May 2019, MLI in force as of 1 August 2019

29 April 2019

April 2019 was a fruitful month in terms of Luxembourg tax laws. Two important laws are now ready to enter into force – namely, the ratified MLI and the 2019 budget law.

Luxembourg's 2019 budget law

Luxembourg's 2019 budget law was approved by parliament on 25 April and published in the Official Journal of 26 April. It will become applicable as of 1 May 2019, with some provisions applicable from 1 January 2019. This budget law concentrates on the priorities set out by the new government coalition, in particular, social cohesion and competition, as well as fairness and sustainability. This law includes tax measures designed to strengthen social cohesion and the buying power of individuals, as well as the competitiveness of companies.

For companies, the new budget includes a reduction of the corporate tax rate (applicable for taxable years closed on or after 1 January 2019) as well as a rule for tax-integrated groups in connection with the ATAD interest expense deduction limitation rule (applicable for taxable years beginning on or after 1 January 2019). This is compliant with the commitment expressed when the directive transposing the EU Anti-Tax Avoidance Directive (ATAD I) into domestic law was voted through last December. The specific interest limitation rule for tax-integrated groups will apply automatically for all tax unities. However, companies that prefer to apply it on a standalone basis will need to request it at the time of filing the joint request for the tax unity. For the existing tax unities, the option to apply limitation of interest deductibility to each member separately will require filing a dedicated joint request before the end of the first financial year for which the interest limitation rules apply (i.e. the tax year beginning on or after 1 January 2019).

For a summary of the main tax measures introduced by the 2019 budget law, please refer to this Deloitte Luxembourg Tax Alert

MLI

The Multilateral Instrument (MLI) is a multilateral tax convention developed to implement changes to tax treaties under some BEPS actions. To date, 87 jurisdictions have signed the MLI and 25 have already ratified the convention and deposited their ratification, acceptance, or approval instruments with the OECD.

Even though signing jurisdictions have already provided provisional lists of reservations and notifications at the time of signature of the MLI, the final list of reservations and covered tax treaties is submitted only upon depositing the ratification instrument with the OECD (and therefore subject to change until the deposit of ratification instrument).

MLI itself became applicable as of 1 January 2019 for the first ratifying countries and should become applicable for most signing countries as of the taxable year 2020 or 2021. Since the MLI does not replace existing tax treaties, but is applied alongside a bilateral tax treaty and functions as an addition, modifying the treaty content on the application of BEPS issues, several conditions must be fulfilled for the specific MLI provision to apply to a specific treaty. In this respect, both parties to that bilateral tax treaty must:

- Sign and ratify the MLI, following their respective internal ratification processes, and
- Select the concerned treaty as a covered tax treaty, and
- Adopt the same provisions, unless asymmetrical adoption is allowed in specific cases (apart from minimum standards, which are mandatory).

For the MLI changes to become effectively applicable to a bilateral tax treaty, it should be verified whether and when both parties have ratified the MLI, to establish when it comes into effect and when the final provisions become effective for the treaty at hand. Therefore, it is important to remember that for each bilateral tax treaty potentially modified by the MLI, its application needs to be analysed on a case-by-case basis.

In addition, although the date of entry into force of the MLI for a bilateral tax treaty chosen would always be the same (i.e. the latest of the dates of entry into force for the parties to that bilateral tax treaty), dates when MLI becomes effectively applicable can differ between the parties to a bilateral tax treaty subject to their individual choices and the type of tax.

MLI ratified in Luxembourg

On 9 April 2019, Luxembourg deposited its instrument of ratification for MLI. Luxembourg's definitive list of reservations and notifications to the MLI (i.e. its MLI position, available in French only) identifies 81 tax treaties that it wishes to be covered by the convention.

The MLI will enter into force in Luxembourg on the first day of the month following a three-month period from the deposit of its instrument of ratification, i.e. on 1 August 2019.

The mutual agreement procedure and arbitration will become applicable for Luxembourg as of this date, for all bilateral tax treaties with countries that have ratified the MLI before Luxembourg.

The MLI provisions will become applicable for taxes withheld at source on amounts paid or credited where the event giving rise to such taxes occurs on or after the first day of the next calendar year that begins on or after the latest of the dates on which the MLI enters into force for the two parties to the covered tax treaty. In Luxembourg, these provisions will enter into effect on 1 January 2020.

With respect to all other taxes, the MLI provisions will become applicable for taxes levied with respect to taxable periods beginning on or after the expiration of six calendar months from the latest of the dates on which the MLI enters into force for the two parties to the covered treaty, i.e. 1 February 2020 in the case of Luxembourg. In practice, where the taxable year of Luxembourg companies follows the calendar year, the MLI provisions, with respect to taxes other than withholding tax, would apply to taxable periods beginning on 1 January 2021 (different application where a divergent taxable year has been selected).

However, for the MLI changes to apply to a bilateral tax treaty concluded by Luxembourg, whether and when the other party has or will ratify the MLI needs to be verified.

The existing Luxembourg-UK tax treaty can serve as an example to illustrate how the effective date will operate for Luxembourg. The UK deposited its instrument of ratification on 29 June 2018 and therefore, in the UK, the MLI entered into force on 1 October 2018. Luxembourg deposited its ratification instrument in April 2019, and therefore, the MLI will enter into force for Luxembourg tax treaties on 1 August 2019. The time limit for the MLI to enter into force for a specific treaty runs from the date on which the second of the two parties to the covered treaty deposits its own instrument of ratification with the OECD. In the circumstances described above, 1 August 2019 will be the date of entry into force of the MLI in relation to the treaty between Luxembourg and the UK. Therefore:

- For taxes withheld at source, the MLI will become effective for both countries where the event giving rise to such taxes occurs on or after 1 January 2020.
- For all other taxes, due to the differences in taxable periods between Luxembourg and the UK, the effective application would be different. Using the above example, the six-month period (see above) would expire on 1 February 2020, so the MLI provisions would apply to taxable periods beginning earliest on 1 February 2020:

  - In Luxembourg, the taxable year usually corresponds to the calendar year (except in cases of a diverging tax year). Therefore, the MLI provisions predominantly will apply for all other taxes as from the taxable year beginning on 1 January 2021 (or as from February 2020 for a diverging taxable year opening at that time); and

  - In the UK, the fiscal year runs from April, so it is likely that the MLI provisions would apply for all other taxes as from the taxable periods beginning in April 2020.

For details regarding the provisions chosen by Luxembourg, please refer to this Deloitte Luxembourg Tax Alert

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