TAXE Committee : Country specific fact sheet Luxembourg

Roadmap for Green delegation

0) Selected Data and figures

- Broad definition of IP. 80% exemption for net income deriving from IP rights and capital gains realized on the sale of IP, which results in a effective tax rate for IP income of 5,72%
- Well-established ruling practice since 1989. Managed by only one bureau, the team around Mr. Kohl (Mr. Kohl was invited, but he is missing on the updated agenda of the delegation visit)
- Extended web of double taxation agreements (DTA) with 69 countries, including some with dubious jurisdiction (see below)
- 2nd largest fund center in the world behind the USA: € 2,5 trillion in net assets managed by sub-funds representing a quarter of the European assets under management
- 1st GDP/capita in Europe
- Lowest standard VAT rate in the EU (17%)

In detail

1) Tax rulings: the core of tax evasion

<u>Background</u>
A ruling is a written statement sought by a taxpayer from the tax authorities about the tax implications of a transaction and how it is going to be taxed by the relevant authorities. It is legally binding.

On the basis of the documents disclosed by the International Consortium of Investigative Journalists (ICIJ) covering an <u>8-year period</u>, it has been demonstrated that <u>548 tax rulings</u> had been granted to more than <u>340</u> Multinational enterprises as well as medium-sized companies.

This is not unlawful in its form as rulings are a common practice. However, the substance of these rulings is shockingly illegal. Indeed, they are patently clear cases of tax avoidance.

All rulings since 1989 were based on one circular letter, beyond that based on good faith. Only in 2014 a legal basis was established in the frame of the 2014 budgetary law. In parallel, Ruling Commission put in place.

<u>What is it we're talking about?</u>
There are different types of rulings. The most prominent types include transfer pricing rulings (for international financing), rulings concerning withholding tax (parent-subsidiary directive, especially used for PE), rulings on IP boxes.

All in all, this is "industrialized tax evasion" routinized by advisors, banks, corporations and Luxembourg. The authorities took aggressive tax planning and tax avoidance to a whole new level by assenting profit minimization and tax arrangements with greedy multinationals.

Thanks to these tax rulings, they secured very low effective tax rates - ranging from 0,5% to 3% on most of their revenues.

Firms such as Amazon or FIAT Finance are involved in these deals but basically MNEs from all sectors have benefited from such rulings.

<u>Current situation / Investigation state of play :</u>
There have already been State-Aid cases in the past opened against Luxembourg but not directly targeting tax rulings. Theses cases primarily concerned the coordination centres and finance companies.

Now, the Luxembourgish tax rulings system is under the Commission scrutiny, just as ten other MSs since December 2014.

Moreover, DG Comp has launched an in-depth investigation on some multinationals that have allegedly benefited from the generous rulings. According to recent updates by the DG Comp, it may take some more time to scrutinize. Nevertheless, the move is not enough, many other multinationals have not yet been targeted and Luxembourg is not willing to significantly overhaul its Tax rulings scheme.

Last February, Luxembourg has accepted to exchange limited information with Belgium following the pressure carried out by its neighbour. However, this exchange of information has had a limited scope and is only the outcome of the unbearable situation provoked by the LuxLeaks. We should not be fooled by the trick: Political will remains absent in Luxembourg.

In fact, Luxembourg has no intention to put an end to its Tax Rulings system unless all MS or the Commission force it to do so. In the Minutes of a hearing of the Minister of Finance and Lux MPs of 10 February 2015, the Minister persists in calling the rulings as "confidential" and therefore "not to be shared or disclosed to the public". This statement has to be absolutely challenged by the recent commitments Luxembourg has undertaken in the view of more transparency ! (See questions at the bottom of the document)

Exchange of information remains scant. Under the BEPS action plan, Luxembourg is due to proceed to Automatic Exchange of Information by 2017 but drastic changes remain to be seen and implemented now. If the Tax Transparency Package is adopted, automatic exchange of rulings will start in 2016.

Lux arguments about rulings
The possibility being highly far-fetched as LUX main argument is repeated over and over:
- It is lawful and,
- It helps and provides taxpayers with legal certainty and predictability on the application of general tax rules

The questions to be asked must aim at challenging authorities and officials (see questions below) on such issues.

Potential contradiction with EU law :
On the grounds of Illegal State-Aid provisions (Article 107 & 108 TFEU), Commission's preliminary view is that these rulings are likely to constitute unlawful State aid under EU law. In our opinion, the toughest criteria to be met to qualify as illegal or unjustifiable State Aid is selective form of an advantage. However, there are good chances that it can be met since the Court of Justice of the European Union set out in Joined Cases C- 182/03 and C-217/03 *Belgium and Forum 187 v. Commission* in 2006 : if the method of taxation for intra-group transfers does not comply with the arm's length principle and leads to a lower taxable base than would result from a correct implementation of that principle, it provides a selective advantage to the company concerned (also applicable to Advance Pricing Agreements)

As soon as the Commission Automatic Exchange Information proposal will be enforced, Luxembourg will have to provide the rulings it granted within a limited timeframe. Should it fail to do so, an infringement procedure might be launched.

2) IntraGroup Financing Companies - Advance Pricing Agreements (APAs)

Background
An APA is a contract between a taxpayer - usually MNEs with big assets and profits - and a tax authority that specifies the pricing-method and benchmarks used for intragroup transactions. In other words, risk-free transactions between related companies. The APAs discussed are abnormal transfer-pricing agreements, meaning those agreements do not comply with the arm's lenght principle.

This practice is widespread in Luxembourg and is very similar to tax rulings. Advance pricing agreement goes back as far as the early 90's when it was first introduced in conjunction with the rulings practice. Until 1996, the system was unregulated - save for a lax circular issued by the LUX tax authorities - leading to utterly aggressive tax planning. Then, the Commission applied pressure on LUX authorities to overhaul the system, to no avail. Intra-group financing practices combined with Advance pricing agreement are still in place in spite of the multiple State aid cases initiated against intra-group financing schemes in the past (to that end, see Coordination centres and Finance companies case IP/02/1481 and Exempt holdings and Billionaire holdings case IP/06/1021 about tax advantages to holdings providing certain financial services.)

What is it we're talking about?

Many countries do make use of APAs. They can be unilateral - between one taxpayer and a tax administration - or multilateral - between one taxpayer and several tax administrations.

In Luxembourg, group financing companies and subsequent APAs are no more, no less, a misuse of transfer pricing agreements. To be harsher: one can lump it with embezzlement. The two 2011 circulars issued by Luxembourg authorities, following new OECD standards have not modified APAs to great depths. Economic substance requirement can be easily circumvented by MNEs - as shows the Amazon case - and even so, former APAs are not challenged nor reassessed by Luxembourg authorities.

In spite of these circulars, feeling of impunity remains when it comes to APAs, tax advisors and benefiting MNEs alike continue to make the best use of these practices.

Current situation / Investigation state of play

As evidenced by Tax justice network contributor, Dimitrios Kyriazis, companies such as Fiat Financial Trade or Amazon have benefited from APA to a very large extent. Complicity of Luxembourg whose analysis has been incomplete and lax was too prompt: For instance, it took only 11 days to validate Amazon's APA! Moreover, Luxembourg refused to submit to the Commission any transfer pricing file report nor its supporting economic analysis.

Even tax service providers acknowledge that there should be stricter rules regarding APAs. See to that effect, Chris Sanger's, Global Director of Tax Policy, EY, intervention and introductory statement on May 5 in front TAXE committee.

Pascal Saint-Amans, head of the OECD tax policy and administration, himself has advocated in favour of giving up the Arm's length principle. The BEPS action plan does not foresee it but aims at stricter rules on transfer-pricing and their subsequent assessment.

Luxembourg's APA practices are also thoroughly scrutinized by the Commission.

Potential contradiction with EU law

The APAs are also potential illegal State Aids and may fall within the provisions of Article 107 TFEU. Selectivity is easier to demonstrate should there be mismatch in the transfer-pricing method ("if the method of taxation for intra-group transfers does not comply with the arm's-length principle and leads to a lower taxable base than would result from a correct implementation of that principle, it provides a selective advantage to the company concerned" Joined Cases C- 182/03 and C-217/03 *Belgium and Forum 187 v. Commission)*

Sources :

"Luxembourg, Amazon, and the State aid connection", January 23, 2015, Tax Justice Network, retrieved on May 8, 2015 http://www.taxjustice.net/2015/01/23/luxembourg-amazon-state-aid-connection/

3) Patent boxes

A tax scheme to foster innovation and intellectual property management. A number of countries have enacted “patent box” regimes that provide a low tax rate (5% to 15%) on profits derived from IP.

Main goal : promote investment in new technology and incentivize innovation. Countries enacting these favorable tax regimes also hope to attract R&D activities to their countries.

LUX:
80% exemption of income from the use, exploitation and/or disposal of qualifying IP rights, bringing the effective tax rate down to 5.76%.

Very broad definition of IP: The exemption regime applies qualifying IP rights such as income from patents, trademarks, designs, models, software copyrights and domain names. An 80% deduction of net deemed income is also available under certain conditions for selfdeveloped patents, which are used internally by the taxpayer.

An IP regime is applicable to qualifying IP rights acquired or developed after 31 December 2007.

Moreover, these IP rights are fully exempt from net worth tax.

Three situations are covered:
- The remuneration for exploitation of IP rights;
- The use of IP rights by a company for its own activity;
- The disposal of IP rights.

For reasons of comparison: The maximum effective tax rates for earnings on royalties are: Belgium (6,8%), France(15%), Great Britain (10%), Luxembourg (5,72%), Malta (0%), Netherlands (5%), Portugal (11,5%), Spain (10%), Hungary (9,5%), Cyprus (0%). Outside the EU: Liechtenstein (0%). Switzerland, Italy and Ireland have announced to introduce patent box regimes.

Country	Exemption Rate	Regular Corporate Tax Rate	Effective Corp. Tax Rate on Qualifying IP	Types of IP that Qualify	Acquired IP Qualifies?	Can R&D be performed abroad?	Expenses that Reduce Qualified Income	Year Enacted
Belgium	80% of patent income is exempt	20%	6.8%	Patents and supplementary protection certificates	Yes, under conditions	Yes	Expenses except license fees and amortization of acquired patents	2008
China	Exemption for revenue below RMB 5M ($783K) and 50% above RMB 5M	25%	0-12.5%	Registered patents and know-how	Yes	No	Most expenses	2008
France	Flat rate	34%	15%	Patents and supplementary protection certificates	Yes, under conditions	Yes	Includes management expenses related to licensing IP	2005
Ireland	Specific rules	10%	<10%	Most IP	Yes	Yes	For capital expenditures after May 7, 2009	1973
Luxembourg	80% of patent income is exempt	17%	5.9%	Software, copyrights, patents, trademarks, designs, or models	Yes	Yes	Most expenses	2008
The Netherlands	Flat rate	25%	10%	Patents or IP from qualifying and approved R&D	No	Yes, but not for R&D certificate	Most expenses	2007

Source : PriceWaterhouseCoopers, "A Comparison of Key Aspects of the International Tax Systems of Major OECD and Developing Countries" (technical report, Business Roundtable, Washington, D.C., May 10, 2010), http://businessroundtable.org/uploads/studies-reports/downloads/BRT_14_country_international_tax_comparison_20100510.pdf.

The Amazon case:

Amazon Inc./USA has established a subsidiary in Luxembourg which holds the intellectual property of the Amazon group (Amazon Europe Technologies Holding Societe en commandite simple, SCS). SCS itself has established a Luxembourgish subsidiary (Amazon EU Societe à responsabilité limitée, SARL) which does the operative transactions in Europe. Business is done between SARL and customers. SARL holds participations in subsidiaries in several European states, where logistics is done, for example Amazon.de GmbH in Germany.

SCS is, due to its legal status, not subject to taxation in LUX. SCS has no business establishment in LUX. SCS also is not taxable in the US as long as its profits are invested outside the US.

SARL is taxable in LUX, but reduces its profits by deducting the royalties paid to SCS. Consequently, profit of SARL reduced from 519 million to 11 million (in 2009).

Amazon.de GmbH is taxable in Germany but officially only generates tiny income. Revenue in Germany (in 2014, according to Handelsblatt): EUR 11.9 billion.
Profit of Amazon.de GmbH (in 2013): EUR 3.9 million

Potential conflict with law:
The amount of royalty paid from SARL to SCS might be too high. The amount of royalties has been negotiated in a ruling with LUX. This advance price agreement is supposed to breach the arm's length principle. COM is investigating the case.

Furthermore, the profit of the logistic centres all over Europe might be far too low in comparison to their function. The French financial administration therefore has questioned the practice of Amazon and wants to recover an additional tax of 252 million dollar. UK has started a tax audit. No information for Germany.

The Amazon case shows what it is all about: problem to tax e-commerce in a globalised world.

Possible solutions

- Withholding tax (due in the state where the royalty expense occurs), but parent-subsidiary directive does not allow to raise withholding tax for intra-company transactions
- Add-back taxation (Hinzurechnungsbesteuerung, the royalty expense cannot be deducted from income), but ECJ ruling "Cadbury Schweppes" does not allow add-back taxation if minimal economic activity can be proven (one employee is already enough)
- Ban of patent boxes, but politically not feasible because of unanimity principle in the field of EU taxation
- Extension of the definition of business establishment (server or subsidiary justifies as business establishment of the parental company)
- CCCTB

4) Possibilities to get money out of Luxembourg

4.1) Hybrid debt instruments

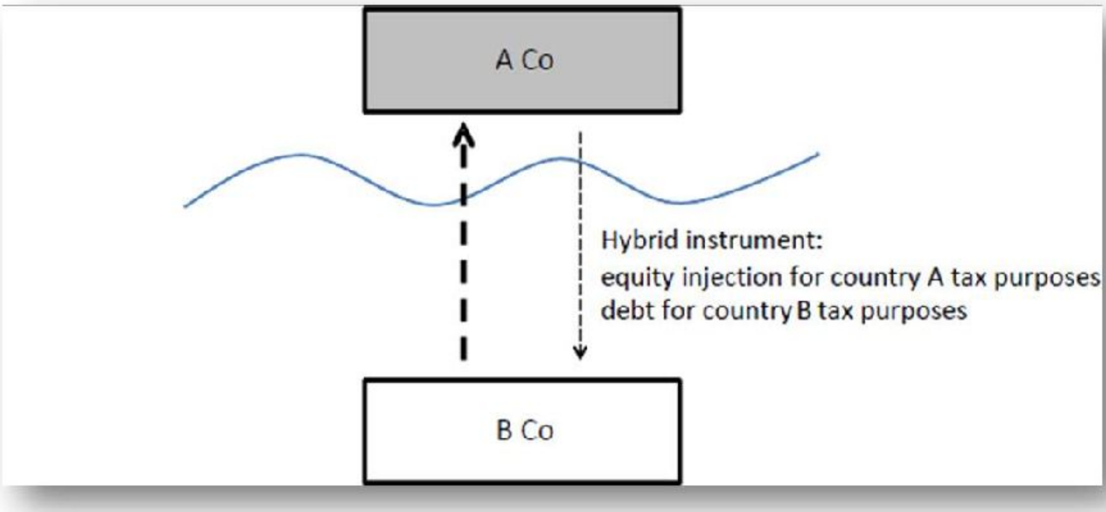
As regards the characterization of the hybrid instruments, Luxembourg follows its domestic principles, without regard to the characterization operated in the other state. The qualification and subsequent tax treatment of any contemplated hybrid instrument can be discussed with the Luxembourg tax authorities.

The LUX financial market has developed responses to reach the desired tax goals of achieving low taxation for income derived from investments, and of facilitating repatriation to foreign investors free of withholding tax. Most of hybrid instruments are frequently used to achieve these objectives; they contain both debt and equity features. These instruments are usually used in intra-group situations, where the distinction between equity and debt is less relevant from a business point of view.

Deduction - no inclusion

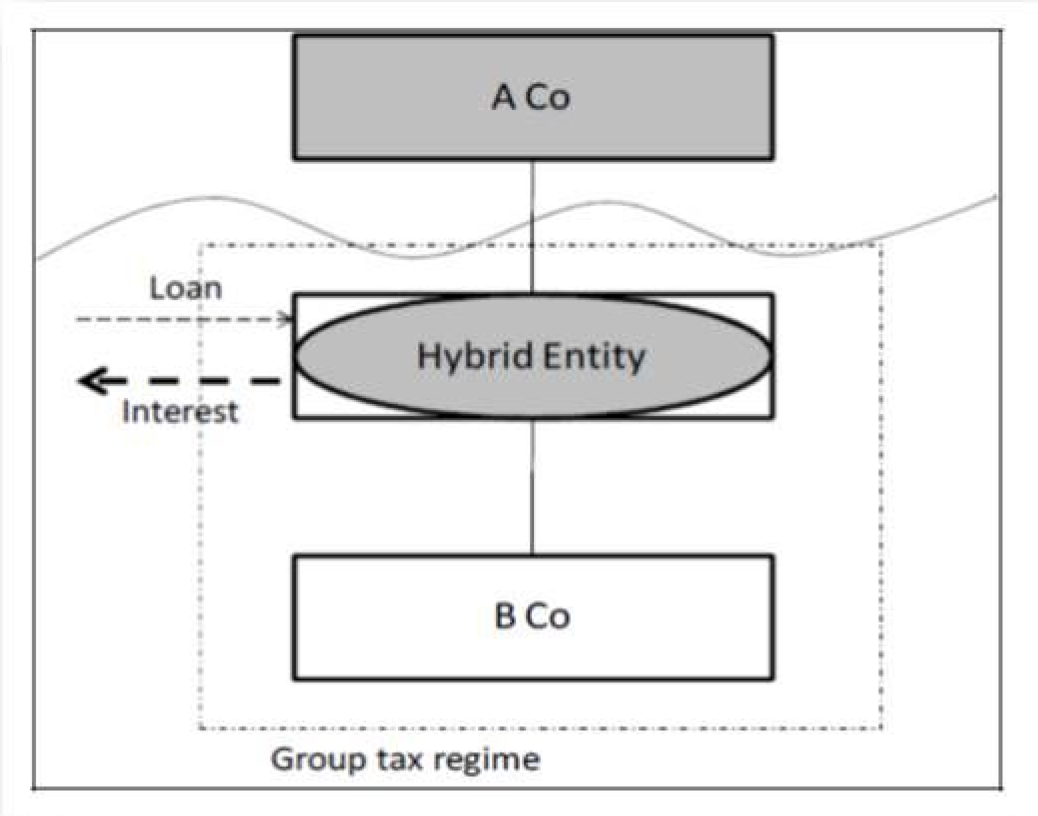
A corporation located in State A ("A Co", for example Belgium) holds a participation in a corporation located in State B ("B Co", for example LUX).

In country A (Belgium) the participation is treated as equity, in country B (LUX) the participation is recognised as debt. In country B (LUX) the interest paid is recognised as tax-deductible expense. In country A (Belgium) the interest received is treated as dividend income (possibly tax-exempt).



Double deduction

Hybrid Entity, resident of MS B (and established under the laws of MS B) takes out a loan from a third party or another group company. The loan amount is used to either buy the shares in B Co. (acquisition) or to inject additional equity into the existing subsidiary B Co. Hybrid Entity pays interest on the loan. As Hybrid Entity is transparent for MS A tax purposes, its interest expenses are deducted directly at A Co level against unrelated income of A Co. In MS B, Hybrid Entity is treated as a corporate taxpayer. Its interest expenses can be offset against other income of B Co and other group companies in MS B under MS B's group relief regime.



Examples for hybrid debt instruments

In the following you will find some examples of hybrids used in LUX. All these instruments have a common feature: they are considered as debt for LUX tax purposes (to benefit from withholding tax exemption and be deductible from LUX corporate income tax base) and as equity by other jurisdictions. They will normally be booked as debt in the LUX subsidiary accounting system, although they contain equity features.

<u>Profit participating loan/income sharing loan</u>

A profit participating loan (PPL) or income sharing loan is a loan whose interest tracks the company's profits or the income derived from a specific asset. A PPL is often used as an extraction mechanism, since it may in some instances lead to a higher repatriation capacity than a standard fixed interest loan. Whether the instrument qualifies as debt and the deductibility/absence of withholding tax on the interest will have to be analysed in the light of the limitations foreseen in LUX law, but the profit-sharing feature may not be an obstacle to qualifying the instrument as debt. Depending on the domestic tax rules of the lender's country, the PPL may also be used as a hybrid instrument where the lender benefits from the most favourable tax regime because the PPL is considered as equity.

Under the current Parent-Subsidiary directive, this loophole has been recently closed by obliging the Member State of the parent company to tax profit distributions which are deductible by the subsidiary. But this applies only to operations between MS. With 3rd country jurisdictions, this type of structure is still profitable: the country of the parent company (if choosing the exemption method to relieve profit distributions from double taxation when this is allowed for by the DTC) has to exempt the received profit distributions even if they were deductible by the paying subsidiary under a hybrid loan arrangement.

Redeemable convertible bonds or convertible preferred equity certificates
The aim of (partly) financing an investment by issuing redeemable convertible bonds or convertible preferred equity certificates (CPECs) is to enable a Luxembourg company to make distributions of future earnings as interest, which is not subject to withholding tax. The use of CPECs is sometimes preferred to bonds because CPECs are considered as equity in some foreign jurisdictions such as the USA. CPECs and bonds are generally long term (more than 10 years), subordinated and convertible into shares.

Mandatory redeemable preferred shares and preferred equity share certificates
Mandatory redeemable preferred shares (MRPSs) form part of the share capital and are stated in the articles of association. However, they are in principle short term (generally 10 years), are preferred to the company's ordinary shares and bear a fixed coupon which can be cumulative. Due to their debt features and the mandatory redemption of the instrument, MRPSs are likely to be assimilated to debt from an accounting perspective, and therefore from a tax perspective as well.

Preferred equity share certificates (PESCs) have the same general features as MRPSs
MRPSs and PESCs are the tools generally used by the financial market to achieve an instrument which is legally share capital, but a debt instrument in essence and from a tax perspective.

PECs (Preferred Equity Certificates) and CPECs (Convertible Preferred Equity Certificates)
CPECs are often used in structuring transactions for foreign based investors, as they are often treated as debt for Luxembourg tax purpose, hence the interest (yield) paid to CPECs' holders would not be subject to withholding tax in Luxembourg. Under certain conditions, CPECs can also be redeemed or repurchased. If a company's investments are successful, the CPECs will be repurchased at a higher price. This would not be considered as a dividend and as such not be subject to Luxembourg withholding tax.
PECs and CPECs can be a good solution for assets like participations, portfolio placements, IP rights, receivables, etc. which need to be ultimately paid out to holders who would like to increase the efficiency of the European participation exemption or double tax treaties.

Contradiction with law
Transactions, if proven as "abuse of law", "lacking economic substance", "fiscal nullity", "business purpose" or "step transactions" can be defeated through general anti-avoidance rules. However, the terms of general anti-avoidance rules and the frequent need to show a direct link between the transactions and the avoidance of that particular jurisdiction's tax tend to make the application of general anti-avoidance rules difficult in many cases involving hybrid mismatch arrangements.

4.2) No Withholding Tax (WHT)

Luxembourg does not impose any withholding tax on the payment of interest, except for very specific cases. There is no withholding tax on royalties paid to resident or non-resident companies related to patents, trademarks and know-how. Furthermore, there is no withholding tax on liquidation proceeds.

The domestic WHT rate on dividends of 15 %is often reduced by a tax treaty for a corporate shareholder holding at least 25 % of the capital or voting rights in the Luxembourg entity. Most of the tax treaties provide for a full exemption from WHT on interest, whereas dividends and royalties are generally subject to a 5 to 10 per cent WHT. Luxemburg has concluded tax treaties with 69 jurisdictions among others Barbados, Hong Kong, Liechtenstein, Monaco, Panama, San Marino, Singapore, Switzerland, or Trinidad and Tobago (source: Liste des conventions en vigueur, Administration des contributions directes du Grand-Duché de Luxembourg). That means that interests paid by a LUX subsidiary to a company located in one of these Tax Havens is free from WHT. For instance, the tax treaty between Luxembourg and Switzerland aims to reproduce the Luxembourg participation exemption regime resulting from the application of the EU Parent–Subsidiary Directive.

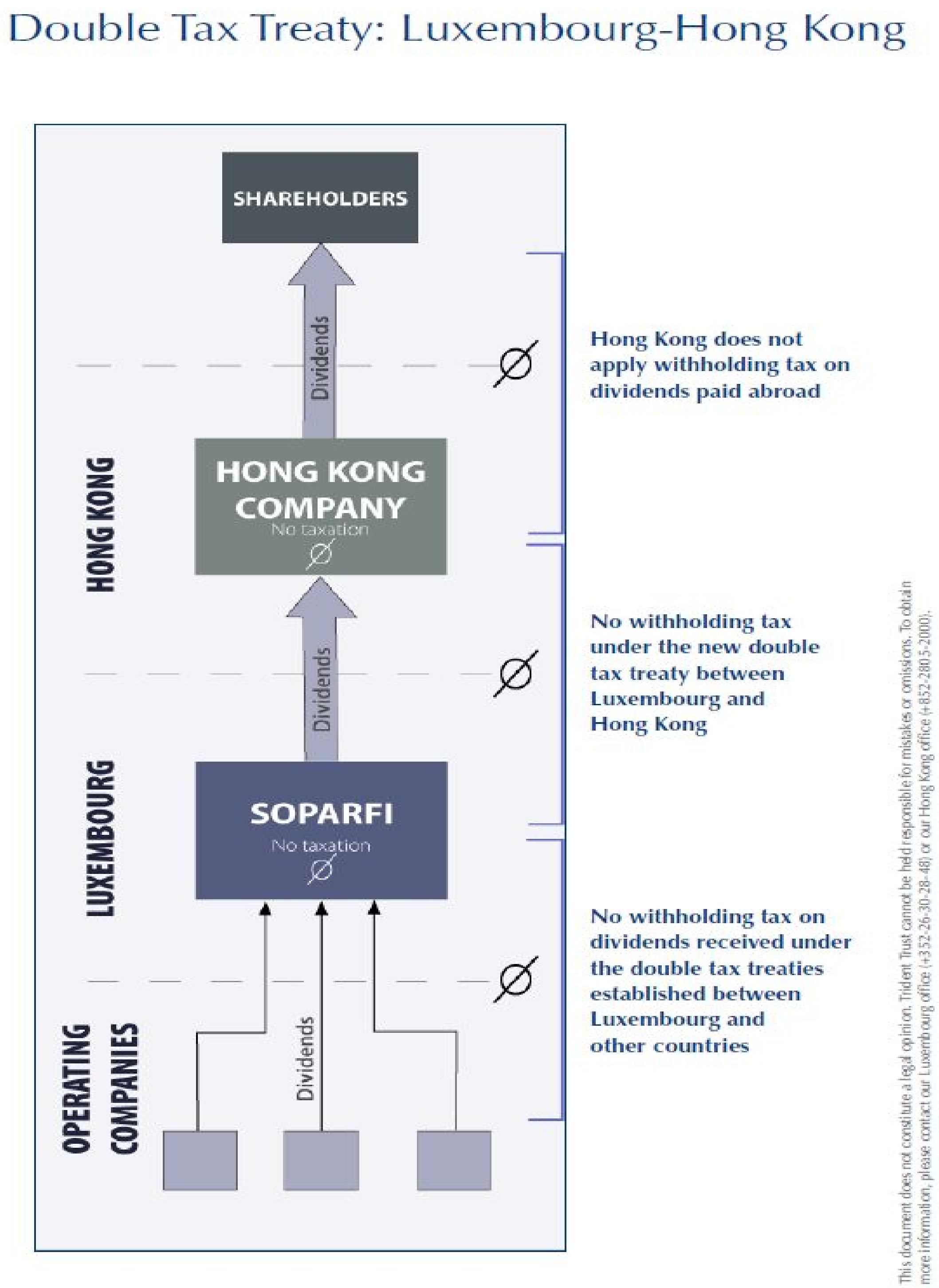
Moreover, most of the foreign WHT paid on the interest income received by the Luxembourg tax resident is creditable against the amount of corporate income tax due on the respective income for Luxembourg tax purposes. Any excess (non creditable) foreign WHT can be deducted as an expense, but cannot be carried forward as a credit.

On top of that the interests paid by the LUX subsidiary are deducted from the corporate income tax base in LUX and compensate for the interests received, which means the operation is neutral for the LUX corporate income tax base.

5) Double-taxation treaties : The Luxembourg network

Luxemburg has concluded tax treaties with 69 jurisdictions among others Barbados, Hong Kong, Liechtenstein, Monaco, Panama, San Marino, Singapore, Switzerland, or Trinidad and Tobago (source: Liste des conventions en vigueur, Administration des contributions directes du Grand-Duché de Luxembourg). Brunei and Oman are still pending.

Let’s pick the Luxembourg-Hong Kong double tax convention. Thanks to the treaty, withholding tax can be avoided up to 3 times!



Here's how the magic trick works:

1) First, <u>you need a double-tax treaty between Luxembourg and another country.</u> The dividends received by the SOPARFI (Luxembourg legal entity, definition see below) from its operating companies located in other countries are <u>not subject to taxation</u>.

2) Then, the <u>SOPARFI transfers the dividends to the Hong-Kong company</u> → still <u>no withholding tax</u>.

3) Eventually, dividends transferred from Luxembourg to the HK entity can be distributed to shareholders in HK without having been subject to any taxation.

The scheme is limpid and is allowed by the double tax treaty. This is what experts call "double non-taxation". The OECD wants to end these situations thanks to the BEPS Action Plan but as long as double tax treaties are in force with such jurisdiction aforementioned, this double non-taxation situation remains.

Contradiction with law: Code of conduct group has so far only concentrated on avoiding double taxation. The case of double non-taxation has not been dealt yet bt the Code of Conduct. And very little progress had been made by the Code of Conduct group overall regarding Luxembourg agressive double tax agreement's web.
The OECD BEPS Action Plan gives much more insight into the fight against treaty shopping and double non-taxtion. Particularly in its Action 2 that aims at neutralising the effects of hybrid mismatch arrangements, Action 4 in limiting base erosion via interestest deductions and other financial payments and Action 6 on preventing treaty abuse.

They are all considered deliverable as of 2015. The Luxembourg-Hong-Kong example is a typical example of the breach of these principles because of this triple non-deduction and the possibility for an investor to make use of treaty shopping by the ease to set up a SOPARFI in Luxembourg and a Hong-Kong subsidiary.
→ The Luxembourg is bragging about his active participation in the OECD's BEPS action plan and steps toward a fairer a tax system but it is still making use of tax practices that contradict the various BEPS Action plan.

Source : Trident trust, Hong-Kong Luxembourg Treaty Memo, http://www.tridenttrust.com/PDFs/THKO-TLUX-Treaty-Memo.pdf

6) Other incentives by entity

Investment funds
Investment funds resident in Luxembourg generally are exempt from corporate income tax, municipal business tax, and withholding tax on dividends. These investment funds are subject to the subscription tax ("taxe d'abonnement") and to the general registration duty regime.
Funds are fully tax exempt in IRL. Because of that, ALFI (Association of the Luxembourg Fund Industry) asks for the abolishment of the "taxe d'abonnement".

Financial participation company (Soparfi)
A Soparfi (Société de Participation Financière) is neither a specific type of company nor a special tax regime. It is rather used to refer to resident companies that hold and manage the shareholdings of subsidiaries. A Soparfi is subject to corporate income tax, municipal business tax, and net wealth tax, but it does benefit from Luxembourg's double taxation treaties, EU Directives (e.g. Parent Subsidiary Directive), the domestic participation exemption on dividends received, and capital gains on qualifying participations.

Private wealth management company (Société de gestion du Patrimoine Familial or SPF)
The SPF has been tailored to enter the private sphere of individuals for the purpose of wealth management. Its corporate objective is restricted to the acquisition, holding, management, and disposal of financial assets, to the exclusion of any commercial activity. As a general rule, an SPF is exempt from Luxembourg taxation on income and wealth tax in Luxembourg. A yearly subscription tax of 0.25% is due on the basis of paid-up capital, share premium, and excessive debts. Subscription tax, however, is capped at EUR 125,000. No withholding tax applies on dividends distributed by an SPF. Non-resident investors are not taxed in Luxembourg on dividends paid by an SPF or on capital gains realised on shares in an SPF.

Securitisation companies (SCs)
An SC is a company that carries out securitisation activities or participates in securitisation transactions. SCs are subject to normal corporate taxation based on their net accounting profit (i.e. gross accounting profits minus expenses). However, the commitment to remunerate the security holders (both capital and debt) issued by the SC qualifies as interest on debt even if paid as return on equity. SCs are not subject to net wealth tax in Luxembourg.

Venture capital vehicle (Société d'Investissement en Capital à Risques or SICAR)
The SICAR benefits from an attractive tax regime. SICARs are notably exempt from net wealth tax. Incorporated under a corporate form, the SICAR is subject to income tax at the normal rate with the benefit of an exemption on income and gains (e.g. dividends, capital gains, liquidation proceeds, interest) from transferable securities qualifying as risk capital as well as income arising from investments in liquid assets pending their investment in risk capital for a maximum of 12 months. In addition, it can benefit from the European directives and double taxation treaties. Under the form of a limited partnership, the SICAR is treated as a tax transparent entity, and investors are taxed according to the rules of their country of residence. SICARs treated as tax transparent entities do not benefit from the European directives and double taxation treaties. The SICAR mainly targets qualified or informed investors (i.e.'professional' investors).

Financial services companies
Banks, securities depositaries, insurance, and reinsurance companies, as well as other financial service companies, may benefit from preferential regulations when establishing their taxable basis for corporate income tax (e.g. provision for the neutralisation of unrealised exchange gains, general banking risk provision, provision for guarantee of deposits, mathematical reserves, and/or catastrophe reserves).

Shipping companies
Luxembourg-resident shipping companies are not subject to municipal business tax and can benefit from investment tax credits and accelerated depreciation (even for used assets).

7) Foreign Tax Credit - Inbound and capital investment incentives

Luxembourg tax law provides for various incentives, with specific requirements, in the areas of risk capital, audiovisual activities, and environmental protection, as well as for research and development (R&D), professional training, and recruitment of unemployed persons.

The most commonly used incentives are the investment tax credits. Luxembourg tax law provides for two types of investment tax credits.

First, a tax credit is available that, as of tax year 2013, amounts to 12% of the increase in investment in tangible depreciable assets made during the tax year. The increase in investment over a given tax year is computed as the difference between the current value of all qualifying assets and the reference value allocated to the same type of assets.

Independently, the company may benefit from a 7% tax credit on the first EUR 150,000 of qualifying new investments, and, as of tax year 2013, a 2% tax credit on the amount of new investments exceeding EUR 150,000 in tangible depreciable assets as well as investments in sanitary and central heating installation in hotel buildings and investments in buildings used for social activities.

The above 7% and 2% rates are increased to 8% and 4% for investments eligible for special depreciation (i.e. investments favouring the protection of the environment, the realisation of energy savings, or the creation of employment for handicapped workers). However, certain investments are excluded from the credit calculation, including investments in real property, intangible assets, and vehicles (unless specifically stated by the law).

Domestic law requires that investments be physically operated in Luxembourg in order to be eligible for the incentive, unless the investment consists in shipping vessels operating in international waters.

In addition, the tax benefit of the tax credit is limited to investments that are made within a Luxembourg business establishment and that are intended to be used permanently in Luxembourg.

Further to the European Court of Justice's decision dated 22 December 2010 (Tankredeerei, C - 287/10), the Luxembourg Tax Authorities issued a Circular letter confirming that the investment tax credit must be granted to any investment used within the EU and EEA member states. Although Luxembourg domestic tax law has not yet been amended accordingly, the application of investment tax credit may be requested for the current tax year, as well as for tax years already assessed but still subject to the introduction of a claim.

<u>Contradiction with law</u>
None, if granted to any investment within the EU/EEA

8) Governance issues in Luxembourg

Behind the curtains, there are some governance issues in Luxembourg regarding authorities and private individuals alike. Although, there are no clear cases of corruption formally reported and linked to the business sector, some practices are ill-fitting.
Three examples may be underlined:

In the financial sector, the supervision of Luxembourg funds is only selectively enforced by the Commission de Surveillance du Secteur Financier (CSSF) as evidence the example of UBS-Luxalpha funds (= breach of financial rules and CSSF 02/77 circular after the liquidation of the LuxAlpha fund), same happened with the four funds set up by Petercam in 2008 when they breached investment rules, CSSF did not act and finally with the Elite Advisers - Nobles fund when the CSSF remained oblivious to enforce sanction to this non-compliant fund.
[For a broader overview, see the letter attached sent by Investor protection managing partner, Mr. Albert Biebuick discussing these issues.]
In addition to this, the CSSF was already challenged by another investor-protection group, ProtInvest, when Mrs. Sarah Khabirpour, sitting at the board of the Banque Internationale du Luxembourg (BIL), was appointed by former Minister of Finance, Mr. Luc Frieden, to the CSSF board in 2013. While at the same time the CSSF is supposed to regulate the BIL's compliance with financial legislation!

There are elements that corroborate the views that the Big 4 consultancies maintain very close ties to the Lux government and public authorities, up to the point that may even directly advised the Prime Minister when forming his government and coalition. See question prepared to Mr. Alain Kinsch, Country Managing Partner E & Y, who has admitted having advised current PM Xavier Bettel to form its government.

There is a cloud of opacity surrounding Luxembourg senior officials, namely those administrators that managed funds of public companies, who are suspected of misappropriation of funds when performing their duty. Basically, they should have returned the funds they earned for their management to the Treasury. This did not occur. Instead, the Lux government does not wish to uncover the veil of secrecy.

9) Shadow-banking: behind the scenes in Luxembourg

Background: Shadow banking covers activities conducted by capital-investment funds, hedge funds, structured investment vehicles funds and money-market funds. It includes activities such as securities lending/borrowing and repos.
Shadow banking relies on credit intermediation involving entities that fall outside the scope of the regular banking system making them even more difficult to control.
Shadow-banking is estimated to total the unbelievable amount of $60 trillion in size.

What is it we're talking about? : Shadow-banking is harmful when it comes to money market funds activities. According to the IMF Managing Director Christine Lagarde, "the opaqueness of these activities warrants heightened vigilance", most of the supervisory bodies such as the Financial Stability Board (FSB) and the European Systemic Risk Board (ESRB) as well as the G-20 have recommended legislators to ban toxic money market funds by guaranteeing a 3% capital buffer and the conversion of constant net asset value money market funds (also called C-NAV) into variable ones (V-NAV). These propositions would help to prevent liquidity crisis such as the 2007-2008 one.

Current situation : Unfortunately, the proposal has been dismissed at the European Parliament because of cold feet coalition parties.
The share of shadow-banking in Luxembourg's economy lacks of consistent data to be accurately estimated.
However, if we compare the financial assets as a percent of GDP, Luxembourg has the biggest size of assets (138 times its GDP) (OECD). It is certain that it stands for a large chunk of the financial flows in Luxembourg thanks to residual bank secrecy.