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Guidance on defensive tax measures against the EU list of non-cooperative jurisdictions

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On 10 February 2021, Luxembourg introduced defensive measures in its tax legislation aiming at disallowing, in certain cases, the deduction of interest and royalty expenses owed to related enterprises located in jurisdictions that are included in Annex I of the European Union list of non-cooperative jurisdictions for tax purposes ("**EU List**").

On 31 May 2022, the Luxembourg tax authorities published an updated circular on the application of these measures ("**Circular**").

The deduction is denied taking into account to the following:

- The rules apply to interest or royalty owed to a collective undertaking within the meaning of Article 159 of the Luxembourg income tax law ("**LITL**"), thus excluding partnerships and physical persons. The Circular clarifies that foreign entities are classified as collective undertaking within the meaning of Article 159 LITL by comparison of their legal and statutory features with those of Luxembourg entities. In addition, such collective undertaking must be :

1. (i) an associated enterprise within the meaning of Article 56 LITL [1];
2. (ii) the beneficial owner of the interest or royalty. It was clarified in the Circular that the beneficial owner of the interest or royalty is the person to whom the income is actually attributable from an economic perspective; and
3. (iii) established in a jurisdiction or a territory that is blacklisted by Luxembourg. The Luxembourg blacklist would be determined once a year based on the latest updated version of the EU list of non-cooperative jurisdictions for tax purposes available at this time. However, the rules cease to

apply as soon as the country or territory concerned is removed from the EU published blacklist. Twelve jurisdictions are currently on the EU blacklist: American Samoa, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, US Virgin Islands, Vanuatu.

- The definitions of interest and royalties are based on those provided under Article 2 of the interest and royalties Directive 2003/49 and Articles 11 and 12 of the OECD Model Tax Convention.
- The rule applies to accrued interest or royalties and not to actual payments. Therefore, those interest or royalties that have accrued before 1 March 2021 (date of entry into force of the law) remain deductible even if payment occurs after 1 March 2021.
- The deduction of interest or royalties will not be denied if the taxpayer can prove (in particular with supporting documentation) that the transaction was implemented for valid commercial reasons that reflect economic reality. The Circular recalls that it is not sufficient simply to state economic reasons, but such reasons, taking into account all relevant facts and circumstances, must be real and economically relevant enough. The Circular confirms that a ruling request can be filed to have confirmation that the commercial reasons are valid and reflect economic reality.
- It was also recalled in the Circular that where the deduction of interest is entirely denied under the defensive rules, the interest limitation rule laid down in Article 168*bis* LITL (see our previous articles on this topic, especially in this newsletter and the article dated 19 January 2021) is not applicable.

1 Under Article 56 LITL, two enterprises are deemed associated when one enterprise participates, directly or indirectly, in the management, control or share capital of the other, or if the same persons participate, directly or indirectly, in the management or share capital of both enterprises.

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