Setting up your Business in Luxembourg
Issues to consider

Located in the heart of Europe, Luxembourg is a gateway to address the International and European market. For decades Luxembourg's economic, political and social stability has made the country a destination of choice for foreign investments: a succession of positive long-term government policies aiming to develop a business-friendly environment, excellent infrastructures, rewarding tax framework and high quality of life make Luxembourg an attractive place to live and develop business.

However there are a number of issues which you must consider when you are looking to set up your business in Luxembourg. This document takes you through some of the common questions we come across and gives you practical information about the issues you need to consider.

What type of Business Structure should we use?

There are advantages and disadvantages to all of them, and there is no one correct answer, it's all dependent on your specific business circumstances and needs. A brief overview of the main structures most often chosen is below:

Establishment (a branch of your overseas business)

- Not a separate legal entity but an extension of the overseas parent company
- No limited liability or ring-fencing of the Luxembourg operations
- If have a permanent establishment in Luxembourg then profits from this PE are liable to Luxembourg Corporation tax
- Must file parent company accounts, prepared under Luxembourg Company Law, at Companies Trade Register for public inspection.

Public Limited Company (Société Anonyme)

- Provide limited liability and ring-fencing to Luxembourg operations
- Give a perception of a local business, with longevity
- Minimum capital subscribed € 31,000 – ¼ of which must be paid-in
- Nominative or bearer shares; 1 or several shareholders ; 1 or at least 3 directors
- Corporation tax to be paid on company profits
- Have to file company accounts at Companies Register for public view once per year
- Subject to a statutory audit; independent audit depending on the company's size.

Private Limited Company (Société à responsabilité limitée)

- Minimum capital subscribed € 12,500 fully paid-in
- Nominative shares only; 1 or several partners (max. 40); 1 or several managers
- Corporation tax to be paid on company profits
- Have to file company accounts at Companies Register for public view once per year
- Subject to audit depending on company's size

How much Corporation Tax will the business pay?

As from 1 January 2013, the current income tax (IT) rate in Luxembourg City is 29.22%, which can be summarized as follows:

- **Corporate Income Tax Rate (CIT) (%)** — **Taxable Profit (EUR)**

Small co-rate	20	0 – 15,000
Full rate	21	Over 15,000

- **Plus solidarity tax of 7% of the CIT rate**

- **Plus Municipal Business Tax (MBT) 6.75% for Luxembourg city (can change for other municipalities)**

Since 2011, a minimum CIT has been introduced for fully taxable resident entities which do not require a business license or the approval of a supervisory authority and which owns financial assets, transferrable securities and cash at bank exceeding 90% of their total balance sheet (e.g. Holding Companies – SOPARFIs). The minimum CIT amounts to EUR 3,210 effective from 1 January 2013.

Luxembourg taxes its corporate residents on their worldwide income and non-residents only on Luxembourg-source income. The CIT does not apply to tax transparent entities – e.g. general or limited partnerships or European Economic Interest Grouping. The CIT takes into account the provisions of the double tax treaties signed between Luxembourg and more than 60 countries: the taxes levied abroad give a right to a tax credit in Luxembourg.

Net operating losses can be carried forward for an unlimited period but cannot be carried back.

- **Net Wealth Tax (NWT)**

Both Luxembourg resident companies and Luxembourg branches of non-resident companies are subject to the Net Wealth Tax levied at an annual rate of 0.5% calculated on the net operating assets as shown in the balance sheet at 1 January of each financial year.

What if we use Luxembourg to set up our holding company?

Luxembourg tax legislation is very attractive to set up a holding company.

This attractiveness is mainly due to the favorable tax regime applicable to dividends (a) and capital gains (b), namely the participation exemption regime derived from qualifying participations, and exemption from withholding tax (c) on dividends paid to qualifying recipients. The conditions to be met are as follows:

a) Holding for a minimum uninterrupted period of 12 months or undertaking to hold (on the allocation date of the income) at least 10% of the share capital of its subsidiary or has acquired it for at least € 1.2 million;

b) Holding for a minimum uninterrupted period of 12 months or undertaking to hold (on the allocation date of the income) at least 10% of the share capital of its subsidiary or has acquired it for at least € 6 million;
c) Provided that the recipient is a collective entity covered by the Parent-Subsidiary Directive or a resident in a treaty country and fully subject to IT comparable to Luxembourg IT, or corporation resident in a member state of the EEA other than an EU Member State and fully subject to IT comparable to Luxembourg IT*.

*NB: This information is not exhaustive due to the conciseness of this document.

Qualifying participations are also exempt from the NWT provided that the conditions applicable for the exemption from IT on dividends are fulfilled in exception to the minimum holding period. However, debts relating to the acquisition of exempt participations are not deductible from the total assets for the NWT purposes.

There is a special regime applicable in Luxembourg called “SOPARFI – Société de Participations Financières”: while a SOPARFI has all the same activities of a Holding Company, it may also have a related commercial activity such as management of participations, financing, real estate, IP, etc..in relation to the purpose stated in its by-laws. This type of a holding company is fully admitted to benefit from the Double-Tax-Treaties and EU Directives.

All of which makes Luxembourg a very advantageous location to set up a holding company.

What if we make cross-border transactions between group companies?

Luxembourg follows internationally recognized **Transfer Pricing** (TP) rules where cross-border trading and financial transactions between affiliated entities have to be conducted on an arm’s length basis. The price and terms should be the same as if the transactions had been between completely independent parties.

Typical transactions between affiliated entities that are covered by TP regulations are:

- Sale and purchase of goods
- Provision of management services
- Property rental charges
- Transfer of intangible assets e.g. trademarks, patents
- Sharing of knowledge, expertise, business contacts etc.
- Provision of financial support e.g. inter-group loans and charging a “market” interest on loans

It must be observed that transfer pricing is becoming a hot topic in Luxembourg. The focus is currently on financing structures but is rapidly expanding to include allocation of profits to branches, licensing, change of business models and restructuring.

Before granting an intra-group loan, the intra-group financing companies should carry out a risk analysis and take into account any other elements influencing the transfer prices to be applied. An advanced pricing agreement (APA) on the remuneration realized on intra-group financing transactions may be obtained to the extent the intra-group financing companies meet certain substance criteria in Luxembourg and effectively bear the risks related to the financial transactions. Moreover, the application of the APA has to include a transfer pricing analysis on the remuneration realized by the financing company.

However, even if an entity is exempt from the Luxembourg's transfer pricing regime it may fall under the scrutiny of the other international tax jurisdictions where it transacts. There may also be other tax regulations which ensure transactions are undertaken at a commercial value.

However this is a very technically complex area and careful planning needs to be undertaken for implementation in Luxembourg.

What Employment Taxes and Social Security will need to be paid?

If an individual is resident in Luxembourg then they are subject to Luxembourg tax laws. An individual taxpayer qualifies as a resident of Luxembourg provided that he has his tax domicile or usual abode in Luxembourg. Nationality is irrelevant to determine tax residence. Tax domicile is defined as a permanent place of residence that the individual actually uses and intends to maintain; a usual abode is deemed to exist after a continuous presence in Luxembourg for a period of six months. Luxembourg tax liability applies to Luxembourg residents on their worldwide income and to Luxembourg non-residents on their Luxembourg source income.

We would advise any new entrant to Luxembourg or person who spends time working in Luxembourg to take professional advice to determine whether they are Luxembourg tax resident or not.

Current Personal Income Tax rates in Luxembourg are

Band of income (EUR)	Tax rate (%)
0 - 11,265	0
11,265 – 100,000	8 - 39
Over 100,000	40

The tax liability is based on individuals' personal situation. The net income is reduced by various deductions.

(NB: rates are for the tax year to 31/12/2013)

Employers and employees also have to pay Luxembourg social security, which is called "Cotisation sociale":

Current Social Security rates are (rates are for the tax year to 31/12/2013):

Coverage	Employee's Rate (%)	Employer's Rate (%)
Sickness 1.2	2.8/3.05	2.8/3.05
Pension 1	8.00	8.00
Accident 1	0	1.10
Mutual insurance 1.3	0	0.42-2.64
Health at work 1	0	0.11
Dependence 4	1.40	0
Total	**12.20/12.45**	**12.43/14.90**

1 Capped for both employee and employers to an annual ceiling of € 112,451.28 (cost of living index 756.27); tax deductible
2 Rate vary depending on the nature of the remuneration (base salary, benefits in kind, etc.)
3 Depends on the average rate of absenteeism of the employee
4 Not capped, not tax deductible

It is the employers' legal responsibility to pay over employee's tax and social security deductions to the Luxembourg tax authorities.

Luxembourg has a Reciprocal Agreement with EU countries whereby when an EU national is seconded to Luxembourg for a defined period of time and continues to pay social security in his/her home country, the employer and employee are exempt from paying social security in Luxembourg for two years if they can supply the evidence that the assignment is temporary and get a valid certificate of coverage in this respect. Workers temporarily transferred to Luxembourg from countries with which Luxembourg has no social security agreement may also be exempt from contributing to the Luxembourg system under certain conditions.

What is Value Added Tax (VAT) and should the business be registered?

VAT is a "goods and services tax" on supplies made, the standard rate of which is 15%. If a business makes taxable supplies in excess of EUR 25,000 in any 12 months then it MUST be registered for VAT.

There are three types of supply

- Taxable – must charge VAT on supplies, can reclaim input VAT
- Exempt – cannot charge VAT nor reclaim input VAT
- Outside the scope – not in the Luxembourg VAT system

The supply of most types of goods and services in Luxembourg would be classed as Taxable supplies. However, when these supplies are made to companies which are outside of Luxembourg, advice needs to be sought as to what rate of VAT, if any, to use.

If a Luxembourg entity sells goods or provides services to its non EU parent then there is no VAT chargeable on this overseas supply, however on the basis that the supply would be VAT'able if made in Luxembourg then the entity will be able to reclaim all its input VAT.

Luxembourg has some advantageous reduced VAT rates according to the goods and services purchased: 3% (e.g. food, except alcohol beverages, pharmaceutical products, books, radio and television broadcasting services), 6% (e.g. supply of gas or electricity), 12% (e.g. wine, advertising pamphlets); some transactions such as export and related transport are zero-rated.

Can we provide Share option plans to our staff?

Many companies see Share Option plans as being an important way of attracting, motivating and retaining key staff.

Luxembourg has a number of "approved" share option plans which give tax benefits to employees and employers alike and it is often possible to adapt an overseas stock option plan to fit into one of these "approved" plans.

However this is a very technically complex area and careful planning needs to be undertaken as soon as share option plans are being considered for implementation in Luxembourg.

How else can we compensate our employees?

Luxembourg has a very comprehensive range of compensation and benefit options available for companies to offer their employees.

Pensions, private medical insurance, life and disability cover are now commonplace benefits provided by many Luxembourg businesses to their workforce.

Flexible benefit packages are also gaining in popularity, giving employees options on how they wish to "spend" their benefits allowance; which can range from "purchasing" additional holiday entitlement to obtaining full family medical cover.

To discuss your requirements please contact the International Office on +44 (0) 1245 449266 or email us directly.

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