The Real Estate Investment Structure Taxation Review

Fourth Edition

Editors
Giuseppe Andrea Giannantonio and Tobias Steinmann

The LawReviews

© 2022 Law Business Research Ltd

THE REAL ESTATE INVESTMENT STRUCTURE TAXATION REVIEW

FOURTH EDITION

Reproduced with permission from Law Business Research Ltd
This article was first published in June 2022
For further information please contact Nick.Barette@thelawreviews.co.uk

Editors
Giuseppe Andrea Giannantonio and Tobias Steinmann

THE LAWREVIEWS

© 2022 Law Business Research Ltd

PUBLISHER
Clare Bolton

HEAD OF BUSINESS DEVELOPMENT
Nick Barette

TEAM LEADER
Katie Hodgetts

SENIOR BUSINESS DEVELOPMENT MANAGER
Rebecca Mogridge

BUSINESS DEVELOPMENT MANAGERS
Joey Kwok and Juan Hincapie

BUSINESS DEVELOPMENT ASSOCIATE
Archie McEwan

RESEARCH LEAD
Kieran Hansen

EDITORIAL COORDINATOR
Leke Williams

PRODUCTION AND OPERATIONS DIRECTOR
Adam Myers

PRODUCTION EDITOR
Jane Vardy

SUBEDITOR
Claire Ancell

CHIEF EXECUTIVE OFFICER
Nick Brailey

Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34–35 Farringdon Street, London, EC4A 4HL, UK
© 2022 Law Business Research Ltd
www.TheLawReviews.co.uk

No photocopying: copyright licences do not apply.
The information provided in this publication is general and may not apply in a specific situation, nor does it necessarily represent the views of authors' firms or their clients. Legal advice should always be sought before taking any legal action based on the information provided. The publishers accept no responsibility for any acts or omissions contained herein. Although the information provided was accurate as at June 2022, be advised that this is a developing area.
Enquiries concerning reproduction should be sent to Law Business Research, at the address above.
Enquiries concerning editorial content should be directed
to the Publisher – clare.bolton@lbresearch.com

ISBN 978-1-80449-088-4

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

© 2022 Law Business Research Ltd

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

AABØ-EVENSEN & CO ADVOKATFIRMA AS

ARENDT & MEDERNACH SA

CAIADO GUERREIRO

CHIOMENTI

CMS PASQUIER CIULLA MARQUET PASTOR SVARA & GAZO

DENTONS

EPRA

GIDE LOYRETTE NOUEL AARPI

GLEISS LUTZ

HCSD TAX ADVISORS

HOMBURGER AG

LOYENS & LOEFF

WILLIAM FRY

© 2022 Law Business Research Ltd

CONTENTS

PREFACE.. v
Giuseppe Andrea Giannantonio and Tobias Steinmann

Chapter 1 BELGIUM 1
Ariane Brohez, Christophe Laurent and Antoine Béchaimont

Chapter 2 FRANCE.. 23
Laurent Modave and Bertrand Jouanneau

Chapter 3 GERMANY.. 45
Johann Wagner

Chapter 4 IRELAND... 59
Ted McGrath, Anne Tobin, Lisa McCarthy and Diane Courtney

Chapter 5 ITALY 73
Giuseppe Andrea Giannantonio, Gabriele Paladini and Giulia Bighignoli

Chapter 6 LUXEMBOURG... 99
Thierry Lesage and Stéphanie Maschiella

Chapter 7 MONACO... 122
Stephan Pastor, Raphaëlle Svara and Sophie Marquet

Chapter 8 NETHERLANDS 132
Rob Havenga and Wiet Crobach

Chapter 9 NORWAY... 154
Henning Raa

Chapter 10 PORTUGAL... 170
Ana Castro Gonçalves and Maria Margarida Torres

© 2022 Law Business Research Ltd

Chapter 11 SWITZERLAND 189
Stefan Oesterhelt and Laetitia Fracheboud

Chapter 12 UNITED KINGDOM 209
Alex Tostevin and Andrew Cromb

Appendix 1 ABOUT THE AUTHORS 221
Appendix 2 CONTRIBUTORS' CONTACT DETAILS 231

© 2022 Law Business Research Ltd

PREFACE

The real estate sector plays a crucial role in the global economy and social environment.

In particular, the commercial property sector offers the infrastructure needed for the growth and development of entrepreneurship and business, including offices, shops, industrial and logistics premises, and hotels. In Europe alone, commercial real estate represents a business of €8.5 trillion.

The real estate sector is also a fundamental source of employment. In 2019, the European real estate sector employed 4.2 million people – more than the car manufacturing and telecommunications sectors combined. Moreover, it provides residential accommodation and is seen as a tool to meet social and public needs. New types of properties are emerging and have increasingly been included in investment portfolios, such as senior living, student accommodation and life sciences. In addition, urban regeneration has become a key element of many decisions taken at EU level, boosting city renovation, decarbonisation and green transition. In this respect, the NextGenerationEU recovery fund will play a key role in supporting this transformation.

In this context, attracting investments from institutional investors such as pension funds, insurance companies and sovereign wealth funds is crucial for the growth of the real estate sector. In particular, it is desirable that those investors are involved in both financing large development projects and investing in properties held for rent.

Based on market practice, investments from foreign institutional investors are mainly carried out indirectly rather than through direct acquisitions, and particularly through specialised vehicles such as non-listed real estate funds, listed property companies and real estate investment trusts.

The emergency caused by the covid-19 pandemic over the past couple of years has affected the real estate sector like so many other sectors. Although any disturbance to private real estate valuations is normally only revealed over time, listed real estate stocks suffered a sharp decline in 2020. However, thanks to strategies put in place after the 2008 global financial crisis (GFC) (most notably restructuring of debt), the listed sector's recovery was five time faster than that following the GFC. With investors increasingly focusing on thematic investment, the post-crisis landscape has been characterised by higher demand for alternative real estate sectors and assets, accelerating a process of transformation that was already ongoing.

After a deep recession in most of the European economies in 2020 due to the pandemic, 2021 has been characterised by an economic recovery that, in principle, was forecasted to continue on a more moderate path in 2022 and 2023.

© 2022 Law Business Research Ltd

However, in April 2022, inflation in the eurozone reached a record level (7.5 per cent) due to heightened uncertainty and geopolitical risks as well as skyrocketing energy and raw material prices caused by the war in Ukraine. This is not slowing down investments despite the uncertainty, because the sector has strong fundamentals.

Based on the above, national legislators are facing a new phase of uncertainty, inflation and geopolitical risks that will have an impact on new provisions aimed at stimulating or attracting selected investments in their countries. Part of the NextGenerationEU recovery fund might be reviewed in light of new 'what if' scenarios as well as tax credits and allowances resulting from increased costs of construction. Any review of national legislation should also take into account international sanctions against Russia.

We are convinced that the role of the real estate sector as an economic, employment and social catalyst needs to be supported by a legislative framework that increases transparency and competitiveness and simplifies, as well as standardises, bureaucratic processes.

However, within the European Union, the covid-19 crisis, the conflict between Russia and Ukraine and, consequently, the rise in inflation have all had different impacts on different countries. This will, of course, further exacerbate differences between the interventions made by legislators in the individual jurisdictions, with allowances, tax credits, and other tax provisions introduced and applied very differently from one Member State to another. Generally, these disparities reflect the level of impact those elements have in particular jurisdictions, the economic policies followed by their respective governments and the level of resources available to achieve those aims.

Correlatively, national legislators will need to adapt any new provisions to those pre-existing types of specialised real estate investment vehicles that currently benefit from tax exemptions or other advantageous tax allowances, for both direct and indirect tax purposes.

Given all of the above, the aim of this volume is to provide a useful guide to those international and institutional investors that are willing to invest in real estate properties located in Europe and elsewhere, and to illustrate in a comparative manner possible alternatives for the establishment of investment platforms in Europe and investment vehicles at a local level. In particular, each country-specific chapter provides insights from leading experts into key tax considerations and investment opportunities based on the relevant national legislation. Furthermore, in this edition, we have sought to provide indications of any allowances and facilitations introduced temporarily in response to the current economic crisis that might also present investors with investment opportunities in specific countries.

We would like to thank the authors of this volume for their extensive expertise and their efforts to ensure the successful outcome of this work. We hope that the reader finds this volume useful and we welcome any comments and suggestions for improvement for the next edition.

Giuseppe Andrea Giannantonio
Chiomenti
Milan

Tobias Steinmann
EPRA
Brussels

June 2022

© 2022 Law Business Research Ltd

Chapter 6

LUXEMBOURG

Thierry Lesage and Stéphanie Maschiella[1]

I OVERVIEW

i Investment vehicles in real estate

Luxembourg has seen its real estate landscape evolve constantly to provide investors with flexible and innovative real estate investment products. Although there is currently no investment vehicle dedicated exclusively to real estate investments, Luxembourg offers a wide range of vehicles that can be used for this purpose. The choice of the vehicle is generally dictated by the profile of the investors, the type of investments to be made, the nature of the funding to be raised and any particular tax considerations to be taken into account.

Luxembourg investment vehicles can be used for real estate investments located either in Luxembourg or abroad. There is no dedicated vehicle for local investments, and the same vehicle can house domestic and foreign investments.

A good illustration of this is presented in the Association of the Luxembourg Fund Industry (ALFI) Real Estate Investment Funds 2020 survey, which shows that 67 per cent of Luxembourg-regulated real estate investment funds focus on the European Union, 9 per cent on North America and 8 per cent on the Asia-Pacific region, whereas 8 per cent do not have a particular geographical focus. This data reflects the position of Luxembourg funds in real estate investments across the world.

Luxembourg investment vehicles can be either regulated (namely fund vehicles authorised and supervised by the Luxembourg financial sector supervisory authority (CSSF)) or unregulated, and may be established under different laws and take different legal forms.

Regulated investment vehicles include the following:

a specialised investment funds (SIFs) governed by the amended law of 13 February 2007 (the SIF Law);

b investment companies in risk capital (SICARs) governed by the amended law of 15 June 2004 (the SICAR Law), which are, however, more focused on the private equity industry; and

c undertakings for collective investment (UCIs-Part II) established under Part II of the amended law of 17 December 2010 (the UCI-Part II Law).

Unregulated vehicles are generally set up as corporations or partnerships subject to the amended law of 10 August 1915 on commercial companies (the Company Law). Falling

1 Thierry Lesage is a partner and Stéphanie Maschiella is counsel at Arendt & Medernach SA. The authors would like to thank Adnand Sulejmani (associate) for his help in the preparation of this chapter. The information in this chapter was accurate as at June 2021.

© 2022 Law Business Research Ltd

between the regulated and unregulated structures are reserved alternative investment funds (RAIFs), governed by the amended law of 23 July 2016 (the RAIF Law), and any unregulated vehicle qualifying as an alternative investment fund (AIF) as defined by the amended law of 12 July 2013 (the AIFM Law) implementing into Luxembourg law Directive 2011/61/EU (AIFMD) on alternative investment fund managers (AIFMs).

An adequate legal, regulatory and tax framework has allowed Luxembourg to position itself as a competitive cross-border distribution hub. This attractiveness is reflected in the increasing number of real estate investment funds (i.e., 449 regulated investment funds investing in real estate as at the end of September 2020,[2] including 80 manager-regulated AIFs, 98 RAIFs, 10 SICARs and 53 non-regulated AIFs). This combination of factors has had an enormous impact on the growth of Luxembourg's real estate market and its competitiveness for a global investor base.

ii Property taxes

Each municipality in the Grand Duchy of Luxembourg is authorised to levy a property tax on immovable property, whether built on or not, which is situated within the limits of the municipality. Luxembourg property tax is a tax assessed on the basis of property ownership, irrespective of how the property is used or the sources of the financing used by the taxpayer to acquire it. The person liable for the property tax for the entire year is the owner of the property (and not the tenant) on 1 January. If the property belongs to several people, they are jointly liable to pay the tax.

The tax base for calculating the property tax corresponds to the unitary value assigned to each property multiplied by the assessment rate (which depends in particular on the type of real estate asset and its location, and generally ranges from 0.7 to 1 per cent). The property valuation section of the Luxembourg tax authorities (LTAs) classifies all buildings and land depending on their use[3] and then assigns a unitary value to each specific property.

The unitary value is set based on the price levels as they existed in 1941. The unitary value is therefore significantly lower than the real estate asset's market value.

The property tax is finally calculated by multiplying the tax base by the municipal rate (which varies depending on the place of establishment and the category of the building).

The direct transfer of real estate assets located in Luxembourg, taking the form of a sale, is also subject to transfer taxes (registration duty and transcription tax) of 7 or 10 per cent for office and commercial properties located in the city of Luxembourg, assessed on either the purchase price or the fair market value of the property, whichever is higher. Where the transfer takes the form of a contribution remunerated by shares, reduced transfer taxes of 3.4 or 4.6 per cent for office and commercial properties located in the city of Luxembourg apply.

---

2 According to the ALFI Luxembourg Real Estate Investment Funds 2020 survey.

3 Six categories exist: commercial buildings, mixed-use buildings, buildings for other uses, single-family houses and houses divided into flats, properties not built on (other than residential building plots) and residential building plots.

© 2022 Law Business Research Ltd

II ASSET DEALS VERSUS SHARE DEALS

i Legal framework

Real estate transactions can be structured either as a direct purchase of the real property asset or as a purchase of the shares of the asset-owning company. In the latter case, there is no direct transfer of the ownership of the property from the seller to the purchaser.

Asset deals are governed by contractual provisions subject to specific rules applicable to sales established, inter alia, by the Civil Code. In respect of share deals, in addition to contractual provisions, provisions of the Company Law apply.

Transactions usually start with negotiations under a confidentiality agreement, taking the form of either a letter of intent or head of terms to be countersigned by the seller. A due diligence process generally follows the signature of the letter of intent, allowing the purchaser to identify any legal, administrative, tax, financial, technical and environmental risk associated with the acquisition. The outcome of the due diligence phase will be decisive as to whether the acquisition process will continue.

Share deal

After the closing of the due diligence process, or even during the due diligence process, a share purchase agreement is negotiated to set out the terms and conditions relating to the sale and purchase of shares in the asset-owning company.

Asset deal

From a legal perspective, the acquisition of a real estate asset is most often performed in two separate stages: a private agreement between parties and a notarial deed.

The private agreement may be established by a number of legal mechanisms, such as an offer letter, an undertaking to sell or, most often, by a preliminary sale and purchase agreement, but no standard forms are imposed. The effect of preliminary sale and purchase agreements is to bind the parties and the transfer of ownership documented in such agreements is perfectly valid. However, those agreements are not enforceable against third parties.

Commonly, preliminary sale and purchase agreements contain conditions precedent relating to the buyer obtaining the necessary funding or administrative authorisations and an obligation requiring the parties to go before a civil law notary within a certain period, and they are frequently coupled with a penalty clause.

To become enforceable against third parties, a notarial deed is required. To have the transfer of ownership registered and to confer rights against third parties, the transfer of title must be recorded in the mortgage register. The fees of the notary are computed according to a tariff and are generally borne by the purchaser. The purchase price, duties and taxes are paid to the notary, who ensures that the necessary duties are paid and releases the amount to the vendor.

ii Corporate forms and corporate tax framework

Luxembourg real estate investment vehicles can be either regulated (i.e., authorised and supervised by the CSSF) or unregulated, and may be established under different laws and take different legal forms.

Unregulated vehicles are generally set up as companies or partnerships subject to the Company Law.

© 2022 Law Business Research Ltd

Standard company

Among the unregulated vehicles governed by the Company Law is the standard Luxembourg resident company subject to general taxation rules in Luxembourg (the standard company). However, a standard company may also qualify as an AIF when relevant conditions are met.

It is most typically organised in the form of a private limited company, a public limited company or a partnership limited by shares.[4]

The key features of a standard company are the absence of investment restrictions or limitations, risk-spreading requirements, investor requirements (unless subject to the AIFMD), and authorisation or prudential supervision by the CSSF. It can only have a fixed share capital and is subject to standard minimum accounting and publication requirements depending on the corporate form chosen (an audit is required if certain quantitative thresholds are exceeded).

Regarding Luxembourg taxation aspects, a standard company is fully subject to corporate income tax (CIT); to municipal business tax (MBT), the rate of which varies depending on the municipality in which the company is located; and to net worth tax (NWT).

The maximum aggregate CIT and MBT rate amounts to 24.94 per cent in 2021 for companies located in Luxembourg City and is levied on the standard company's net worldwide profits, subject to double tax treaties and domestic exemptions. As a general rule, taxable profits are determined on the basis of the accounting profits as established in accordance with the Luxembourg generally accepted accounting principles, except where the valuation rules for tax purposes require otherwise.

The NWT is levied at the rate of 0.5 per cent on the standard company's net assets not exceeding €500 million and at the rate of 0.05 per cent on the portion of the net assets exceeding €500 million[5] as determined at 1 January of the fiscal year. A minimum NWT (MNWT) is applicable as well, set at €4,815 if the company's fixed financial assets, receivables against related companies, transferable securities and cash exceed 90 per cent of its total gross assets and €350,000. In all other cases, the MNWT ranges from €535 to €32,100, depending on the company's total gross assets.

Dividends distributed by a standard company to its shareholders are, as a rule, subject to withholding tax at the rate of 15 per cent, subject to double tax treaties and domestic exemptions. Liquidation proceeds, deriving from a complete or partial liquidation, are not subject to withholding tax in Luxembourg.

Tax losses incurred since the 2017 tax year may be carried forward for a maximum of 17 years under certain conditions, whereas losses incurred between 1 January 1991 and 31 December 2016 may be carried forward without time limitation.

As a key tax feature, standard companies benefit from a participation exemption regime and are generally entitled to claim the application of double tax treaties. Under the participation exemption regime, the following exemptions are available:

a dividends, liquidation proceeds, and capital gains received and realised on qualified shareholdings in eligible subsidiaries are exempt from CIT and MBT;

b qualified shareholdings in eligible subsidiaries are exempt from NWT; and

4 The Company Law reform of August 2016 has introduced a new type of company, the simplified limited company, or SAS.

5 This is the unitary value, basically calculated as the difference between assets generally estimated at their fair market value and liabilities with regard to third parties, subject to double tax treaties and domestic exemptions.

© 2022 Law Business Research Ltd

c dividends distributed to eligible parent companies are exempt from the 15 per cent dividend withholding tax.

Limited partnership

Among the unregulated vehicles governed by the Company Law, common limited partnerships (CLPs) and special limited partnerships (SLPs) may often be a suitable alternative if a tax-transparent vehicle is desired. The essential difference between the two limited partnerships is that the SLP does not have legal personality distinct from that of its limited partners. It may further be noted that these limited partnerships may also qualify as an AIF when relevant conditions are met.

Contractual flexibility is the key feature of the Luxembourg partnership legislation. Statutory default rules kick in only when the limited partnership agreement (which may be entered into under private seal or as a notarial deed and published as an excerpt including limited generic provisions, thus guaranteeing confidentiality with regard to the partnership arrangements and terms) remains silent in respect of certain key points that are of importance in protecting investors. Most of the economic and non-economic terms, including corporate governance, voting rights of the limited partners (or removal thereof), deployment of capital, and profit and loss allocation, may be tailored to the specific needs of a project. The other key features are the absence of investment restrictions or limitations, risk-spreading requirements, investor requirements (unless subject to the AIFMD), and authorisation or prudential supervision by the CSSF. CLPs and SLPs are also subject to simplified accounting obligations.

Both CLPs and SLPs are, in principle, transparent for CIT and NWT purposes and hence not subject to CIT (except in the case of application of the rules on reverse hybrids from tax year 2022) and NWT in Luxembourg.

The partnership may, however, be subject to Luxembourg MBT in limited circumstances if it pursues a business activity or it is deemed to pursue a business activity by virtue of the 'business-taint' theory, namely if its general partner is a limited company that owns at least 5 per cent of its capital or economic interests (which in practice is generally not the case). In respect of the business activity, the LTA confirmed[6] that CLPs and SLPs qualifying as AIFs within the meaning of the AIFM Law are deemed not to be conducting a business activity.

Luxembourg resident partners of the partnership are personally subject to income and NWT in respect of their share in the profits and assets of these entities, regardless of whether the profits and assets are effectively distributed or not.

Non-Luxembourg resident partners may be subject to taxation in Luxembourg only in respect of their partnership interests in a limited number of situations (see Section II.iii and Section II.iv).

Any distributions by the partnership are, as a rule, made free of withholding tax in Luxembourg. Given its tax transparency, the partnership may not benefit for its part from double tax treaties, but its partners may generally claim treaty benefits from the source state.

6 Circular Letter L.I.R. No. 14/4 dated 9 January 2015.

© 2022 Law Business Research Ltd

iii Direct investment in real estate

Registration duties

In the case of an asset deal, the direct transfer of a real estate asset located in Luxembourg is subject to Luxembourg transfer taxes assessed on the basis of the highest of the purchase price, as indicated in the notarial deed, and the fair market value of the property. Transfer taxes are usually paid by the purchaser.

Where the asset deal takes the form of a sale or of a contribution for valuable consideration, Luxembourg transfer taxes amount to 7 per cent or 10 per cent and are composed of a registration duty of 6 per cent, plus a municipal surcharge of 50 per cent (i.e., 9 per cent in aggregate) where the asset comprises an office or a commercial property located in the city of Luxembourg, and a transcription tax of 1 per cent.

Where the asset deal takes the form of a contribution remunerated by shares, reduced Luxembourg transfer taxes of 3.4 or 4.6 per cent apply and are composed of a registration duty of 2.4 per cent, plus a municipal surcharge of 50 per cent (i.e., 3.6 per cent in aggregate) where the asset comprises an office or a commercial property located in Luxembourg City, and a transcription tax of 1 per cent.

Considering the significant cost of transfer taxes, intra-group transfers are rarely made through a direct sale but, instead, through a contribution remunerated by shares or a share deal (as detailed hereafter, the acquisition of shares in a Luxembourg tax-opaque company should not be subject to Luxembourg transfer taxes, even when the main or sole asset of the company is a real estate asset located in Luxembourg).

Direct taxation on acquisition

The corporate buyer should typically break down the total price paid for the asset between the price related to the plot and the one related to the construction as only the latter is depreciable for tax purposes.

Direct taxation on holding and upon exit

As a general rule, income and gains deriving from real estate assets are taxed in the jurisdiction of the location of the assets.

Rental income derived from the direct holding by a standard company of a real estate asset located in Luxembourg and capital gains realised upon the disposal of that asset are subject to CIT and MBT at ordinary rates in Luxembourg, after deduction of permitted tax-deductible costs and fiscal losses carried forward, if any. Constructions can be depreciated over their useful economic life. As from 2019, apart from exceptions, annual exceeding borrowing costs can be deducted up to the higher of €3 million or 30 per cent of earnings before interest, taxes, depreciation and amortisation.

The standard company is also subject to NWT on the unitary value assigned to the property, after deduction of tax-deductible liabilities.

The Luxembourg Income Tax Law (ITL)[7] provides for a rollover regime, whereby the capital gain realised upon disposal of a real estate asset (that has been part of the net assets of a standard company for at least five years before disposal) may be transferred, under certain conditions, to fixed assets acquired or built up by the company (by the end of the second fiscal year following the year of disposal at the latest) in reinvestment of the real estate's

7 Article 54 of the ITL.

© 2022 Law Business Research Ltd

sale price. The capital gain transferred on the reinvested fixed asset reduces the acquisition price of that asset accordingly, to ensure that the transferred capital gain is taxed through reduced depreciation and ultimately at the time the reinvested fixed asset is sold. In that scenario, when the reinvested fixed asset is a participation, the transferred capital gain remains subject to taxation notwithstanding the application of the Luxembourg participation exemption regime.

Where the Luxembourg property is held through an unregulated Luxembourg limited partnership (CLP or SLP), tax neutrality may be achieved in the hands of the limited partnership to the extent that it does not pursue or is not deemed to pursue a business activity. In the presence of a business activity, rental income and capital gains relating to the real estate asset located in Luxembourg are subject to MBT, after deduction of permitted tax-deductible costs and fiscal losses carried forward, if any.

Luxembourg resident partners of a CLP or SLP are personally subject to income and NWT in respect of their share in the profits and assets of the entity, regardless of whether those profits and assets are effectively distributed, and under the tax provisions applicable in their particular circumstances.

As a matter of principle, Luxembourg non-resident partners of a CLP or SLP should not be subject to Luxembourg tax on income and gains arising from their interest in the entity, except where the partner holds its interest in the entity through a permanent establishment (PE) or permanent representative in Luxembourg, or the income and gains attributable by tax transparency of the CLP or SLP to that partner are Luxembourg source income that is taxable in Luxembourg (e.g., income and gains from a Luxembourg real estate asset when that asset is directly held by the entity). With regard to NWT, a Luxembourg non-resident partner of a CLP or SLP is generally not subject to it except where the partner (other than an individual) holds its interest in the entity through a PE or permanent representative.

Value added tax

As a general rule, real estate transactions, including purchase and rental activities, involving real estate located in Luxembourg are exempt from value added tax (VAT) in Luxembourg. Accordingly, input tax incurred on related expenses by the seller or the lessor is unrecoverable.

However, it is possible to waive the VAT exemption. Article 45 of the VAT Law provides a right to opt for VAT in both cases (i.e., the purchase or rental of the real estate), if the transaction occurs between taxable persons for VAT purposes and involves a building dedicated to the pursuit of activities that allow for 100 per cent input VAT in the case of businesses for which the whole turnover is subject to VAT, or at least 50 per cent input VAT for mixed-use buildings and partially taxable persons. The VAT option must be submitted for the approval of the VAT authorities. Accordingly, input VAT incurred on related costs becomes recoverable.

© 2022 Law Business Research Ltd

iv Acquisition of shares in a real estate company

Registration duties

Luxembourg real estate assets are generally individually owned by a dedicated property company,[8] thereby offering a prospective purchaser the choice to acquire either the asset directly or the property company (i.e., a share deal). In the latter case, no Luxembourg transfer taxes should apply, in principle, considering that there is no direct transfer of the ownership of the property from the seller to the purchaser (apart from exceptional circumstances of simulation).

There is, however, one exception to this principle. Transfer taxes apply to the transfer of shares in a Luxembourg tax-transparent entity (such as limited partnerships) in the same way as if the real estate asset was directly transferred, except for the transcription tax that does not apply.

The transfer of shares in a property company (or, as the case may be, in an intermediary holding company) may be subject to real estate transfer taxes in the country where the real estate asset is located.

Direct taxation on acquisition

The purchase price of the shares in a Luxembourg property company (including related costs) constitutes the acquisition cost for Luxembourg tax purposes.

Direct taxation on holding and exit

As a general rule, and subject to the provisions of a relevant double tax treaty, income and gains deriving from the shares in a property company are taxed in the jurisdiction of residence of the beneficiary of the revenues. However, where the land-rich entity provision clause in a double tax treaty grants taxation rights to the country where the real estate asset of the property company is located in accordance with that country's domestic tax rules, capital gains upon disposal of the shares in the property company are taxable in the jurisdiction where the real estate asset is located. Luxembourg's domestic tax law does not contain such a rule.

Where the shares in the Luxembourg property company are held by Luxembourg resident individual shareholders, any dividends and other payments are subject to Luxembourg income tax at the progressive ordinary rates (50 per cent of the dividends distributed are, however, exempt from income tax). Capital gains realised upon the disposal of the shares in the property company by Luxembourg resident individual shareholders acting in the course of the management of their private wealth are not subject to Luxembourg income tax, provided that this disposal takes place more than six months after the shares were acquired and provided that the shares do not represent a substantial shareholding.[9] Capital gains

8 For the purpose of this chapter, a property company refers to a fully taxable entity (hence tax-opaque) that is generally resident, but not necessarily, in the jurisdiction of location of the real estate asset.

9 A shareholding is considered to be a substantial shareholding in limited cases, in particular if the shareholder has held, either alone or together with their spouse or partner, or minor children, or both, either directly or indirectly, at any time within the five years preceding the realisation of the gain, more than 10 per cent of the share capital of the company or if the shareholder acquired free of charge, within the five years preceding the disposal, a participation that constituted a substantial participation in the hands of the alienator (or alienators, in the case of successive transfers free of charge within the same five-year period).

© 2022 Law Business Research Ltd

realised on a substantial shareholding more than six months after the acquisition thereof are instead subject to Luxembourg income tax according to the half-global rate method. Capital gains realised upon the disposal of the shares in the property company by a Luxembourg resident individual shareholder acting in the course of the management of their professional or business activity are subject to Luxembourg income tax at the ordinary rates.

Where the shares in the Luxembourg property company are held by Luxembourg resident corporate shareholders, they shall include any profits derived, as well as any gains realised on the disposal of the shares in the property company, in their taxable profits for Luxembourg income tax assessment purposes, unless the conditions of the Luxembourg participation exemption regime are satisfied. The same tax treatment generally applies when a standard company is used to hold shares in a non-Luxembourg property company.

Where the shares in the Luxembourg property company are held by an unregulated Luxembourg limited partnership (CLP or SLP), tax neutrality may be achieved in the hands of the limited partnership to the extent that it does not pursue or is not deemed to pursue a business activity. If a business activity is deemed pursued, distributions and capital gains relating to the property company are subject to MBT, after deduction of permitted tax-deductible costs and tax losses carried forward, if any.

In this respect, distributions to a CLP or SLP (other than advances on liquidation proceeds) are generally subject to the 15 per cent Luxembourg withholding tax, unless the conditions of the Luxembourg participation exemption regime are fulfilled at the level of the partners. Luxembourg resident partners of a CLP or SLP are personally subject to income and NWT in respect of their share in the profits and assets of the entity, irrespective of whether the profits and assets are effectively distributed, and under the tax provisions applicable in their particular circumstances.

As a matter of principle, a Luxembourg non-resident partner of a CLP or SLP should not be subject to Luxembourg tax on income and gains arising from its interest in the entity, except where that partner holds its interest in the entity through a PE or permanent representative in Luxembourg, or the income and gains attributable by the tax transparency of the CLP or SLP to that partner are Luxembourg source income that is taxable in Luxembourg – for example, where, subject to the provisions of an applicable double tax treaty:

a dividends from the Luxembourg property company are subject to Luxembourg withholding tax; or

b when the partner holds indirectly through the CLP or SLP a substantial shareholding in the Luxembourg property company and the shares in the latter are disposed of:
- within six months; or
- after six months, where the partner has been a Luxembourg resident taxpayer for more than 15 years and has become a Luxembourg non-resident taxpayer less than five years before the disposal takes place.

Tax on capital gains in Luxembourg would also apply if the Luxembourg non-resident partner holds a substantial shareholding in the Luxembourg property company indirectly through the CLP or SLP and if, subject to the provisions of an applicable double tax treaty, that partner disposes of its investment in the CLP or SLP within six months. A Luxembourg non-resident partner of a CLP or SLP is generally not subject to NWT except where that partner (other than an individual) holds its interest in the entity through a PE or permanent representative.

© 2022 Law Business Research Ltd

Where the shares in the Luxembourg property company are held directly by Luxembourg non-resident shareholders, the latter are generally not subject to any tax on income and capital gains in Luxembourg. However, non-resident shareholders may become liable for tax on the income and gains in Luxembourg – for example, where:

a those shareholders hold the shares in the property company through a PE or permanent representative in Luxembourg;[10] or

b subject to the provisions of a relevant double tax treaty, the shareholders hold a substantial shareholding in the Luxembourg property company and either:
   - they dispose of their participation in the property company within six months; or
   - the disposal takes place after six months and the shareholders have been Luxembourg resident taxpayers for more than 15 years and have become Luxembourg non-resident taxpayers less than five years before the disposal takes place.

VAT

The acquisition of shares in a Luxembourg property company is considered to be outside the scope of VAT in Luxembourg.

III REGULATED REAL ESTATE INVESTMENT VEHICLES

i Regulatory framework

The local legal framework comprises the SIF Law, the SICAR Law, the UCI-Part II Law and the RAIF Law. As SICARs, SIFs and UCIs are regulated vehicles (i.e., fund vehicles that are authorised and supervised by the CSSF), their status as AIFs adds a supplementary layer of supervision via their manager.

Furthermore, fund vehicles established under a corporate form must also comply with the set of rules provided by the Company Law.

The AIFMD introduced a harmonised manager regime across Europe, whereby AIFs could be subject to regulation both at product level and via the manager, or only through the regulation of the manager. Through the introduction of the RAIF, Luxembourg has moved from its long-established double-tier regulatory model to a single-tier AIFM regulation model.

ii Overview of the different regulated investment vehicles

SIF

The SIF regime is a multi-purpose AIF and is Europe's most recognisable AIF regime. It is widely accepted by managers and investors alike. It offers maximum structuring flexibility combined with the usual Luxembourg investor protection features.

10 Shareholders who are non-residents of Luxembourg but who have a PE or a permanent representative in Luxembourg to which or whom the shares in the Luxembourg property company are attributable shall include any income received, as well as any gain realised on the disposal of the shares in the property company, in their taxable income for Luxembourg tax assessment purposes, unless the conditions of the Luxembourg participation exemption regime are satisfied.

© 2022 Law Business Research Ltd

The SIF may take the form of a mutual fund (FCP) or be constituted as an investment company with fixed capital (SICAF) or variable capital (SICAV). These are typically organised as an SCA, SA, SARL, CLP or SLP. An FCP has no legal personality and must be managed by a management company.

The key features of a SIF are as follows:

a there are no restrictions on eligible assets;
b there is a requirement that eligible investors be limited to well-informed investors;
c there are risk-spreading requirements (in general, a 30 per cent rule);
d there must be prior authorisation and ongoing prudential supervision by the CSSF;
e there is an a depositary requirement; and
f there is an independent audit requirement.

A SIF may be set up as an umbrella fund with multiple segregated compartments (each corresponding to a distinct segregated portfolio of assets) and may have fixed or variable share capital structures. It is also subject to standard minimum accounting and publication requirements depending on the corporate form chosen.

SICAR

The SICAR is a dedicated private equity and venture capital investment company regime. The SICAR must invest in assets qualifying as risk capital investments, namely the direct or indirect contribution of assets to entities in view of their launch, their development or their listing on a stock exchange.

CSSF Circular 06/241 defines 'risk capital' as an investment characterised by a certain level of risk and made with a view to developing the underlying investment. The circular deals in particular with real estate investments.

Although the SICAR Law does not allow SICARs to hold real estate directly, indirect investment via entities that hold or invest in real estate assets constituting risk capital is possible (private equity real estate). To qualify as private equity real estate, it must be demonstrated, in addition to the development character, that the underlying real estate assets represent a particular risk going beyond the normal real estate risk in a given market (e.g., the building cannot be easily rented, or is located in a disaster or disadvantaged construction area).

The purpose of the SICAR is to buy to sell at a profit. A company whose investment policy is limited to the holding and administration of a family or group's real estate assets is not eligible for the SICAR regime. Generally speaking, an opportunistic investment strategy (in particular, the absence of rental income, development or construction) is, in principle, acceptable.

Despite their regulation, SICARs are not subject to investment diversification rules, or lending or leverage restrictions, but owing to the high risk associated with the investments made, SICARs are restricted to qualified investors, 'well-informed investors', encompassing institutional investors, professional investors and other investors.[11]

The SICAR is typically organised as an SCA, SA, SARL, CLP or SLP. No contractual form is thus available.

11 'Other investors' are those that confirm in writing that they adhere to the status of 'well-informed' investors and who either invest a minimum of €125,000 or have been assessed by a credit institution, an investment firm or a management company to certify the investors' ability to understand the risks associated with investing in the SICAR.

© 2022 Law Business Research Ltd

The key features of a SICAR are as follows:

a the eligible assets are restricted to investments in risk capital;
b the eligible investors are limited to well-informed investors;
c there are no risk-spreading requirements;
d there must be prior authorisation and ongoing prudential supervision by the CSSF;
e there is a depositary requirement; and
f there is an independent audit requirement.

A SICAR may be set up in the form of an umbrella fund with multiple segregated compartments (each corresponding to a distinct segregated portfolio of assets) and may have fixed or variable share capital structures. It is subject to standard minimum accounting and publication requirements depending on the corporate form chosen.

RAIF

Based on the success of the SICAR and SIF regimes, from 2004 and 2007 respectively, the RAIF Law combines both and joins them into one single legislative text, creating a new regime reserved, in principle, for fully authorised AIFMs based in Luxembourg or any other EU Member State.

A RAIF may be launched in accordance with the AIFMD marketing rules and is not subject to the prior authorisation or the ongoing direct prudential oversight by the CSSF. Instead, given that the RAIF may be managed only by authorised AIFMs, prudential oversight is in fact exercised indirectly through the AIFM.

Like the SIF, the RAIF may take the form of an investment company or a mutual fund, and is typically organised either as an SCA, SA, SARL, CLP or SLP or (except the RAIF -SICAR as defined below) as an FCP.

The key features of a RAIF are as follows:

a there are no restrictions on eligible assets unless the RAIF elects to invest in qualifying risk capital investments;
b the eligible investors are limited to well-informed investors;
c the risk-spreading requirements are the same as those applicable to SIFs unless the RAIF elects to invest only in qualifying risk capital investments, in which case there are no risk-spreading requirements;
d there is no requirement for prior authorisation and ongoing prudential supervision by the CSSF but an authorised AIFM must be appointed;
e there is a depositary requirement; and
f there is an independent audit requirement.

A RAIF may be set up in the form of an umbrella fund with multiple segregated compartments (each corresponding to a distinct segregated portfolio of assets) and may have fixed or variable share capital structures. It is subject to standard minimum accounting and publication requirements depending on the corporate form chosen.

Although RAIFs are, in principle, subject to the same tax regime as SIFs (RAIFs (SIF-like)), RAIFs that exclusively invest in risk capital, in accordance with the RAIF documentation, may also opt for a tax and regulatory regime similar to the SICAR (RAIFs (SICAR-like)).

© 2022 Law Business Research Ltd

iii Tax payable on acquisition of real estate assets

The same registration duties, direct tax and VAT aspects on acquisition as those detailed in Section II.iii are applicable.

iv Tax regime for the investment vehicle

SIFs and RAIFs (SIF-like)[12]

These vehicles are not subject to CIT (except for CLPs, SLPs or FCPs that would be within the scope of application of the rules on reverse hybrids from tax year 2022), MBT and NWT in Luxembourg. As they are themselves, in principle, exempt from income tax, withholding tax incurred at source on underlying income or gains, if any, is not creditable or refundable in Luxembourg.

They are, however, subject to an annual subscription tax of 0.01 per cent in Luxembourg, that tax being calculated and payable quarterly, on the aggregate net assets of the fund vehicle valued on the last day of each quarter. Limited exemptions are also available. Distributions made to investors are not subject to withholding tax in Luxembourg.

In certain cases, limited to situations where these funds (except the ones under the form of CLPs, SLPs or FCPs) invest in real estate assets located in Luxembourg either directly or indirectly through one or a series of tax-transparent entities, they are, as of 1 January 2021, liable to a lump sum 20 per cent real estate levy on gross rental income and capital gains (asset and share deals) from real estate assets located in Luxembourg, in proportion to the stake held.

With regard to VAT, these fund vehicles have the status of a taxable person for VAT purposes (where the fund vehicle is set up as an FCP, it is considered to be one single VAT person together with its management company) without any input VAT deduction right. A VAT exemption applies in Luxembourg for services qualifying as fund management services.

Other services supplied to the fund (or its management company when applicable) could potentially trigger VAT and require the VAT registration of the fund (or of the management company when applicable) in Luxembourg. As a result of VAT registration, the fund (or its management company when applicable) is in a position to fulfil its duty to self-assess the VAT regarded as due in Luxembourg on taxable services (or goods to some extent) purchased from abroad. No VAT liability arises, in principle, in Luxembourg in respect of any payments made by the fund to its investors, to the extent that those payments are linked to their subscription of shares or interests in the fund and do not constitute the consideration received for taxable services supplied.

Regarding the activities performed by the fund vehicles in respect of real estate, a distinction must be made from a VAT perspective between property management services, which are considered to be linked to immovable property, and portfolio management services, which are not.

Property management services are fully taxable from a VAT perspective and are deemed to be located and subject to VAT in the country in which the property is located. These services are defined as services that have a sufficiently direct connection with immovable property, such as services derived from immovable property in which the property makes up a constituent element of the services supplied.

12 This section deals with any type of SIF and RAIF (SIF-like) vehicle in corporate or partnership form (SCA, SA, SARL, CLP or SLP) or mutual fund form (FCP).

© 2022 Law Business Research Ltd

Portfolio management services are services that focus on the smooth running and operation of the immovable property with a view to preserving and building up the assets invested. These services, which notably relate to the selection, purchase and sale of immovable property, and to administration and accounting tasks, are not deemed to be immovable property services and therefore may qualify as investment fund management services and thus benefit from the VAT exemption in accordance with Article 44, Section 1(d) of the VAT Law.

Tax-opaque SICARs and RAIFs (SICAR-like)[13]

These vehicles are subject to CIT and MBT at ordinary rates in Luxembourg. However, pursuant to their applicable law (the SICAR Law or Article 48 of the RAIF Law), income derived from transferable securities, as well as income derived from the transfer, contribution or liquidation of those securities, does not constitute taxable income. Correlatively, realised losses resulting from the transfer of such securities, as well as unrealised losses accounted for upon the reduction of the value of those securities, do not constitute deductible losses.

Income arising from funds held pending their investment in risk capital does not constitute taxable income, although this exemption is applicable only for a period of 12 months preceding their investment in risk capital and where it can be established that the funds have effectively been invested in risk capital.

Further, although these vehicles are not subject to NWT, they remain subject to the MNWT. Distributions made to investors are not subject to withholding tax in Luxembourg. The same analysis regarding VAT set out above is applicable to the RAIF-SICAR.

v Tax-transparent SICARs and RAIFs (SICAR-like)[14]

These vehicles are not subject to CIT (except in the case of application of the rules on reverse hybrids from tax year 2022), MBT, NWT or subscription tax in Luxembourg. They may be subject to withholding tax on dividends and interest, and tax on capital gains in the countries of origin of the investments. As they are themselves, in principle, exempt from income tax, withholding tax levied at source, if any, is not creditable or refundable in Luxembourg. Distributions made to investors are not subject to withholding tax in Luxembourg.

The same VAT analysis applies as for the other vehicles described in Section III.iv.

vi Tax regime for investors

Investors who are residents of Luxembourg are taxable in Luxembourg on income derived as well as on capital gains realised upon the disposal of shares in the fund (when the fund is tax transparent, on their share in the income and gains of the fund) under the tax provisions applicable in their particular circumstances. Depending on the nature of the revenues, on the profile of the investor and on the type of fund vehicle, (partial) exemptions may apply. However, SIFs, family wealth management companies governed by the amended law of 11 May 2007, UCIs-Part II and RAIFs (SIF-like) are tax-exempt entities in Luxembourg and therefore not subject to any Luxembourg income tax.

Further, Luxembourg resident investors (other than individuals) are subject to Luxembourg NWT on the shares in the fund, unless the investor is a securitisation vehicle

13 SICARs and RAIFs (SICAR-like) set up in the form of an SCA, SA or SARL.

14 SICARs and RAIFs (SICAR-like) set up in the form of CLP or SLP.

© 2022 Law Business Research Ltd

governed by the amended law of 22 March 2004 on securitisation, a SICAR, a professional pension institution governed by the amended law of 13 July 2005, a SIF, a family wealth management company governed by the amended law of 11 May 2007, an UCI-Part II or a RAIF. However, a securitisation company governed by the amended law of 22 March 2004 on securitisation, a tax-opaque SICAR, a professional pension institution governed by the amended law of 13 July 2005 and a tax-opaque RAIF (SICAR-like) remain subject to MNWT.

Investors who are non-residents of Luxembourg are, in principle, not subject to tax in Luxembourg on income and capital gains deriving from the fund, unless these shares in the fund are owned through a PE or a permanent representative in Luxembourg.

Similarly, NWT is applicable to Luxembourg non-resident investors (other than individuals) only if their shares in the fund are attributable to a PE or a permanent representative in Luxembourg.

Finally, as previously indicated, no Luxembourg tax is withheld at source on distributions from the fund vehicles and no VAT liability arises, in principle, in Luxembourg for any payments made by the fund to its investors, to the extent that the payments are linked to their subscription to shares in the fund and do not constitute the consideration received for taxable services supplied.

IV REAL ESTATE INVESTMENT TRUSTS AND SIMILAR STRUCTURES

This section does not apply to Luxembourg.

V INTERNATIONAL AND CROSS-BORDER TAX ASPECTS

i Tax treaties

General

Luxembourg has an extensive double tax treaty network. Eighty-four double tax treaties are currently in force in Luxembourg. Moreover, as at the time or writing, 13 double tax treaties are soon to enter into force (awaiting ratification or publication) or are under negotiation, which highlights Luxembourg's willingness to further expand its double tax treaty network.

The existence of a double tax treaty between two countries favours cross-border real estate investments by avoiding international double taxation. To avoid international double taxation, double tax treaties provide a set of distributive rules with regard to different types of income, as well as relief from international double taxation.

The most relevant types of income from cross-border real estate investments are rental income, dividends and capital gains. The general tax treatment of these types of income under double tax treaties concluded by Luxembourg are analysed below, followed by a discussion of specific details observed in respect of certain double tax treaties concluded by Luxembourg.

Whether an investment vehicle is eligible to benefit from a double tax treaty depends on the double tax treaty in question and must be determined on a case-by-case basis. In general terms, investment vehicles established in a corporate form that are fully subject to tax in Luxembourg benefit from tax treaty protection. On the contrary, investment vehicles that are set up as partnerships that are transparent for tax purposes do not, in principle, benefit from tax treaty protection. Despite their personal tax exemption, corporate SIFs benefit from certain double tax treaties.

© 2022 Law Business Research Ltd

Tax treatment of rental income

Typically, double tax treaties concluded by Luxembourg are based on Article 6 of the Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital (the OECD MC) as far as the taxation of rental income is concerned. According to Article 6 of the OECD MC, rental income (including income from agriculture and forestry) is taxed in the state where the immovable property is located.

In general, under the double tax treaties concluded by Luxembourg, when the income recipient is a Luxembourg resident and the income is in respect of immovable property located in another contracting state, then Luxembourg often exempts the income from tax to provide relief from double taxation, rather than granting a tax credit.

The term 'immovable property' should be defined according to the domestic law of the state where the property is located. If the immovable property is located in Luxembourg, the term 'immovable property' should be defined in accordance with Article 517 et seq. of the Civil Code. Under these Articles, immovable property includes land, buildings, windmills, water-powered mills, other objects fixed and forming part of a building, usufruct of immovable property, rights of way and any right to claim immovable property.

Further, Article 98 of the ITL defines 'rental income' as income derived from a rental activity of immovable property, from any right to exploit and extract minerals or fossils from the soil, from the assignment of receivables concerning rents and from the rental value of the immovable property occupied by the owner.

In addition to the domestic law definition, Article 6 of the OECD MC provides that 'immovable property' should include in any case property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources. However, ships, boats and aircraft should not fall within the definition of 'immovable property'.[15]

The rental income must be derived from the direct use, letting or use in any other form of the immovable property in question. Thus, Article 6 of the OECD MC deals with income derived from all forms of exploitation of immovable property. The rental income derived by an enterprise resident in a contracting state from the exploitation of immovable property situated in the other contracting state may be taxed in the state where the property is located even if that enterprise has no PE in that state.

Some of the double tax treaties concluded by Luxembourg depart – albeit slightly – from Article 6 of the OECD MC. For instance, the double tax treaty concluded between Luxembourg and Brunei (2015) includes within the definition of 'rental income' income derived from fishery. Other double tax treaties concluded by Luxembourg include within the scope of Article 6 of the OECD MC income derived from the alienation of immovable property,[16] which under the OECD MC should fall within the scope of Article 13 dealing with capital gains.

15 The double tax treaty concluded between Luxembourg and Uzbekistan (1997) also excludes expressly from the definition of 'immovable property' road or railway vehicles. Similarly, the new double tax treaty between Luxembourg and France (2018) also excludes railway vehicles.

16 A provision of this kind can be found in the double tax treaties concluded by Luxembourg with Austria (1962), Canada (1999), France (1958) and Latvia (2004).

© 2022 Law Business Research Ltd

Some of the double tax treaties concluded by Luxembourg have a specific provision aiming to ensure that the interposition of a company does not prevent the state where the property is located from exercising its primary taxing right.[17] This applies mostly to time-sharing agreements for the acquisition of holiday real estate. Such a provision extends that state's primary taxing right to the (actual or imputed) income derived by a shareholder from the use or enjoyment of immovable property owned by a company, provided that the use or enjoyment results from the shareholding relationship. The shareholder would be taxed in the same way as a resident of that state.

The double tax treaty concluded between Luxembourg and Russia (1993) provides that the state where the property is located has the primary taxing right on the income derived by a resident of the other state from an investment fund organised in their state mainly to invest in immovable property situated in the other contracting state.

Tax treatment of dividend distribution

Dividends distributed by a fully taxable Luxembourg resident company are, in principle, subject to a 15 per cent withholding tax in Luxembourg, except for the application of the participation exemption regime or an exemption or reduced withholding tax rate provided under a double tax treaty.

To benefit from the reduced withholding tax rate provided under a double tax treaty, the income recipient must be the beneficial owner of the income and, as a rule, hold at least a certain percentage – which depends on the double tax treaty in question – of the capital (or voting rights) of the distributing company. The reduced withholding tax rates provided under the double tax treaties concluded by Luxembourg range between zero and 5 per cent. In cases where these conditions are not met, the double tax treaties concluded by Luxembourg usually provide for a 15 per cent withholding tax rate, which corresponds to the Luxembourg domestic withholding tax rate. As an exception, the double tax treaty concluded between Luxembourg and Singapore (2013) provides for no dividend withholding tax.

Certain double tax treaties concluded by Luxembourg contain specific provisions with regard to dividends that are linked to the income of real estate investments. For instance, the double tax treaty concluded between Luxembourg and Canada (1999) provides that Canada might impose an additional tax – additional to the tax that would be chargeable on the earnings of a company incorporated in Canada – that should nevertheless not exceed 5 per cent of the earnings derived from the alienation of immovable property situated in Canada by a Luxembourg resident company carrying on trade in immovable property, even if that Luxembourg resident company does not have a PE in Canada.

The double tax treaty concluded between Luxembourg and France in 2018, which has been in force since January 2020, provides that dividends paid out of income or gains derived from immovable property by an investment vehicle established in a contracting state that distributes most of this income annually, and whose income or gains from the immovable property are exempt from tax, are subject to a 15 per cent withholding tax if the beneficial owner resident in the other contracting state holds less than 10 per cent of the capital of that vehicle directly or indirectly.

However, if the beneficial owner is a resident of the other contracting state and holds more than 10 per cent of the capital of the distributing company, the dividend should be

17 Such a provision can be found in the double tax treaties concluded by Luxembourg with Finland (1982), Latvia (2004), Lithuania (2004) and Panama (2010).

© 2022 Law Business Research Ltd

subject to the ordinary withholding tax rate provided under the domestic law of the country where the investment vehicle is established. Under this new double tax treaty, a zero per cent withholding tax rate applies to dividends paid by a company resident in a contracting state to a beneficial owner resident in the other contracting state where such a beneficial owner is a company that holds directly at least 5 per cent of the capital of the company paying the dividends throughout a 365-day period.

Tax treatment of capital gains

The tax treatment reserved to capital gains under double tax treaties concluded by Luxembourg is, to a large extent, typically based on Article 13 of the OECD MC. Under the double tax treaties, a distinction is made between capital gains realised upon an asset deal and the capital gain realised upon a share deal, although some double tax treaties provide the same tax treatment for both asset and share deals.

In the case of an asset deal, the double tax treaties concluded by Luxembourg are, as a rule, based on Article 13.1 of the OECD MC, which provides that the capital gains realised by a resident of a contracting state upon the alienation of an immovable property situated in the other contracting state may be taxed in that other state. The state of residence of the alienator must provide relief for the taxes paid in the state where the property is located. Luxembourg exempts the capital gains from tax if they may have been taxed in the other contracting state.

In the case of a share deal, the tax treatment depends on whether the relevant double tax treaty contains a provision similar (or identical) to Article 13.4 of the 2003 OECD MC. Only 27 of the 84 double tax treaties in force in Luxembourg contain such a provision.[18]

According to Article 13.4 of the 2003 OECD MC (the land-rich entity provision), capital gains realised by a resident of a contracting state upon the alienation of shares of a company deriving directly or indirectly 'more than 50 per cent[19] of their value'[20] from immovable property (i.e., a land-rich entity) situated in the other contracting state may be taxed in the state where the property is located. That state has a primary taxing right in respect of the entire capital gains and not only on the part of the capital gains corresponding to the value of the immovable property held by the company. The alienator's country of residence must grant relief from double taxation, which is carried out in Luxembourg typically by exempting the capital gains taxed in the other state.

A certain number of conditions must be met for the land-rich entity provision to apply. First, the provision applies only to an alienation of shares of a company. Some of the double tax treaties concluded by Luxembourg not only make reference to the alienation of shares in a company but also target the alienation of 'similar rights of a company' or 'other corporate

18 A land-rich entity provision as provided under Article 13.4 of the OECD MC can be found in the double tax treaties concluded by Luxembourg with Andorra (2014), Armenia (2009), Canada (1999), China (1994), Croatia (2014), Cyprus (2017), Estonia (2014), Germany (2012), Hong Kong (2007), Hungary (2015), India (2008), Israel (2004), Kazakhstan (2008), Malta (1994), Moldova (2007), Panama (2010), Poland (1995), Russia (1993), Saudi Arabia (2013), Senegal (2016), Spain (1986), Sri Lanka (2013), Sweden (1996), Ukraine (1997), the United States (1996), Uruguay (2015) and Vietnam (1996).

19 Certain double tax treaties use the term 'principally', which has the same meaning as 'more than 50 per cent'. Other double tax treaties concluded by Luxembourg use the terms 'greater part' or 'mainly', which also have the same meaning as 'more than 50 per cent'.

20 Certain double tax treaties make reference to 'property' instead of 'value', but both terms should be understood as synonyms.

© 2022 Law Business Research Ltd

rights in a company'. The term 'alienation' should include, in principle, all transactions or incidents that are similar from an economic and legal point of view to an alienation (i.e., the transfer of property).

Second, to determine whether the company derives more than 50 per cent of its value from immovable property, it is necessary to compare the value of the immovable property with the value of all the assets held by that company. In this respect, it is important to focus on the target company itself and not on the controlling entity.

Some of the double tax treaties concluded by Luxembourg that include a land-rich entity provision present certain specific details that are worth highlighting. For instance, the double tax treaty concluded between Luxembourg and Cyprus makes express reference only to companies deriving directly 50 per cent of their value from immovable property. The alienation of the shares of a company deriving indirectly 50 per cent of its value from immovable property is not covered by the land-rich entity provision.

Other double tax treaties do not even make reference to 'directly or indirectly' at all.[21] In those cases, it should be verified whether the state where the property is located interprets the provision as including both the alienation of companies deriving their value directly and indirectly from immovable property.

In principle, when a double tax treaty makes reference to the terms 'direct' and 'indirect', it does not matter how many companies are interposed between the target company and the immovable property. The former double tax treaty between Luxembourg and France (1958), for instance, expressly provided that the land-rich entity provision was also applicable in the case of 'interposition of one or more other companies' between the target company and the immovable property. However, in the absence of such an explicit reference, the position of the state where the property is located in this regard should be clarified on a treaty-by-treaty basis, although most double tax treaties should be interpreted as including the interposition of more than one company between the target company and the immovable property.

Under the double tax treaty concluded between Luxembourg and Canada (1999), the land-rich entity provision applies only where the alienator holds a substantial interest in the capital stock of the land-rich entity. The alienator is considered to hold a substantial interest where it owns 10 per cent or more of the shares of any class or the capital stock of that entity.

Some double tax treaties provide exceptions under which the land-rich entity provision is not applicable. Some or all of the following exceptions can be observed in certain double tax treaties concluded by Luxembourg:[22]

21 The double tax treaty concluded between Luxembourg and Spain (1986) does not make such a reference, but it seems that Spanish tax authorities also claim a taxation right in the case of an indirect transfer of a land-rich entity.

22 One or more or all of these exceptions can be found in the double tax treaties concluded by Luxembourg with Canada (1999), Croatia (2014), Estonia (2014), Hong Kong (2007), Kazakhstan (2008), Panama (2010), Russia (1993), Senegal (2016), Sri Lanka (2013) and Ukraine (1997).

© 2022 Law Business Research Ltd

a the alienation of shares of a company listed on an approved or recognised stock exchange of one of the contracting states (or any other stock exchange as agreed between the contracting states);
b the alienation of shares in the course of a corporate reorganisation; and
c where the immovable property from which the alienated shares derive their value is used to carry out a business activity[23] (i.e., a mine or a hotel, etc.).

The double tax treaty concluded between Luxembourg and Russia (1993) provides a further exception and excludes from the application of the land-rich entity provision the capital gains realised by a pension fund, a similar entity or the government upon the alienation of the shares of a company deriving more than 50 per cent of its value from immovable property located in the other contracting state. Finally, the double tax treaty concluded between Luxembourg and Sri Lanka (2013) also excludes from the scope of the land-rich entity provision the alienation of shares of a company if a person owns directly less than 75 per cent of the capital of that company.

If the double tax treaty does not include a land-rich entity provision, capital gains realised upon the alienation of shares may only be taxed in the residence country of the alienator (i.e., a catch-all provision, corresponding to Article 13.5 of the OECD MC, which is included in all double tax treaties concluded by Luxembourg).

However, some double tax treaties concluded by Luxembourg also include a provision based on Article 13.5 of the United Nations Model Convention (the UN MC). Under Article 13.5 of the UN MC, capital gains realised by a resident of a contracting state from the alienation of shares of a company resident in the other contracting state may be taxed in that other contracting state if the alienator holds a certain percentage of the capital of that company (i.e., a substantial shareholding). The percentage is freely determined by the contracting states and differs from double tax treaty to double tax treaty.

Finally, the double tax treaty concluded between Luxembourg and Mexico (2001) provides that if the capital gains are not taxed under the domestic law of the alienator's country of residence, the country of residence of the company whose shares are alienated may tax the capital gains.

Taxation of capital under double tax treaties

Luxembourg resident companies are, in principle, subject to NWT. Double tax treaties concluded by Luxembourg typically contain a provision identical to Article 22 of the OECD MC according to which the capital represented by immovable property owned by a Luxembourg resident and situated in the other contracting state may be taxed in that other contracting state. Immovable property located in another country with which Luxembourg has concluded a double tax treaty is correspondingly exempt from NWT in Luxembourg pursuant to the double tax treaties concluded by Luxembourg.

The only variations in this regard concern the double tax treaties concluded with Spain (1986) and Sweden (1996), under which the capital represented by shares or similar rights in a company – the assets of which consist principally of immovable property situated in the other contracting state – held by a Luxembourg resident may be taxed in the other state. Such shares are exempt from NWT in Luxembourg under these double tax treaties.

23 The double tax treaty concluded between Luxembourg and Sri Lanka (2013) requires only that 75 per cent of the immovable property is used to carry out a business activity.

© 2022 Law Business Research Ltd

Impact of the Multilateral Instrument on Luxembourg double tax treaties

The implementation of the Base Erosion and Profit Shifting (BEPS) Actions through the Multilateral Instrument (MLI)[24] should not have an adverse impact on the double tax treaties concluded by Luxembourg with regard to real estate investments, and more specifically with regard to the taxation of the different income streams analysed above.

Under the MLI, countries had the option of including within their double tax treaty a land-rich entity provision or of aligning their existing land-rich entity provisions with Article 13.4 of the 2017 OECD MC, which has been amended pursuant to the BEPS Project. Luxembourg did not choose to amend its tax treaties in respect of this point.

However, the new double tax treaties concluded with France, in 2018, and with Argentina, in 2019 (the latter is not in force yet), are the only double tax treaties to be concluded by Luxembourg including a provision identical to Article 13.4 of the 2017 OECD MC. Article 13.4 of the 2017 OECD MC includes, in addition to the above-mentioned features of Article 13.4 of the 2003 OECD MC, an explicit reference to the alienation of a comparable interest, such as a partnership or trust, that derives more than 50 per cent of its value from immovable property. Furthermore, under the 2017 OECD MC, the 50 per cent threshold is assessed over a 365-day period preceding the alienation and not only at the date of the alienation.

ii Cross-border considerations

Luxembourg does not provide for any limits or restrictions for foreign companies investing directly or indirectly in real estate assets located in Luxembourg or in cases where a Luxembourg investment vehicle is used to invest abroad.

iii Locally domiciled vehicles investing abroad

Located in the heart of Europe, Luxembourg has become a leading jurisdiction for the establishment of investment funds. Over the last 20 years, Luxembourg has been able to create, develop and promote a business-enabling environment. Among the factors that have contributed to its appeal, one can mention the relatively high contractual freedom allowed by the Company Law, the responsiveness of the Luxembourg legislature to practitioners' needs, a multilingual community of professional service providers, experienced and business-oriented authorities, and a politically stable environment.

Tax features combined with the evolving Luxembourg legal structuring toolbox (e.g., the standard company, the SIF, the SICAR, the Luxembourg limited partnership structures and recently the RAIF) ensure that investors can find an efficient structure adapted to their real estate investment policies.

The structuring of foreign investments through Luxembourg has evolved considerably, with the emergence of regulated or unregulated pan-European real estate funds falling within the scope of the AIFMD and that invest through a combination of holding companies, property companies and local regulated funds based on corporate, financing, regulatory and tax considerations.

24 The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.

© 2022 Law Business Research Ltd

In general, the above-mentioned investment vehicles must be registered with the Luxembourg Trade Register and must comply with the accounting and tax compliance obligations provided under Luxembourg law, such as the filing of annual accounts and the submission of tax returns.

VI YEAR IN REVIEW

The Law of 20 December 2019 transposed the second EU Anti Tax Avoidance Directive (ATAD II) into domestic law,[25] extending the scope of anti-hybrid mismatch rules to new situations (PE mismatches, imported mismatches, hybrid transfer mismatches, dual resident mismatches, reverse hybrids and double tax relief at source) and to third countries. These new measures, which are generally in line with the provisions of ATAD II, apply to tax years starting from 1 January 2020, except for the rules on reverse hybrids, which apply from tax year 2022.

Specific measures have been introduced to address unintended consequences for investment funds. In particular, the law of 20 December 2019 provides for a *de minimis* threshold for investment funds when applying the acting-together concept for the purposes of the definition of 'associated enterprises', whereby an individual or entity that holds, directly or indirectly, less than 10 per cent of the securities or units in an investment fund and that is entitled to receive less than 10 per cent of the profits of that investment fund shall be deemed not to be acting together with another individual or entity holding securities or units in the same investment fund, unless it is proven otherwise.

In addition, most investment funds should be excluded from the rules on reverse hybrids. Collective investment vehicles (defined as investment funds or vehicles that (1) are widely held, (2) hold a diversified portfolio of securities and (3) are subject to investor protection regulation in the country in which they are established) are outside the scope of the reverse hybrids rule. Further, based on the commentaries to the bill of law, this 'CIV exemption' covers not only regulated investment vehicles but also unregulated vehicles qualifying as AIFs within the meaning of the AIFM Law to the extent that they fulfil the aforementioned three requirements.

Aside from these anti-tax avoidance measures, the Budget Act 2021 introduced several tax measures in favour of social justice, some of which impact the real estate sector:

a introduction from 1 January 2021 of a lump sum 20 per cent real estate levy on gross rental income and capital gains (asset and share deals) from real estate assets located in Luxembourg for UCIs, SIFs and RAIFs (except the ones under the form of CLPs, SLPs or FCPs) investing in real estate assets located in Luxembourg, either directly or indirectly through one or a series of tax-transparent entities, in proportion to the stake held, together with applicable reporting formalities and information requirements;

b increase from 1 January 2021 of transfer taxes (registration duty and transcription tax) applicable upon contribution of a real asset located in Luxembourg remunerated by shares, from an aggregate rate of 1.1 per cent to 3.4 per cent (from 1.4 per cent to 4.6 per cent where the asset comprises an office or a commercial property located in the city of Luxembourg); and

25 Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

© 2022 Law Business Research Ltd

c prohibition for family wealth management companies governed by the amended law of 11 May 2007 (known as SPFs) to hold real estate assets through tax-transparent entities as from 1 July 2021.

VII OUTLOOK

Rules on reverse hybrids will have an impact on many real estate players, particularly for investors resident in jurisdictions that regard certain Luxembourg tax-transparent vehicles as taxable persons in Luxembourg.

© 2022 Law Business Research Ltd

Appendix 1

ABOUT THE AUTHORS

THIERRY LESAGE

Arendt & Medernach SA

Thierry Lesage is a partner in the tax law practice of Arendt & Medernach. He advises on both national and international tax issues and is active in private equity, real estate and finance transactions. He is a member of the Luxembourg Bar, the American Bar Association, the International Bar Association and the International Fiscal Association (IFA), where he was appointed national co-reporter for the IFA Congress in 2003, 2005 and 2014. Moreover, he is vice chair of the fiscal commission of the Luxembourg Bankers' Association.

Prior to joining Arendt & Medernach, he worked as a tax manager with one of the 'Big Four' firms and as head of the corporate tax department with a bank in Luxembourg.

Thierry Lesage holds a master's degree in law from the University of Liège, Belgium, as well as a master's degree in fiscal law from the Université libre de Bruxelles, Belgium. He is the co-author of the Luxembourg chapter of the international guide to the taxation of holding companies published by IBFD, Amsterdam.

Thierry Lesage is recognised as a major-league tax lawyer by the leading legal directories, including *Best Lawyers*, *The Legal 500* and *Chambers Europe*. He speaks English, French, Dutch and Italian, and has a reading knowledge of German.

STÉPHANIE MASCHIELLA

Arendt & Medernach SA

Stéphanie Maschiella is a counsel in the tax law practice of Arendt & Medernach. She advises on both national and international tax issues and is active in private equity, real estate and finance transactions, with a particular focus on the Italian market.

Prior to joining Arendt & Medernach, Stéphanie worked as a tax director within one of the 'Big Four' firms for over 12 years, where she advised a wide range of pan-European funds throughout their life cycle, as well as Italy-related clients and investment structures across a range of industries.

Stéphanie Maschiella holds a master's degree in finance from Audencia Business School in Nantes, France, as well as a master's degree (LLM) in European and international tax law from the University of Luxembourg. She speaks French, English and Italian.

© 2022 Law Business Research Ltd

ARENDT & MEDERNACH SA

41 Avenue John F Kennedy
2082 Luxembourg
Tel: +352 40 78 78 328
Fax: +352 40 78 04 657
thierry.lesage@arendt.com
stephanie.maschiella@arendt.com
www.arendt.com

© 2022 Law Business Research Ltd

ISBN 978-1-80449-088-4

© 2022 Law Business Research Ltd