universität wien

MASTER THESIS

Titel der Master Thesis / Title of the Master‘s Thesis

„International Tax Planning in the Fund Industry: The Case of Luxembourg“

verfasst von / submitted by

Marina Alonso Morea

angestrebter akademischer Grad / in partial fulfilment of the requirements for the degree of

Master of Laws (LL.M.)

Wien, 2023 / Vienna 2023

Studienkennzahl lt. Studienblatt / Postgraduate programme code as it appears on the student record sheet:	UA 992 548
Universitätslehrgang lt. Studienblatt / Postgraduate programme as it appears on the student record sheet:	Europäisches und Internationales Wirtschaftsrecht / European and International Business Law
Betreut von / Supervisor:	Dr. Dimitar Hristov

TABLE OF CONTENT

LIST OF ABBREVIATIONS

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
ATAD	Anti-Tax Avoidance Directive
BEPS	Base Erosion and Profit Shifting
CFC	Controlled Foreign Company
CIT	Corporate Income Tax
CIU	Collective Investment Undertaking
CSSF	*Commission de Surveillance du Secteur Financier*
ECJ	European Court of Justice
ETR	Effective Tax Rate
EU	European Union
FCP	*Fonds Commun de Placement*
GAAR	General Anti-Abuse Rule
IRD	Interest and Royalty Directive
LITL	Luxembourg Income Tax Law
Lux HoldCo	Luxembourg Holding Company
Lux PropCo	Luxembourg Property Company
MBT	Municipal Business Tax
MNE	Multinational Enterprise
NWT	Net Wealth Tax

OECD	Organization for Economic Cooperation and Development
OECD-MC	OECD Model Tax Convention
PE	Permanent Establishment
PPL	Profit Participating Loans
PSD	Parent-Subsidiary Directive
RAIF	Reserved Alternative Investment Fund
S.à r.l.	*Société à responsabilité limitée*
SAS	*Société par Actions Simplifiée*
SCS	*Société en Commandite Simple*
SCSp	*Société en Commandite Spéciale*
SICAF	*Société d'Investissement à Capital Fixe*
SICAR	*Société d'Investissement en Capital à Risque*
SICAV	*Société d'Investissement à Capital Variable*
SIF	Specialised Investment Fund
SOPARFI	*Société de Participation Financière*
SPF	*Société de gestion de Patrimoine Familial*
TP	Transfer Pricing
UCI	Undertakings for Collective Investment
UCITS	Undertakings for Collective Investment in Transferable Securities
UN	United Nations
VAT	Value-Added Tax

WHT	Withholding Tax

INTRODUCTION

In an increasingly interconnected global economy, the fund industry has witnessed remarkable growth over the past decades serving as an essential vehicle for investors seeking to capitalize on diverse financial opportunities. Particularly, Luxembourg has emerged as a leading European hub for investment funds and has positioned itself as a global financial centre by attracting a substantial worldwide inflow of capital from investors.

Hence the well-developed financial industry together with a favourable regulatory environment has positioned Luxembourg to the forefront of the international fund management landscape. Since most investments are done on a cross-border basis, the effective implementation of international tax planning strategies becomes essential for investment fund managers and participants operating within the fund industry.

This thesis aims to provide a comprehensive analysis of the important role that international tax planning plays in ensuring the smooth functioning and sustained success of investment funds, focusing on the especial jurisdiction of Luxembourg. By examining the intricate interplay between national and international regulatory frameworks, fund structures, and the sustainable growth of the funds industry, this study lays down the strategies and considerations employed by fund managers to optimize tax efficiency, mitigate risks, and enhance overall investment returns.

The analysis provides the study of different key concepts such as the taxation of investment funds, the application of double tax treaties ("**DTTs**"), the use of tax advantages and incentives available, as well as some key concepts on international tax law. By conducting a thorough examination of these concepts, this paper endeavours to provide insights into the tools, mechanisms, and structures employed in international tax planning to maximize the tax advantages available to Luxembourg investment funds and their stakeholders.

Through a combination of theoretical analysis together with a real case study, the findings and insights obtained from this research endeavour to contribute to the already existing bibliography and studies of this specialized field, offering valuable guidance to investment fund professionals, tax advisors, policymakers, and academics interested in the Luxembourg investment fund industry from a tax perspective.

I. THE FUND INDUSTRY IN LUXEMBOURG

1. Introduction

The financial industry has always been in the spotlight of different debates and specially when new regulations came into force since the events related to the global financial crisis of 2008. International financial centres appear to be the locations capable of providing the sophisticated infrastructure and enormous resources required to coordinate global capital and information flows.

International financial centres can be defined as the nodes within the complex network of large-scale capital and information flows that regulate and facilitate the trade of diverse financial goods.[1] Due to the benefits derived from this industry well-paid jobs, tax revenues and international connections, national governments are increasingly paying attention to their international financial centres.[2]

Within the area of global finance, asset management is a large and growing sector that invests capital of individuals and institutions (banks, insurance companies, pension funds, family offices, and sovereign wealth funds) in a variety of assets (equity and debt securities).[3] That is the reason why the demand for asset management services has grown for the last 40-50 years due to broader processes, including the establishment of the welfare state in advanced economies, the increase of wealthy emerging economies, as well as the globally individualisation of risk.[4]

However, competition between international financial centres arises both in the sphere of national regulation and on the local level of financial product innovation and process optimisation. After the financial crisis, the finance industry has been confronted with fundamental change enforced by continuous changing regulations and thus impacting small states that have a particular tendency to apply arbitrage strategies on liberal

---

[1] Sabine Dörry, 'Strategic nodes in investment fund global production networks: the example of the financial centre Luxembourg' (*Journal of Economic Geography*, V. 15, 2014, pp. 797–814) <https://doi.org/10.1093/jeg/lbu031> accessed 20 January 2023

[2] The Economist, 'Magnets for money: a special report on financial centres' (2007) <https://www.economist.com/sites/default/files/special-reports-pdfs/9753157.pdf> accessed 23 January 2023

[3] D Wojcik, M Urban, and S Dörry, 'Luxembourg and Ireland in global financial networks: Analysing the changing structure of European investment funds' (Transactions of the Institute of British Geographers, 2022) <https://doi.org/10.1111/tran.12517> accessed 18 January 2023

[4] Paul Langley, 'The everyday life of global finance. Saving and borrowing in Anglo-America' (Oxford University Press, 2008) <https://doi.org/10.1093/acprof:oso/9780199236596.001.0001> accessed 16 January 2023

regulatory settings and/or favourable taxation policies due to their difficulties to develop a diversified economy with sufficient economies of scale.[5]

Luxembourg has emerged as a global investment fund centre being the first one in Europe which plays a key role in shaping the international financial landscape. With a legacy dating back several decades, Luxembourg has cultivated an ecosystem that fosters innovation, attracts investors, and provides a robust framework for fund management activities. Indeed, Luxembourg is a structuring hub where investment funds are domiciled and managed but also prepared for distribution to other countries, so companies do not set up their funds in Luxembourg if they are to be solely distributed locally.[6]

This chapter begins by understanding the historical evolution of Luxembourg to understand the factors that have taken the country to its current status as a leading global fund domicile. We examine the strategic initiatives, regulatory developments, and forward-thinking policies that have shaped Luxembourg into a jurisdiction of choice for fund managers and investors alike while controlled by the *Commission de Surveillance du Secteur Financier* (“**CSSF**”) as the regulatory authority in charge of maintaining the integrity and stability of the financial sector.

Besides laying down the definition and economic purposes of funds and the legal sources of international fund law, this chapter analyses in the last section the legal framework of the different Luxembourg investment fund vehicles available under domestic law, as well as the legal forms available for its set-up. The latter will be important for the case-study in Chapter IV.

2. Luxembourg as a financial centre

Prior to 1985, cross-border asset management in Europe was relatively a small industry, focused mainly on private wealth with London, Switzerland, and Luxembourg as key centres. By that time, Luxembourg’s development was marked by its reliance on its main

[5] Sabine Dörry, ‘Strategic nodes in investment fund global production networks: the example of the financial centre Luxembourg’ (*Journal of Economic Geography*, V. 15, 2014, pp. 797–814) <https://doi.org/10.1093/jeg/lbu031> accessed 20 January 2023

[6] A Binder and M Robic, ‘Luxembourg: Home of the (Cross-Border) Global Fund Industry’ (HEC Paris Alternative Investments Society, 2022) < https://www.hec-ais.com/insights/luxembourg-home-of-the-cross-border-global-fund-industry > accessed 15 January 2023

policy pillars of strict banking secrecy and a tax system targeting the financial sector.[7] However, with the hit of the Eurodollar market between 1983 and 1988, Luxembourg provided banks with substantial allowances for sovereign risks in order to tackle the consequences of the international debt crisis for its financial centre.[8] This is how Luxembourg re-oriented its financial centre in close cooperation with the banking sector towards private banking and wealth management as well as the investment fund industry.[9]

Luxembourg role in European economic integration has deep roots, dating back to the 1920s when an economic union and common currency was signed with Belgium. Its long history of attracting international business through regulation and taxation includes the 1929 Holding Company regime and other treaties with the aim to avoid double taxation and tax evasion.[10]

Nevertheless, the key to the early growth of Luxembourg and Ireland as investment funds domiciles comes from the quick implementation of the Council Directive (EEC) 85/611 of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ("**UCITS Directive**"), as amended, into national investment law.

The latter was a path-breaking of the domestic affair with investment funds and associated functions located in the same country as the country of their investors[11] and a milestone of European financial integration. Therefore, its implementation allowed new investment funds to be registered or relocated to Member States that were not the main markets for fund distribution.

Luxembourg was the first country to implement the UCITS Directive in 1988 followed by Ireland in 1989, which gave Luxembourg a competitive advantage as a financial centre. However, the development of the financial industry in both countries did not

---

[7] Risto Laulajainen, *Financial Geography: A Banker's View* (Routledge, London, 2003) p. 376
[8] Sabine Dörry, 'Strategic nodes in investment fund global production networks: the example of the financial centre Luxembourg' (*Journal of Economic Geography*, V. 15, 2014, pp. 797–814) <https://doi.org/10.1093/jeg/lbu031> accessed 20 January 2023
[9] O Walther, C Schulz, and S Dörry, Specialised *international financial centres and their crisis resilience: the case of Luxembourg* (Geographische Zeitschrift, 2011) pp. 123–142
[10] B Majerus and B Zenner, 'Too small to be of interest too large to grasp? Histories of the Luxembourg financial centre' (European Review of History: *Revue européene d'histoire*, 2020, pp. 548–562) < https://doi.org/10.1080/13507486.2020.1751587> accessed 21 January 2023
[11] J Story and I Walter, *Political economy of financial integration in Europe* (Manchester University Press, Manchester, 1997)

happen overnight. Only in the early 1990s, international financial markets recovered from the 1987 stock market crash. After that, Luxembourg implemented different legislations that strengthened the future growth of the investment fund sector by enlarging the range of investment fund structures. As a result, the country's visionary approach, together with its ability to adapt swiftly to changing market demands, brought Luxembourg to be the leading UCITS centre by attracting worldwide funds.[12]

Different factors come into play when explaining the fast growth of this industry since the early 2000s. While the establishment of the Eurozone accelerated the integration process of funds and made it more attractive for investors, the implementation of a more widespread securitization brought new financial instruments relevant for investment funds. In addition, further regulation of investment funds came into force such as the several amendments of the UCITS Directive which allowed funds to invest in a significantly larger variety of financial products, including derivatives. Furthermore, the requirement for investors to be domiciled in the same country where the investment fund was domiciled was removed by the introduction of the management company passport.[13]

The above explains why the existing Luxembourg regulatory framework of the fund industry is a key factor for its own success. The CSSF diligently oversees the industry while seeking for the right balance between investor protection and the freedom of fund managers for the set-up of new funds.[14] Even though the regulatory framework is continuously evolving to tackle aggressive practices, Luxembourg legislation and supervision has provided confidence among investors, fund managers, and service providers.

The strategic geographic location of Luxembourg within Europe also plays an important role. Situated at the crossroads of major financial centres, the country offers unparalleled access to a vast pool of investors and markets. Its advantageous positioning together with

[12] Sabine Dörry, 'Strategic nodes in investment fund global production networks: the example of the financial centre Luxembourg' (*Journal of Economic Geography*, V. 15, 2014, pp. 797–814) <https://doi.org/10.1093/jeg/lbu031> accessed 20 January 2023

[13] D Wojcik, M Urban, and S Dörry, 'Luxembourg and Ireland in global financial networks: Analysing the changing structure of European investment funds' (Transactions of the Institute of British Geographers, 2022) <https://doi.org/10.1111/tran.12517> accessed 18 January 2023

[14] M Schmitz and PJ Warner, *Luxembourg in International Tax* (EY Luxembourg, 3rd revised edition, 2015) p. 383

its openness to cross-border investments and its multilingual workforce has made it a natural gateway for fund managers expanding their global network.[15]

Furthermore, the extensive network of DTTs that Luxembourg has is also an important factor that appeals international investors seeking for legal protection on their investments. Tax treaties provide clarity and reduce tax burdens, ensuring that funds domiciled in Luxembourg can efficiently navigate the complexities of cross-border taxation.[16]

The extended network of different financial services that Luxembourg hosts such as fund administrators, custodians, legal professionals, and auditors provide specialized support to everything related with the funds industry. This well-established infrastructure combined with the commitment to put in place regulations that lay down provisions on transparency and good governance has established an environment where the interests of investors are safeguarded and operational efficiency is prioritized.

In relation to the above, the financial industry in Luxembourg has a significant economic and social impact. On the one hand, companies providing financial services generate an important number of employment opportunities which in turn increases the economic growth of the country by contributing to its national fiscal revenues. On the other hand, as the fund industry operates in an international level, people from different countries find themselves working in Luxembourg in a broad international network of professionals.

One could state that Luxembourg is a specialized centre and its competitors tend to vary on a per activity basis. As already mentioned, Ireland seems to stand as the top competitor for Luxembourg.[17] Switzerland stands for its private banking activity[18] while in alternative funds London is traditionally the most vibrant financial centre.[19] Furthermore, Paris is increasingly becoming more attractive for alternative managers. However, these

---

[15] *Ibid.,* p. 16
[16] *Ibid.,* p. 42
[17] The Economist, 'Magnets for money: a special report on financial centres' (2007) < https://www.economist.com/sites/default/files/special-reports-pdfs/9753157.pdf> accessed 23 January 2023
[18] D Wojcik, M Urban, and S Dörry, 'Luxembourg and Ireland in global financial networks: Analysing the changing structure of European investment funds' (*Transactions of the Institute of British Geographers*, 2022) <https://doi.org/10.1111/tran.12517> accessed 18 January 2023
[19] Paul Langley, 'The everyday life of global finance. Saving and borrowing in Anglo-America' (Oxford University Press, 2008) <https://doi.org/10.1093/acprof:oso/9780199236596.001.0001> accessed 16 January 2023

countries should not be seen as a win or lose game for Luxembourg but rather a way of expertise that helps firms grow internationally.

According to all the factors stated above, Luxembourg is the leading domicile of investment funds in a European level. Its historical achievements and its continuous efforts to be updated on regulatory provisions that seek the right balance between protecting investors and evolving in the financial area has ensured its continuous presence in the dynamic global funds industry. [20]

3. Definition and economic purposes of investment funds

Broadly, a fund collects money from investors in exchange for shares or participations. The manager or the management company plays a key role in providing guidance for the fund.[21] That is, the manager invests the money raised from the investors on behalf of them and in their best and sole interest in different type of assets. [22] The latter is done according to the legal regime of the fund and the risk-spreading provisions laid down in the investment policy in order to achieve the investors' expectations.

Even though there is no legal definition for an "investment fund" as such, these are known as Undertakings for Collective Investment ("**UCI**") or Collective Investment Undertakings ("**CIU**") at European level and a main distinction of UCIs is made between Undertakings for Collective Investment in Transferable Securities ("**UCITS**"), also known as mutual funds in US law, and Alternative Investment Funds ("**AIF**").

One could state that the concept of "fund" is a broad term. However, this paper specifically focuses on funds that exist within the investment management or financial services industry, namely hedge funds, private equity funds and mutual funds for which different investment strategies, structures, and management practices can be adopted.[23]

[20] Sabine Dörry, 'Strategic nodes in investment fund global production networks: the example of the financial centre Luxembourg' (*Journal of Economic Geography*, V. 15, 2014, pp. 797–814) <https://doi.org/10.1093/jeg/lbu031> accessed 20 January 2023
[21] Matthew Hudson, *Funds: Private Equity, Hedge and all Core Structures* (Wiley, United Kingdom, 2014) p. 2
[22] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 11
[23] Matthew Hudson, *Funds: Private Equity, Hedge and all Core Structures* (Wiley, United Kingdom, 2014) p. 3

Investment funds may serve different economic purposes but from an investor's perspective, it is considered a profit-making investment product. The fund units can be incorporated as part of an investor's portfolio managed on an individual and discretionary basis by a financial service provider.[24]

An important use of investment funds is venture capital and private equity. Companies looking for funding can increase the share capital by issuing new shares or by borrowing bonds. In such case, investment funds can be used to finance companies but also micro-finance institutions, among others.

One should note that, the important financial and social role that investment funds play within the society explains why public authorities have been regulating this area to control the risks of shadow banking created by certain types of funds such as money market funds, hedge funds and, in particular, with regards the systemic risk attached to them.[25]

4. Main features for setting up an investment fund

Different actors come into play before and during the lifetime of a new fund. The management company in charge of implementing the new fund usually will require the approval from the national regulator, in the case of Luxembourg the CSSF, and a bank will act as the depositary.

Once implemented, the management company establishes the specific investment strategy and takes over the administration of the fund, acting as a fiduciary. In some cases, the management company may hire an independent investment manager in charge of the portfolio management of the fund. The latter can also advise the management company on investment decisions, which are then carried out by the transfer agent responsible for registering the shares or participations of the investors, the additional subscriptions, and redemptions.

[24] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 11
[25] *Ibid.,* p. 11

Even though a prime broker might be also crucial in some specific funds such as hedge funds, in Luxembourg is not that common since this type of funds are not predominant.[26]

Investment funds registered in a Member State of the European Union ("**EU**") are eligible to obtain a fund passport which allows for easy distribution throughout the EU. Before reaching such EU-wide distribution, different compliance and regulatory requirements should be met in each target jurisdiction.[27]

Therefore, the specialized activities related to fund domiciliation, administration, and distribution in Luxembourg need for an in-depth and specialized knowledge of legal requirements, different tax systems, investors preferences, and the specific administrative details of the targeted market. In other words, investment funds are domiciled in places characterised by a high degree of specialisation[28] and Luxembourg is one of the global and European centres of excellence to develop such knowledge within alternative business firms. As such, the functioning of Luxembourg as a financial centre relies on both onshore and offshore financial activities.[29]

5. Sources of investment fund law

Luxembourg investment fund industry operates within a well-defined legal framework that ensures investor protection, regulatory compliance, and operational transparency. The laws and regulations governing investment funds in Luxembourg are derived from a variety of sources, including domestic legislation, EU Directives and Regulations, as well as regulatory guidelines and circulars. [30] This section provides an overview of the key sources of investment fund law in Luxembourg.

5.1. Domestic law – Luxembourg

Luxembourg domestic legislation is the basis of the legal framework for investment funds. It is important to distinguish between regulated funds, authorised and supervised

[26] Sabine Dörry, 'Global production networks in finance. The example of Luxembourg's investment fund industry' (*L'espace géographique*, V. 43, 2014, pp. 227–239) <https://doi-org.uaccess.univie.ac.at/10.3917/eg.433.0227> accessed 4 February 2023
[27] *Ibid.*
[28] *Ibid.*
[29] *Ibid.*
[30] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 12

by the CSSF, and unregulated funds, which can be authorized or not, registered or not, depending on the unregulated investment vehicle.

The primary law governing regulated investment funds in Luxembourg is the Law of 17 December 2010 on Luxembourg Undertakings for Collective Investment[31] (the "**UCI Law**"). The latter establishes the legal framework for both UCITS and non-UCITS investment funds in Luxembourg. It outlines the requirements for fund establishment, governance, risk management, valuation, reporting, and distribution, among other aspects. The UCI Law is complemented by (i) CSSF Regulation nº 10-04 transposing Commission Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organizational requirements, conflicts of interest, conduct of business, risk management, and content of the agreement between a depositary and a management company, and (ii) CSSF Regulation nº 10-05 transposing Commission Directive 2010/44/EU of 1 July 2020 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards certain provisions concerning fund mergers, master-feeder structures, and notification procedure.[32]

If an investment fund does not fall within the scope of the UCITS Directive, a different set of rules apply: (i) Part II of the UCI Law, (ii) the Law of 15 June 2004 on the Luxembourg investment company in risk capital (the "**SICAR Law**")[33], and (iii) the Law of 13 February 2007 on Luxembourg specialised investment funds (the "**SIF Law**")[34].

Unregulated funds may be governed by the Law of 23 July 2016 on Luxembourg reserved alternative investment funds (the "**RAIF Law**")[35] to the extent that they qualify as AIFs as established within the Law of 12 July 2013 on alternative investment fund managers (the "**AIFM Law**") implementing the AIFM Directive[36].

[31] Law of 17 December 2010 relating to Luxembourg Undertakings for Collective Investment transposing Council Directive (EC) 2009/65 on the coordination of laws, regulations, and administrative provisions, relating to UCITS [2009] OJ L 302/32, as amended
[32] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 14
[33] Law of 15 June 2004 on the Luxembourg investment company in risk capital, as amended
[34] Law of 13 February 2017 relating to Luxembourg specialised investment funds, as amended
[35] Law of 23 July 2016 on Luxembourg reserved alternative investment funds, as amended
[36] Council Directive (EU) 2011/61 on Alternative Investment Fund Managers [2011] OJ L 174, as amended

Last but not least, both regulated and unregulated funds are also governed by the Law of 10 August 1915 on Luxembourg commercial companies (the "**Company Law**") to the extent that the above laws do not derogate from the 1915 Companies Law.

Besides legislation, the Luxembourg investment fund industry is governed by regulatory guidelines and circulars issued by the CSSF which provide detailed instructions and interpretations on various aspects of fund operations, including risk management, valuation methodologies, governance, and reporting requirements. These guidelines complement the legal framework and provide additional guidance to market participants, ensuring compliance with regulatory standards and best practices.

Thus, market participants, such as fund managers, depositaries, and administrators must stay updated on the CSSF guidelines and circulars to ensure ongoing compliance with regulatory obligations.

5.2. European Union law

The investment fund industry operating within EU borders is subject to various EU Directives and Regulations that harmonize fund regulations. As already mentioned previously, the most significant EU Directive in this regard is the UCITS Directive[37] which establishes a comprehensive regulatory framework for UCITS funds, ensuring investor protection, disclosure requirements, and portfolio diversification.

Other EU legal sources such as the AIFM Directive also have a significant impact on the regulation and distribution of investment funds in Luxembourg. All these provisions aim to enhance investor protection, promote market stability, and harmonize practices across the EU.

In addition, several stand-alone European regulations have been adopted in this field to establish uniform rules applicable to certain categories of investment funds. For instance, the Venture Capital Funds Regulation[38] and the European long-term investment funds Regulation[39] which provides an harmonized framework for management and cross-border marketing of funds are designed to procure long-term financing for infrastructure

[37] Council Directive (EC) 2009/65 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities [2009] OJ L 302/32, as amended
[38] Council Regulation (EU) 345/2013 on European venture capital funds [2013] OJ L 115/1
[39] Council Regulation (EU) 2015/760 on European long-term investment funds [2015] OJ L 123/98

projects, unlisted companies and listed small- and mid-sized companies that issue equity of debt instruments.[40] Other EU Directives and regulations may not be specifically dedicated to investment funds but that may be applied to them.

In a nutshell, investment fund law in Luxembourg derives its authority from a combination of domestic legislation, EU Directives and Regulations, and regulatory guidelines issued by the CSSF. The harmonization of EU laws together with Luxembourg's proactive approach to regulatory compliance and investor protection, has positioned the country as a leading jurisdiction for investment funds. Market participants must go through various sources of law to ensure adherence to the legal and regulatory requirements that govern the functioning of investment funds in Luxembourg.

6. Luxembourg Investment Fund Vehicles

Setting up a new fund requires different conditions to be fulfilled. The key features to address from a Luxembourg perspective are (i) the regulatory regime governing the investment fund, (ii) the structure most suited for the specific needs, and (iii) which service providers will be needed for the well-functioning of the fund.

Luxembourg offers a broad range of regulatory regimes, legal forms, and tax status in order to set up an investment fund that needs to meet different interests. For regulated investment vehicles, these share the common feature of investing their assets on a collective basis in accordance with the principle of risk-spreading, either if these are governed by the UCI Law in the case of UCITS and UCIs, or by the SIF Law for SIFs.[41]

Before deciding the regulatory regime of the fund, one should know first the targeted investors for the new fund. In the case of willing to raise capital from the public within the European Economic Area with a regulated investment fund, UCITS is the best choice. Instead, UCIs and SIFs are the most appropriate vehicles for regulated funds.

6.1. Regulated investment vehicles

[40] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 13

[41] Arendt & Medernach SA, 'Investment management: setting up your regulated investment fund in Luxembourg' (Arendt, 2014, p. 7) < https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_setting_up_your_regulated_investment_fund_in_luxembourg.pdf> accessed 16 February 2023

Luxembourg offers a diverse range of regulated investment vehicles that meets the needs of both institutional and retail investors. These vehicles provide a robust legal and regulatory framework, investor protection, and operational flexibility.

UCITS

According to Article 1(2)(a) of the UCITS Directive, a UCITS is an undertaking with the sole object of collective investment in transferable securities or in other liquid financial assets of capital raised from the public and which operate based on the principle of risk spreading.

The criteria laid down in the UCITS Directive and implemented in Part I of the UCI Law of Luxembourg is that UCITS must (i) exclusively invest in transferable securities and/or in other liquid assets, and (ii) be an open-ended fund.[42] The right of investors to repurchase and redeem their shares sets out the difference between open-ended and closed-ended funds. In open-ended funds, the investors have a right to repurchase and redeem at all times and at their own and discretionary request while, in closed-ended funds, the investors have no right to repurchase and redeem during the life of the fund, so the number of units or shares is fixed.

Even though UCITS are subject to detailed, complex and constantly evolving rules regarding eligible assets and diversification requirements, these are not rigid investment vehicles and asset managers have been able to adopt innovative strategies while still complying with the principles governing UCITS.[43] Furthermore, UCITS benefit from a pan-European passport and the CSSF plays a crucial role in supervising them, ensuring compliance with regulatory requirements and investor protection standards.

UCI

---

[42] Eddy Wymeersch, *Alternative Investment Fund Regulation*, (Wolters Kluwer, V. 16, Netherlands, 2012) p. 262

[43] Arendt & Medernach SA, 'Investment management: setting up your regulated investment fund in Luxembourg' (Arendt, 2014, pp. 7–8) < https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_setting_up_your_regulated_investment_fund_in_luxembourg.pdf> accessed 16 February 2023

In the context of the UCI Law, UCIs are investment funds that in principle invest in securities other than transferable securities and other liquid financial assets but which do not fall under the category of UCITS.[44]

This type of investment vehicle should be compared to SIFs. Even though these two are not subject to a defined list of eligible assets and investment strategies, they are subject to precise investment limits provided for by the CSSF such as limitations to invest in non-listed securities, in other UCIs, in short sales, in financial derivative instruments, among others. However, the CSSF has adopted a flexible approach since UCIs remain marginal in Luxembourg.[45]

SIF

The SIF regime is well-known for being the most flexible regulated investment vehicle in Luxembourg. It is regulated under the SIF Law and particularly well-suited for private equity and venture capital investments. It is considered to be one of the most chosen vehicles to develop alternative investment strategies in Luxembourg due to its flexibility for structuring a new fund and its posterior functioning.

A SIF is not subject to any restriction on the type of assets in which it invests, but it is reserved to well-informed investors. According to Article 2 of the SIF Law, well-informed investors are professional investors and any other investor who can either invest a minimum of EUR 125,000 or have been assessed by a credit institution, an investment firm, or a management company which certifies the investors' ability to understand and bear the risks associated with investing in the fund.[46]

Regardless of their investment policy, all SIFs remain subject to the principle of risk diversification as interpreted in the Circular N° 07/309 regarding Luxembourg risk-spreading in the context of SIFs.[47] Accordingly, a SIF may not in principle invest more than 30% of its assets or commitments to subscribe to securities of the same nature issued by the same issuer. For the avoidance of doubt, such restriction does not apply to

---

[44] *Ibid.,* p. 8
[45] *Ibid.,* p. 8
[46] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 21
[47] Circular N° 07/309 regarding Luxembourg risk-spreading in the context of specialised investment funds [2007]

investments in UCIs which are themselves subject to risk diversification requirements at least comparable to those applicable to the SIF.

Even though the risk-spreading principles of CSSF Circular N° 07/309 apply to all SIFs, the CSSF may grant derogations on a case-by-case basis upon adequate justification and/or accept a "start-up period" during which SIFs may depart from the above risk diversification rules.[48]

Moreover, a SIF may be organised as an umbrella fund whereby the fund has one or more compartments or sub-funds, each corresponding to a separate part of the assets and liabilities of the SIF. The subscribed capital of a SIF may not be less than EUR 1,250,000. This minimum must be reached within a period of 12 months following the authorisation of the SIF by the CSSF.

The approval of a SIF would typically take between two and four months from the date of submission to the CSSF of the application file, depending on the degree of complexity of the application submitted. Following the approval of the CSSF and its subsequent establishment, the SIF will be registered on the official list of SIFs held by the CSSF.

SICAR

The SICAR regime was introduced by the SICAR Law even though the Company Law may apply in those cases where the SICAR is organised in a corporate form. As its name suggests, SICAR is specifically designed for private equity and venture capital investment company regimes. Since it is a vehicle reserved for investment in risk capital, Luxembourg law restricts its access to well-informed investors who can fully acknowledge the risk borne.[49]

Contrary to the SIF regime, SICARs are not subject to risk-spreading requirements. However, the CSSF in its Circular N° 06/241[50] has clarified the concept of risk capital under the SICAR Law. Hence SICARs must fulfil the criteria of (i) high risk, which can

---

[48] Arendt & Medernach SA, 'Investment management: setting up your regulated investment fund in Luxembourg' (Arendt, 2014, p. 8) <https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_setting_up_your_regulated_investment_fund_in_luxembourg.pdf> accessed 16 February 2023

[49] Eddy Wymeersch, *Alternative Investment Fund Regulation*, (Wolters Kluwer, V. 16, Netherlands, 2012) p. 265

[50] Circular N° 06/241 regarding the Luxembourg concept of risk capital under the Law of 15 June 2004 relating to the Luxembourg investment company in risk capital [2006]

be demonstrated through various characteristics of the investment, and (ii) the active development intent in respect of the target entities, i.e. to create value on these entities upon exit.[51]

In order to perform its activities, the SICAR is subject to the prior approval and ongoing supervision of the CSSF. Nevertheless, the authorization regime is relatively strict as it is limited to the approval by the CSSF of its sales and constitutive documents, its directors, the choice of the depositary, the auditor, and the place of its central administration.[52]

6.2. Alternative investment funds

Along with the regulatory regime, it is necessary to decide before choosing the legal structure of the investment vehicle whether it will have the features to qualify as an AIF.

As mentioned previously, AIFs are subject to a pan-European regulation that creates an harmonised set of provisions which aim to enhance transparency, a closer oversight of systematic risks and more stringent operational rules across Europe.[53] However, the AIFM Directive essentially addresses the legal status of the asset manager rather than the fund itself. Hence the AIFM Directive is applicable to asset managers that manage or market AIFs irrespective of the type of assets in which they invest.[54]

Article 4(1)(a)(ii) of the AIFM Directive defines in wide terms an AIF as any collective investment undertaking which "raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors". Some of the advantages laid down in the AIFM Directive for AIFs are the creation of a European brand of quality for AIF and the possibility, under certain conditions, of marketing the AIFs across Europe on the basis of a passport.

[51] Arendt & Medernach SA, 'Alternative Investment Funds' (Arendt, 2021, p. 10) <https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_alternative_investment_funds_-_aifs.pdf> accessed 22 February 2023

[52] Eddy Wymeersch, *Alternative Investment Fund Regulation*, (Wolters Kluwer, V. 16, Netherlands, 2012) p. 265

[53] Arendt & Medernach SA, 'Investment management: setting up your regulated investment fund in Luxembourg' (Arendt, 2014, p. 8) < https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_setting_up_your_regulated_investment_fund_in_luxembourg.pdf> accessed 16 February 2023

[54] Eddy Wymeersch, *Alternative Investment Fund Regulation*, (Wolters Kluwer, V. 16, Netherlands, 2012) p. 435

UCIs are by law automatically considered to be AIFs while SIFs only if they meet certain criteria. For instance, when the latter are a collective investment undertaking raising capital from a number of investors with a view to investing it in accordance with a defined policy for the benefit of those investors. [55] Article 2(3) of the AIFM Directive specifically provides for a list of entities such as UCITS that are excluded from its scope.

One could state that the requirements laid down under the regime of AIFMD, applicable to fund managers and AIFs, differ from the provisions applicable to UCITS. The latter is essentially aimed at protecting investors while the former addresses more issues regarding financial stability and orderly functioning of the markets. Although the protection of investors is not completely absent in the AIFMD, its regulation is to a certain extent left to the Member States where the fund is domiciled.[56]

6.3. Unregulated investment vehicles

SOPARFI

The S*ociété de Participation Financière* ("**SOPARFI**") is an ordinary unregulated Luxembourg resident commercial corporate vehicle not subject to the supervision of the CSSF and governed by the Luxembourg Company Law. It is the most common European corporate vehicle used for cross-border acquisitions[57] and it is used for managing holdings and for financing and holding venture capital and private equity investments.[58]

The sole purpose of SOPARFIs is to hold and manage financial participations in other undertakings. Other than that, no investment or risk-spreading requirements apply to this type of investment vehicle. The SOPARFI regime does not impose any restrictions on the eligibility of investors, neither it is subject to any prior authorization from the CSSF.[59]

---

[55] Arendt & Medernach SA, 'Investment management: setting up your regulated investment fund in Luxembourg' (Arendt, 2014, p. 9) <https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_setting_up_your_regulated_investment_fund_in_luxembourg.pdf> accessed 16 February 2023

[56] Eddy Wymeersch, *Alternative Investment Fund Regulation*, (Wolters Kluwer, V. 16, Netherlands, 2012) p. 494

[57] Arendt & Medernach SA, 'Alternative Investment Funds' (Arendt, 2021, p. 7) <https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_alternative_investment_funds_-_aifs.pdf> accessed 22 February 2023

[58] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 10

[59] Eddy Wymeersch, *Alternative Investment Fund Regulation*, (Wolters Kluwer, V. 16, Netherlands, 2012) p. 266

RAIF

A RAIF is an investment vehicle introduced by the RAIF Law. The sole objective is to collectively invest the funds raised in assets under risk spreading considerations.[60] It allows fund investors to set up a new type of AIF which combines features of well-known SIF and SICAR fund regimes.[61]

One of the reasons why RAIF was designed is to put an end to the often-criticized planning uncertainty for fund launches. Hence a RAIF may be launched in accordance with the AIFMD marketing rules and will not be subject to the prior authorization and the ongoing oversight by the CSSF.[62] However, RAIFs must be managed by an AIFM through which the regulatory supervision will be performed.

SPF

A *Société de gestion de Patrimoine Familial* ("**SPF**") is a family estate management company which replaced Luxembourg's former 1929 holding companies, which were abolished due to be considered an unfair State-aid regime by the European Commission.

Luxembourg introduced the SPF, a non-regulated company, through the amended Law dated 11 May 2007 on the family wealth management company as amended with the purpose of creating legal framework for the management of family wealth by individuals. It is a simple, flexible wealth management vehicle that complies with EU regulatory requirements.[63]

SPFs are not subject to any risk diversification rule. It is strictly limited to the acquisition, holding, management and disposal of financial assets including shares, bonds, cash and derivative products. The SPF may hold participation in other companies but only to the extent that the SPF does not become actively involved in the management of these companies. The SPF may not carry out any commercial or financing activity.

---

[60] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 46

[61] Arendt & Medernach SA, 'Alternative Investment Funds' (Arendt, 2021, p. 9) <https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_alternative_investment_funds_-_aifs.pdf> accessed 22 February 2023

[62] *Ibid.*, p. 9

[63] Arendt & Medernach SA, 'Corporate taxation in Luxembourg' (Arendt, 2018, pp. 39–40) < https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_corporate_taxation_in_luxembourg.pdf> accessed 3 March 2023

Qualifying shareholders of the SPF are limited to (i) individuals managing their private wealth, (ii) wealth management entities acting exclusively in the interest of the private wealth of individuals (e.g. family offices, trusts, etc.) and (iii) intermediaries holding the shares of the SPF on a fiduciary basis or in a similar capacity on behalf of investors who are themselves qualifying shareholders.

7. Legal Structures of Luxembourg Funds

In Luxembourg, investment funds can be established as a contractual form (*Fonds Commun de Placement* – "**FCP**") or corporate form. The former is a contractual, incorporated co-proprietorship of assets which does not have any legal personality and, therefore, may not itself enter into contracts or obligations. A management company will be in charge of managing the FCP in accordance with its regulations and in the exclusive interests of the unitholders.[64]

In turn, investment companies may be created as a structure with variable capital (*Société d'Investissement à Capital Variable* – "**SICAV**") or as a structure with fixed capital (*Société d'Investissement à Capital Fixe* – "**SICAF**") but both will have a legal personality and are usually managed by a board of managers.[65]

Both SICAV and SICAF offer protection to investors limiting their liability to the amount invested in or committed to the fund. However, in a SICAV the share capital increases and decreases automatically as a result of the subscriptions and redemptions of the investors without any further formality while in a SICAF it is required a formal decision to increase or reduce the share capital in accordance with the requirements applicable to regular companies.[66]

Under the UCI Law, UCITS and UCI can be structured as investment companies or common funds.[67] However, open-ended UCITS organised as SICAV must adopt the legal form of a public limited company (*Société Anonyme* – **SA**)[68] whereas UCITS organised

[64] *Ibid.,* p. 34
[65] *Ibid.,* p. 35
[66] *Ibid.,* p. 34
[67] *Ibid.,* p. 35
[68] Arendt & Medernach SA, 'Investment management: setting up your regulated investment fund in Luxembourg' (Arendt, 2014, p. 9) < https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_setting_up_your_regulated_investment_fund_in_luxembourg.pdf> accessed 16 February 2023

as SICAFs may also be created as corporate partnerships limited by shares (*Société en Commandite per Actions* – **SCA**).[69]

SIFs structured under an investment company have a wider choice of legal forms so many factors such as the corporate governance model, tax treatment of the structure, desired degree of flexibility, among others, will play a key role. Whether they are SICAVs or SICAFs, most SIFs are structured as SA, private limited companies (*Société à responsabilité limitée* – "**S.à.r.l**."), SCA, limited partnerships (*Sociétés en Commandite Simple* – **SCS**) or special limited partnerships (*Sociétés en Commandite Spéciale* – "**SCSp**").[70] In addition, SIFs can also be organized under a form of a mutual fund.

It is worth mentioning that the company law reform of August 2016 introduced a new type of company, the *Société par Actions Simplifiée* ("**SAS**"). A SIF may be organised as a SICAF under the corporate form of an SAS.

Among the non-regulated investment vehicles, SICARs are typically organised as a SCA, SA, S.à.r.l., SCS or SCSp; a SOPARFI in the form of an SCA, SA, or S.à r.l.; a RAIF under the corporate form of an SCA, SA, S.à r.l., SAS (only in case of fixed capital structures), as a partnership such as a SCS or SCSp or in the contractual form of a FCP[71]; and a SPF in the corporate form of a S.à r.l., SA, a cooperative in the form of a limited company or an SCA.

An investment fund can issue several classes of units or share classes subject to different rules for distribution or to different management, subscription, and/or redemption fees. The UCITS Directive does not lay down any details as to the different unit/share classes, but the European Securities and Markets Authority issued an opinion on 30 January 2017[72] emphasizing principles to be followed. [73] However, the minimum unit/share capital depends upon the particular legal form of the fund chosen.

[69] *Ibid.,* p. 9
[70] *Ibid.,* p. 9
[71] Arendt & Medernach SA, 'Alternative Investment Funds' (Arendt, 2021, p. 7–9) <https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_alternative_investment_funds_-_aifs.pdf> accessed 22 February 2023
[72] European Securities and Markets Authority, 'Opinion on UCITS Share Classes' (ESMA 34-43-296, 2017) <https://www.esma.europa.eu/sites/default/files/library/opinion_on_ucits_share_classes.pdf> accessed 15 March 2023
[73] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 23

Both UCITS and AIF can be established as compartments of investments or be part of a master and feeder structure in order to pool assets, achieve economy of scales, and to diversify their investment offer. If established as an umbrella structure or compartments of investments, it will consist of one single fund with one or more sub-funds where each sub-fund corresponds to a distinct portfolio of certain assets and liabilities. Each sub-fund has a separate pool of assets ring-fenced against the liabilities of any other sub-fund.[74]

In regards a feeder fund, the latter is considered an investment fund raising capital from its investors to invest in another fund referred as the "master fund". Thus, one could state that a feeder fund is a sort of "fund of fund" that invests mainly in another fund.[75] Under the UCITS and AIFM Directives certain requirements and limitations are laid down in order for regulators to better monitor these structures.

[74] Arendt & Medernach SA, 'Corporate taxation in Luxembourg' (Arendt, 2018, p. 35) < https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_corporate_taxation_in_luxembourg.pdf> accessed 3 March 2023

[75] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 24

II. SOURCES OF INTERNATIONAL TAX LAW

1. Introduction

International tax law provides a comprehensive framework for the taxation of cross-border transactions, income, and assets.[76] It lays down rules and principles for determining the allocation of taxing rights between countries involved in a cross-border situation as well as the different methods for computing taxable income and tax liabilities in an international context. This framework allows taxpayers to understand their rights and obligations and helps to structure their affairs according and compliant with the complexities that cross-border taxation can have.

International tax planning has become an essential tool for businesses and individuals operating in a globalized economy. As cross-border transactions and investments continue to increase, taxpayers seek effective strategies to optimize their tax positions, minimize tax liabilities, and ensure compliance with tax regulations in different jurisdictions. At the heart of successful international tax planning lies international tax law, a complex and dynamic field that shapes the opportunities and challenges that taxpayers face by engaging in cross-border activities.

Due to the importance that international tax law plays behind tax planning strategies, this chapter lays down the main aspects of this field of law. It provides an overview of the sources of international tax law, beginning from a domestic point of view and laying down different principles, to EU law and the OECD Model Tax Convention (the "**OECD-MC**")[77]. By leveraging from international tax law, then we will focus on the main guiding concepts for international tax planning that operate within the boundaries of legal and regulatory requirements.

2. Domestic legislations

Each country has its own domestic tax laws which constitute the foundation of its tax system. Domestic tax laws involve legislation, regulations, and administrative guidelines that lay down the rules on how to compute the taxable income, tax liabilities, as well as how the tax system is managed within a specific jurisdiction. These laws are the primary

---

[76] Klaus Vogel, *Double Tax Treaties and Their Interpretation*, (Berkeley Journal of International Law, 1986) pp. 6-7

[77] OECD, 'Model Tax Convention on Income and on Capital' (OECD Publishing, Condensed Version 2017, Paris) <http://dx.doi.org/10.1787/mtc_cond-2017-en> accessed 10 March 2023

source of authority for taxing income and assets within the borders of a specific country, addressing international tax scenarios such as the treatment of foreign-sourced income, withholding taxes ("**WHT**"), and the availability of tax incentives or deductions.

3. Tax treaties

Tax treaties are international agreements entered by countries and hence subject to general international law on treaties as codified in the Vienna Convention on the Law of Treaties of 23 May 1969. Tax treaties are seen as having a dual nature since these are international agreements between governments that lay down the allocation of fiscal jurisdiction but also become part of the domestic tax law system of each Contracting State, whether by direct incorporation into the domestic law or by enactment into that law.[78]

Several players are of importance within the international field of taxation since they all try to influence the design of the international tax regime. Most tax treaties are based on the OECD-MC and the United Nations ("**UN**") Model[79]. While the OECD-MC is drafted for negotiations between developed economies, the UN Model is drafted for negotiations between developed and developing economies which tends to give wider taxing rights to the source state.[80]

The international tax regime is mainly influenced by the OECD-MC, the UN Model, and their respective commentaries but from a formal perspective, it is a regime primarily based on bilateral agreements, that is, two countries allocating taxing rights of income and capital taxes. However, there are some examples of other multilateral tax treaties such as the Nordic Convention on income and capital signed by Denmark, Finland, Iceland, Norway and Sweden concluded in 1983 and subsequently replaced.

3.1. Purpose of double tax treaties

The purpose of tax treaties is typically expressed in their preamble, mainly the avoidance of double taxation and the prevention of fiscal evasion. Since double taxation is

---

[78] Andrea Amatucci, *International Tax Law* (Wolters Kluwer, 2nd edition, the Netherlands, 2012) p. 161
[79] United Nations, 'Model Double Taxation Convention between Developed and Developing Countries' (United Nations, 2017, New York) <https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf > accessed 15 March 2023
[80] C Finnerty, P Merks, M Petriccione and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) p. 12

considered to hinder trade and free flow of goods and services between states, the implementation of a DTT between two Contracting States helps to eliminate or reduce this obstacle.[81]

Concretely, a tax treaty is an instrument that refines and improves existing provisions in domestic legislation which are designated to eliminate international juridical double taxation. To do so, the provisions laid down in DTT allocate exclusive and shared taxing rights to one of the Contracting States in cases where both could have the right to claim taxes for the same transaction and, therefore, double taxation for the taxpayer.[82]

Another important operational objective of tax treaties is the prevention of fiscal evasion, that is, when taxpayers fraudulently conceal income in an international setting and rely on the inability of tax administrations to obtain information abroad. Over the last decades, globalization and multinational companies operating in the international market have contributed to the spread of international tax avoidance and evasion to the extent that countries needed to overcome the strict rule of territoriality and to cooperate with each other.[83]

Furthermore, there are several ancillary objectives for tax treaties such as the elimination of discrimination against foreign nationals and non-residents and the reduction of the WHT rates on investment income. Thus, a DTT can be considered as a bridge linking two different domestic legislations of the states concerned.[84]

3.2. Double tax treaties and domestic law

As already mentioned, DTTs are international agreements created according to the rules contained in the above-mentioned Vienna Convention on the Law of Treaties. However, a treaty cannot be applied until it is concluded or comes into force, that is, when the Contracting States declare their consent or ratify it through an exchange of instruments under their respective constitutional laws.[85]

---

[81] *Ibid.,* p. 14
[82] Andrea Amatucci, *International Tax Law* (Wolters Kluwer, 2nd edition, the Netherlands, 2012) p. 164
[83] *Ibid.,* p. 165
[84] C Finnerty, P Merks, M Petriccione and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) p. 14
[85] Andrea Amatucci, *International Tax Law* (Wolters Kluwer, 2nd edition, the Netherlands, 2012) p. 166

In certain states, treaties must be ratified to become part of their domestic legislation, while in others, once signed, they immediately become part of the signatory states' domestic legislation.[86] In other words, each state follows its own rules for the inclusion of the treaty under its law. Two group of countries can be identified depending on their approach to comply with its international obligations: (i) the "direct effect" of international treaties under which these are self-executed and automatically become a part of the domestic law when they are ratified or a parliamentary approval is required, and (ii) the "indirect effect" of treaty provisions where these must be enacted into domestic law and require special legislative steps. For the latter, the treaty provisions cannot be enforced by courts until they are transposed into domestic law. [87]

When a conflict of laws arises between domestic legislation and an international treaty, the latter generally prevails even if the domestic law has been adopted after the entry into force of the treaty. However, when a treaty provision is expressly overridden by the state's legislative body, then such override will generally apply as long as the relevant state's constitutional law allows it.[88]

The so-called "three steps approach" of M. Edwardes-Ker explains the relationship between DTTs and domestic legislation.[89] As a first step, it should be analysed whether the domestic tax law of the state concerned addresses the tax in question. On the one hand, if no tax arises from domestic tax law, the tax treaty is never applied since a treaty cannot impose or create a tax. On the other hand, if tax arises under the domestic law, then step two would be to define how the DTT allocates the right to tax the income or the capital in question.

If the DTT does not allocate the right to tax to the state concerned, the tax treaty will override the domestic tax law provision in question, even though there are some treaties that could impose a limit up to which the State can tax. Therefore, step three is to determine the actual right that the state concerned has within treaty-defined limits.[90]

---

[86] C Finnerty, P Merks, M Petriccione and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) pp. 12–13
[87] Andrea Amatucci, *International Tax Law* (Wolters Kluwer, 2nd edition, the Netherlands, 2012) p. 167
[88] C Finnerty, P Merks, M Petriccione and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) pp. 12–13
[89] Michael Edwards-Ker, *Tax Treaty Interpretations* (Queen Mary University of London, Ch. 33, 1994)
[90] Andrea Amatucci, *International Tax Law* (Wolters Kluwer, 2nd edition, the Netherlands, 2012) p. 168

4. OECD Model Tax Convention

Most existing bilateral tax treaties are concluded based on the OECD-MC which plays a crucial role in removing tax related barriers to cross-border trade and investment. Therefore, it is the basis for negotiation and application of DTTs between countries with the aim to assist business while helping to prevent tax evasion and avoidance. Furthermore, the OECD-MC also provides different means for settling on a uniform basis the most common problems that arise in the field of international double taxation.

The main part of the OECD-MC contains the classification and allocation rules for the avoidance of double taxation. These rules make a classification of the various items of income by type and source and then assign the taxing rights to the Contracting States. There are three types of allocation rules: (i) the exclusive allocation rule for which only one of the Contracting States will have the right to tax, either the residence or the source state, (ii) the limited or shared allocation rule, under which both Contracting States may have the right to tax, and (iii) the non-taxing rights for one of the Contracting States.

Due to potential double-taxation scenario because of a shared allocation rule in place, the OECD-MC provides with two methods to avoid such situation. On the one hand, the credit method (Article 23 B OECD-MC) is based on the state of residence of a taxpayer taxing all income or the entire assets of a taxpayer and sets off the tax paid abroad by the taxpayer against the domestic tax. On the other hand, the exemption method (Article 23 A OECD-MC) assigns the individual tax sources of a taxpayer to one of the Contracting States for taxation and, in the other State, tax sources are exempt from tax but with a potential effect on progressive tax rates in the residence state.

By using the OECD-MC as a contract template, a far-reaching harmonization of the individual bilateral agreements should be achieved. However, it should be noted here that the Convention is only a recommendation with no legal binding force. Thus, it is simply a document concluded by the OECD, an international organization, and its use is discretionary rather than mandatory. Nonetheless, the Member States of the OECD, and non-Member States, largely use it as a basis for negotiating their DTTs.[91]

[91] *Ibid.,* p. 163

As a result, while there can be substantial variations between one tax treaty and another, DTTs generally follow a relatively uniform structure, often analogous to the OECD-MC with certain deviations. The structure can be defined as a list of provisions performing separate and distinct functions: (i) articles dealing with the scope and application of the tax treaty, (ii) articles addressing the conflict of taxing jurisdiction, (iii) articles providing for double taxation relief, (iv) articles concerned with the prevention of tax avoidance and fiscal evasion, and (v) articles addressing miscellaneous matters (e.g. administrative assistance).[92]

4.1. Scope of application

Under Articles 1, 3 and 4 of the OECD-MC, the personal scope is laid down. According to Article 1(1), the provisions of the DTTs apply to persons who are "residents on one or both of the Contracting States". According to Article 3(1), the term "person" includes "an individual, a company and any other body of persons". Hence any legal entity that is recognized under the laws of a Contracting State is likely to be under the scope of the DTT.[93]

"Resident of a Contracting State" should be understood as the criteria of one Contracting State such as the domicile, residence, place of management or any other criterion of a similar nature which, under domestic law, establishes the worldwide tax liability of a person, i.e. subject to unlimited taxation in that State (Article 4(1)). However, paragraph 2 of the same Article contains the so-called tie-breaker rule in case of an individual being subject to unlimited tax liability in both Contracting States, that is, having a dual residency. In this scenario, the provision lays down connecting factors that will determine the individual's treaty residence.

In the event a legal entity is subject to unlimited tax liability in several countries and according to the 2017 update of the OECD-MC, Article 4(3) states that the solution of such conflicts of residence is left to a mutual agreement between the two Contracting States. Before that but practically still important, the state of residence was the state in which the actual management of the legal person was located.

---

[92] OECD, *Addressing the Tax Challenges of the Digital Economy* (OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, 2014, p. 36) <http://dx.doi.org/10.1787/9789264218789-en> accessed 26 March 2023

[93] Andrea Amatucci, *International Tax Law* (Wolters Kluwer, 2nd edition, the Netherlands, 2012) p. 176

Regarding the material scope of the OECD-MC, Article 2(1) states that taxes related on income and property are covered. Instead, inheritance and gift taxes are not under the scope but rather regulated in a separate OECD-MC. However, Article 2(4) plays an important role because it regulates those situations in which a specific tax in one of the Contracting States ceases to exist because of the introduction of a new tax. Thus, in those cases where the newly introduced tax is similar to the previous one, the respective DTT remains valid giving a dynamic approach for DTTs.

4.2. Allocation rules

As already mentioned previously, the OECD-MC contains different allocation rules from Article 6 to 22 depending on the type of income. The first allocation rule can be found in Article 6 which gives the right to tax the income derived by a resident of a Contracting State from immovable property or real property situated in the other Contracting State to that State. This allocation rule is not exclusive and is based on the principle of *situs*, so the State where the asset is located has the primary taxing right. Nevertheless, in those cases where a shared taxing right may arise, the Contracting States can decide whether the exemption or the credit method is applicable.

In regards of the business income of enterprises operating cross-border, Article 5 and 7 of the OECD-MC deals with it. Concretely, Article 7 lays down the allocation rule for business profits but also the income from professional services and other activities of an independent character. According to the first paragraph, the exclusive taxing right remains for the Contracting State where the enterprise is resident, unless it carries on business in the other Contracting State through a Permanent Establishment ("**PE**") situated therein. However, the taxation right of the source State is based on the PE principle, meaning that it is limited to the taxable income attributable to that PE. In such case where the taxing right is shared, the credit or the exemption method would apply. It should be noted here that the 2010 update of the OECD-MC introduced a renewed version of Article 7 which now requires the use of the arm's length principle to determine the attributable business profits.

The definition of the term PE is provided in Article 5 of the OECD-MC. Throughout the seventh paragraphs of the Article, different types of PE are defined. At the end, this concept reflects the involvement of a non-resident person in the economy of the source State to a significant degree.[94]

Moving towards the treatment of passive income, Articles 10, 11 and 12 lay down the allocation rules for dividends, interest, and royalties, respectively. Within the concept of "dividends", income from shares, profit participation rights or bonus certificates, among others, are included (Article 10(3)). The general allocation rule stated in Article 10(1) is that the country of residence of the beneficial owner has the right to tax. However, one should keep in mind that also the country where the company proceeding with the payment is based, usually has the right to levy a WHT, expressed as a percentage of the gross dividend (Article 10(2) OECD-MC).

For instance, a taxable individual resident in Spain receiving an amount of 100€ dividends from a German company. According to Article 10(1) DTT, Spain has the right to tax dividends. However, Germany is also entitled to levy 15% WHT of the gross amount of the dividend (Article 10(2)lit b)). Thus, Germany would hold 15€ and the recipient would receive an amount of 85€. In Spain, the total gross amount of 100€ would be declared but 15€ would be credited against the Spanish tax law due to the application of the credit method.

The allocation rule for interests is laid down in Article 11. Within the meaning of this provision, "interest" is to be understood as a payment for the provision of temporary capital. The first two paragraphs state that the residence State of the recipient of the payment has the unlimited taxing right to tax that income. However, the source State may also tax the interest, but only at a limited rate of 10% of the gross interest and such tax levied by the State of source can be credited in the State of residence.

It should be noted here that under the Parent-Subsidiary Directive ("**PSD")**[95] and the Interest and Royalty Directive ("**IRD**")[96], dividends and interests fulfilling the conditions of the respective directives are completely exempt from WHT.

[94] *Ibid.*, p. 178
[95] Council Directive (EU) 2011/96 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2011] OJ L345/8
[96] Council Directive (EC) 2003/49 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49

The last item of passive income is the royalties for which Article 12(1) lays down that the State of residence of the investor has the exclusive taxing right for this type of income. However, this Article does not have a practical role since many agreements deviate from this rule and grant the source State a right to tax such as in the case of interests (Article 11(1) OECD-MC).

The taxation of profits from the sale of assets is regulated in Article 13. The first paragraph contains a general clause while the first fourth paragraphs are special provisions. For instance, a resident of Switzerland acquires shares from an Austrian company for the value of 10€ and sells them for 100€, making a gain of 90€. Since the operation at hand does not fit within any of the special provisions, the general clause on capital gains of Article 13(5) comes into play. According to the latter, the resident principle would apply in this case which means that Switzerland has the only right to tax the capital gain, but its domestic tax law does not actually tax capital gains from the alienation of shares. Therefore, since Austria does not have the right to tax and it is exempt under Swiss domestic tax law, that would lead into a double non-taxation situation. In this case, hybrid mismatches rules should apply.

The provisions for employment income are divided into private employment (Articles 15 and 18) and remuneration from the public service (Article 19). Regarding the first type of employment, Article 15 lays down the taxing rights on income from private employment but it should be considered as a *lex generalis* in relation to other provisions such as Article 16 on director’s fees, Article 17 on artistes and sportsmen, Article 18 on pensions and Article 19 on government services, which take precedence as *leges speciales*.

Under Article 15(1), the basic rule is that the State of residence of the recipient has the exclusive right to tax the salaries, wages and other similar remuneration. Nonetheless, if the work is carried out in the other Contracting State, the latter may tax the remunerations derived by the activity performed in its territory only if three cumulative conditions are met, the so-called “installer clause” (Article 15(2)). Therefore, the basic rule is not an exclusive taxing right but rather a shared right between Contracting States for which the application of the exemption or credit method will be needed in the event both states have the right to tax.

4.3. Special provisions

After mentioning the allocation rules, Chapter VI of the OECD-MC contains special provisions with basic principles that should govern and be included within DTTs for the assurance of its well-functioning. Article 24 lays down the non-discrimination principle. In a nutshell, it ensures that foreign investors in a country are not discriminated in any case against by the tax system compared with domestic investors.[97] It should be noted here that this prohibition of discrimination do not only apply to taxes covered by the DTT but rather also to all taxes in the relationship between the two Contracting States (Article 24(6)).

A mutual agreement procedure is regulated within Article 25, including a dispute resolution mechanism in relation to the application of the provisions of tax treaties to specific cases, allowing the countries to settle common interpretations and applications of their tax treaty and resolve cases of double taxation not otherwise dealt with. Furthermore, Article 26 of the OECD-MC provides for an exchange of information between the tax authorities of the Contracting States and with the 2003 update of the OECD-MC, Article 27 includes an intergovernmental enforcement assistance.

5. EU Law

Within the legislative tools at the disposal of taxpayers to structure their cross-border investments, attention has also to be given to the EU tax system. Even though the latter does not imply that there is an actual fiscal union within the EU Member States, EU law has significantly influenced the domestic tax systems through primary and secondary law.

Primary law establishes the general principles on which the EU legal system is based, including the Treaty on the European Union[98], the fundamental freedoms laid down in the Treaty on the Functioning of the European Union[99], the European Atomic Energy Community, and Charter of Fundamental Rights. In addition, primary law is complemented by secondary law, that is, the body of laws that comes from the principles

[97] *Ibid.*, p. 187
[98] Consolidated Version of the Treaty on European Union [2016] OJ C 202/1
[99] Consolidated Version of the Treaty on the Functioning of the European Union [2016] OJ C 202/1

and objectives of the Treaties which includes regulations, directives, decisions, recommendations, and opinions.[100]

5.1. Primary EU law

The fundamental freedoms are an important part of EU primary law and have a significant impact on the design of domestic tax systems in EU Member States. The case-law from the European Court of Justice ("**ECJ**") limits the actions that Member States can take in tax matters, even though there is no comprehensive harmonization of direct taxation through positive integration.[101] The case *Commission v France (*known as *Avoir Fiscal)*[102] marked the starting point of a broad net of decisions which have influenced the tax systems of EU Member States. The Court held that the tax position of enterprises in the EU might differ since there is no harmonization of (corporate) income taxation. However, the Court states that Member States are not allowed to discriminate against foreign persons exercising their fundamental freedoms, even if there is a difference in tax positions between nationals and foreign persons.[103]

5.2. Secondary EU law

EU Member States have only partly limited their taxing authority by transferring certain powers to the EU institutions and thus direct taxes are not harmonized at an EU level. According to Article 115 TFEU, the EU still has the possibility to adopt directives for the benefit of the establishment and functioning of the internal market. Although enacting these directives requires unanimity, the EU has agreed on the following directives which are relevant from a tax perspective.

Parent-Subsidiary Directive

The PSD[104] applies to cross-border distributions of intra-group profits between parent and subsidiary companies of EU Member States with the objective to eliminate economic double taxation of corporate profits. It is worth to mention that the scope of the PSD has

[100] Andrea Amatucci, *International Tax Law* (Wolters Kluwer, 2nd edition, the Netherlands, 2012)
[101] *Ibid.,* p. 383
[102] Case C-270/83 *Commission of the European Communities v French Republic* [1986] ECLI:EU:C:1986:37
[103] *Ibid.,* para. 24 with respect to the freedom of establishment
[104] Council Directive (EU) 2011/96 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2011] OJ L345/8

been extended to situations where distributions of profits are attributable to PE situated in an EU Member State of companies of other Member State which come from their subsidiaries of a Member State other than that where the PE is situated.[105]

The main tax provisions are the following: (i) the state of the parent company must grant relief on dividends received either through exempting such income or deducting the taxes paid in the State of the subsidiary[106]; (ii) no WHT levied on distributions from the subsidiary to the parent company[107]; (iii) no WHT levied on the profits received by the parent company[108].

Regarding the second provision, certain requirements need to be met from the parent company: (i) a 10% minimum shareholding in the subsidiary[109], (ii) to be subject to corporate income tax[110], and (iii) Member States have the option to also require a holding period of the participation for at least two years[111].

It is worth mentioning that the Directive lays down the application of domestic anti-abuse provisions under which EU Member States can withdraw the benefits of the Directive at any time for those transactions whose principal motive is tax evasion, tax avoidance or abuse.[112]

Interest and Royalty Directive

The IRD[113] states in Article 1(1) that the source State is prohibited from levying taxes on interests and royalties if the beneficial owner of the interest and royalties is a company situated in another Member State or a PE of such a company. Both terms “interest” and “royalty” are defined in Article 2(a)(b) IRD together with a list of payments which are not in scope in Article 4(1)(a) IRD.

---

[105] C Finnerty, P Merks, M Petriccione and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) p. 23
[106] Article 4 PSD
[107] Article 5 PSD
[108] Article 6 PSD
[109] Article 3 PSD
[110] Article 1(2) PSD
[111] Article 3(2) PSD
[112] C Finnerty, P Merks, M Petriccione and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) p. 25
[113] Council Directive (EC) 2003/49 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49

As already seen in the PSD, the companies in scope of the IRD are also mentioned in its Annex and these have to be subject to corporate income tax.[114] Furthermore, the paying company must have direct participation of 25% in the receiving company or vice versa, or a third company has a participation of at least 25% in both the paying and the receiving company.[115]

Merger Directive

One of the main objectives of the Merger Directive[116] is to enhance tax neutral reorganizations within the internal market as well as to protect the right of States to tax unrealized gains that accrued in their fiscal territory. In other words, reorganizations within the internal market shall not be hampered by negative tax consequences in the Member States.[117]

Hidden reserves shall not be taxed because of a reorganization only because the book values for tax purposes are taken over by the receiving company. Therefore, the capital gains are deferred until the realization of the hidden reserves transferred at book value to the receiving company. However, this is only possible if the assets and liabilities are connected with a PE of the receiving company in the Member State of the transferring company.[118] On the other hand, the Directive also foresees that shareholders will not be taxed if they exchange their shares against new shares of another company in the course of a merger.[119]

Anti-Tax Avoidance Directive I & II

With the adoption of the BEPS project and based on Article 115 TFEU, the EU Member States have agreed to go beyond the minimum standard laid down within the BEPS project and decided to implement a specific Directive to fight against tax avoidance, i.e. the Anti-Tax Avoidance Directive (the "**ATAD I**")[120]. It is important to note that the

---

[114] Article 3(a) IRD
[115] Article 3(b) IRD
[116] Council Directive (EC) 2009/133 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States [2009] OJ L310/34
[117] Andrea Amatucci, *International Tax Law* (Wolters Kluwer, 2nd edition, the Netherlands, 2012) p. 161
[118] Article 4(1) and 4(2)(b) of the Merger Directive
[119] Article 8(1) of the Merger Directive
[120] Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L193/1, Article 3

Directive does not necessarily aim to standardize all anti-avoidance rules, since EU Member States can follow a higher level of protection in their domestic laws.

ATAD I was adopted by the EU on 12 July 2016 and came into force on 1 January 2019. The Directive covers a wide range of tax practices, including the interest limitation rules (Article 4), exit taxation rules (Article 5), a general anti-abuse rule ("**GAAR**") (Article 6), controlled foreign company rules ("**CFC**") (Article 7), and the anti-hybrid rules (Article 9).

Since ATAD I introduced anti-hybrid provisions covering only intra-EU hybrid instruments and hybrid entity mismatches, the EU amended ATAD I by adopting the so-called ATAD II[121] which extends the hybrid mismatch definition of ATAD I to include notably mismatches resulting from arrangements involving PEs, hybrid transfers, imported mismatches, reverse hybrid entities and tax residency mismatches. Furthermore, ATAD II also extends the hybrid mismatches within non-EU countries.

DAC6

For the sake of completeness, the EU adopted the Directive on Administrative Cooperation[122] ("**DAC6**") to discourage aggressive cross-border tax planning arrangements and further enhance tax transparency by requiring certain cross-border transactions to be reported to the tax authorities.

Under DAC6, intermediaries such as tax advisors, lawyers, accountants, and in some cases taxpayers themselves, have to report certain cross-border transactions and arrangements to the domestic tax authorities if they meet certain criteria.

The reporting requirements are aimed at identifying potential aggressive tax planning schemes and improving cooperation between EU tax authorities. The reports will trigger the subsequent automatic exchange of information between the tax authorities of all EU Member States through access to a central directory.

---

[121] Council Directive (EU) 2017/952 amending Council Directive (EU) 2016/1164 as regards hybrid mismatches with third countries [2017] OJ L144/1

[122] Council Directive (EU) 2018/822 amending Council Directive (EC) 2011/16 as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements [2018] OJ L139/1

III. GUIDING CONCEPTS FOR INTERNATIONAL TAX PLANNING

1. Introduction

As already mentioned previously, international tax planning is a strategic process undertaken by businesses and individuals to optimize their tax positions while ensuring compliance with tax regulations in a global context.

Through the complexities that cross-border taxation can bring to the table, taxpayers rely on certain guiding concepts that provide a framework for effective and responsible tax planning. As such, this chapter provides for an overview of the most important guiding concepts that shape international tax planning strategies and highlight their significance in achieving tax efficiency, managing risks, and fostering responsible tax practices in an increasingly interconnected world.

2. Tax evasion, tax avoidance and tax planning

Tax evasion can be defined as any action by the taxpayer to circumvent or mitigate taxation by illegal means with the sole purpose of escaping tax payments despite an existing liability. Consequences of tax evasion not only involve the payment of previous taxes and its respective monetary fines, but it can also be regarded as a criminal act.[123]

Tax avoidance is usually defined as any legal behaviour solely driven by tax considerations, where the crucial aspects are the lack of a business purpose, a certain level of discretion, and taking advantage of loopholes in the law. Instead, tax planning is generally used in the context of regular, legal, and legitimate use of existing tax provisions with the aim to reduce the overall tax burden.

One of the main challenges for states is to differentiate between tax planning and unacceptable tax avoidance practices. According to the principle of freedom of contract, taxpayers are free to arrange their affairs as they wish. Although it does not necessarily endorse or approve tax avoidance, in several jurisdictions, courts have ruled in favour of taxpayer's attempts to minimize tax liabilities under this principle.[124]

---

[123] D Endres and C Spengel, *International Company Taxation and Tax Planning* (Wolters Kluwer, the Netherlands, 2015) p. 391

[124] C Finnerty, P Merks, M Petriccione and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) p. 51

Furthermore, taxpayers also rely on the principle of legal certainty under which they trust that the legal transactions that they have been entered into will be respected by the tax authorities and the courts. However, for the sake of economic efficiency and fiscal fairness, a taxpayer should not be able to use legal constructions or transactions to avoid similar situations being subject to the same tax burden.[125]

In this regard, the concept "aggressive tax planning" introduced by the OECD in the context of the BEPS project can be confusing. Generally, tax avoidance often implies a certain degree of uncertainty as to the consequences of a given tax structure. However, the latter depends on the facts and circumstances in a case-by-case basis so that a clear distinction is not actually possible.[126]

3. Categories of international tax planning

3.1. Substantive versus formal tax planning

International tax planning can be differentiated between substantive and formal tax planning. On the one hand, substantive tax planning seeks to change an economic activity, reduce operating costs, or give it up entirely to save taxes by redesigning the business functions, the re-engineering of flows of goods and services or to expand into new markets. Therefore, substantive tax planning has a negative impact on both investment and employment.

On the other hand, formal tax planning seeks to keep the taxes on a given structure of economic activity as low as possible while retaining the substance of the activity. For instance, debt financing to subsidiaries located in high-taxed countries to take the advantage from the deductibility of interest payments from taxable income in the source state.[127]

3.2. Temporary versus permanent tax savings

Another distinction that can be made is the different outcomes that the application of tax planning techniques can lead to. International tax planning leads to temporary tax savings when the tax payments are postponed to future periods and follow from a deferral of

[125] *Ibid.,* p. 52
[126] D Endres and C Spengel, *International Company Taxation and Tax Planning* (Wolters Kluwer, the Netherlands, 2015) p. 392
[127] *Ibid.,* p. 392

taxable income. The longer the period of the deferral, the more valuable the tax planning technique for the underlying taxpayer.[128] For instance, the retention of profits at the level of a foreign subsidiary or the high depreciation rates available under domestic tax law for certain assets.

Instead, tax planning leads to permanent tax savings when the overall tax burden of the international investor is reduced by making use of legal provisions. For example, the use of a lower foreign tax rate or the use of income which is not taxed either in the residence or source state.[129]

4. Objectives of international tax planning

The main goal of international tax planning can be divided into: (i) the avoidance or reduction of double taxation, (ii) the avoidance or reduction of single taxation, and (iii) the negative taxation. One should note here that the scope of the use of international tax planning in these areas varies from one company to another. The three main areas are discussed in more detail below.

First, avoiding or reducing double taxation is usually considered to be harmless, a justified behaviour of the taxpayer investing across borders, and in line with the domestic tax authorities, the EU and the OECD. This can be achieved with the effective application of the tax relief method in the state of residence, that is, the credit or the exemption method.[130]

Second, the avoidance or reduction of single taxation, also known as "double non-taxation", is considered harmful and contradictory to the objectives of the tax authorities, the EU, and the OECD. For instance, the avoidance of taxable transfers of assets, the avoidance of taxable intra-group transactions, the tax-efficient use of transfer pricing, among others.[131] This is the reason why many states have recently increased the

[128] C Finnerty, P Merks, M Petriccione and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) p. 65
[129] D Endres and C Spengel, *International Company Taxation and Tax Planning* (Wolters Kluwer, the Netherlands, 2015) p. 392
[130] C Finnerty, P Merks, M Petriccione and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) p. 63
[131] D Endres and C Spengel, *International Company Taxation and Tax Planning* (Wolters Kluwer, the Netherlands, 2015) p. 394

incorporation of the "subject-to-tax-clauses" in DTTs to prevent the previously mentioned practices.

Third, negative taxation implies a tax refund from the tax authorities that is higher than the amount that was originally paid by the multinational investor. This is a relatively rare case and may include the scenario in which the tax authorities used an interest rate on accounts payable that is higher than the interest rate on similar accounts that is used by banks.[132]

5. Structure and goals of a multinational enterprise

5.1. Globalization and its impact on tax planning

Businesses tend to move away from operating solely in national markets into international markets as the movement of capital and labour becomes easier within and between globalized and increasingly homogeneous markets.[133] As a result, multinational enterprises ("**MNEs**") face constant organizational changes.

Due to the increasingly competition in foreign markets, companies have been forced to optimize their costs' structure and perform better profit margins. For that, companies aim to reduce their tax burden by making use of international tax planning techniques, which at the end also implies a complex tool of MNE corporate strategy in view of the multitude different tax regulations worldwide.[134]

In a nutshell, globalization is one of the main factors that has caused operational models to evolve, has made international tax planning more complex and has created a need to better align tax strategy of MNEs.[135] Thus, business together with tax strategies lead to operational and financial efficiencies which, at the ultimate stage, lowers the worldwide effective tax rate for a MNE.

5.2. Impact of tax strategy and planning on shareholder value

[132] C Finnerty, P Merks, M Petriccione and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) p. 64
[133] D Endres and C Spengel, *International Company Taxation and Tax Planning* (Wolters Kluwer, the Netherlands, 2015) pp. 392–393
[134] *Ibid.,* pp. 392 – 393
[135] C Finnerty, P Merks, M Petriccione and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) p. 72

International tax planning plays a key role when determining the shareholder value of a multinational company measured by the earnings-per-share ratio, equal to the after-tax income of the company divided by the average number of shares issued.[136] Since taxes directly decrease the net income, implementing an appropriate tax planning for the company is likely to have more business benefits beyond tax savings and will be better aligned with the operations of the company.

5.3. Effective tax rates

The effective tax rate ("**ETR**") is a tax efficiency measure that can determine whether tax costs can or should be reduced for a company.[137] This measure not only makes possible to quantify the degree of risk but also the quality of the tax strategy adopted. It summarizes the cumulative effects of various tax incentives such as deductions, exemptions, and credits that a company benefits from, and identifies the level of neutrality of the tax system in firms with different tax burdens.[138]

On the one hand, ETRs are an important consideration when planning or changing for corporate tax planning strategies.[139] First, a company with a lower ETR has a competitive advantage over its competitors since it can generate higher profits, reinvest more in its own business, or offer lower prices to its customers. Second, ETRs are essential for compliance purposes as they help identify areas of tax risk and ensure that the tax matters of a company are in order. Third, ETRs also play a crucial role in location decisions since companies may decide to locate their operations in countries with lower ETR as it can lead to significant tax savings. Fourth, ETRs can also influence decisions related to repatriation of profits. Fifth, companies can identify potential tax risks and develop strategies to mitigate them by analysing the ETRs in different countries.

[136] D Endres and C Spengel, *International Company Taxation and Tax Planning* (Wolters Kluwer, the Netherlands, 2015) p. 393

[137] C Finnerty, P Merks, M Petriccione and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) p. 74

[138] K Ftouhi and W Ghardallou, 'International tax planning techniques: a review of the literature' (Journal of Applied Accounting Research, Vol. 21, Emerald Publishing, 2019, p. 337) < https://www.emerald.com/insight/0967-5426.htm> accessed 15 April 2023

[139] S Dyreng, M Hanlon and E Maydew (2008) 'Long-Run Corporate Tax Avoidance' (The Accounting Review, V. 83, No. 1, 2008, pp. 61-82) <https://www-jstor-org.uaccess.univie.ac.at/stable/30243511?sid=primo> accessed 20 April 2023

On the other hand, several recent studies found out that ETRs also reflect aggressive tax planning techniques[140] such as investments in tax heavens with lower foreign tax rates, tax-exempt investments, tax incentives and participation in tax shelters.[141]

As a result, the importance of an ETR analysis not only lays down a company's competitiveness, compliance, location decisions, repatriation of profits, and risk management, but it also serves as a measure of tax aggression most frequently used by university researchers. [142]

6. Tax planning strategies

The use of tax planning strategies can significantly reduce the taxable profits of firms in high-tax states.[143] In order to achieve that, companies may use different techniques which require a detailed knowledge of the different tax system and tax treaties of the countries where companies are operating or making profits. These are briefly discussed below and thoroughly applied and analysed in the case study of this paper.

6.1. Profit migration strategies

Profit migration is at the core of global tax planning and one of the most used techniques that involves the transfer of revenues by geographical area. In other words, MNEs try to identify a portion of its profits that legally and within risk tolerances can be migrated to lower-tax jurisdictions and permanently deferred (or effectively permanently deferred) from taxation through acceptable tax planning actions.[144]

---

[140] J.R Robinson, S.A Sikes, and C.D Weaver, 'Performance Measurement of Corporate Tax Departments' (The Accounting Review, V. 85, No. 3, 2010, pp. 1035-1064) <https://www-jstor-org.uaccess.univie.ac.at/stable/27802679> accessed 20 April 2023

[141] Ryan J Wilson, 'An Examination of Corporate Tax Shelter Participants' (The Accounting Review, V. 84, No. 3, 2009, pp. 969-999) <https://www-jstor-org.uaccess.univie.ac.at/stable/27784200> accessed 20 April 2023

[142] Sonja O Rego, 'Tax-avoidance activities of U.S. multinational corporations' (Contemporary Accounting Research, V. 20, No. 4, 2003 pp. 805-833) <https://www.proquest.com/docview/194211056?parentSessionId=gz%2BYCv8E%2FV3R0gy4wuldSOxv8tr38H5maPTEI80cMDs%3D&pq-origsite=primo&accountid=14682> accessed 20 April 2023

[143] D Bruce, J Deskins, and W.F Fox, 'On the Extent, Growth, and Efficiency Consequences of State Business Tax Planning' (2007) in A.J Auerbach, J.R Hines, and J Slemrod, 'Taxing Corporate Income in the 21st Century' (Cambridge University Press, pp. 226-256) <https://www-cambridge-org.uaccess.univie.ac.at/core/books/taxing-corporate-income-in-the-21st-century/on-the-extent-growth-and-efficiency-consequences-of-state-business-tax-planning/9C2DB62D9A3D088F30332EC62B8BD583> accessed 22 April 2023

[144] C Finnerty, P Merks, M Petriccione, and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007) p. 76

This practice can be achieved through various means, such as transfer pricing, intra-group transactions, and the use of offshore companies or tax heavens. For corporations, profit migration may involve transferring profits from subsidiaries in high-tax jurisdictions to subsidiaries in low-tax jurisdictions through transfer pricing or other means. Alternatively, companies can provide debt via intercompany asset or share sales that create interest deductions in high-tax jurisdictions, tax-efficient factoring of receivables and leasing. [145] All of them can result in lower tax liabilities for the corporation concerned.

Profit migration has increased in recent years and governments have become more aggressive in their efforts to combat tax avoidance and evasion.[146] Many countries have implemented measures to limit profit migration, such as transfer pricing rules, anti-abuse provisions, and increased reporting requirements.

6.2. Jurisdictional strategies

Jurisdictional strategies for tax planning refer to the practice of strategically choosing the jurisdiction in which to conduct business operations or hold assets in order to minimize tax liabilities. There are several jurisdictional strategies that can be used for tax planning which are described below.

First, tax heavens or jurisdictions that offer low tax rates or no taxes at all, along with other incentives, such as confidentiality and ease of doing business. Companies and individuals may use tax heavens to reduce their tax liabilities by shifting profits or assets to these jurisdictions.

Second, transfer pricing involves setting prices for goods or services traded between related companies in different jurisdictions. Companies may use transfer pricing to shift profits from high-tax jurisdictions to low-tax jurisdictions.

Third, holding companies are entities set up to hold and manage investments in other companies or assets. By setting up a holding company in a jurisdiction with favourable tax laws, companies can reduce their tax liabilities on investment income.

---

[145] *Ibid.,* p. 76

[146] R.H Gordon and J.B Slemrod, 'Are "Real" responses to Taxes Simply Income Shifting Between Corporate and Personal Tax Bases?' (National Bureau of Economic Research, Cambridge, 1998) <https://www-nber-org.uaccess.univie.ac.at/papers/w6576> accessed 26 April 2023

Fourth, companies may choose to hold their intellectual property in a jurisdiction with favourable tax laws, such as tax heavens, and then license the use of that intellectual property to related companies in other jurisdictions at a higher price.

Fifth, tax treaties are agreements between countries that are designed to prevent double taxation and to promote cooperation between tax authorities. Companies may use tax treaties to structure their operations in a way that minimizes their tax liabilities.

It is important to note that while some of these jurisdictional strategies may be legal, others may be considered aggressive tax planning and may be subject to challenge by tax authorities. It is important to seek professional advice and to ensure that all tax planning strategies are compliant with applicable laws and regulations.

7. Developing a tax planning strategy

Within a multinational corporate group made of a parent company and various affiliated domestic and foreign subsidiaries, the attribution of company profits usually follows the direct method. In other words, each company of the group determines its profits under the statutory provisions of its residence country.

The establishment of contractual arrangements with specific and arranged transfer prices for intra-group services, transfer of assets, delivery of goods and intercompany financing between the members of an affiliated group of companies can increase or reduce the profits of the group members concerned.[147] Since one of the main goals of companies and groups of companies is to maximize net group profits including minimizing the tax burden, transfer prices play a key role for having an immediate impact on the taxable profits in the given jurisdiction.

Therefore, the relationship between businesses organised in a global and integrated way and the local and often on a company-by-company basis application of tax laws has led to question how the relationship among different companies of the same group needs to be considered for tax purposes. In order to address this issue, the arm's length principle

[147] D Endres and C Spengel, *International Company Taxation and Tax Planning* (Wolters Kluwer, the Netherlands, 2015) p. 360

has been internationally adopted to avoid profits shifting between members of an affiliated group.

8. The arm's length principle

The arm's length principle is a key accepted standard in international tax planning that requires the price of a transaction established between related companies to be comparable to the price that would have been determined between unrelated companies conducting a similar transaction.[148] Therefore, it aims to prevent arbitrary profit shifting between members of an affiliated group of companies and ensure a fair and equitable distribution of tax burdens.

To comply with the arm's length principle, multinational companies are required to document and substantiate their intercompany transactions, including pricing methodologies and any adjustments made to align with market conditions. That is why it is essential that the principle is supported by guidelines provided by the OECD and is widely adopted by countries around the world.

An arm's length transaction can be verified with an external comparison of transfer prices charged by independent parties in similar circumstances or with an internal comparison of transfer prices charged to outside third parties. However, in certain cases the arm's length price can be completely hypothetically when the product or service is not available in a similar form in the open market.[149]

In the event of a non-arm's length price, the taxable income will be adjusted accordingly either under domestic law or under the respective tax treaty.[150] Article 9 of the OECD-MC lays down the arm's length principle by dealing with adjustments to profits that may be made for tax purposes where transactions have been entered between associated enterprises on other than arm's length terms. For the avoidance of double taxation, the second paragraph of the same Article provides guidance on the corresponding profit adjustment in the other state based on the arm's length price for those cases where the transfer price needs to be modified.

[148] *Ibid.,* p. 360
[149] *Ibid.,* p. 360
[150] Article 9 OECD-MC

Certain domestic laws treat income from a non-arm's length price as hidden profit distributions and hidden capital contributions, the same treatment as in breaches of limitation to intercompany financing. The reason behind is to reallocate inacceptable profit allocations between a controlling entity and its subsidiaries irrespective of the dividend distribution policy. [151]

A hidden profit distribution from the foreign subsidiary to its parent company occurs, for instance, where the price for the purchase of assets or services by the foreign subsidiary from the domestic parent is inappropriately high. Instead, a hidden capital contribution is the reverse case and occurs when a parent company charges a price for the delivery of assets to the foreign subsidiary lower than the market price.[152]

With all the above stated guiding concepts for companies using international tax planning as well as the whole previous analysis on Luxembourg fund industry and international tax law, one can now step into the case study in chapter IV to understand how all the previous analysed tax features are connected in a real scenario.

[151] D Endres and C Spengel, *International Company Taxation and Tax Planning* (Wolters Kluwer, the Netherlands, 2015) p. 360
[152] *Ibid.,* p. 360

IV. CASE STUDY

1. Introduction

International tax planning becomes a critical aspect of fund management strategies as investment funds operate in a cross-border basis. This chapter analyses a hypothetical case of international tax planning in the fund industry in Luxembourg which will lay down the main aspects to take into consideration when optimizing tax efficiencies, enhance after-tax returns, and ensure compliance with international tax regulations.

Fund structuring is complex for different reasons but mostly due to tax liabilities, the relevant regulatory framework in place, currency controls, and the political and economic stability of the relevant jurisdiction. Taking into consideration all these complexities, it is essential that fund managers set-up a fund structure that meets legal requirements, optimizes tax efficiency, satisfies investor preferences, and achieves the objectives laid down in its investment policy.

For purposes of this chapter, the following case study is confined solely to domestic and international tax considerations relevant for the structuring of a Luxembourg fund with different target jurisdictions. The aim is to demonstrate how international and domestic legal provisions are used for the development of an efficient tax planning strategy around the creation of a new fund that will invest in different jurisdictions. At the end, investors want to invest in a structure that is, to the largest extent possible, tax neutral.[153]

The vehicle chosen is a regulated AIF investing in real estate in different European countries. The rationale behind this choice is that AIFs are subject to more relaxed regulation and can now invest in a wider range of eligible investments.[154] Moreover, since real estate investments often require more complex tax structuring than a typical private equity structure, its study makes it more interesting for the aim of this chapter.

Please note that the below analysis presented in this paper is pure hypothetical and may not cover all relevant tax aspects of a proposed investment structure. In addition, structures described in this case are only generic structures that give an indication of possible routes that could be used to operate a real-estate investment. They are not a legal

[153] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 283
[154] Danielle Sougné, *Fund Industry in Luxembourg: A Practitioner Guide* (Éditions Larcier, 2013) pp. 28–32

advice recommending the structures depicted as the most appropriate for an actual investment.

2. Proposed case scenario

The case contemplates the launch of a new pan-European real estate fund (the "**Fund**"). It is proposed that the Fund would be set up as an investment company with variable capital – specialized investment fund ("**SICAV SA-SIF**") in accordance with the SIF Law (please refer to Chapter I, Section 6 for more information on Luxembourg investment vehicles).

From a tax perspective, a fund can be set up as a transparent entity or an opaque entity. According to Article 175 of the Luxembourg Income Tax Law[155] ("**LITL**"), a transparent entity is deemed to not exist, and its shareholders are viewed as directly holding the assets of the fund. Instead, if the fund is set up as an opaque entity, normally it would be a taxable entity if it is not benefitting from a special tax regime that grants tax neutrality to the fund.[156]

The Fund of our case study will be set up as a Luxembourg public limited liability company benefiting from a special tax regime under the SIF Law.[157] During its lifetime it will be managed by an authorized AIFM which will in turn outsource some functions to professional investment advisors.

When the fund has a tax-transparent treatment, such in our case, choosing an interposed holding company that is fully taxable can present the advantage of having an entity that can claim treaty benefits or the protections offered by EU Directives, as well as for third-party financing purposes.[158] Therefore, Luxembourg taxable entities will normally be interposed below the Fund as described in this case study.

As per the structure chart attached below, the Fund will invest in real estate in different European countries, namely Germany, France, and the Netherlands. For investments in Germany and the Netherlands, a Luxembourg holding company (the "**Lux HoldCo**") in

[155] Law of 4 December 1967 on Luxembourg Income Tax, as amended
[156] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 283
[157] Articles 66, 68 and 69 of the SIF Law
[158] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 284

the form of a S.à r.l. will be incorporated below the Fund which will in turn own the shares of a Luxembourg property company (the "**Lux PropCo**") in the form of a S.à r.l. that holds the real estate investment in the respective jurisdiction. Instead, for French investments it is commonly used for real estate investments the use of a French OPCI under the Fund which will own the shares of a French PropCo holding the real estate in France. Please note that the tax treatment of French companies is not in the scope of this case study and, therefore, only the Luxembourg tax consequences will be analysed from an international and domestic tax point of view.

It is envisaged that Lux PropCos will be funded with a combination of bank loans, equity granted by Lux HoldCo and subordinated loans granted directly by the Fund. Instead, the funding of Lux HoldCos will consist of equity and profit participating loans ("**PPL**") granted directly by the Fund without third-party debt financing.

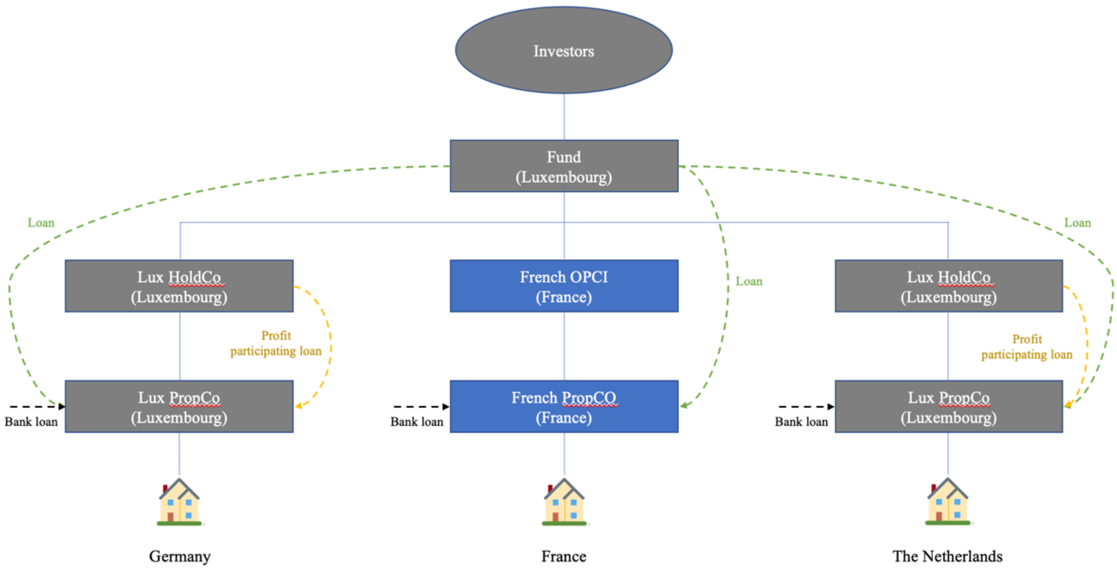

Figure 1 - Fund Structure

The analysis below starts by identifying the general Luxembourg tax aspects and continues with a more specific tax analysis of the Fund and the different corporate entities incorporated within the investment structure. At the end, different tax topics are developed in the framework of international and domestic legislation due to its importance when using a tax planning strategy for the structuring of an investment fund.

3. Ongoing Luxembourg taxation

3.1. Corporate income tax and net wealth tax

Corporate entities and cooperatives that have either their registered office or their central administration in Luxembourg are subject to a Luxembourg aggregate corporate income tax ("**CIT**") rate of 24.94%, including a corporate tax rate of 17%, solidarity surcharge of 1.19% and municipal business tax ("**MBT**") of 6.75%.[159]

Luxembourg resident taxable entities are subject to net wealth tax ("**NWT**") unless specific exemptions apply. The NWT base is computed on the unitary value set on 1st January of each year and determined by the difference between the assets and the liabilities to third parties generally at their fair market values with some exceptions.[160] The net wealth tax due is computed pursuant to the following sliding scale:

(i) 0.5% up to a NWT base of EUR 500 million; or
(ii) for a NWT base of more than EUR 500 million, NWT of the sum of EUR 2.5 million plus 0.05% of the portion of the NWT base above EUR 500 million;
(iii) no cap is set.

However, participations qualifying for the Luxembourg participation exemption regime are exempt from the NWT basis. As laid down in Section 7 of this Chapter, the participation must represent either at least 10% of the share capital of the subsidiary's share capital or have an acquisition value of at least EUR 1,200,000. There is no minimum holding period requirement for this exemption.[161]

A flat annual minimum net wealth tax of EUR 4,815 would however be due assuming that the Luxembourg company's assets, transferable securities, and cash deposits represent (i) at least 90% of its total gross assets and (ii) a minimum amount of EUR 350,000. Alternatively, a progressive annual minimum NWT ranging from EUR 535 to EUR 32,100 will be due for Fiscal Year 2023 depending on the Luxembourg company's total gross assets.

---

[159] Article 159 LITL
[160] M Schmitz and PJ Warner, *Luxembourg in International Tax* (EY Luxembourg, 3rd revised edition, 2015) p. 120
[161] Paragraph 60 of the Law of 16 October 1934 on Luxembourg valuation of goods and values *(Bewertungsgesetz*)

Debts including intra-group liabilities are usually tax deductible for NWT purposes provided they are incurred in the framework of the business activity, are effectively due, and properly valued. Debts related to exempt assets are not deductible only to the extent that the value of the debt does not exceed the value of the asset. Otherwise, the excess will be regarded as not related to the asset and thus tax deductible against the NWT base.[162]

3.2. Thin capitalisation rules

An important question when structuring a fund is how to stream the financing into the structure, that is, to choose between equity and debt or a mix of both. Furthermore, as the case study contemplates third-party debt financing, it is important to keep in mind that regular income from real estate will first be used to service its bank debt.[163]

Luxembourg tax law does not contain any specific thin capitalization rules that lay down a certain debt-to-equity ratio to be met by companies subject to tax in Luxembourg. However, the tax administration has developed an administrative practice which generally requires that Luxembourg companies comply with an 85:15 debt-to-equity ratio when financing the acquisition of shares with related party debt, excluding third party debt unless financially guaranteed by the shareholders. Plus, the general leverage of the structure will be also determined in line with thin capitalization rules of the targeted jurisdictions.[164]

The rationale behind this practice is that if debt is supplied by a related party in circumstances where an independent third party would not lend funds to the company, this debt should be reclassified as capital.

Higher amounts of debt may be possible if these are supported by a debt-capacity analysis, i.e. a TP study, if sound economic arguments can be provided in respect of financing activities.[165] It is highly recommended to have in place such study as per the recent OECD guidance there may be a risk that the Luxembourg tax authorities request

---

[162] M Schmitz and PJ Warner, *Luxembourg in International Tax* (EY Luxembourg, 3rd revised edition, 2015) p. 123
[163] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 290
[164] *Ibid.,* p. 291
[165] M Schmitz and PJ Warner, *Luxembourg in International Tax* (EY Luxembourg, 3rd revised edition, 2015) p. 237

in the future to receive a TP analysis assessing the maximum debt capacity of the company.

Where a company is considered to be thinly capitalized, the interest paid on the debt in excess of the ratio is not tax deductible and subject to 15% WHT except if a reduction based on a tax treaty or another exemption is applicable. This excess interest should not be tax deductible either.

4. Tax considerations at the level of the Fund

As mentioned previously, the Fund would be set up as an investment company with variable capital – specialized investment fund in accordance with the SIF Law and the AIFM Directive.

4.1. Taxation at the Fund level

The current legislation covering investment funds is the UCI Law which lays down that Luxembourg investment funds that comply with the UCI Law are exempt from all taxation except for registration duty and annual subscription tax.[166]

Therefore, the Fund will not be liable for any Luxembourg CIT, MBT and NWT (including the minimum annual NWT charge) and income received from the French entity holding the French investment, from Lux HoldCo and for capital gains realised upon the disposal of its participations. Moreover, interest received on the shareholder loans granted to Lux PropCos should not be taxable in Luxembourg at the level of the Fund.

Given this tax treatment, all assets and liabilities of the Fund should be allocated for taxation purposes to its partners in proportion to their interest held in the Fund. Consequently, the income derived from such assets should be automatically allocated and taxed in the hands of the partners irrespective the actual distribution of the income by the Fund to the partners.

The Fund will however be liable to an annual 0.01% subscription tax computed on its net assets, such tax being payable quarterly based on the value of the aggregate assets of the Fund at the end of the relevant calendar quarter.

[166] Article 174 UCI Law

4.2. Profit repatriation

Profit allocated by the Fund to the investors will not be subject to withholding tax in Luxembourg. No withholding tax will be due on liquidation proceeds arising from the Fund, as such proceeds do not fall within the scope of the WHT according to Luxembourg tax law.

4.3. Other tax considerations

The Fund should be considered as a taxable person for Luxembourg value added tax ("**VAT**") purposes according to the Law of 12 February 1979 on VAT (the "**VAT Law**") as amended.[167] Consequently, services rendered to the Fund should in principle be deemed located for VAT purposes in Luxembourg and should therefore fall within the scope of Luxembourg VAT.

In this respect, management services should benefit from the VAT exemption that applies to management services, as laid down in Article 44(1)(d)(i) of the VAT Law. If the exemption does not apply, the services rendered to the Fund would be subject to Luxembourg VAT at the regular rate of 17% being a final tax burden for the Fund.

Although the concept of management is not clearly defined in the VAT law, the following services are, for example, generally considered as falling under this definition and being exempt of VAT:

i) daily management of the portfolio;
ii) administration services (such as computation of the NAV, accounting, and domiciliation services); and
iii) marketing

However, this list is not exhaustive as the ECJ has confirmed in the case C-275/11 *GfBk Gesellschaft für Börsenkommunikation GmbH*[168], that investment advisory services benefit from the VAT exemption on management services provided that such services are intrinsically connected to the activity of the fund, specific to and essential for the fund.

[167] Article 4 VAT Law
[168] Case C-275/11 *GfBk Gesellschaft für Börsenkommunikation GmbH* [2013] ECLI:EU:C:2013:141

Concurrently, the ECJ held that management services do not cover the actual management of immovable property.[169]

The VAT position of other services to be received by the Fund needs to be considered on a case-by-case basis, for instance, custodian services qualifying as "control and supervisory services" would be subject to VAT at a rate of 14%.

5. Tax considerations at the level of Lux HoldCo

5.1. Taxation at the Lux HoldCo level

A Luxembourg fully taxable holding, a Lux HoldCo, will be used as an intermediate holding vehicle for investments in Germany and the Netherlands. Based on current practice, please note that the French investments are not held through a Lux HoldCo but rather a French PropCo and therefore, its study is out of scope of this case.

Lux HoldCo would be a fully taxable company liable to tax in Luxembourg on its worldwide profits and entitled to the benefits of the Luxembourg tax treaty network and the EU tax directives, subject to compliance with usual substance and equity at risk requirements as well as anti-abuse provisions.

However, as long as the Lux HoldCo is entitled to the benefits of the Luxembourg participation-exemption regime, no CIT and MBT would be due in Luxembourg on dividends or liquidation proceeds distributed by Lux PropCos nor on capital gains derived from disposal of their shares but subject to recapture rules (note of the memo on recapture rules) if the requirements laid down in Section 7 of this Chapter are met.

Deductibility of expenses, costs and impairments in value in relation with shares qualifying for the Luxembourg participation-exemption regime would be limited in case exempt income is received during the year, i.e. no tax deductibility up to the amount of the exempt income.

Regarding the alienation of Lux PropCo holding the Dutch and German investments, further research on the respective DTTs is required to analyse whether these provide for a land-rich clause or not. On the one hand, pursuant to Article 12(1) of the Luxembourg-Dutch DTT dated 8 May 1968 (as amended), capital gains derived from the disposal of

---

[169] Case C-595/13 *Fiscale Eenheid X NV* [2015] ECLI:EU:C:2015:801, para. 79

Lux PropCos shares are taxable in Luxembourg, thus not providing for a land-rich clause. However, these capital gains could be exempted under the same conditions of the participation exemption regime laid down in Section 7 but subject to the so-called recapture rules.

One should note that if Lux HoldCo partly sells its shares in Lux PropCos, the EUR 6 million or the 10% thresholds should be alternatively maintained at any time after such a sale in order to benefit from the Luxembourg participation-exemption regime upon any further sale.

On the other hand, Article 13(2) of the Luxembourg-German DTT dated 23 April 2012 lays down a land-rich clause since capital gains derived from the disposal of Lux PropCos shares are taxable in Germany where these shares derive more than 50% of their value directly or indirectly from the German real estate property.

The above-mentioned recapture rule involves that the capital gain realized will become taxable up to the amount of the aggregate expenses and write-downs deducted during the year of the disposal and previous years in relation to the participation and impairment on shareholder loan receivables. Provided that the aggregate expenses and write-downs related to the participation have not been used to offset other taxable income, the impact of the recapture rule should be neutral, i.e. the taxable gain realized on the disposal of the shares would then correspond to the accumulated expenses deriving form the shares.

In regards the financing activity, if shareholder loans are granted directly from the Fund to the Lux PropCos, it would avoid the application of the Luxembourg tax administration Circulars (the "**TP Circulars**")[170], that is, need for taxable margin or equity at risk at Lux HoldCo level. This may be a recommended route if it does not trigger additional WHT at local and foreign level.

Lux HoldCo would in principle be subject to annual NWT in Luxembourg on its worldwide net wealth (or net assets on 1 January of each year). Typically, cash held by Lux HoldCo at year-end may generate a NWT cost if there are no sufficient debt liabilities to offset such cash.

---

[170] Circular N° 164/2 and N° 164bis/2 on Luxembourg tax treatment applicable to Luxembourg companies engaged in intra-group financing transactions [2011]

However, if the conditions of the Luxembourg participation-exemption regime are fulfilled, the shareholdings in Lux PropCos would be exempt from NWT. In any case, Lux HoldCo would remain liable to the minimum annual NWT.

5.2. Profit repatriation

As mentioned previously, the main goal is to structure the repatriation to the largest extent possible that the return on equity is free of WHT.[171] In our case, dividends distributions would be subject to a 15% WHT without any exemption whereas interest paid by Lux HoldCo to Fund should not suffer Luxembourg WHT.

The cash held by Lux HoldCo could be repaid to the Fund by way of repayment of interest and principal under the PPLs at arm's length. According to Article 147(2) LITL, interest payments made under the PPLs would not be subject to any WHT in Luxembourg in accordance with Luxembourg domestic law provided that (i) the arm's length principle is respected, (ii) Lux HoldCo is sufficiently capitalised, and (iii) the interest is not derived from a participating security.

Lux HoldCo will be financed with 15% equity in the form of share capital/share premium and 85% debt in the form of PPLs granted by the Fund with the aim to comply with the current administrative practice. In order to mitigate WHT exposure on dividends paid by Lux HoldCo to the Fund, it should be envisaged to upstream profits through redemption of classes of shares by way of buy-back of classes of shares followed by its immediate cancellation.

Lux HoldCo could issue classes of shares with different economic rights upon its incorporation. According to Article 49(2) of the Luxembourg Company law, Lux HoldCo would be able to repurchase its own shares by decision of its respective board of managers and if certain conditions are met. As such, any income or gain derived from the underlying assets could then be remitted by way of redemption of a class of shares.

The redemption of all the shares of a given class followed by the immediate cancellation of such shares and a corresponding capital decrease of Lux HoldCo would be considered as a partial liquidation for Luxembourg tax purposes. Since partial liquidations are treated

---

171 Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 284

from a tax point of view as a full liquidation of Lux Holdco, these will not be subject to WHT.[172]

It should be noted here that the Administrative Tribunal of Luxembourg ruled in Case Nº 42432 dated on 27 January 2023[173] that the Luxembourg tax treatment of the redemption and cancellation of an entire class of shares is in principle to be qualified as capital gain and not as distribution but to the extent the repurchase price exceeds the FMV of the repurchased shares, the excess would qualify as a hidden dividend distribution subject to WHT.[174]

Consequently, the redemption and automatic cancellation of classes of shares might be subject to increased scrutiny from the tax authorities. Therefore, taxpayers will have to be able to demonstrate the value of the shares redeemed to avoid the risk of successful recharacterization as a hidden dividend distribution.[175]

It is important to note that the proper drafting of the bylaws is a key element for the tax analysis as the Administrative Court of Luxembourg ruled in the Case Nº 39193C dated on 23 November 2017[176] that each class of shares has to be properly identified with its distinctive economic rights.

One could state that WHT leakage in Luxembourg could be fully eliminated if the investors fulfil the conditions of the Luxembourg WHT exemption (please refer to Sub-Section 7.4 for further details). However, the assessment of each investor whether qualifies or not for the Luxembourg WHT exemption might be difficult and therefore, the classes of shares alternative should be chosen as the safest route.[177]

6. Tax considerations at the level of Lux PropCo

[172] Articles 101 and 146 LITL in combination with Article 97(1) LITL
[173] Case N° 42432 of the Luxembourg Administrative Tribunal relating to the tax treatment of redemption of a share class [2023]
[174] Clifford Chance, 'Redemption of "alphabet" classes of shares – guidance on the Luxembourg tax treatment from the Administrative Tribunal ' (Clifford Chance, 2023, p. 1) <https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2023/02/tax-case-law.pdf> accessed 15 May 2023
[175] *Ibid.,* p. 3
[176] Case N° 39193C of the Luxembourg Administrative Court relating to the tax treatment of share class redemptions [2017]
[177] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 292

Lux PropCos would be fully taxable companies liable to tax in Luxembourg on their worldwide profits and entitled to the benefits of the Luxembourg tax treaty network and the EU tax directives, subject to compliance with usual substance requirements as well as anti-abusive provisions.

Lux PropCos would acquire real estate located in Germany and the Netherlands financed (i) by Lux HoldCo through equity contributions (i.e share capital and share premium), and (ii) by the Fund through loans (the "**Loans**"). In addition, Lux PropCos would be financed by bank loans (the "**Bank Loans**") from third-party creditors.

As previously mentioned, and based on Luxembourg administrative practice, an 85:15 debt-to-equity ratio may be considered when financing the acquisition of immovable property with related party debt. A different ratio may be applied if sound economic arguments could be provided and in case of non-compliance, the interest paid in excess of the ratio is not tax deductible and subject to 15% WHT except if a reduction based on a DTT or an exemption based on domestic law is applicable.

6.1. Taxation at the Lux PropCo level – The Netherlands

According to Articles 6 and 23(3) of the Luxembourg – Dutch DTT, income derived by a Luxembourg resident from real estate property situated in the Netherlands shall only be taxable in the Netherlands. Moreover, capital gains derived from the alienation of real estate property located in the Netherlands shall only be taxable in the Netherlands.[178]

As such, interest paid on the Loans and on the Bank Loans would not be tax deductible at Lux PropCo level and therefore allocated to the foreign real estate property as being in direct economic link with a tax-exempt income in Luxembourg.

Lux PropCos would in principle be subject to the annual NWT in Luxembourg on their worldwide net wealth (or net assets on 1 January of each year). However, based on the provisions of Article 22 of the Luxembourg – Dutch DTT, Lux PropCos should not be subject to NWT on the value of their real estate properties located in the Netherlands (and concurrently, the Loans and Bank Loans would not be deductible for NWT purposes).

[178] Articles 14(1) and 23(3) of the Luxembourg – Dutch DTT

Cash held by Lux PropCos at year-end may generate a NWT cost if there are no sufficient debt liabilities (e.g. Loans and Bank Loans) to offset such cash.

In any case, Lux PropCo should be liable for a minimum annual NWT. As stated above, assets taxable only in the Netherlands such as immovable property situated in the Netherlands should be eliminated from their balance sheet when determining the minimum Luxembourg NWT.

Cash may be available at Lux PropCo level and ideally it should be distributed to not incur in NWT. However, the so-called “cash trap” position may happen if from an accounting perspective due to amortization instalments booked on the real estate properties these distributions cannot be made. To mitigate this cash trap issue, several options could be considered: (i) upstream the cash to the Fund through an upstream loan or (ii) use the cash to repay a portion of the Loans or the Bank Loans.

6.2. Taxation at the Lux PropCo level – Germany

According to Articles 6 and 22(2)(a) of the Luxembourg – German DTT dated 23 April 2012, income derived from the German property such as lease income shall only be taxable in Germany.

Concurrently, interest accrued on the shareholder loans and on the bank debt as well as amortization instalments booked on the German property would not be tax deductible for Luxembourg income tax purposes as being in direct economic link with an income the taxation of which is not allocated to Luxembourg.

The Lux PropCo would in principle be subject to annual NWT in Luxembourg. However, based on the provisions of Article 21 of the Luxembourg – German DTT, the Lux PropCo should not be subject to NWT on the value of the German property and consequently, the shareholder loans as well as the bank debt would not be deductible for NWT purposes. The Lux PropCo would then remain only liable to the minimum NWT.

Cash held by the Lux PropCo at year-end may generate an additional NWT cost if there are no sufficient debt liabilities to offset such cash. In this respect, cash may be available at the Lux PropCo level but in a trapped position due to amortization instalments booked on the real estate property. To mitigate this cash trap issue, several options could be considered: (i) upstream the cash to the Fund through an upstream loan or (ii) use the cash to repay a portion of the Loans or the Bank Loans.

6.3. Profit repatriation

Dividend distributions, if any, from Lux PropCo to Lux HoldCo fall within the scope of the 15% Luxembourg WHT but should be exempt under the Luxembourg participation exemption regime if the conditions are met (please refer to Section 7). It should be noted that the first 12-month period suffering the WHT will be refunded after the period. As per liquidation proceeds from Lux PropCos, these should not suffer the 15% WHT.

Interest paid by Lux PropCos to the Fund should not suffer Luxembourg WHT but subject to their arm's length qualification and thin capitalisation rules.

Upon exit, any capital gain realized upon de sale of Lux PropCos' shares should be exempt under the Luxembourg participation exemption regime if the conditions are met (please refer to Section 7 for the requirements on the applicability of the Luxembourg participation exemption regime).

7. Luxembourg participation exemption regime

7.1. Dividends received

Dividends received by a Luxembourg fully taxable resident company should, in principle, be subject to corporate income tax and MBT at the aggregate rate of 24.94% for Luxembourg city for Fiscal Year 2023. However, Article 166 of the LITL provides for the exemption of the dividends if all of the following conditions are fulfilled.

Dividends received by a fully taxable Luxembourg resident company from a subsidiary will qualify for the participation exemption regime if:

i) the Luxembourg company owns at least 10% of the share capital of the subsidiary or a participation with an acquisition cost of at least EUR 1.2 million;
ii) at the date of the distribution, the Luxembourg company holds or commits itself to hold this minimum shareholding for an uninterrupted period of at least twelve months. In this respect, any dividend received before the twelve-month period elapsed (e.g. after a few days) would still benefit from the exemption if the 10%

and the EUR 1.2 million participation is held for a total period of twelve months; and

iii) the subsidiary is a fully taxable corporation resident in Luxembourg or a corporation resident in a jurisdiction where it is liable to tax corresponding to the Luxembourg corporate income tax (at a minimum rate of 8.5% and with taxable basis computed in a similar way as in Luxembourg) or a corporation resident in an EU Member State and falling within the scope of Article 2 of the PSD.

For the application of the exemption, an indirect holding of a participation through an entity listed under Article 175 of the LITL is deemed to be a direct shareholding in proportion with the part of net asset value held in such entity.

However, according to the general principle in Luxembourg income tax law which denies the deductibility of expenses connected to exempt income, any charges incurred during the year in which the dividend is received, and which are connected to the exempt participation, are not deductible. Additionally, if a write-down in the value of the participation has been booked either as a consequence of the distribution of dividends or otherwise, this write-down will not be deductible up to the amount of the exempt dividend.

Even though the exemption would not be applicable if the above conditions are not met, 50% of the dividend received will be still exempt if the distributing company is:

i) a Luxembourg fully taxable *société de capitaux*, or
ii) a *société de capitaux* resident in a State which has signed a DTT with Luxembourg and is fully taxable to a corporate tax corresponding to the Luxembourg corporate income tax (at a minimum rate of 8.5% and with taxable basis computed in a similar way as in Luxembourg), or
iii) a European Union resident company (in the meaning of Article 2 of the PSD.

7.2. Capital gains

Capital gains realized by a fully taxable Luxembourg resident company upon disposal of shares in a subsidiary will not be subject to capital gains tax under the participation exemption regime if the following conditions are met:

i) the Luxembourg holding company owns at least 10% of the share capital of the subsidiary or a participation with an acquisition cost of at least EUR 6 million;
ii) at the date of the shares' disposal, the Luxembourg company holds or commits itself to hold this minimum shareholding for an uninterrupted period of at least twelve months; and
iii) the subsidiary is a fully taxable corporation resident in Luxembourg or a corporation resident in a jurisdiction where it is liable to tax corresponding to the Luxembourg corporate income tax (at a minimum rate of 8.5% and with taxable basis computed in a similar way as in Luxembourg) or a company resident in an EU Member State and falling within the scope of Article 2 of the PSD.

The exempt amount of the gain is reduced by the sum of the economically related expenses and capital losses deducted over previous years and in the year of disposal.

A recapture system exists, under which the exempt amount of the gain is reduced by the algebraic sum of any expenses principally connected with the participation (such as financing costs and write-downs in the value of the participation), to the extent that they have reduced the taxable base of that year or previous years. Basically, an effect of this rule is that the capital gain realised will become taxable up to the amount of the aggregate expenses and write-downs deducted during the respective and previous years in relation to the participation.

The purpose of the above system is to avoid the taxation vacuum which could result if the deductibility of expenses and write-downs connected to the participation was allowed whereas the income arising from the participation was tax exempt.

7.3. Net wealth tax

A shareholding in the share capital of a subsidiary held by a fully taxable Luxembourg resident company will be exempt from the NWT provided that at the closing date of the company's accounting year:

i) the Luxembourg company owns at least 10% of the share capital of the subsidiary or a participation with an acquisition price of at least EUR 1.2 million; and

ii) the subsidiary is a fully taxable corporation resident in Luxembourg or a corporation resident in a jurisdiction where it is liable to tax corresponding to Luxembourg CIT (at a minimum 8.5% rate and with taxable basis computed in a similar way as in Luxembourg) or a company resident in an EU Member State and falling within the scope of Article 2 of the PSD.

7.4. Withholding tax on dividends paid

Dividends paid by a Luxembourg resident company to a parent beneficiary will be exempt from Luxembourg WHT provided that the following cumulative conditions are met:

i) the parent beneficiary owns at least 10% of the share capital of the Luxembourg resident company or a participation with an acquisition cost of at least EUR 1.2 million;
ii) at the date of the distribution, the parent beneficiary holds this minimum shareholding for an uninterrupted period of at least twelve months (in case of a distribution before the twelve-month period has elapsed, the domestic 15% WHT should be due, and a refund could be claimed after the twelve-month period has elapsed).

The parent beneficiary must be one of the following:

i) a fully taxable corporation resident in Luxembourg; or
ii) a corporation resident in an EU Member State fulfilling the conditions of Article 2 of the PSD and listed in the appendix to this directive; or
iii) a Luxembourg PE of an EU resident company within the meaning of Article 2 of the PSD; or
iv) a corporation resident in a country with which Luxembourg has a DTT and which is fully subject to income tax comparable to the Luxembourg CIT (at a minimum 8.5% rate and with taxable basis computed in a similar way as in Luxembourg) as well as a Luxembourg PE of such a corporation; or
v) a corporation resident of Switzerland and subject to tax without being exempt; or

vi) a corporation or a cooperative company resident in a Member State of the European Economic Area, other than a Member State of the EU, and that is fully subject to tax equivalent to the Luxembourg CIT; or

vii) a Luxembourg PE of a corporation or a cooperative company resident in a Member State of the European Economic Area, other than a Member State of the EU, and that is fully subject to tax equivalent to the Luxembourg CIT.

7.5. Anti-avoidance measures

It should be noted here that the Luxembourg government has implemented into domestic law since 1 January 2016 the changes to the EU PSD which would affect the relevant parts of the dividends received and dividends distributed exemptions of the Luxembourg participation exemption regime. The law states that such exemptions would be denied if the dividend received or dividend distribution was part of an arrangement or a series of arrangements which, having been put in place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the Directive, are not genuine having regard to all relevant facts and circumstances.

The law also states that an arrangement may comprise more than one step or part. In this context, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put in place for valid commercial reasons which reflect economic reality.

Under secondary ATAD II rules, dividend income received by a Luxembourg company should not be exempt where the third country-based payor, i.e. non-EU, of the dividend benefits from a tax deduction in relation to such dividend payment.

8. ATAD I

On 21 December 2018, the Luxembourg law implementing the ATAD I Directive, as amended, was published in the Official Gazette. The ATAD I came into force on 1 January 2019 with respect to the following measures: (i) interest limitation rules, (ii) CFC rules, (iii) intra-EU anti-hybrid rules, and (iv) GAAR. The provisions laying down exit tax rules came into force on 1 January 2020.

8.1. Interest limitation rules

According to Article 4 of ATAD I, the portion of interest expenses exceeding interest income, the so-called exceeding borrowing costs, would be tax deductible up to the higher of (i) 30% of the adjusted EBITDA of the Luxembourg taxpayer or (ii) EUR 3 million.

The definition of "borrowing costs" is quite expanded and not exhaustive, it includes interest expenses on all forms of debt, other costs economically equivalent to interest and expenses incurred in connection with the raising of finance as defined in national law, including but not limited to the payments under profit participating loans and the finance cost element of finance lease payments.

Article 2(2) ATAD I define "exceeding borrowing costs" as "(…) the amount by which the deductible borrowing costs of a taxpayer exceed its taxable interest revenues and other economically equivalent taxable revenues*"*. Luxembourg has not retained an option to treat a tax consolidation or group relief regime as a single taxpayer for the purpose of the interest limitation rules application.

The third paragraph of the same Article provides for a grandfathering rule to be applied to any loans granted to a Luxembourg company before 17 June and to the extent that these loans have not been modified since this date and will not be modified afterwards. If these conditions are met, exceeding borrowing costs (over interest income earned) incurred by the Luxembourg borrowing company should remain tax deductible (i.e. not falling under the interest capping rules limited to the higher between EUR 3 million or 30% of the EBITDA. Borrowing costs arising from long-term infrastructure projects are also excluded from the scope of the interest limitation rules.

8.2. Hybrid mismatch provisions

Based on the anti-hybrid rules that Article 9 of the ATAD I states, the tax deductibility of payments between two entities may be further restricted if (i) such payments result in a hybrid mismatch, defined as a situation where, because of a difference in the legal characterization of a financial instrument, a tax deductible payment is not included in the taxable base of the ultimate recipient/beneficiary[179], and (ii) (a) the ultimate recipient/beneficiary of the payment and the payer are "associated enterprises"[180] within the meaning of ATAD I or (b) the ultimate recipient/beneficiary and the payer have

[179] Article 2(9) ATAD I
[180] Please refer to Article 2(4) of ATAD I for the meaning of "associated enterprise"

entered into a "structured arrangement" which resulted in this hybrid mismatch (the "**Anti-Hybrid Rules**").

However, a hybrid mismatch would not arise if the absence of taxation at the level of the recipient is due to (i) its own tax status, that is, the recipient is a tax-exempt vehicle, or (ii) the fact that it can credit taxes to offset its taxable base.

One should pay attention to the hybrid treatment of vehicles and financing instruments as it can lead to undesired tax consequences in Luxembourg and/or other jurisdictions if not carefully monitored.[181]

8.3. CFC rules

CFC rules apply to corporate entities and PEs. The rule laid down in Article 7 of ATAD I targets non-distributed income of CFCs arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage. Under these rules, two cumulative conditions have to be fulfilled before an entity or PE is considered to be a CFC.[182]

First, an entity is a controlled entity if the Luxembourg taxpayer by itself (or together with its associated enterprises) holds a direct or indirect participation of more than 50% of the voting rights or capital (or is entitled to receive more than 50% of the profits) of the entity.

Associated enterprises in this context refers to an entity in which the Luxembourg taxpayer holds directly or indirectly a participation of more than 25% of the voting rights or capital (or is entitled to receive more than 25% of the profits) of the entity; or an individual or entity that holds directly or indirectly a participation of more than 25% of the voting rights or capital (or is entitled to receive more than 25% of the profits) in the Luxembourg taxpayer.

Second, there will be a CFC if the actual corporate income tax paid by the controlled entity (or PE) on its profits is lower than 50% of the corporate income tax charge which

[181] Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018) p. 283
[182] Article 7(1) ATAD I

would have been payable in Luxembourg under local tax rules had the controlled entity (or PE) been resident or established in Luxembourg.

When an entity or PE meets both criteria and thus, is regarded as a CFC, the Luxembourg taxpayer must include in its taxable basis the non-distributed income of the CFC up to a limit of the amount of income that is generated through assets and risks which are linked to "significant people functions" carried out by the Luxembourg taxpayer.[183]

9. ATAD II

The ATAD II Directive[184] extends the hybrid mismatch definition of ATAD I to include notably mismatches resulting from arrangements involving PEs, hybrid transfers, imported mismatches, reverse hybrid entities and tax residency mismatches. ATAD II also extends the hybrid mismatches with non-EU countries.

On 8 August 2019, the Luxembourg Government tabled a bill before the Luxembourg Parliament aiming at transposing ATAD II into domestic law. The bill set out a detailed commentary which in places gives guidance on how ATAD II rules, as implemented in Luxembourg, may be interpreted. On 19 December 2019, the Luxembourg Parliament voted to approve the law implementing ATAD II into Luxembourg domestic law.

The domestic law applies to any Luxembourg corporate income taxpayer, including foreign entities that have a PE in Luxembourg as defined by the domestic legislation. As from the 2022 tax year, the scope is also extended to Luxembourg entities that are regarded under Article 175 LITL as being tax transparent for Luxembourg tax purposes, effectively, in some cases, turning such entities into Luxembourg taxpayers for CIT for all or part of their income.[185]

Following the amendment of the ATAD I, the reverse hybrid mismatch rules will apply in the case of an EU resident entity, which is treated as tax transparent in its residence state, but as opaque in the State of its non-resident direct or indirect owners (which may lead to a situation of double non-taxation). ATAD II also provides for a carve-out when

[183] Article 7(2) ATAD I
[184] Council Directive (EU) 2017/952 of 29 May 2017 amending Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L193/1
[185] Article 1(2) ATAD II

it comes to collective investment vehicles, subject to investor-protection regulation in their State of residence, for instance SIFs.

The scope of the domestic law covers hybrid mismatch situations arising: (i) between associated enterprises, or (ii) between a head office of an entity and a PE, or (iii) between two or more PEs of the same entity, or (iv) in cases of dual residency, or (v) under a structured arrangement.

10. ATAD III

On 22 December 2021, the European Commission has published the text of a draft Directive ("**ATAD III**")[186] laying down the rules to prevent the misuse of shell entities for tax purposes and to amend DAC 6. Once adopted, the Directive should be transposed into national law by the Member States before 30 June 2023 to come into effect from 1 January 2024.

The draft Directive aims at tackling the abusive use for tax purposes of entities and arrangements that have no or little substance by denying them certain tax benefits and by imposing disclosure requirements and automatic exchange of information between EU Member States. As such, the draft Directive aims at preventing the misuse of shell entities and provides for a multi-step test to facilitate their identification.

ATAD III would apply to all undertakings that are considered tax resident and are eligible to receive a tax residency certificate in an EU Member State regardless of their legal form, for instance including SMEs, partnerships that are deemed residents for tax purposes, trusts, among others.

However, certain entities are out of scope of ATAD III and not subject to reporting requirements. Undertakings that meet one of the following criteria should be considered as being out of the scope of ATAD III: (i) a company with a transferable security listed on a regulated market or multilateral trading facility; (ii) an entity that is regulated financial undertaking in the meaning of ATAD III, which include AIFs, a securitisation special purpose entity, etc.; (iii) undertakings that have the main activity of holding shares

[186] Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU <https://taxation-customs.ec.europa.eu/system/files/2021-12/COM_2021_565_1_EN_ACT_part1_v7.pdf>

in operational businesses located in the same EU Member State as the undertaking's beneficial owner(s) for tax purposes; (iv) undertakings with holding activities that are resident for tax purposes in the same Member State as the undertaking's shareholder(s) or ultimate parent entity; and (v) undertakings with at least five own full-time employees or member of staff exclusively carrying out the activities generating the relevant income.

On the basis of a self-assessment, if an entity tax resident in a Member State passes the different steps laid down within the draft Directive and does not qualify for a derogation, reporting entities should declare their annual tax return each year specifying they meet the minimum substance indicators.

If an entity meets all the substance indicators by providing documentary evidence, it will be presumed to have minimum substance for the tax year. On the contrary, a reporting entity should be presumed to not have minimum substance for the tax year if it fails to meet the minimum substance indicators. Nevertheless, this presumption can be rebutted by the entity by providing additional supporting evidence to the local tax authorities.

Alternatively, the entity can claim an exemption from its obligations under the Directive by demonstrating to the tax authorities that it was for genuine commercial reasons and that it does not generate any tax benefit for itself or for its beneficial owner(s).

Entities without minimum substance may face adverse tax consequences such as not being eligible for DTT or EU Directives benefits and an administrative pecuniary sanction of at least 5% of the entity's turnover in case of non-compliance with its reporting obligations under the Directive. Moreover, there will be an automatic exchange of information between the EU Member States where the entity is resident for tax purposes in a timely and extensive manner with the other EU Member State through a central directory.

11. Luxembourg transfer pricing rules

A Luxembourg taxable company borrowing or lending funds to affiliated parties will be subject to the Luxembourg's transfer pricing rules under Articles 56 and 56*bis* LITL and the Luxembourg TP Circulars (the **"Luxembourg's TP rules")**.

On 27 December 2016, the Luxembourg tax authorities issued a new transfer pricing circular[187] aiming at clarifying the tax treatment applicable to companies realizing principally intra-group financing transactions, effective from 1 January 2017.

The arm's length principle is reflected in Article 56 LITL, which allows a transfer pricing adjustment where the transaction prices differ from prices that would have been agreed between independent entities for comparable transactions in comparable circumstances on the open market. Furthermore, the new Article 56*bis* LITL further outlines the basic principles to be complied with when conducting a transfer pricing analysis. This new Article focuses on the comparability analysis and provides new elements to be taken into consideration in the context of a comparability analysis by setting out the technique to be used, and the methodology to follow, for the application of the arm's length principle.[188]

A Luxembourg company realizing intra-financing activity may evidence and document in advance the methodology used to determine the intra-group remuneration (i.e. financing margin). Auditing such documentation, the Luxembourg tax authorities may agree upon the applicable methodology. The binding decision will apply unless the documentation filed were incorrect, incomplete, or not in conformity with international standards.

11.1. Methodology

Transactions must be in line with the comparability analysis pursuant to Article 56*bis* LITL. The comparability analysis should be based on the economic background, the contractual terms of the financing, the functional analysis, and the risk analysis in financial relationship.

11.2. Substance

In order to be able to control the risks, the company performing the intra-group financing transaction should have the decision-making capabilities to execute the transaction and to monitor the risk. To this end, the Luxembourg group financing company must have an

[187] Circular N° 164/2 and N° 164bis/2 [2011] on Luxembourg tax treatment applicable to Luxembourg companies engaged in intra-group financing transactions, as amended by Circular N° 56/1 and N° 56bis/1 [2016]

[188] M Schmitz and PJ Warner, *Luxembourg in International Tax* (EY Luxembourg, 3rd revised edition, 2015) p. 192

actual presence in Luxembourg and thus to comply with the following substance requirements:

i) most of the members of the board of directors, directors, or managers with decision power to bind the group financing company, should be either residents or non-residents carrying on in Luxembourg professional activity subject to tax in Luxembourg on at least 50% of the total of such income. If a member of the board of directors is a legal person, it must have its registered office and its central administration in Luxembourg;
ii) the company should have qualified employees to control the performed transactions. However, the company could outsource some functions that do not have a significant impact on the control of the risks;
iii) key decisions concerning the management of the company must be taken in Luxembourg. In addition, for companies for which the company law foresees general meetings, at least one general meeting per year must be held at the place indicated in the articles of association; and
iv) the company must not be considered as a tax resident of another State.

Besides, in order to be considered as the beneficial owner of the interest, the Luxembourg company should be adequately equity financed. In this respect, the equity at risk will now be determined according to a genuine equity at risk approach, i.e. to be evaluated on a case-by-case basis taking into account the facts and circumstances of a specific transaction.

According to the tax authority's view, these criteria show or demonstrate the strength of the company's local substance. Besides, where one or several transactions cannot be observed between unrelated parties and no commercial rationale can support them, such transactions and the associated tax consequences should be disregarded so as to meet the arm's length principle.

For the sake of completeness, Luxembourg companies may also need to demonstrate a level of substance in order to avail certain relief from WHT under certain EU Directives and/or DTTs. The fact that tax authorities are trying to challenge artificial tax structures has brought them to question whether legal entities within an international group are indeed tax-resident in their country of incorporation, or whether it can be argued that they are resident elsewhere.[189] In order to mitigate this risk, taxpayers may take into account to conduct a detailed substance analysis covering the different substance requirements laid down among domestic legislation, DTTs, and EU law.

11.3. Documentation and information

Several documents and information must be provided to the Luxembourg tax authorities when seeking an advanced confirmation. These documents and information notably related to the applicant information, the group structure, the tax years covered by the request, the transaction description, a transfer pricing study in compliance with the principles set out in the previous sections and the recommendations of the OECD in this field, any other countries involved as well as the assurance that the information required to assess the facts is complete and truthful.[190]

12. Disclosure requirements – DAC 6

On 25 March 2020, the Luxembourg Parliament passed the final vote on the bill of law nº 7465, to transpose DAC 6 into Luxembourg legislation. DAC 6 makes it mandatory for intermediaries (or taxpayers, if there is no intermediary, or if intermediaries are subject to professional secrecy as defined by the Member States' domestic laws) to report certain cross-border transactions and arrangements to the domestic authorities. Reports that are made will trigger the subsequent automatic exchange of information between the tax authorities of all EU Member States, through access to a central directory.

12.1. Timing of reporting

The Luxembourg DAC 6 Law requires that reportable cross-border arrangements implemented between 25 June 2018 and 1 July 2020 are to be disclosed by 31 August 2020 at the latest. For cross-border arrangements established after this date, the reporting shall be made within 30 days.

In the context of COVID-19, the EU released an update to the Directive, granting an option to EU Member States to defer by up to 6 months the time limits for the filing and

---

[189] A Smits and I Verlinden, *Substance. Aligning international tax planning with today's business realities* (PricewaterhouseCoopers, 2009) p. 34
[190] M Schmitz and PJ Warner, *Luxembourg in International Tax* (EY Luxembourg, 3rd revised edition, 2015) pp. 194–195

exchange of reportable cross-border tax planning arrangements. The amendment allows the EU Council to extend the deadline by an additional maximum three months.

Luxembourg bill nº 7625, voted by the Luxembourg Parliament on 22 July 2020, provides for a postponement of six months as far as DAC 6 is concerned meaning that: (i) the final deadline for filing arrangements linked to the transition period would be postponed to 28 February 2021, and (ii) the date for the beginning of the period of 30 days for reporting on reportable cross-border arrangements by intermediaries (or taxpayers) would be changed from 1 July to 1 January 2021.

12.2. Intermediaries and professional secrecy

Reporting obligations are placed primarily on intermediaries. The Luxembourg DAC 6 Law defines the notion broadly and regards as intermediary, any person which helps in designing, marketing, organising, making available for implementation, or managing the implementation of a reportable arrangement (including persons that know, or could reasonably be expected to know that they have agreed to provide assistance or advice in relation to such service).

The Luxembourg DAC 6 Law provides for a reduced reporting obligation for lawyers, chartered accountants, and auditors on the basis of the professional secrecy. The Luxembourg DAC 6 Law waives any reporting obligation of such exempt intermediaries to the Luxembourg tax authorities. Consequently, exempt intermediaries will not be required to file anonymised reporting, however, will be subject to a notification obligation. Thus, exempt intermediaries will notify such intermediaries not subject to the professional secrecy or he taxpayer concerned by the relevant reporting obligations within ten days.

CONCLUSIONS

The aim of the current study was to provide a comprehensive analysis of the important role that international tax planning plays within the funds industry, with special attention to the country of Luxembourg. From the undertaken research, the following conclusions can be laid down.

First, the fund industry has substantially grown in the past years turning into a dynamic and influential sector within the global financial landscape. Since Luxembourg has been prominent in being up-to-date and adapting the needed regulations for the well-functioning of this industry, it is indisputable that the country has positioned itself as one of the main domiciles for funds. Due to its advantageous legal and regulatory framework, together with its extensive network of DTTs, Luxembourg will keep attracting fund managers and international investors seeking for a tax efficient and safe environment.

Second, the taxation of cross-border transactions and investments is not always straightforward and so the international tax law regime is essential for these cases to allocate taxing rights between the concerned countries. As seen in the case study, fund managers need to combine international and domestic laws across different jurisdictions when setting up a new fund. Therefore, it is crucial that the operations and transactions are structured in a way that align with commercial objectives but also with legal and tax requirements laid down in both international and domestic provisions.

Third, governments and supranational organizations have been regulating this area to combat tax avoidance and promote transparency and exchange of information of cross-border transactions. Luxembourg exemplifies how countries have committed to implement international tax standards to stay aligned with initiatives such as the BEPS project led by the OECD.

Furthermore, ongoing discussions around global tax reforms including proposals for minimum taxation and digital services taxation may reshape the tax planning strategies. Thus, regulatory scrutiny and stricter enforcement of tax laws may require fund managers to adopt more rigorous compliance practices and demonstrate substance in their operations.

Fourth, the future of international tax planning within the funds industry holds both opportunities and challenges. The digitalization of financial services together with technological developments will most likely enable fund managers to leverage from sophisticated tools and data analytics to establish fund structures that optimize tax efficiencies, streamline compliance processes, and enhance transparency in cross-border transactions. However, new challenges for fund managers and tax advisors may arise due to the continuous changing global tax landscape, especially with initiatives such as the BEPS project and the increasing focus on tax transparency.

In a nutshell, international tax planning is one of the main important aspects that need to be considered for the well-functioning of an investment fund. One could state that thanks to these strategies, fund managers are able to provide investors with the expected returns of their investments. Luxembourg is one example of agility, adaptability, and a proactive approach to go through changing regulations, seize opportunities for optimization, and uphold transparency and compliance standards, all together bringing the country to be considered as the preferred fund domicile in Europe.

REFERENCES

Legislation

Circular N° 06/241 regarding the Luxembourg concept of risk capital under the Law of 15 June 2004 relating to the investment company in risk capital [2006]

Circular N° 07/309 regarding Luxembourg risk-spreading in the context of specialised investment funds [2007]

Circular N° 164/2 and N° 164bis/2 [2011] on Luxembourg tax treatment applicable to Luxembourg companies engaged in intra-group financing transactions, as amended by Circular N° 56/1 and N° 56bis/1 [2016]

Consolidated Version of the Treaty on European Union [2016] OJ C 202/1

Consolidated Version of the Treaty on the Functioning of the European Union [2016] OJ C 202/1

Council Directive (EC) 2003/49 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49

Council Directive (EC) 2009/65 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities [2009] OJ L 302/32

Council Directive (EC) 2009/133 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States [2009] OJ L310/34

Council Directive (EU) 2011/61 on Alternative Investment Fund Managers [2011] OJ L 174

Council Directive (EU) 2011/96 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2011] OJ L345/8

Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L193/1

Council Directive (EU) 2017/952 amending Council Directive 2016/1164/EC as regards hybrid mismatches with third countries [2017] OJ L144/1

Council Directive (EU) 2018/822 amending Council Directive (EC) 2011/16 as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements [2018] OJ L139/1

Council Regulation (EU) 345/2013 on European venture capital funds [2013] OJ L 115/1

Council Regulation (EU) 2015/760 on European long-term investment funds [2015] OJ L 123/98

Law of 10 August 1915 on Luxembourg commercial companies

Law of 16 October 1934 on Luxembourg valuation of goods and values *(Bewertungsgesetz*)

Law of 4 December 1967 on Luxembourg Income Tax

Law of 15 June 2004 on the Luxembourg investment company in risk capital

Law of 17 December 2010 relating to Luxembourg Undertakings for Collective Investment transposing Council Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions, relating to UCITS [2009] OJ L 302/32

Law of 23 July 2016 on Luxembourg reserved alternative investment funds

Law of 13 February 2017 relating to Luxembourg specialised investment funds

The Vienna Convention on the Law of Treaties of 23 May 1969

Jurisprudence

Case C-270/83 *Commission of the European Communities v French Republic* [1986] ECLI:EU:C:1986:37

Case C-275/11 *GfBk Gesellschaft für Börsenkommunikation GmbH* [2013] ECLI:EU:C:2013:141

Case C-595/13 *Fiscale Eenheid X NV* [2015] ECLI:EU:C:2015:801

Case N° 39193C of the Luxembourg Administrative Court relating to the tax treatment of share class redemptions [2017]

Case N° 42432 of the Luxembourg Administrative Tribunal relating to the tax treatment of redemption of a share class [2023]

Bibliography

Andrea Amatucci, *International Tax Law* (Wolters Kluwer, 2nd edition, the Netherlands, 2012)

AGEFI Luxembourg, 'How come Luxembourg is such a financial hub' (Square Management, 16 February 2022) < https://www.square-management.com/articles/how-come-luxembourg-is-such-a-financial-hub/> accessed 5 January 2023

Arendt & Medernach SA, 'Alternative Investment Funds' (Arendt, 2021) <https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_alternative_investment_funds_-_aifs.pdf> accessed 22 February 2023

Arendt & Medernach SA, 'Corporate taxation in Luxembourg' (Arendt, 2018) < https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_corporate_taxation_in_luxembourg.pdf> accessed 3 March 2023

Arendt & Medernach SA, 'Investment management: setting up your regulated investment fund in Luxembourg' (Arendt, 2014) < https://www.arendt.com/upload/docs/application/pdf/2018-06/brochure_-_setting_up_your_regulated_investment_fund_in_luxembourg.pdf> accessed 16 February 2023

A Binder and M Robic, 'Luxembourg: Home of the (Cross-Border) Global Fund Industry' (HEC Paris Alternative Investments Society, 2022) < https://www.hec-ais.com/insights/luxembourg-home-of-the-cross-border-global-fund-industry > accessed 15 January 2023

A Smits and I Verlinden, *Substance. Aligning international tax planning with today's business realities* (PricewaterhouseCoopers, 2009)

B Majerus and B Zenner, 'Too small to be of interest too large to grasp? Histories of the Luxembourg financial centre' (European Review of History: *Revue européene d'histoire*, 2020, pp. 548–562) < https://doi.org/10.1080/13507486.2020.1751587> accessed 21 January 2023

Clifford Chance, 'Redemption of "alphabet" classes of shares – guidance on the Luxembourg tax treatment from the Administrative Tribunal ' (Clifford Chance, 2023) <https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2023/02/tax-case-law.pdf> accessed 15 May 2023

C Finnerty, P Merks, M Petriccione, and R Russo, *Fundamentals of International Tax Planning* (IBFD, the Netherlands, 2007)

Danielle Sougné, *Fund Industry in Luxembourg: A Practitioner Guide* (Éditions Larcier, 2013)

D Bruce, J Deskins, and W.F Fox, 'On the Extent, Growth, and Efficiency Consequences of State Business Tax Planning' (2007) in A.J Auerbach, J.R Hines, and J Slemrod, 'Taxing Corporate Income in the 21st Century' (Cambridge University Press, pp. 226-256) <https://www-cambridge-org.uaccess.univie.ac.at/core/books/taxing-corporate-income-in-the-21st-century/on-the-extent-growth-and-efficiency-consequences-of-state-business-tax-planning/9C2DB62D9A3D088F30332EC62B8BD583> accessed 22 April 2023

D Endres and C Spengel, *International Company Taxation and Tax Planning* (Wolters Kluwer, the Netherlands, 2015)

D Wojcik, M Urban, and S Dörry, 'Luxembourg and Ireland in global financial networks: Analysing the changing structure of European investment funds' (Transactions of the Institute of British Geographers, 2022) <https://doi.org/10.1111/tran.12517> accessed 18 January 2023

Eddy Wymeersch, *Alternative Investment Fund Regulation*, (Wolters Kluwer, V. 16, Netherlands, 2012)

European Report, 'Interview with Marc Saluzzi, President, Association of the Luxembourg Investment Fund Industry (ALFI): Investment Funds should become a "Recognised Brand" ' (Europolitics, 2013) <https://go.gale.com/ps/i.do?p=AONE&u=43wien&id=GALE|A328508892&v=2.1&it=r&sid=bookmark-AONE&asid=26874a37> accessed 18 January 2023

European Securities and Markets Authority, 'Opinion on UCITS Share Classes' (ESMA 34-43-296, 2017) <https://www.esma.europa.eu/sites/default/files/library/opinion_on_ucits_share_classes.pdf> accessed 15 March 2023

Hedgeweek, 'Luxembourg: Hub of European fund industry' (2017) < https://www.hedgeweek.com/2017/12/04/258413/luxembourg-hub-european-fund-industry > accessed 18 January 2023

IrishFunds, 'Our Industry: Irish Funds – A Leading Voice in the Industry' < https://www.irishfunds.ie/about/our-industry/> accessed 3 January 2023

J Story and I Walter, *Political economy of financial integration in Europe* (Manchester University Press, Manchester, 1997)

J.R Robinson, S.A Sikes, and C.D Weaver, 'Performance Measurement of Corporate Tax Departments' (The Accounting Review, V. 85, No. 3, 2010, pp. 1035-1064) <https://www-jstor-org.uaccess.univie.ac.at/stable/27802679> accessed 20 April 2023

Klaus Vogel, *Double Tax Treaties and Their Interpretation*, (Berkeley Journal of International Law, 1986)

K Ftouhi and W Ghardallou, 'International tax planning techniques: a review of the literature' (Journal of Applied Accounting Research, Vol. 21, Emerald Publishing, 2019) < https://www.emerald.com/insight/0967-5426.htm> accessed 15 April 2023

Mary Christine Joy, 'Report: UK fears French-backed move against access to Ireland, Luxembourg funds' (S&P Global Market Intelligence, 2018)

<https://www.spglobal.com/marketintelligence/en/news-insights/trending/sc8tkgkv2jw8mvaannogia2 > accessed 20 January 2023

Matthew Hudson, *Funds: Private Equity, Hedge and all Core Structures* (Wiley, United Kingdom, 2014)

Michael Edwards-Ker, *Tax Treaty Interpretations* (Queen Mary University of London, Ch. 33, 1994)

M Schmitz and PJ Warner, *Luxembourg in International Tax* (EY Luxembourg, 3rd revised edition, 2015)

O Walther, C Schulz, and S Dörry, *Specialised international financial centres and their crisis resilience: the case of Luxembourg* (Geographische Zeitschrift, 2011)

OECD, 'Model Tax Convention on Income and on Capital' (OECD Publishing, Condensed Version 2017, Paris) <http://dx.doi.org/10.1787/mtc_cond-2017-en> accessed 10 March 2023

Paul Langley, 'The everyday life of global finance. Saving and borrowing in Anglo-America' (Oxford University Press, 2008) <https://doi.org/10.1093/acprof:oso/9780199236596.001.0001> accessed 16 January 2023

Risto Laulajainen, *Financial Geography: A Banker's View* (Routledge, London, 2003)

Ryan J Wilson, 'An Examination of Corporate Tax Shelter Participants' (The Accounting Review, V. 84, No. 3, 2009, pp. 969-999) <https://www-jstor-org.uaccess.univie.ac.at/stable/27784200> accessed 20 April 2023

R.H Gordon and J.B Slemrod, 'Are "Real" responses to Taxes Simply Income Shifting Between Corporate and Personal Tax Bases?' (National Bureau of Economic Research, Cambridge, 1998) <https://www-nber-org.uaccess.univie.ac.at/papers/w6576> accessed 26 April 2023

Sabine Dörry, 'Global production networks in finance. The example of Luxembourg's investment fund industry' (*L'espace géographique*, V. 43, 2014, pp. 227–239) <https://doi-org.uaccess.univie.ac.at/10.3917/eg.433.0227> accessed 4 February 2023

Sabine Dörry, 'Strategic nodes in investment fund global production networks: the example of the financial centre Luxembourg' (Journal of Economic Geography, V. 15, 2014, pp. 797–814) <https://doi.org/10.1093/jeg/lbu031> accessed 20 January 2023

Sonja O Rego, 'Tax-avoidance activities of U.S. multinational corporations' (Contemporary Accounting Research, V. 20, No. 4, 2003 pp. 805-833) <https://www.proquest.com/docview/194211056?parentSessionId=gz%2BYCv8E%2FV3R0gy4wuldSOxv8tr38H5maPTEI80cMDs%3D&pq-origsite=primo&accountid=14682> accessed 20 April 2023

S Dyreng, M Hanlon and E Maydew (2008) 'Long-Run Corporate Tax Avoidance' (The Accounting Review, V. 83 No. 1, 2008, pp. 61-82) <https://www-jstor-org.uaccess.univie.ac.at/stable/30243511?sid=primo> accessed 20 April 2023

The Economist, 'Magnets for money: a special report on financial centres' (2007) < https://www.economist.com/sites/default/files/special-reports-pdfs/9753157.pdf > accessed 23 January 2023

United Nations, 'Model Double Taxation Convention between Developed and Developing Countries' (United Nations, 2017, New York) <https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf> accessed 15 March 2023

Werner Haslehner, *Investment Fund Taxation: Domestic Law, EU Law, and Double Taxation Treaties* (Wolters Kluwer, United Kingdom, 2018)

Wurzel E., Azzopardi D., 'Luxembourg: addressing new challenges in a major financial sector' (OECD Economics Department Working Papers, N° 1239, OECD Publishing, Paris, 2015) <https://www.oecd-ilibrary.org/economics/luxembourg-addressing-new-challenges-in-a-major-financial-sector_5jrzxgz5tvwj-en> accessed 15 March 2023

ANNEXES

Annex I – Summary

Summary – English version

In an increasingly interconnected global economy, the fund industry has witnessed remarkable growth over the past decades serving as an essential vehicle for investors seeking to capitalize on diverse financial opportunities. Particularly, Luxembourg has emerged as a leading European hub for investment funds and has positioned itself as a global financial centre by attracting a substantial worldwide inflow of capital from investors.

Since most investments are done on a cross-border basis, the effective implementation of international tax planning strategies becomes essential for investment fund managers. Therefore, this thesis provides a comprehensive analysis of the important role that international tax planning plays in ensuring the smooth functioning and sustained success of investment funds, focusing on the specific jurisdiction of Luxembourg.

Tax strategies employed by fund managers to optimize tax efficiency, mitigate risks, and enhance overall investment returns fall within the international tax planning field. The analysis carried out through this paper on national and international regulatory provisions, the different available fund vehicles, the application of double tax treaties, and international tax law, provides an overview of the important role that international tax planning strategies play within the funds industry.

Furthermore, the study of the proposed real case scenario spotlights how operations and transactions need to be well-structured to align with commercial objectives as well as with the requirements laid down from the regulatory framework and the tax authorities.

However, the continuous changing practices from companies on adopting tax planning strategies has brought governments and supranational organizations to fight tax avoidance and develop further regulations that promote transparency among different jurisdictions. Thus, stricter tax laws may require fund managers to adopt more rigorous compliance practices and demonstrate substance in their operations.

From the analysis of the above-mentioned points, the need for agility, adaptability, and a proactive approach to go through changing regulations, seize opportunities for optimization, and uphold transparency and compliance standards may arise new challenges for fund managers and tax advisors. However, as a forward-looking perspective on the future of international tax planning in the field of investment funds, further technological developments and digitalization of financial services will enable fund managers to leverage sophisticated tools and data analytics to set-up structures that optimize tax efficiencies, streamline compliance processes, and enhance transparency in cross-border transactions.

Summary – German version

In einer zunehmend vernetzten Weltwirtschaft hat die Fondsbranche in den letzten Jahrzehnten ein bemerkenswertes Wachstum erlebt und ist ein wichtiges Instrument für Anleger, die von verschiedenen finanziellen Möglichkeiten profitieren wollen. Insbesondere Luxemburg hat sich zu einer führenden europäischen Drehscheibe für Investmentfonds entwickelt und sich als globales Finanzzentrum positioniert, indem es einen beträchtlichen weltweiten Kapitalzufluss von Investoren anzieht.

Da die meisten Investitionen grenzüberschreitend getätigt werden, ist die wirksame Umsetzung internationaler Steuerplanungsstrategien für Investmentfondsmanager unerlässlich. Daher bietet diese Arbeit eine umfassende Analyse der wichtigen Rolle, die die internationale Steuerplanung für das reibungslose Funktionieren und den nachhaltigen Erfolg von Investmentfonds spielt, und konzentriert sich dabei auf den spezifischen Gerichtsstand Luxemburg.

Steuerstrategien, die von Fondsmanagern eingesetzt werden, um die Steuereffizienz zu optimieren, Risiken zu mindern und die Gesamtanlagerendite zu erhöhen, fallen in den Bereich der internationalen Steuerplanung. Die in diesem Papier durchgeführte Analyse der nationalen und internationalen gesetzlichen Bestimmungen, der verschiedenen verfügbaren Fondsvehikel, der Anwendung von Doppelbesteuerungsabkommen und des internationalen Steuerrechts gibt einen Überblick über die wichtige Rolle, die internationale Steuerplanungsstrategien in der Fondsbranche spielen.

Darüber hinaus zeigt die Untersuchung des vorgeschlagenen realen Szenarios, wie Operationen und Transaktionen gut strukturiert sein müssen, um sowohl mit den kommerziellen Zielen als auch mit den Anforderungen des regulatorischen Rahmens und der Steuerbehörden in Einklang zu stehen.

Die sich ständig ändernden Praktiken von Unternehmen bei der Anwendung von Steuerplanungsstrategien haben jedoch Regierungen und supranationale Organisationen dazu veranlasst, die Steuervermeidung zu bekämpfen und weitere Vorschriften zu entwickeln, die die Transparenz zwischen den verschiedenen Rechtsordnungen fördern. So können strengere Steuergesetze von den Fondsmanagern verlangen, dass sie strengere Compliance-Praktiken anwenden und Substanz in ihren Geschäften nachweisen.

Aus der Analyse der oben genannten Punkte ergibt sich, dass die Notwendigkeit von Agilität, Anpassungsfähigkeit und eines proaktiven Ansatzes, um sich ändernde Vorschriften zu berücksichtigen, Optimierungsmöglichkeiten zu nutzen und Transparenz- und Compliance-Standards aufrechtzuerhalten, neue Herausforderungen für Fondsmanager und Steuerberater darstellen kann. Ein Ausblick auf die Zukunft der internationalen Steuerplanung im Bereich der Investmentfonds zeigt jedoch, dass weitere technologische Entwicklungen und die Digitalisierung von Finanzdienstleistungen es Fondsmanagern ermöglichen werden, hochentwickelte Tools und Datenanalysen zu nutzen, um Strukturen zu schaffen, die die Steuereffizienz optimieren, Compliance-Prozesse rationalisieren und die Transparenz bei grenzüberschreitenden Transaktionen erhöhen.