

TAX NEWS:

LUXEMBOURG LAW DATED DECEMBER 5, 2007: IMPLEMENTATION OF THE EU MERGER DIRECTIVE 2005/19/EC (THE “SECOND MERGER DIRECTIVE”)

The Luxembourg Law dated December 5, 2007 (adopting the bill 5708) (the “**Law**”) aims primarily at implementing (a) the EU Merger Directive 2005/19/EC (the “Second Merger Directive” revising the EU Directive 90/434/EEC (both referred to as the “Merger Directive”) on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States) and (b) the EU Directive 2006/98/EC (adapting certain Directives in the field of taxation, by reason of the accession of Bulgaria and Romania).

Implementation of the Second Merger Directive

Broadly speaking, the Merger Directive sets forth a system of deferral of the taxation of the capital gains relating to the assets transferred upon mergers, divisions, transfers of assets and exchanges of shares until their actual disposal, thus permitting exemption from taxation of the corresponding capital gains (the “**Merger Regime**”).

Luxembourg, having already implemented some of its provisions, the implementation by the Law of the Second Merger Directive results in the following:

- Extension of the Merger Regime to European companies (SE) and European cooperative companies (SCE);
- Amendment to the Luxembourg “entity classification” rules: any entity covered by article 3 of the amended EU directive 90/434/EEC is now considered as non transparent for all relevant Luxembourg tax purposes (article 175 LIR and § 11bis StAnpG). A similar provision had already been introduced by Law dated November 17, 2006 for entities covered by article 2 of the EU Parent-Subsidiary. For entities which are not covered by article 3 of the EU Merger Directive or by article 2 of the EU Parent-Subsidiary Directive, the general entity classification rules (i.e., classification of foreign entities on the basis of a comparison of their legal features with Luxembourg entities) remain applicable;
- Reduction of the minimum threshold from 25% to 10% required from the absorbing company to benefit from the exemption of capital gains on shares it holds in the absorbed company (article 171, (3) LIR).

Implementation of the EU directive 2006/98/EC

The EU Directive 2006/98/EC adapts certain Directives, inter alia the EU Parent-Subsidiary Directive, the Merger Directive and the EU Savings Directive, by reason of the accession of Bulgaria and Romania to the EU. The Law implements the EU Directive 2006/98/EC by extending the scope of the Luxembourg domestic tax provisions related to the Merger Regime, the Parent-Subsidiary Regime and the EU Saving Directive to Bulgaria and Romania.

Other tax measures

The Law introduces the following other salient tax measures:

- Extension of the Merger Regime and the Parent-Subsidiary regime to capital companies or cooperative companies resident in a country of the European Economic Area other than EU Member States (i.e. Liechtenstein, Norway and Iceland), provided

they are subject to a tax comparable to the Luxembourg corporate income tax, i.e., a corporate income tax levied in their country of residence at a rate of at least 11% on a tax basis which is comparable to the tax basis determined under Luxembourg rules;

- Change of the criteria used to determine the tax residence of a company: the criteria of “principal establishment” is replaced by the criteria of “central administration”; however, this change should in principle not have any consequences, as it is only aimed at bringing the Luxembourg income tax law in line with the Luxembourg Law of 10th August, 1915 on commercial companies (article 159 of the Luxembourg income tax law);
- The activity of Luxembourg capital companies, cooperatives and mutual insurance associations will automatically be considered as a commercial activity, the real purpose of the entity being insignificant: this provision brings the Luxembourg income tax law in line with the existing case-law and legal doctrine according to which capital companies are deemed to be engaged in a business (article 162 LIR).

Most of the abovementioned measures will have retroactive effect as from tax year 2007.

The above is for information purposes only and does not constitute nor can it be relied upon as binding legal advice. Before implementing a transaction on the basis of the above it is highly recommended to seek detailed advice.