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The use of corporate tax losses and the concept of abuse of law: The Administrative Court restores much needed legal certainty

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01 INTRODUCTION

On 30 March 2023, the Luxembourg Administrative Tribunal (*Tribunal Administratif*, the "**Tribunal**", which is the first instance jurisdiction) held its decision in a case that concerns the use of corporate tax losses by a Luxembourg company ("**LuxCo**").[1]

LuxCo incurred its tax losses when it was a holding company and intended to use these losses, following several years of being dormant, to offset a capital gain realised upon disposal of a Luxembourg real estate property.

The Luxembourg tax authorities ("**LTA**") challenged the use of the tax losses based on the abuse of law provision provided in § 6 of the Tax Adaptation Law (*Steueranpassungsgesetz* or "**StAnpG**"). The Tribunal followed the decision of the LTA and rejected the use of the tax losses.

On 25 April 2024, the Administrative Court (the "**Court**") overturned the decision of the Tribunal. The Court disagreed with the Tribunal's decision that the use of tax losses carried forward from the taxpayer's previous shareholding activities to offset a capital gain realised on the sale of a Luxembourg real estate property constituted an abuse of law.

02 FACT PATTERN OF THE CASE

A Luxembourg public limited company (*société anonyme, S.A.*) company ("**LuxCo**") was incorporated on 14 January 2000, with the purpose of holding participations. LuxCo was never part of a fiscal unity and, crucially, has had a stable shareholder base since 2001 (i.e. the shares of LuxCo have been owned by a Luxembourg resident individual since 2001).

The object of LuxCo was defined very broadly in the LuxCo's bylaws which state that "*the company may carry out all commercial, industrial or financial transactions, as well as all transfers of real or personal property. The company's object is also to carry out all operations relating directly or indirectly to the acquisition of participations in any form whatsoever, in any company, as well as the administration, management, control and development of these participations. In particular, it may use its funds for the creation, management, development and liquidation of a portfolio consisting of all securities and patents of any origin, participate in the creation, development and control of any company, acquire by way of contribution, subscription, underwriting or purchase option and in any other way, all securities and patents, realise them by way of sale, transfer, exchange or otherwise, have these businesses and patents developed, and grant to the companies in which it is interested all assistance, loans, advances or guarantees*". In practice LuxCo mainly performed holding activities until 2008.

From 2009 until 2013, LuxCo ceased its previous activity as a holding company and did not dispose of any corporate assets of significant economic value (i.e. LuxCo was a dormant company during that period).

On 12 May 2014, LuxCo acquired an immovable property situated in Luxembourg that was resold on 31 October 2014, i.e. less than six months later. LuxCo realised a significant capital gain (circa 80% of the acquisition costs) on its investment which was included as income in the company's 2014 corporate tax return. However, LuxCo's taxable income was offset by tax losses carried forward from the time LuxCo performed holding activities. In 2014, LuxCo indicated a change of its activity from the "holding of shares" to the "management/trade of real estate" in its financial statements and its corporate tax returns.

The LTA denied the deductibility of LuxCo's tax losses, arguing that the conditions of the abuse of law provision were met.

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[1] Administrative Tribunal, Decision No. 45984 of 30.3.2023.

Following the real estate transaction in 2014, LuxCo did not perform any further activities. According to the representants of the company this was due to the uncertainty created by the LTA through the challenge of the tax loss carry-forward.

The tax authorities denied the use of losses carried forward by arguing that the change of the LuxCo corporate object (from "holding activities" to "property management") was made only with the aim of avoiding taxation of the profits and the use of the tax losses carried forward in the case at hand was an abuse of law based on the § 6 StAnpG.

03 DECISION OF THE TRIBUNAL

In a first instance, the Tribunal concluded that all the conditions of the abuse of law under §6 StAnpG. (as applicable in fiscal year 2014) were met. The Tribunal based its decision on the following elements:

- LuxCo undisputedly ceased all activity from 2009 to 2013 and did not have any assets of significant economic value at its disposal during that period.
- LuxCo was "reactivated" in 2014 for acquiring and selling a Luxembourg real estate property within a period of less than six months.
- LuxCo was initially established for performing holding activities, not for investing into real estate (i.e. no real estate investment has been made since its incorporation in 2000 until 2014).
- The use of tax losses allowed LuxCo to substantially reduce the tax burden in relation to the capital gain through a deduction of the operating losses carried forward from previous years.
- It is assumed that LuxCO was only "reactivated" in 2014 for the purpose of carrying out the real estate investment.
- LuxCo is ultimately owned and controlled by a Luxembourg resident individual who is the actual beneficiary of LuxCo who derives a tax advantage from carrying out this very profitable real estate transaction through LuxCo (that has sufficient tax losses to offset the capital gains). The Tribunal highlighted that the speculative capital gain, had it been realised directly by the shareholder, would have resulted in a tax liability.
- The Tribunal considered that there was sufficient evidence that the legal and tax personality of LuxCo was used solely to benefit from its tax loss carry-forward and to reduce the tax that would otherwise have been payable on such a transaction.

Consequently, the Tribunal held that LuxCo's tax loss carry-forward was not available to compensate the capital gain realised upon disposal of the Luxembourg real estate property because the transactions carried out by LuxCo constitute an abuse of law and that these transactions are not motivated by considerations other than fiscal ones.

04 DECISION OF THE COURT

The Administrative Court overturned the Tribunal's decision and ruled in favour of the taxpayer.

According to the Court, it is not an abuse of law for a company to offset taxable income against tax losses realised in the past in connection with another business activity, irrespective of whether the company has been dormant for some time.

The Court points out that Article 114 of the Luxembourg Income Tax Law ("**LITL**") does not make the right to carry forward losses subject to the existence of identity of the company in terms of economic criteria such as the pursuit of the same economic activity.

Moreover, neither Article 114 of the LITL nor the underlying rationale supports the conclusion that the legislator intended to make the availability of a company's tax loss carry-forward dependent on the company's identity based on economic criteria.

Similarly, Title II of the LITL (tax provisions applicable to entities subject to corporate income tax) does not contain an explicit provision requiring the maintenance of an economic identity within a company as a condition for the deduction of tax losses from previous fiscal years.

The Court thus states that "*the taxpayer is the company and the right to carry forward losses within a company is determined solely by its status as a company under company law and by the legal identity of the corporate body*". On the basis of the facts of the case, the Court therefore concludes that LuxCo satisfies the requirement of the personal nature of the right to carry forward the losses in question under Article 114 of the LITL.

The Court also held that the absence of a clear tax rule requiring economic identity does not automatically and universally preclude an economic assessment of a particular transaction in order to determine whether it constitutes an abuse of law.

An abuse of law within the meaning of Section 6 StAnpG is to be assumed in particular if the legal and tax personality of the company is used for the sole purpose of circumventing the personal nature of the right to carry forward losses and the resulting prohibition of a transfer of such losses for the sole purpose of avoiding taxation of the related profits.

However, in the present case, the Court notes that it is not disputed that, from the time of its creation in 2000 until 2014, LuxCo's shareholding did not change either in its majority or in its entirety.

In addition, the Court recognises that a corporate taxpayer who has incurred losses in connection with a particular activity must be allowed to cease that activity, to dispose of the assets associated with it and to redirect its business towards another activity which it considers likely to generate positive income.

Consequently, although it is true that LuxCo indicated 'acquisition of shareholdings' as the object of its business in its tax returns for the years 2000 to 2013 and that, in view of the acquisition and resale of a property in 2014, it indicated 'property management' as the object of its business in its tax return for the year 2014, this particular change of activity cannot be considered an inappropriate way of continuing to benefit from the right to carry forward previous losses.

Furthermore, the analysis is not affected by the fact that LuxCo was a 'dormant' company with no significant corporate assets from 2009 to 2013 and that in 2014 it carried out a single real estate transaction, involving an agreement to sell a building even before it was purchased, resulting in a significant profit, despite the fact that it had never 'positioned itself as an economic actor in the eyes of the general public' in the real estate sector.

According to the Court, individuals are free to engage in self-employment or to carry out certain transactions through an opaque company. This does not in itself indicate an inappropriate route and taxpayers are free to choose the least taxed route.

On this basis, the Court concluded that, in the circumstances of the case, LuxCo's acquisition of the property and its subsequent resale should be regarded as falling within the freedom to choose the least taxed route. Therefore, LuxCo cannot be considered to have taken an inappropriate route and the relevant abuse of rights criterion is therefore not met in this case.

The decision overturns the decision of the Tribunal, which upheld the position of the LTA (i.e. the LTA considered the use of the tax loss carry-forward to be an abuse of the law, as LuxCo's activity had changed).

05 CONCLUSION

The use of tax losses is a fundamental feature of the Luxembourg (corporate) tax system and the deductibility of tax losses can only be challenged in exceptional cases. In this respect, established Luxembourg and German case law has provided a clear framework for interpreting the concept of abuse of law in the event of a change in the majority, if not all, of the shares of a Luxembourg company with tax losses.

Here, the Tribunal's decision has created massive legal uncertainty by contradicting established case law. The issue of tax losses is already an area of concern for many, as tax losses can only be considered final in the tax year in which they are used to offset taxable income (and accepted by the LTA).

Ultimately, the Administrative Court reaffirms the legal certainty of the use of corporate tax losses by a Luxembourg company.

06 APPENDIX: THE MANTELKAUF JURISPRUDENCE

In this appendix, the authors summarise the relevant Luxembourg and German case law regarding the Mantelkauf jurisprudence as well as the Tax Circular that has been issued by the LTA following a decision of the Administrative Court of 15 July 2010.

6.1. Opening comments

"*Mantelkauf*" is a term that refers to the acquisition of a dormant company that owns no valuable assets but its tax loss carry-forward.

The "*Mantelkauf*" jurisprudence is German case law that specifically dealt with the potential application of the abuse of law provision when a dormant company (with tax losses) is transferred to a third party. As such, the "*Mantelkauf*" jurisprudence defines the scope of application of the abuse of law provision in case of corporate tax losses.

Back in 2009 and 2010, the Luxembourg Courts also had to decide in a case that concerned the use of corporate tax losses following a change in shareholders. The German and Luxembourg jurisprudence is analysed below.

6.2. Relevant German case law

6.2.1. Main issues

The fundamental principle governing tax losses is that they may only be deducted from the taxable income of the taxpayer that actually incurred them (*Grundsatz der Personenidentität*).[2] In case of corporate tax losses, this should be verified by reference to the company's legal identity (*rechtliche Identität*) and economic identity (*wirtschaftliche Identität*).[3]

The foundations for the application of this principle lay within case law modelled through the years by the German Reich Tax Court (Reichsfinanzhof) and the German Federal Tax Court (*Bundesfinannzhof*) relating to the so-called "*Mantelkauf*" (that is the acquisition of a dormant company with tax losses).

Based on this jurisprudence, the deductibility of tax losses carried forward may be denied on grounds of the economic approach[4] (*wirtschaftliche Betrachtungsweise*) or the abuse of law provision (*Gestaltungsmissbrauch*) should most, if not all, of the shares of a company be transferred and the economic identity be lost.[5]

Given that the economic approach and the abuse of law provision under Luxembourg tax law are similar to the relevant provisions under German tax law (at the time of the decisions), this case law should be taken into consideration in Luxembourg.

6.2.2. Legal identity

The legal identity is linked to the company's legal personality that is determined by reference to formal criteria set out under company law. The deduction of tax losses generally requires the legal identity between the company which incurred the tax losses and the company which deducts them. The legal personality of a company is lost in case of liquidation.

The conversion of a company's legal form should not affect its legal identity provided that the new legal form remains that of a company

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[2] Article 114 (2) No. 3 LITL; BFH, Decision of 8.1.1958, I 131/57 U, BStBl III 1958, p. 97.

[3] BFH, Decision of 8.1.1958, I 131/57 U, BStBl III 1958, p. 97; BFH, Decision of 15.2.1966, I 112/63, BFHE 85, 217, BStBl III 1966; BFH, Decision of 17.5.1966 I 141/63, BFHE 86, 369, BStBl III 1966, 513, this decision has been confirmed by the German Federal Constitutional Court, BVerfG, Decision of 26.3.1969, 1 BvR 512/66, BStBl II 1969, p. 331; BFH, Decision of 19.12.1973, I R 137/71, BFHE 111, 155, BStBl II 1974, 181;

[4] The economic approach (*wirtschaftliche Betrachtungsweise*) is at large comparable to the substance over form principle.

[5] BFH, Decision of 8.1.1958, I 131/57 U, BStBl III 1958, p. 97; BFH, Decision of 15.2.1966, I 112/63, BFHE 85, 217, BStBl III 1966; Case-law based on § 10d Einkommensteuergesetz (EStG), to be read in parallel to Article 114 LITL; a mere change in indirect shareholders should not suffice for the denial of tax losses carried forward.

(e.g. conversion of a S.à r.l. into a S.A.).[6] When the conversion is made in a tax-neutral manner, tax losses should remain available.[7]

When companies are merged, tax losses carried forward by absorbed companies may not be transferred to the absorbing company. Tax losses of absorbed companies may, however, offset income realised upon their deemed liquidation (i.e. when latent capital gains are disclosed).

6.2.3. Economic identity

While the determination of a company's legal identity is straightforward, that of its economic identity may give rise to some difficulties and remains obscure to many.

The economic approach may justify the denial of the economic identity of a company where its business activity is fundamentally changed following a transfer of most, if not all, of its shares. Alternatively, tax losses may exceptionally be disregarded on grounds of the abuse of law provision[8] to avoid corporate tax losses from being traded through the sale of dormant companies for tax saving purposes.[9]

A sound understanding of these exceptional cases requires a close examination of relevant German case law. In two major cases before German courts,[10] the companies involved had performed insignificant or no economic activity before the change in shareholder. Their sole "asset" comprised tax losses carried forward. Following a transfer of the companies' shares, the companies have been newly funded, and their purpose and seat changed in the Articles of Incorporation (one of the companies even had its name changed). It was upheld that the new shareholders only intended to acquire the companies to benefit from the existing tax loss carry-forward.

The German Federal Tax Court regularly remained in-line with these two decisions.[11] However, in 1986 the German Federal Tax Court held that solely the legal identity would have to be considered for the deduction of tax losses.[12]

The German legislator reacted to this change through the introduction of a specific anti-abuse rule that restricted the availability of tax losses following a change in shareholders as from 1990.[13] These rules have been further tightened over the last decades.[14] Notably, in the absence of a change in shareholders, corporate tax losses remain available under German tax law.[15]

A mere transfer of shares in a company should not impact the availability of the company's tax loss carry-forward. Likewise, a change in indirect shareholders or a transfer of a company within a group of companies (under the same ultimate parent company) should not suffice for the denial of the economic identity in accordance with the aforementioned case law.

6.2.4. Summary

Tax losses generally remain tax deductible despite a change in shareholders. Only in "exceptional" circumstances where a company's business is fundamentally changed following a transfer of most, if not all, of its shares, may a different tax treatment be justified on grounds of the economic approach or the abuse of law provision.

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[6] BFH, Decision of 27.3.1996, I R 112/95, BStBl II 1996, p. 480; BFH, Decision of 27.10.1994, I R 60/94, BStBl II 1995, p. 326.

[7] Article 170 (2) LITL in connection with Article 172bis (1) LITL; if the conversion is not made in a tax-neutral manner, the tax losses may be used to offset the latent capital gains realised upon conversion.

[8] § 6 StAnpG.

[9] Woeste, Karlfriedrich: "Erwerb eines Gesellschaftsmantels mit Verlustvortrag", GmbHR 1958, p. 161; BFH, Decision of 8.1.1958, I 131/57 U, BStBl III 1958, p. 97; BFH, Decision of 15.2.1966, I 112/63, BStBl III 1966, p. 289.

[10] BFH, Decision of 8.1.1958, I 131/57 U, BStBl III 1958, p. 97; BFH, Decision of 15.2.1966, I 112/63, BFHE 85, 217, BStBl III 1966.

[11] BFH, Decision of 17.5.1966, I 141/63, BStBl II 1966, p. 513; BFH, Decision of 19.12.1973, I R 137/71, BStBl II 1974, p. 181.

[12] BFH, Decision of 29.10.1986, I R 318-319/83, BStBl II 1987, p. 310; BFH, Decision of 29.10.1986, I R 202/82, BStBl II 1987, p. 308.

[13] § 8 (4) KStG.

[14] § 8 (4) KStG has been replaced in 2008 by a new § 8c KStG that provides for detailed rules on the denial of a company's tax loss carry-forward in case of a change in shareholders.

[15] The anti-abuse provision provided under § 8c KStG (resulting in a denial of a company's tax loss carry-forward) generally only applies if at least 50% of the shares in a company are transferred.

The German Federal Tax Court restricted the non-recognition of tax losses to exceptional cases for the avoidance of legal uncertainty.[16]

The possible loss of a company's economic identity (e.g. following a restructuring) must be carefully monitored in complex cases, and genuine economic reasons for the transfer of shares should be established. At the very least, genuine economic reasons may prove that the (third) parties did not aim at solely trading a company's tax loss carry-forward.

Nevertheless, absent a change in shareholders, the deductibility of tax losses may not be denied irrespective of a business restructuring or a complete change of the business activities. This may include the transfer of a profitable commercial business by an individual shareholder to the company or the allocation of additional functions, risks and/or assets in the context of multinational groups.[17]

6.3. Relevant Luxembourg case law

6.3.1. Opening comments

Apart from the German "*Mantelkauf*" jurisprudence, the Luxembourg Courts had in 2009 and 2010 to deal with a case that concerned the availability of a company's tax loss carry-forward following a transfer of all its shares, accompanied by a business restructuring. The decisions of the Administrative Tribunal and the Administrative Court are analysed below.

6.3.2. Fact pattern

A Luxembourg company (here, a public house) had incurred tax losses in 1995 and 1996. Following the transfer of all the shares to a new shareholder in 1998, the company's activities extended to heating, ventilation and air conditioning.

The LTA considered the company's economic identity lost and denied the availability of tax losses incurred in 1995 and 1996 (prior to the change in shareholder) because of (i) a transfer of all the shares to a new shareholder, and (ii) a fundamental change in activity. The LTA thereby remained in line with the original "*Mantelkauf*" jurisprudence and the economic approach.[18]

Undisputedly, the company's legal identity had survived. However, the LTA claimed that the new shareholder had bought shares in an "empty shell" company with tax losses relating to a previous activity as a public house. In light of the economic approach, the LTA considered the company newly created and disallowed the deductibility of previously incurred tax losses. They further argued that the company did not perform significant business activities anymore before the change of shareholders.

6.3.3. Decision of the Administrative Tribunal

On 6 July 2009, the Tribunal reversed the LTA's position and held that the company's tax loss carry-forward should remain available.[19] The Tribunal acknowledged the overarching principle that tax losses may only be deducted from the taxable income of the taxpayer that actually incurred them[20] but adhered to a strict interpretation of Luxembourg tax law.

Notably, the Tribunal held that a change of economic identity is no reason for the denial of a company's tax loss carry-forward. Rather, as long as the legal identity of the company incurring tax losses and the company deducting them is the same, tax losses should remain available. Accordingly, the relevant standard for the deductibility of corporate tax losses shifted from the economic identity to the legal identity.

As a company's legal identity is linked to its legal personality under Luxembourg company law, the Tribunal held that the legal identity test was satisfied and thereby rendered available the tax loss carry-forward incurred prior to the change in shareholder.

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[16] BFH, Decision of 8.1.1958, I 131/57 U, BStBl III 1958, p. 97.

[17] BFH, Decision of 15.2.1966, I 112/63, BStBl III 1966, p. 289.

[18] § 1 (2) StAnpG.

[19] Administrative Tribunal, Decision of 6.7.2009, No. 23982.

[20] Article 114 (2) No. 3 LITL applicable to companies via Article 162 (1) LITL.

6.3.4. Decision of the Administrative Court

Further to an appeal against the decision of 6 July 2009, the Administrative Court confirmed to a large extent the decision of the Tribunal.[21]

In its decision, the Court reiterated that inter-periodical loss utilisation is a necessary component of a fair tax system ensuring taxation in accordance with the "ability to pay" principle. Effectively, the taxable income of Luxembourg companies is determined separately for each fiscal year. Should taxpayers realise losses in one year and profits in another, their tax burden should be mitigated through the deduction of previous losses in a profitable year.[22]

While it has been stated that tax losses may only be deducted from the taxable income of the company that actually incurred them, the Administrative Court acknowledged that the legal identity should generally suffice. According to the Court, the economic identity requirement could be deduced neither from the text of the Luxembourg tax law nor from the parliamentary documents relating thereto.

However, the Administrative Court held that tax losses may in exceptional circumstances be disregarded on grounds of abuse of law[23] to avoid the trade of a company's tax loss carry-forward.

The Administrative Court considered an abuse of law to be present in the following circumstances:
(i) the shares of a Luxembourg company are sold to new shareholders; and
(ii) upon disposal, the company has no assets with significant economic value (i.e. its sole "asset" is the tax loss carry-forward); and
(iii) the company ceases its previous (loss generating) activity following the transfer of the company's shares; and
(iv) exercises subsequently a completely different and profitable activity.

Thus, the deductibility of tax losses may be denied where the new shareholder(s) merely acquired the company to benefit from the existing tax loss carry-forward. The burden of proof for an abuse of law lies with the LTA.

6.3.5. Summary

The decision of the Administrative Court of 15 July 2010 clarifies that tax losses should generally remain deductible regardless of a change in shareholders. Only in "exceptional" circumstances, where a company's business is fundamentally changed following a transfer of most, if not all, of its shares, may a different tax treatment be justified based on the abuse of law provision.

However, the trading of "empty shell" loss companies for tax saving purposes is not permissible. Therefore, when the shares of loss generating companies are transferred, genuine economic reasons should be established to demonstrate that the trading of the company's tax loss carry-forward was not the parties' sole purpose.

6.4. Tax Circular released in response to the decision of the Administrative Court

Following the decision of the Administrative Court[24], the LTA released a Tax Circular that provides guidance on when the availability of a company's tax loss carry-forward may be challenged.[25]

The Circular starts from the basic premise that the Administrative Court confirmed that tax losses may be denied when the legal personality of the company is used for the sole purpose of circumventing the personal nature of the right to carry forward tax losses and the resulting prohibition of a transfer of tax losses solely for tax avoidance purposes.

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[21] Administrative Court, Decision of 15.7.2010, No. 25957.

[22] Art. 158 (2) LITL and Art. 163 (1) LITL.

[23] § 6 StAnpG.

[24] Administrative Court, Decision of 15.7.2010, No. 25957.

[25] Circular L.I.R. n° 114/2 of 2 September 2010.

The Circular further repeats a key statement of the decision of the Administrative Court that reads as follows: "*The circumstances in which the tax loss carry-forward is claimed by a company that has ceased its previous activity and no longer has assets of relevant economic value, that the shares of this company have been transferred to new shareholders and that this company then carries out an entirely different activity (possibly already prior to the new shareholders) and that it is profitable, must be qualified as evidence of the existence of an abuse of law.*" In these circumstances, the LTA consider that the tax loss carry-forward of a Luxembourg company should be refused in accordance with the abuse of law provision provided under § 6 StAnpG.

Based on the decision of the Administrative Court, the Circular provides for the following principles:

- the right to carry forward previous losses is not denied for the sole reason that a company's shareholder(s) change (either partially or completely) as long as the company continues its economic activities or extends its corporate purpose;
- the right to carry forward previous tax losses is denied if the LTA can conclude based on the facts and circumstances of the takeover of the loss-making company, such as:
  - the cessation of the previous activity that generated the losses,
  - the absence of corporate assets with economic value (i.e. the company is dormant when its shares are transferred),
  - the transfer of the company's shares with an almost simultaneous change of activity,

  that the takeover can be qualified as an abuse of law if it was carried out for the sole purpose of using the company's tax losses to offset future profits.

Hence, the Tax Circular only seeks to deny the availability of corporate tax losses in exceptional circumstances where it is clear from the facts and circumstances that the trading of the company's tax loss carry-forward was the sole purpose of the takeover. In the absence of a change in shareholder(s), there is no starting point for denying the deductibility of corporate tax losses.

6.5. Subsequent Luxembourg case law

Following the landmark decision of the Administrative Court in 2010, the Luxembourg Courts had to decide in another case concerning "*Mantelkauf*" back in 2015 and 2016.[26]

6.5.1. Fact pattern

In this case, all the shares of a Luxembourg dormant company (LuxCo) were acquired in 2006 by another Luxembourg company (LuxCo II). At the time of the acquisition, LuxCo had incurred more than 4 million Euro of tax losses in relation to real estate activities performed from 1992 until 2005.

LuxCo was incorporated in 1990. The purpose of LuxCo was "*the intermediation, acquisition and sale, the promotion, construction, development, rental and administration of all movable and immovable property located in the Grand Duchy of Luxembourg or abroad, as well as any commercial, industrial or financial operation, directly or indirectly, whether for its own account or for the account of third parties; the acquisition of participations, under whatever form whatsoever, in other Luxembourg or foreign companies, as well as the management, control and development of these participations; it may in particular acquire by way of contribution, subscription, option, purchase and in any other manner transferable securities of any kind and realize them by way of sale, transfer, exchange or otherwise*".

In 1991, LuxCo started its business activity with the acquisition of a Luxembourg real estate asset that was sold in 1995. LuxCo realised a loss on this sale that resulted in tax losses. Since then, LuxCo did not hold any tangible assets and, in the years 1999 until 2005, LuxCo's liabilities consisted of negative equity and small advances from shareholders.

Following the acquisition of LuxCo by LuxCo II, LuxCo started (in 2007) to charge commissions to another group company (Luxco III) for services provided in relation to important real estate transactions (as claimed by the taxpayer).

6.5.2. Decision of the Administrative Court

The LTA challenged the reality of the services provided and (1) refused the deduction of the commissions at the level of the paying group

[26] See Administrative Tribunal, 28.1.2015, No. 33982 and Administrative Court, 16.2.2016, No. 35978C; Administrative Tribunal, 28.1.2015, N° 33984 and Administrative Court, 16.2.2016, No. 35979C.

company (LuxCo III), (2) reduced the taxable basis of LuxCo by the amount of the commissions received and (3) denied the deduction of the tax losses carried forward by LuxCo. The Tribunal confirmed the position of the LTA based on § 5 (simulation) and § 6 (abuse of law) StAnpG.

The Administrative Court confirmed in two different decisions[27] the two judgments of the Tribunal (one dealing with the taxation of LuxCo and another one dealing with the taxation of Luxco III) and qualified the operations, taken as a whole (i.e. acquisition of the shares of LuxCo, related request to carry forward the tax losses of LuxCo, intra-group reinvoicing of services and deduction of the commissions at the level of LuxCo III) as an abuse of law within the meaning of § 6 StAnpG.

The decision of the Administrative Court was mainly based on the fact that LuxCo II decided to acquire shares in LuxCo, even though LuxCo did not perform any activity anymore, had neither staff available nor the infrastructure needed to perform real estate transactions and had a significant amount of tax loss carry-forward.

According to the Court, the acquisition of LuxCo was only motivated by the LuxCo's tax loss carry-forward and was, therefore, considered inappropriate. As far as the economic reasons of the transaction are concerned, the Administrative Court was not convinced by the arguments put forward by the taxpayer to evidence the reality of the services provided. The taxpayer also did not provide any supporting documentation to the Court in order to support its arguments.

The Court stated, in line with the Tax Circular LIR 114/2 of 2 September 2010, that independently of whether the legal identity of the person is maintained, "*an economic assessment of a concrete transaction cannot be excluded in order to verify whether it does not constitute an abuse of law within the meaning of § 6 StAnpG, the existence of which should be admitted in the event that the legal and tax personality of the company is used for the sole purpose of circumventing the personal nature of the right to carry-forward losses and the prohibition resulting therefrom of a transmission of said losses for the sole purpose of using the carry-forward of losses in order to avoid the taxation of the related profits*".

The Court added that even if taxpayers remain, in principle, free to choose the least taxed route, the path chosen will be considered as inappropriate if the economic objective achieved through this path in the given economic context is such that it allows obtaining a tax effect that the legislator cannot be considered to have intended to grant in the context of the application of a tax provision.

Finally, the Court referred to its previous decision of 2010 and reminded the circumstances in which the tax loss carry-forward can be denied. Accordingly, indices of the existence of an abuse of law include (i) a company ceased in the past its previous activity, (ii) the company had no longer any corporate asset of a relevant economic value, (iii) the shares of this company have been sold to new shareholders and (iv) the company subsequently carries out an entirely different and profitable activity (possibly already carried out at the level of the new partners).

6.5.3. Assessment

The two decisions of the Administrative Court concerned two tax aspects:

(i) The deductibility of the commissions at the level of LuxCo III and the taxation of these commissions at the level of LuxCo (which were linked to the analysis of the reality of the services provided by LuxCo to Luxco III) and;
(ii) The deductibility of the tax losses incurred by LuxCo prior to the transfer of its shares (which was linked to the acquisition of the shares of Luxco by Luxco II).

However, the Court, in the same way as the Tribunal, analysed these two aspects as a whole in order to assess whether all operations which took place, taken globally, were to be considered as an abuse of law.

Here, we will focus on the deductibility of the tax losses carried forward by LuxCo.

The deductibility of the tax loss carry-forward of LuxCo may be challenged on grounds of the abuse of law provision if the economic identity of LuxCo was lost.

[27] See Administrative, 16.2.2016, No. 35978C, as far as LuxCo is concerned and see Administrative Court, 16.2.2016, No. 35979C as far as LuxCo III is concerned.

When analysing the economic identity, the following facts and circumstances are key:

- All of the shares of LuxCo have been sold to a new shareholder (i.e. LuxCo II);
- LuxCo had no longer any corporate asset of relevant economic value at the moment of its takeover;
- LuxCo ceased its previous activities and seemed to have been inactive for several years prior to the transfer of its shares;
- Following the takeover of LuxCo, the latter performed a new, profitable activity (given that LuxCo had been dormant for several years, it can be assumed that the activities performed as from 2007 were new activities).

Based on the above and absent economic or other genuine reasons for the takeover of LuxCo, the availability of LuxCo's tax loss carry-forward may be challenged on grounds of the abuse of law provision given that the economic identity was lost and the trading of LuxCo's tax loss carry-forward seem to have been the only motivation for the transaction.

Prior results do not guarantee similar outcome. This publication was not designed to provide tax or legal advice and it does not substitute for the consultation with a tax or legal expert.

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