

## 7. LUXEMBOURG

### 7.1. General

The Luxembourgian Income Tax Act (memorial A No 76; respective valid version in *Le Code Fiscal Luxembourgeois Vol.II*) is based on the German Income Tax Act. The final withholding tax at source is provided for in Art 146 et seq. *Loi de l'Impôt sur le Revenu, L.I.R*, which states that domestic income from dividends, shares of profit, and bonds is subject to final withholding tax at source in addition to any additional tax it may be subject to depending on the amount of the profit distributions (of the borrower). Other domestic<sup>33</sup> earnings from equities, capital shares, participation certificates and shareholdings are also subject to final withholding tax<sup>34</sup>.

The final withholding tax at source in the amount of 20% is levied on income from capital assets, that is, domestic capital income from shareholdings (dividends). Interest income is subject to a 10% final withholding tax at source. In accordance with the EU Savings Tax Directive of 2005, the initial tax rate, which amounts to 15%, is progressively raised to 20% and 35%<sup>35</sup>. Profit distributions to holders of controlling equity stakes in a company are tax-exempt if this company is fully tax-liable and domiciled in Luxemburg and does not present the characteristics of a holding company.

The Luxembourgian foundation law is closely tied to the non-profit association (*association sans but lucratif*) law. The Act of 21 April 1928 for Associations and Foundations, hereafter "Foundation Act" (*Gesetz vom 21. April 1928 über die Vereine und die Stiftungen ohne Gewinnzweck*) was amended on 22 February 1984, on 4 March 1994, on 1 August 2001 and on 19 December 2002. Currently, approximately 150 foundations with legal personality exist in Luxembourg. The majority of these foundations are active in the areas of education and in social projects<sup>36</sup>. Pursuant to the will of the Luxembourgian legislators, the Belgian provisions concerning the application of the Foundation Act and Belgian case-law is also applicable to Luxembourg. Pursuant to Article 27 Foundation Act, a foundation must use its profits to pursue a philanthropic, social, religious, scientific, artistic, educational, athletic or touristic purpose. In contrast to Belgium, Luxembourg only recognises foundations that serve the public interest or so-called public utility purposes; there are no foundations for private benefit.

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<sup>33</sup> Domestic capital income is all earnings of a natural person domiciled in Luxembourg, a private company domiciled or headquartered in Luxembourg, or a Luxembourgian public corporation.

<sup>34</sup> Cf. Knist (1996), p. 17.

<sup>35</sup> Cf. Fort (2007), p. 32.

<sup>36</sup> Cf. Beissel/Gabriel (2007), p. 1140.

## **7.2. Establishment**

Pursuant to Art 27, anyone may use his assets, either in full or in part, to establish a foundation through a deed or testament and upon approval by Grand-Ducal Decree<sup>37</sup>. The certified declaration of foundation establishment is presented to the Ministry of Justice for approval. Upon receipt of the approval, the establishment is published in the Luxembourgian Official Gazette, the *Mémorial, Recueil des Sociétés et Associations*, and is also entered in the commercial and company register. Moreover, the members of the administrative board must present and publish the annual financial statements and a budget.

The administrative board constitutes the only statutory body of a foundation. The founders may determine the content of the foundation statutes. The foundation statutes include the use of the foundation's assets in the event of dissolution. The Foundation Act does not stipulate a minimum amount of capital; however, in general practice a minimum initial capital of EUR 25,000 is required. If the foundation statutes do not state otherwise, the foundation is established for an indeterminate period of time.

## **7.3. Existing foundation**

The exclusion of the aim to make profit does not mean that the foundation may not own any funds. Funds are required in particular for the pursuit of the set foundation purpose; also ancillary economic activity is permitted as a rule if the profits are exclusively used for the foundation purpose.<sup>38</sup> The foundation Act explicitly limits the ownership of real property; foundations may only own land or buildings insofar as these are required to achieve the foundation purpose.

Gifts may be made to a foundation during a person's lifetime (*inter vivos*) or upon death (*causa mortis*).

The Tax Act has not taken up the definition of "foundation" included in the Foundation Act. Art. 12 and 25 of the Corporation Tax Act stipulate that contributions in cash and in kind in the framework of the establishment of a foundation are exempt both from capital tax as well as from the registration fee. This is only valid in the case of legally recognised foundations in accordance with the Foundation Act.

Foundations are in principle liable to corporate income tax, wealth tax and trade income tax. Corporate tax exemptions exist for foundations directly performing church-related, charitable or public utility activities. The same requirements for exemption are also valid for wealth tax and trade income tax. As a general rule, only the income earned on commercial activity or assets is taxed, while the foundation in itself remains tax-exempt. This partial taxation only

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<sup>37</sup> Cf. *ibid.*, p 1142.

<sup>38</sup> Cf. *ibid.*, p. 1147.

applies if that the commercial activity is performed as on an ancillary basis; this means that the profits related to this activity may only be used to pursue the foundation purpose.

Thus, income from a business activity is subject to income taxation. The profit is determined by means of comparing the assets of a company in two subsequent years on the basis of the annual financial statements. Depreciations, amortisations and write-offs and provisions as well as operating expenses are deductible. Contributions out of tax-exempt private assets are deemed part of the foundation capital; however, the profit for tax purposes is reduced by the amount of such deposits. Conversely, so-called private withdrawals are to be added to the profits for tax purposes. Contributions as well as private withdrawals are to be stated with their current value on the respective date.

The assets used for the business activity are subject to wealth tax of 0.5%. For tax purposes, donations to foundations are treated as income (as described above). As a general rule, donations, gifts and contributions to foundations may not be deducted from taxable income. Pursuant to Art 109 Income Tax Act, however, these may be considered eligible for deduction as special expenses within the meaning of Art 112 Income Tax Act. Certified registered donations are subject to a register entry fee in the amount of 6 percent.

Payments by a foundation to a third party are subject to gift tax<sup>39</sup>.

#### **7.4. Alternatives to the foundation**

There are no special foundation forms in Luxembourg. Similar legal institutions exist, however, namely trusts and the Luxembourgian fiduciary contract (*contrat fiduciaire*). These legal entities may, in addition to public utility purposes, also serve purely financial or economic interests; thus, they are similar to a private law foundation, at least with regard to the purpose. Luxembourg has approved their legal recognition with its law of 27 July 2003.

In recognising these alternative forms, Luxembourg recognises in particular the dichotomy of the basis of ownership. The beneficiary (in most cases the founder of the trust) is granted rights which are similar to ownership rights; these rights stand independently and in addition to the ownership rights transferred to the trustee (the administrator of the trust). Thus, the beneficiary may for instance claim that a third person (with no ownership rights) or, in the event of solvency, the liquidator return the trust property to him. From a legal perspective, the trustee is treated as an owner; the trust assets and the private assets are considered as two separated properties.

In contrast to the trust, the trustor forfeits his basis of ownership in full in the case of a Luxembourgian fiduciary contract. The law exclusively applies to fiduciary contracts in which the

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<sup>39</sup> Cf. Fort (2007), p. 36 et seq.

trustee is a financial institution, a securities company, an investment company, a pension fund or an insurance enterprise. In Luxembourgian legal practice, however, the law also applies trustees that are natural persons.

Transfers of trust property without consideration are subject to gift tax; the applicable tax rate depends on the degree of relationship. No additional special regulations exist. If the founder of a trust or the trustor himself is the economic beneficiary of the trust/fiduciary contract, the profit is taxed at his level in accordance with fiscal transparency. In the case of a third-party beneficiary, taxations depends on the respective structure of the trust or fiduciary contract; here, the profit may be considered as an “independent legal estate” pursuant to Section 159 Income Tax Act and is then accordingly treated for tax purposes.<sup>40</sup>

### ***7.5. Dissolution***

If a foundation is no longer in a position to perform its purpose, its dissolution may be decided and a liquidator can be appointed. The liquidation proceeds are exempt from corporate tax. Dissolution profit from the foundation business activity is to be taxed pursuant to Article 55 et seq.

### ***7.6. International context***

Luxembourgian legislation applies, on the basis of French and Belgian law, the so-called company seat theory: Abroad-based foundations with legal capacity are recognised as legal persons also in Luxemburg. It is permissible to move a foundation’s seat from Luxemburg into another country.

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<sup>40</sup> Cf. Beissel/Gabriel (2007), p. 1159.