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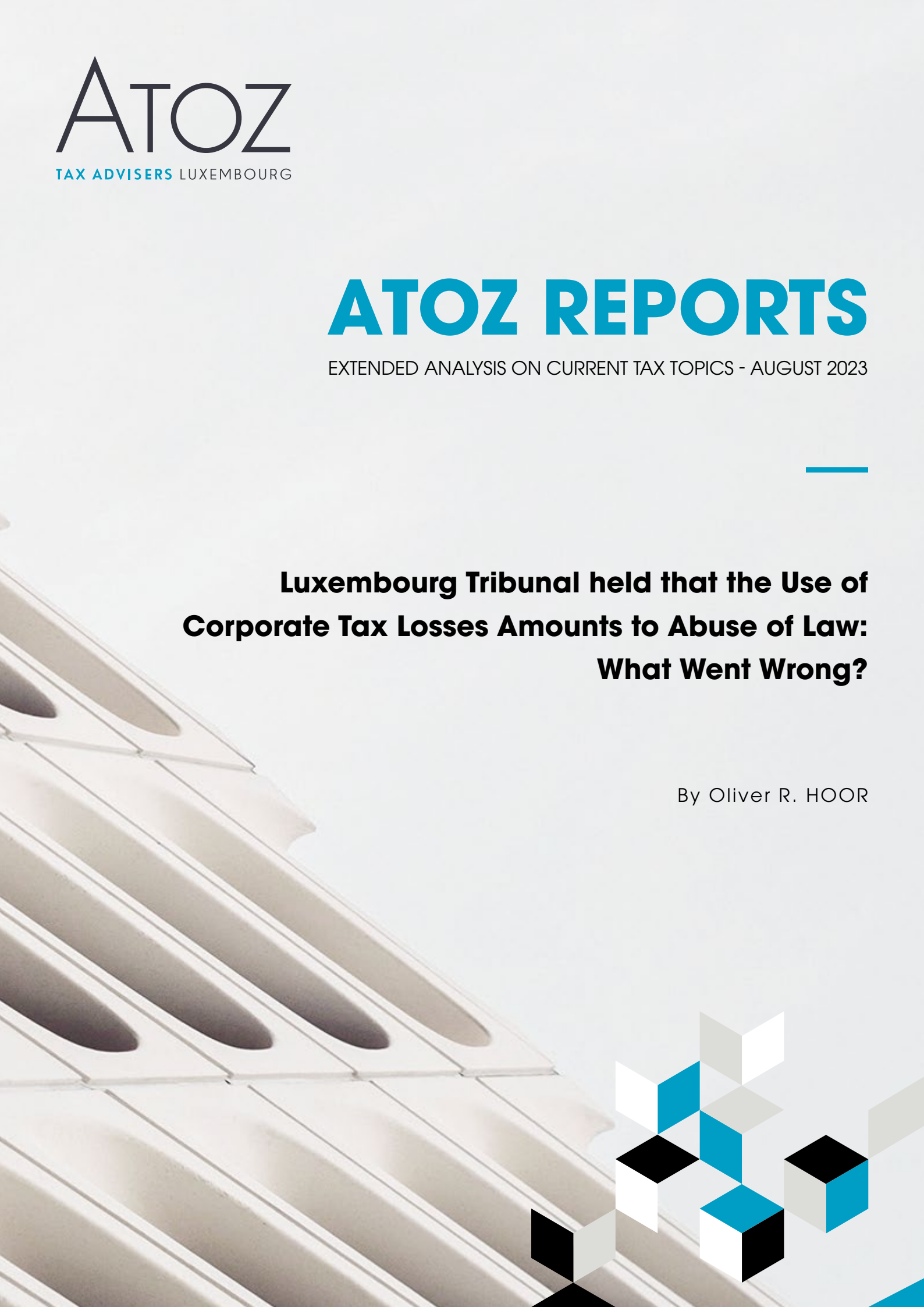
EXTENDED ANALYSIS ON CURRENT TAX TOPICS - AUGUST 2023

Luxembourg Tribunal held that the Use of Corporate Tax Losses Amounts to Abuse of Law: What Went Wrong?

By Oliver R. HOOR



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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 (the "**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.

The case further concerns the payment of (excessive) charges to a UK resident company for a mandate to find a buyer for the Luxembourg real estate property. As it seems that the UK company had some links to the shareholder of LuxCo, it is rather likely that the high level of fees paid by LuxCo entails an advantage that should be classified as a hidden dividend distribution. Therefore, this aspect of the Decision seems to be uncontroversial and will not be further analysed.

At the time this article was drafted, an appeal against the Decision had been filed with the Luxembourg Administrative Court (*Cour Administrative*, which is the second instance jurisdiction). As the use of corporate tax losses is a fundamental feature of the Luxembourg (corporate) tax system, the decision of the Administrative Court will be of utmost importance to restore legal certainty.

The question arises whether the LTA and the Tribunal were right when concluding that the use of tax losses by LuxCo was an abuse of law. This question is analysed in detail in this article.

02 FACT PATTERN OF THE CASE

LuxCo was incorporated on 14 January 2000 in the legal form of a public limited company (*société anonyme*, S.A.) for 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 company'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*". However, 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

1 Administrative Tribunal, Decision No. 45984 of 30.3.2023.

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.

Following the real estate transaction in 2014, LuxCo did not perform any further activities. This has been explained by the representants of the company with the uncertainty created by the LTA through the challenge of the tax loss carry-forward.

03 DECISION OF THE TRIBUNAL

The Tribunal had to decide whether LuxCo could use its tax loss carry-forward to offset the 2014 taxable income or whether the use of these tax losses was an abuse of law, as claimed by the LTA.

The abuse of law concept applies if four conditions are cumulatively met. The Tribunal analysed these conditions as follows:

a) Use of private law forms and institutions

The Tribunal agreed with the LTA that the first condition is satisfied since the purchase of a property by a company constitutes the use of forms and institutions of private law within the meaning of § 6 StAnpG.

The Tribunal further pointed out that LuxCo was undisputedly out of business from 2009 to 2013 and did not have any assets of significant economic value at its disposal during that period.

b) Tax saving resulting from the circumvention or reduction of the tax burden

According to the Tribunal, 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.

Here, the Tribunal reiterated that LuxCo ceased all activity between 2009 and 2013, and that the company was "reactivated" in 2014 when acquiring and selling a Luxembourg real estate property within a period of less than six months.

c) Use of an inappropriate path

The Tribunal stated that LuxCo indicated the "acquisition of participations" as the company's object in its corporate tax returns filed for the fiscal years 2000 to 2013. In 2014, when LuxCo acquired and sold the Luxembourg real estate asset, LuxCo declared "real estate management" as business purpose in its corporate tax return. Likewise, in the 2014 financial statements of LuxCo, it was stated that "the company's main object is the trading of real estate".

The Tribunal emphasised that it was not the initial intention of LuxCo to invest into real estate as no real estate investment had been made since its incorporation in 2000 until 2014. Given the facts and circumstances of the case, it was considered that LuxCo was established for performing holding activities, not for investing into real estate.

According to the Tribunal, it is settled case law that the application of the abuse of law requires an analysis of all the transactions carried out, and the individuals or legal entities involved, regardless of the question of which person is at the origin of the (potential) abuse of law.

The Tribunal considered that:

(i) the tax loss carry-forward was claimed by a company that ceased its previous activity from 2009 to 2014 and had, during that period, no corporate assets of significant value; and

(ii) there is every reason to believe that the company was only "reactivated" in 2014 for the purpose of carrying out the real estate investment.

On this basis, the Tribunal concluded that there is 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 have otherwise been incurred on such a transaction.

The Tribunal further reminded that 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.

d) Absence of valid non-tax reasons that could justify the chosen path

According to LuxCo, its shareholder intended to limit the "significant risks with regard to the work to be carried out and the uncertainty as to the possibility of finding a buyer at the desired price" by "reactivating" a dormant company to carry out the real estate investment.

However, the Tribunal found that these arguments were not sufficient to reverse the finding of the LTA's Director that the disputed transactions carried out by LuxCo constitute an abuse of law and that they are not motivated by considerations other than fiscal ones.

On this basis, the Tribunal concluded that all the conditions of the abuse of law provision (as applicable in fiscal year 2014) were met. Consequently, LuxCo's tax loss carry-forward was not available to compensate the capital gain realised upon disposal of the Luxembourg real estate property.

04 CRITICAL ANALYSIS OF THE DECISION

4.1. Overview

The review of the Decision requires a comprehensive analysis of (i) the rules applicable to corporate tax losses, (ii) the abuse of law provision and (iii) the so-called *Mantelkauf* jurisprudence that specifically deals with the application of the abuse of law provision in case of corporate tax losses. All these topics will be carefully analysed in the following sections.

4.2. Corporate tax losses

4.2.1. Opening comments

Companies that have their seat or place of effective management within the territory of Luxembourg are subject to corporate income tax [2] and municipal business tax[3] on their worldwide income.[4]

The taxable income of a Luxembourg company is determined for each fiscal year (*Abschnittsbesteuerung*).[5] A negative taxable income (or tax losses) may be carried forward and offset the taxable income realised by the company in subsequent fiscal years.

Inter-periodical loss utilisation is not a tax benefit but a necessary component of a fair tax system that ensures taxation in accordance with the "ability to pay" principle (*Leistungsfähigkeitsprinzip*). Therefore, the tax burden of taxpayers suffering tax losses should be mitigated through a deduction of these losses in future, profitable fiscal years.

4.2.2. Deductibility of corporate tax losses

The general rules governing the use of tax losses provided in Article 114 of the Luxembourg Income Tax Law ("**LITL**") also apply to Luxembourg corporate taxpayers.[6] While the carry forward of tax losses incurred as from 2017 is restricted to a period of 17 tax years, tax losses incurred before the fiscal year 2017 (like in the Decision) may be carried forward without limitation in time. A carry-back of tax losses is not possible.

The deduction of tax losses does not require a special request by the taxpayer and is considered automatically once the company realises taxable income in a subsequent fiscal year. The tax loss carry-forward may already be considered when assessing the company's advance tax payments.

The overarching principle governing tax losses is that they may only be deducted from the taxable income of the taxpayer that actually incurred them (*Grundsatz der Personenidentiät*). A transfer of tax losses (for example, to a shareholder or a subsidiary) is not possible.[7]

Crucially, all income realised by a Luxembourg company is deemed to be "commercial income" within the meaning of Article 14 LITL (i.e. the income is not segregated into different income categories).[8] Hence, tax losses incurred by a Luxembourg company may offset any taxable income which is not limited to income derived from the same activity. Tax losses incurred during the company's lifetime may also be used to offset latent capital gains realised upon (a deemed) liquidation.[9]

2 Article 159 (1) A No. 1 LITL.
3 § 2 (2) No. 2 GewStG.
4 Article 159 (2) LITL.
5 Article 158 (2) LITL and Article 163 (1) LITL.
6 Article 162 (1) LITL.
7 Article 114 (2) No. 3 LITL.
8 Article 10 No. 1 LITL, Article 162 (3) LITL.
9 Article 169 LITL.

4.2.3. Assessment of tax losses

The amount of tax losses indicated in a tax assessment does not bind the tax authorities in subsequent years. Instead, the amount of tax losses may only be considered final once the tax losses effectively offset taxable income. In other words, the LTA have the possibility to challenge the amount of available tax losses in the fiscal year in which these losses would otherwise be used to offset taxable income.[10]

The deduction of tax losses may not, however, be maliciously denied by the LTA. The rule by which "tax losses are final once they are deducted" is to be construed in a way that previous inaccuracies in the determination of tax losses may be rectified in the tax year in which tax losses are deducted (for example, when there was a mistake in the tax loss computation).

Nevertheless, the lack of a tax loss assessment in the fiscal year in which a company incurred the losses inserts some legal uncertainty as to the availability of these losses. This can make it difficult to forecast the future tax burden.

4.3. The concept of abuse of law

4.3.1. Opening comments

Taxpayers have far-reaching freedom regarding the structuring of their economic activities and investments. Here, the flexible and diverse Luxembourg legal framework provides for a multitude of options that may, quite naturally, result in different tax treatments. However, the freedom of taxpayers to structure their affairs finds its limits in the abuse of law provision.

According to § 6 (1) StAnpG (in its version in force before 2019[11]) "*the tax liability cannot be circumvented or reduced through the abuse of forms and structuring possibilities provided under civil law*". Thus, the abuse of law concept is a vague legal concept (*unbestimmter Rechtsbegriff*) that may apply when taxpayers take advantage of technicalities of (or loopholes in) tax law.

Paragraph 6 (2) StAnpG thereof further states that "*if there is an abuse, the taxes shall be levied as they would have been levied in case the appropriate legal pass had been chosen considering the economic transactions, facts and circumstances*".[12]

4.3.2. Application principles

Taxpayers may not circumvent a tax liability through the abuse of forms and structuring options under private law. Hence, the legal form chosen by the taxpayer must be abusive to be open to challenge by the LTA as an abuse of law.

In other words, the chosen legal form has to be clearly inappropriate in view of the economic facts and circumstances. This further implies that the tax treatment of the legal path chosen is inconsistent with the object or purpose of the tax law, and the intent of the legislator.

As a tendency, the more often a legal form can be witnessed in the market, the less likely a structuring option may be classified as an abuse of law. Nevertheless, even an unusual structuring option does not per se represent abuse.

When taxpayers have economic or other genuine reasons for the choice of a particular legal form, the presumption of an abuse of law is generally rebutted.[13]

Different legal forms and structuring options result in different tax consequences. As a principle, taxpayers are free to choose the

10 Administrative Tribunal, Decision of 21.9.2005, No. 20.376.; BFH, Decision of 17.3.1961, VI 67/60 U, BStBl III 1961, p. 427; BFH, Decision of 16.7.1964, V 92/61 S, BStBl 1964 III, p. 634; BFH, Decision of 12.1.1966, I 184/63, NJW 1966, p. 1536; whether the tax assessment of a fiscal year in which tax losses have been incurred may still be amended according to provisions of the General Tax Code (Abgabenordnung) is irrelevant.

11 With effect as from 1 January 2019, the Law of 21 December 2018 amended § 6 StAnpG in order to implement the General Anti-Abuse Rule ("**GAAR**") of Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (so-called Anti-Tax Avoidance Directive or "**ATAD**").

12 „§ 6 Steueranpassungsgesetz: (1) Durch Missbrauch von Formen und Gestaltungsmöglichkeiten des bürgerlichen Rechts kann die Steuerpflicht nicht umgangen oder gemindert werden. (2) Liegt ein Missbrauch vor, so sind die Steuern so zu erheben, wie sie bei einer den wirtschaftlichen Vorgängen, Tatsachen und Verhältnissen angemessenen rechtlichen Gestaltungen zu erheben wären."

13 See Reichsfinanzhof („RFH"), Decision of 28.5.29, Kartei AO Paragraph 5 R. 83; Bundesfinanzhof („BFH"), Decision of 9.12.1959, HFR 61, 34; see Dr. Rolf Kühn, Heinz Kutter, Dr. Ruth Hofmann, „Abgabenordnung, Finanzgerichtsordnung", 11. Auflage, 1974, Fachverlag für Wirtschafts- und Steuerrecht Schäffer & Co GmbH, p. 857.

structuring option that results in the lowest tax liability. This is consistent with the intention of the legislator that actively influences the decisions of taxpayers through its tax policy, providing taxpayers with different options to organise their affairs.[14]

Even structuring options that exclusively aim at obtaining a tax benefit do not per se amount to abuse of law. The intention of the taxpayer to reduce its tax liability through the choice of a legal option must be respected when the choice was within the freedom of the taxpayer (i.e. when it was not abusive).

The protection of the individual sphere of the taxpayer, the requirement that taxes are levied in accordance with the law (*Gesetzmäßigkeit der Besteuerung*) and the need for legal certainty require a restrictive interpretation of the abuse of law provision.

Notably, taxpayers do not commit a criminal offence regardless of how unusual or abusive the circumstances appear as long as the taxpayer discloses all information without hiding anything.

Last but not least, when applicable, the economic approach (*wirtschaftliche Betrachtungsweise*)[15] takes precedence over the application of the abuse of law concept.[16]

4.3.3. Characteristics of abuse of law

Based on Luxembourg case law[17], the following conditions must be cumulatively met in order to characterise a transaction as abusive within the meaning of § 6 StAnpG:

- The use of forms and structuring possibilities under private law (by reference to the forms and structuring options under private law, the abuse of law concept requires the use of legal acts or arrangements and does not include simple facts or actions);
- The reduction of a tax liability or the avoidance of a taxable event;
- The use of an inappropriate path[18]; and
- The absence of valid non-tax reasons (i.e. the structuring is exclusively motivated by tax reasons).[19]

The abuse of law concept aims to delineate the limits of legitimate tax planning within the legal framework and abusive tax avoidance. However, absent specific definitions, the application of this provision remains a bit of a grey area.

The following elements, constituting an abuse of law under Luxembourg tax law, must be cumulatively met.

a) The use of forms and institutions of law

According to § 6 StAnpG, taxable events may not be avoided through the use of forms and institutions of law. As such, "forms and institutions of law" is a very broad concept.

b) Circumvention or reduction of a tax liability

The abuse of law provision may only apply when taxpayers circumvent or reduce their tax burden. In other words, taxpayers obtain illegitimate tax savings through either reducing a tax liability or by way of circumventing the triggering of a taxable event. It is not necessary that the taxpayer itself benefits from the illegitimate tax saving; third parties may also fall within the scope of the abuse of law concept if there is a common interest or another relationship with the taxpayer. The tax savings may be achieved immediately or in the future.

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14 See BFH, Decision of 22.8.1951, BStBl. III p. 181; see Dr. Rolf Kühn, Heinz Kutter, Dr. Ruth Hofmann, „Abgabenordnung, Finanzgerichtsordnung", 11. Auflage, 1974, Fachverlag für Wirtschafts- und Steuerrecht Schäffer & Co GmbH, p. 857; in her opinion, Advocate General Kokott reminds that "taxpayers are even free to choose, within the bounds of the law, the fiscal arrangements that are most favourable to them"; see Opinion of the Advocate General Kokott, 4 May 2023, Case C-454/21 P, Case C-451/21 P, No. 149;

15 § 1 of the Tax Adaptation Law (Steueranpassungsgesetz).

16 See Dr. Rolf Kühn, Heinz Kutter, Dr. Ruth Hofmann, „Abgabenordnung, Finanzgerichtsordnung", 11. Auflage, 1974, Fachverlag für Wirtschafts- und Steuerrecht Schäffer & Co GmbH, p. 858.

17 See, for example, Administrative Court, 7.2.2013, no. 31320C; Administrative Court, 18.3.2014, no. 32984C; Administrative Tribunal, 14.1.2015, no. 33678; Administrative Court, 22.8.2012, No. 31320C; Administrative Tribunal, 21.5.2013, No. 31058; Administrative Tribunal, 29.1.2014, No. 32151, Administrative Court, 16.2.2016, No. 35978C; Administrative Court, 16.2.2016, N° 35979C.

18 See Alain Steichen and Charles Duro, "Limits to the use of low tax regimes by multinational businesses: current measures and emerging trends", IFA branch report 2001.

19 See Administrative Court, 15.7.2010, No. 25957C, as acknowledged by the tax authorities in their circular LIR 114/2 of 2 September 2010.

However, the fact that the taxpayer benefits from a tax saving is not enough to trigger the application of the abuse of law concept. On the contrary, as it was explicitly confirmed by the Luxembourg *Conseil d'Etat*[20], every taxpayer has the right to choose the regime under which the tax burden is the lowest, provided that certain limits are not crossed, and the measures taken are not inappropriate.[21]

It should be noted that there is clearly a difference between claiming the benefits of a relief, exemption or deduction in the way intended by the legislator and unacceptable tax avoidance that can be tackled through the abuse of law provision.

c) The use of an inappropriate path

The abuse of law provision further requires the use of an inappropriate path. This is determined through a comparison of the path chosen by the taxpayer with the appropriate path.

A legal construction that would lead to a tax saving is considered as appropriate if it is simple, direct, straightforward and transparent.[22] In principle, the legislator provides for appropriate measures in the form of vehicles and tax regimes that may be used by the taxpayers. The mere fact that a structure is unusual does not automatically lead to the suspicion of being inappropriate.

An arrangement is considered as inappropriate if it does not "formally" trigger a taxable event (or would lead to a lower tax burden) despite the contrary objectives and intentions of the law.[23]

The intention of the legislator is generally expressed through explicit tax law and related guidance (such as the commentary to the draft law included in the parliamentary documents). The tax treatment of an arrangement is deemed to be inconsistent with the intention of the legislator if the arrangement takes advantage of technicalities of the applicable tax system. Conversely, the tax treatment of an arrangement is consistent with the intent of the legislator when the tax treatment of the arrangement merely relies on the application of explicit tax law (which is the expression of the intent of the legislator).

d) The absence of valid non-tax reasons (*i.e. the structuring is exclusively motivated by tax reasons*)

When taxpayers have economic or other genuine (non-tax) reasons for the choice of a particular legal form, the presumption of an abuse of law is generally rebutted.[24] Thus, even measures that have been chosen for their tax dimension should not be considered abusive in the presence of non-tax considerations.[25]

According to relevant case law, there is no abuse of law when there are economic or other honourable reasons in addition to tax reasons.[26] The LTA should not be able to successfully challenge a transaction that was made both for tax and other economic reasons. The taxpayer may, amongst others, sustain the existence of non-tax reasons by demonstrating the economic rationale behind the transaction and by appropriate transaction documentation.

The Luxembourg Administrative Court has indicated that it is not enough for the taxpayer to claim to have had economic reasons since these economic reasons must be real and advantageous in addition to the tax benefit.[27]

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20 See Conseil d'Etat, 9 January 1963, "Hélios", No. 5677.

21 Recital 11 of Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market ("**ATAD**") confirms that the general anti-abuse rule ("**GAAR**") provided therein should only be applied to arrangements that are not genuine. Otherwise, the taxpayer has the right to choose the most tax efficient structure for its commercial affairs. Hence, as long as an arrangement is genuine, the GAAR should not apply. While ATAD required Luxembourg to amend its abuse of law provision as from fiscal year 2019, this clarification should also illuminate the interpretation of the abuse of law provision before 2019.

22 See Winandy, "Fraude à la loi et abus de droit en droit fiscal luxembourgeois", Annales du Droit Luxembourgeois 2001, p. 128, and see Winandy, "Les impôts sur le revenu et sur la fortune", Promoculture, p. 144.

23 See Winandy, "Fraude à la loi et abus de droit en droit fiscal luxembourgeois", Annales du Droit Luxembourgeois 2001, p. 134: "toute solution qui, sans être formellement constitutive d'un fait générateur de l'impôt, permettrait d'échapper à l'imposition qui serait due compte tenu des objectifs de la loi. L'essence du contournement de la loi fiscale est donc que la voie choisie ne correspond pas au fait générateur formel de l'impôt."

24 See RFH, Decision of 28.5.29, Kartei AO Paragraph 5 R. 83; BFH, Decision of 9.12.1959, HFR 61, 34; see Dr. Rolf Kühn, Heinz Kutter, Dr. Ruth Hofmann, „Abgabenordnung, Finanzgerichtsordnung", 11. Auflage, 1974, Fachverlag für Wirtschafts- und Steuerrecht Schäffer & Co GmbH, p. 857.

25 See BFH, 14.10.1964, BStBl. 1964 lll, p. 667.

26 See Klein, „Die nicht "angemessene rechtliche Gestaltung" im Steuerumgehungstatbestand des §42 AO", p. 67.; Administrative Tribunal, Decision of 21 March 2013, No. 31058; Administrative Tribunal, Decision of 14.1.2015, No. 33678.

27 See Administrative Court, 18.3.2014, No. 32984C, p. 9; see Administrative Tribunal, 28.1.2015, No. 33984 as confirmed by the decision of the Administrative Court, 15.2.2016, No. 25979C.

4.3.4. Tax consequences

When the LTA can evidence an abuse of law, taxes should be determined on the basis of the legal route that is considered as the genuine path, i.e. based on the legal route which would have been put into place for valid commercial reasons which reflect economic reality.

The LTA are, however, not free to simply replace an arrangement as implemented by another arrangement or to selectively disregard certain elements of a series of arrangements. Instead, the LTA must remain as close as possible to the arrangement as implemented.

According to § 6 (3) StAnpG, taxes levied based on the legal remedy used (which is disregarded in accordance with the abuse of law provision) shall be set off against the amount of tax due under the arrangement that is deemed to be appropriate. Otherwise, taxes paid may be set off against other tax arrears of the taxpayer and, insofar as such set-off is not possible, tax payments may be refunded.[28]

4.3.5. Considerations regarding the burden of proof

Under Luxembourg tax law, the burden of proof is generally split between the taxpayer and the LTA. For facts and circumstances resulting in an increase of the tax base, the burden of proof is on the LTA, whilst the taxpayer must prove the facts and circumstances that entail a reduction of the tax base.[29]

Applying this logic to the abuse of law provision, the onus to prove that an arrangement is abusive within the meaning of the abuse of law provision is on the LTA. When the tax authorities can evidence that the conditions of the abuse of law provision are reasonably met, there is a rebuttable presumption that the arrangement is abusive. In this case, the taxpayer must present evidence that the conditions of the abuse of law provision are not met to rebut the presumption of abuse.

4.4. The "*Manterkauf*" jurisprudence

4.4.1. 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.

4.4.2. Relevant German case law

4.4.2.1. 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*).[30] 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*).[31]

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28 § 6 (3) Steueranpassungsgesetz: "Steuern, die auf Grund der für unwirksam zu erachtenden Maßnahmen etwa entrichtet worden sind, werden auf den Betrag, der nach Absatz 2 zu entrichten ist, und auf andere Rückstände des Steuerpflichtigen angerechnet und, soweit eine solche Anrechnung nicht möglich ist, erstattet. Nach Ablauf des Jahrs, das auf die endgültige Feststellung der Unwirksamkeit folgt, kann der Steuerpflichtige die Anrechnung oder Erstattung nicht mehr verlangen."

29 Article 59 of the Law of 21 June 1999; BFH, Decision of 24.6.1976, IV R 101/75, BStBl. II 1976, p. 562; BFH, Decision of 11.4.1984, I R 175/79, BStBl. II 1984, p. 535.

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

31 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;

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*" (i.e. the acquisition of a dormant company with tax losses).

Based on this jurisprudence, the deductibility of tax losses carried forward may be denied on the grounds of the economic approach[32] (*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.[33]

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.

4.4.2.2. 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 (e.g. conversion of a S.à r.l. into an S.A.).[34] When the conversion is made in a tax-neutral manner, tax losses should remain available.[35]

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).

4.4.2.3. 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 the grounds of the abuse of law provision[36] to avoid corporate tax losses from being traded through the sale of dormant companies for tax saving purposes.[37]

A sound understanding of these exceptional cases requires a close examination of relevant German case law. In two major cases before German courts,[38] 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.[39] 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.[40]

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32 The economic approach (wirtschaftliche Betrachtungsweise) is at large comparable to the substance over form principle.

33 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.

34 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.

35 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.

36 § 6 StAnpG.

37 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.

38 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.

39 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.

40 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.

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.[41] These rules have been further tightened over the last decades.[42] Notably, in the absence of a change in shareholders, corporate tax losses remain available under German tax law.[43]

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.

4.4.2.4. 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 the grounds of the economic approach or the abuse of law provision.

The German Federal Tax Court restricted the non-recognition of tax losses to exceptional cases for the avoidance of legal uncertainty.[44]

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.[45]

4.4.3. Relevant Luxembourg case law

4.4.3.1. Opening comments

Apart from the German "*Mantelkauf*" jurisprudence, in 2009 and 2010 the Luxembourg Courts had 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.

4.4.3.2. 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.[46]

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 before the change of shareholders.

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41 § 8 (4) KStG.

42 § 8 (4) KStG was replaced by a new § 8c KStG in 2008 that provides for detailed rules on the denial of a company's tax loss carry-forward in case of a change in shareholders.

43 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.

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

45 BFH, Decision of 15.2.1966, I 112/63, BStBl III 1966, p. 289.

46 § 1 (2) StAnpG.

4.4.3.3. 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.[47] The Tribunal acknowledged the overarching principle that tax losses may only be deducted from the taxable income of the taxpayer that actually incurred them[48] 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.

4.4.3.4. 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.[49]

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.[50] 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.

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 the grounds of abuse of law[51] 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.

4.4.3.5. 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 generating 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

47 Administrative Tribunal, Decision of 6.7.2009, No. 23982.
48 Article 114 (2) No. 3 LITL applicable to companies via Article 162 (1) LITL.
49 Administrative Court, Decision of 15.7.2010, No. 25957.
50 Art. 158 (2) LITL and Art. 163 (1) LITL.
51 § 6 StAnpG.

company's tax loss carry-forward was not the parties' sole purpose.

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

Following the decision of the Administrative Court[52], the LTA released a tax circular n°114/2 on 2 September 2010 ("**Tax Circular**") that provides guidance on when the availability of a company's tax loss carry-forward may be challenged.[53]

The Tax 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.

The Tax 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 Tax 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(s) (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.

4.4.5. 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.[54]

4.4.5.1. 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 euros 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 operations, 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,*

52 Administrative Court, Decision of 15.7.2010, No. 25957.

53 Circular L.I.R. n° 114/2 of 2 September 2010.

54 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.

purchase and in any other manner transferable securities of any kind and realise 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).

4.4.5.2. 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 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[55] 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 activities 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 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, 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 constitutes 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 the obtaining of 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 recalled 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 its previous activity in the past, (ii) the company had no longer any corporate assets 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).

4.4.5.3. Additional judgment of the Tribunal

In a judgement of 13 July 2023[56] related to subsequent tax years (2014 and 2015), the Tribunal ruled that since the carry forward of the tax losses generated by LuxCo over the years 1992-2005 had been qualified as an abuse of law by the Court in 2016, the same tax losses could no longer be used to offset profits related to other tax years.

55 See Administrative Court, 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.

56 Administrative Tribunal, 13.07.2023, No. 46446.

LuxCo brought forward that its activity and the conditions under which it was performed had evolved substantially since the 2016 decision of the Administrative Court. On this basis, LuxCo considered that the conditions for the application of the abuse of law provision would no longer be met and LuxCo should be able to deduct the tax loss carry-forward in 2014 and 2015 when the company was profitable.

In terms of activity, LuxCo had absorbed another company of the group and was since then performing an activity of buying and selling real estate assets. It had five to ten real estate assets on its balance sheet during the tax periods concerned and then had the infrastructure and personnel needed to perform its activity. Finally, LuxCo argued that following the 2016 decision of the Administrative Court, its tax losses had not been cancelled but only "frozen".

However, the Tribunal disregarded the arguments of LuxCo and followed the abuse of law qualification of the Administrative Court. As a result, the Tribunal denied the carry forward of the tax losses generated by LuxCo over the period 1992-2005 once again.

4.4.5.4. 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 the grounds of the abuse of law provision if the economic identity of LuxCo is lost.

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 no longer had any corporate assets 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, it 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 the grounds of the abuse of law provision given that the lost economic identity and the trading of LuxCo's tax loss carry-forward seem to have been the only motivation for the transaction.

In the decision of 13 July 2023, the Tribunal confirmed the application of the abuse of law provision and again denied the deductibility of LuxCo's tax loss carry-forward; this time with respect to the fiscal years 2014 and 2015. Indeed, once the economic identity is lost and the tax loss carry-forward denied on the grounds of the abuse of law provision, it cannot be restored.

4.5. Application of the case at hand

In the years 2000 to 2008, LuxCo performed holding activities that resulted in a tax loss carry-forward. In the years 2009 to 2013, LuxCo was a dormant company with no corporate assets of significant economic value. In 2014, LuxCo acquired a real estate asset situated in Luxembourg which was sold in the same year with a significant capital gain.

The LTA and the Tribunal argued that LuxCo was intended to perform holding activities, not investments into real estate. It has been

further reiterated that following four years of being a dormant company, LuxCo was "reactivated" to invest into the Luxembourg real estate property. While these conclusions seem to be correct, these elements have no impact whatsoever on the availability of LuxCo's tax loss carry-forward.

All income realised by a Luxembourg company is deemed to be "commercial income" within the meaning of Article 14 LITL.[57] As such, the income and losses of a Luxembourg company are not segregated into different categories and, therefore, tax losses incurred by LuxCo in relation to its holding activities may offset any taxable income regardless of the nature of income realised. Here, it is irrelevant that LuxCo changed its activity from the "holding of shares" to the "management/trade of real estate".

It is undisputed that the legal identity of LuxCo did not change irrespective of the lack of activity in the years 2009 until 2013. Moreover, absent a transfer of LuxCo's shares, the economic identity was not at stake despite LuxCo changing its activities. Thus, the LTA and the Tribunal were wrong when denying the availability of LuxCo tax loss carry-forward.

A different conclusion could only be reached if most, if not all, of the shares of LuxCo had been transferred to a new shareholder before the implementation of the new activity. This is consistent with the decision of the Administrative Court and the content of the subsequent Tax Circular which even refers to a "take-over" (*rachat*) of the company with tax losses. The abuse of law provision can only be applied in exceptional circumstances for avoiding the trade of corporate tax losses.

On the contrary, the deduction of corporate tax losses may not be denied when the business activities of a Luxembourg company are reorganised or even completely changed by its shareholder for improving profitability.

05 CONCLUSION

The Tribunal held that the tax loss carry-forward of LuxCo could be denied by the LTA on the grounds of the abuse of law provision. While there was no change in shareholders, the Tribunal seems to suggest that the economic identity was lost as (i) LuxCo changed its business activities, (ii) investments into real estate were not planned when incorporating LuxCo, and (iii) LuxCo was dormant for a few years before being "reactivated" for the investment into Luxembourg real estate.

However, LuxCo's tax loss carry-forward cannot be denied given that the legal identity remained unchanged, and the economic identity could not be lost absent a change in shareholders. Moreover, as all income of LuxCo is classified as commercial income, tax losses incurred in relation to holding activities may be used to offset the capital gain realised upon disposal of the Luxembourg real estate property.

The decision of the Tribunal created massive legal uncertainty in an area that was already a concern for many, as tax losses can only be considered final in the fiscal year in which they are used to offset taxable income (and accepted by the LTA).

Ultimately, it remains to be seen whether the Administrative Court will reiterate long-standing case law, restore legal certainty and restrain the LTA that appear to excessively invoke the vague abuse of law provision to challenge taxpayers.

57 Article 10 No. 1 LITL, Article 162 (3) LITL.

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