

Luxembourg Tax Authority clarifies application of new foreign permanent establishment definition

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Luxembourg's law of 21 December 2018 implemented the European Union Anti-Tax Avoidance Directive¹ (ATAD). Under implementation of the ATAD, the definition of a domestic permanent establishment (PE), codified in art. 16 of the Tax Adaptation Law (StAnpG), was expanded by an additional paragraph relating to the recognition of foreign PEs. On 22 February 2019, the Luxembourg Tax Authority issued a Circular² outlining how the tax authorities intend to apply the new provision to determine if a resident taxpayer has a PE in a country that has concluded a tax treaty with Luxembourg.

The Circular sets forth that the recognition of a PE in a treaty country will be based exclusively on the criteria set forth by the tax treaty concluded with that country. Where an existing tax treaty does not define a specific term, and most importantly what constitutes a "business activity," Luxembourg will apply its domestic PE definition, according to which a taxpayer will be considered as having a PE in the other Contracting State if the activity that is exercised in the other country constitutes an independent activity and represents a participation in the general economic life in that other country. The Circular seems to indicate that the focus is put on the analysis of the activity that is carried out and not on the level of substance; the mere fact of not having an extensive infrastructure or a substantial and permanent presence of human resources would not seem to automatically result in Luxembourg not recognizing the existence of a PE in the other country.

Since in some circumstances the assessment of the factual situation by the Luxembourg tax authorities may be difficult, the Luxembourg taxpayer may be requested to provide confirmation that the other country recognizes the existence of a PE. Such confirmation must be provided where the relevant tax treaty does not contain a provision entitling Luxembourg to tax income or capital if the other country applies the provisions of the tax treaty to exempt such income or capital (i.e., a provision similar to art. 23A (4) OECD³ Model Tax Convention or art. 5 option A of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*⁴ (the MLI)).⁵ The Circular specifies that such mandatory confirmation must be appended by the taxpayer to its annual income tax return.

The new provision does not explicitly require the PE to be effectively taxed in the other country. However, in line with the parliamentary document to the law of 21 December 2018, the Circular states that the taxpayer must provide a document that proves that the competent authority of the

other Contracting State recognizes the existence of a PE in its territory. It can be any supporting evidence allowing verification of the statements of the taxpayer that a PE exists and in particular an income tax assessment or a certification of the competent authority of the other country confirming the existence of a PE. However, according to the Circular, it will not be sufficient to produce a document indicating that the tax authorities of the other country recognize the existence of a commercial activity of the taxpayer in its territory without the activity rising to the level of a PE.

Where the taxpayer does not provide the aforementioned confirmation, whether mandatory or upon request, the tax administration will consider that the taxpayer has no PE in the other contracting country. Luxembourg taxpayers will need to carefully assess PEs where a treaty exemption is claimed to assure that the PE definition is met and that they will be able to produce confirmation from the competent authority of the other Contracting State recognizing the existence of a PE.

Endnotes

1. See EY Global Tax Alert, [Luxembourg: A detailed review of the EU ATAD implementation law](#), 28 December 2018.
2. Circular L.G. - n°19 of 22 February 2019.
3. Organisation for Economic Co-operation and Development.
4. Base Erosion and Profit Shifting.
5. See EY Global Tax Alert, [Luxembourg explains its positions on Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS](#), 13 June 2017.

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