Use and advantages of SOPARFI by Sonia Bellamine

The Grand-Duchy of Luxembourg offers a very attractive legal and tax framework for the localization of holding companies of international groups. When certain conditions are fulfilled, financial participation companies (“**SOPARFI**”) are not taxed on dividend income they receive and on capital gains arising from the sale of participations as well as, upon liquidation, the liquidation surplus.Such advantages make this type of vehicle particularly attractive for the implementation of corporate structures aiming at achieving a tax optimization for international groups.**How is a SOPARFI taxed?**Where the SOPARFI undertakes commercial activities (which is not mandatory), it is subject, for the revenues generated by these activities, to the standard taxation regime at the rate of 28.80%. However, the SOPARFI benefits from a number of tax exemptions. These tax exemptions make the SOPARFI attractive in a number of circumstances.**What are the tax exemptions which SOPARFI may benefit from?**

1. **Exemption of dividend incomes:**

The SOPARFI may benefit from an exemption on its dividend income. The inbound dividends are tax exempt where the SOPARFI holds or undertakes to hold a participation of at least 10% in the share capital of subsidiary (or a participation having a minimum purchase value of EUR 1.2 million) for an uninterrupted 12 months period (the “Exemption Conditions”).To benefit from this regime, the subsidiary generating the dividends must be (i) a trading company; and (ii) fully taxable.In case of a foreign non-EU-based subsidiary, this condition is deemed to be met (i) where the corporate tax levied in the subsidiary’s jurisdiction amounts to at least 11% and (ii) when the taxation basis is not substantially different from that applicable in Luxembourg. The tax administration will consider the effective rate of the tax paid by the subsidiary as well as the scope of the tax base.If the SOPARFI does not benefit from a full exemption on received dividends as set forth pursuant to Art. 166 of Tax law, the SOPARFI may claim under certain circumstances the application of Art. 115.15a which grants a 50% rebate on the dividends received.**Exemption of withholding tax on dividend distributions:**The distribution of dividends may benefit from a withholding tax exemption where the beneficiary is another SOPARFI or another company based in Europe (EU or AEE) fulfilling the Exemption Conditions. In other cases, dividends paid by a SOPARFI are subject to a withholding tax at a normal rate of 15%. This withholding tax will not apply if the distribution is made to a company located in a country having a tax treaty with Luxembourg. In this respect, it should be noted that Luxembourg has a large network of tax treaties concluded by Luxembourg (60 treaties are in force so far and 9 have already been (i) initialed or 8(ii) entered into negotiation).**Exemption of capital gains on the sale of shares:**Capital gains generated by the sale of shares forming part of a substantial participation benefit from an exemption where the SOPARFI holds a participation fulfilling the Exemption Conditions (save for the alternative acquisition cost condition amounts to at least EUR 6 million for capital gain exemption purposes as opposed to EUR 1.2 million for exemption dividends).**Exemption of withholding tax on interests:**SOPARFI’s participation are often debt financed, the loan being generally granted by the Mother Company usually located in another country (EU member or not).As a rule, Luxembourg Law does not apply withholding tax on interests (save for those paid according to bonds with profit participation).**Thin capitalization rule:**As abovementioned, SOPARFI’s participations are often debt financed. Luxembourg Law does not apply any such rule as “Thin-Capitalization”.However, the financial ratio regarding debt/equity admitted by the tax administration usually amounts to 85/15. Beyond this threshold, given the abuse of right consideration, the contemplated operation may be put at risk.**Exemption on a liquidation surplus:** Although upon the liquidation, the unrealized profits should be taxed at the standard rate of 28.80%, the company may however benefit from an exemption on the capital gain deriving from the sale of participation when the Exemption Conditions are met.There is no withholding tax on the distribution to the shareholders of a liquidation surplus, allowing specific withholding tax free repatriation schemes.**Net wealth tax:**Normally, a SOPARFI is subject to a yearly wealth tax of 0.5% on its “unitary value”. This value is close to the net assets value (assets less liabilities, valuated according to tax law provisions) of the company. However, participations which fulfill the Exemption Conditions (except for the criteria of 12 months of holding uninterrupted period above-mentioned, no more applicable since Law 28 December 1995) are exempt (excluded from the tax base). Debts in relation with exempt assets (i.e.: loan taken to finance the acquisition of an exempt participation) are not deductible for unitary value computation purposes.**Extension of the tax exemption:**The tax exemption on dividends and capital gains (and wealth tax) is available to Luxembourg permanent establishments (i.e.: branches) of foreign companies established in another EU country or in a country having entered into a tax treaty with Luxembourg.The exemption are also applicable to participations held through transparent entities.**Minimum taxation:**Companies such as SOPARFI which assets are mainly (min. 90%) constituted of financial assets including current assets (participations in other companies, bonds, shares, bank accounts, receivables) are subject to a minimum Corporate Tax of EUR 1 500.-**How value is added tax treated?**A passive SOPARFI, the purpose of which is limited to the holding of participation in other companies, is normally not subject to VAT. Hence, in such a case, it may not deduct the VAT charged by its suppliers. VAT registration is of course available to SOPARFI carrying out economic activities. In such a case, VAT is recoverable in proportion of the turnover realized.