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The Tax System of the Financial Participation Companies (SOPARFI)

The system of the Financial Participation Companies (SOPARFI), introduced by a grand-ducal decree of December 24, 1990, did not have as effect to create a new form of company. Indeed a SOPARFI is an ordinary commercial company established in Luxembourg and fully taxable according to the common law, which is mainly used as a holding. This system is nevertheless not without interest.

It mainly allows, under certain conditions, the tax exemption of three kinds of income which are:

- the dividends,
- the increased values realized on the transfers of participation stock, by application of the parent company/ subsidiary system provided for by the Council Directive 90/435/EEC of July 23, 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States,
- the liquidation bonus.

I. Application of the parent company/ subsidiary system

The directive 90/435/CEE has instituted a system permitting to limit the fiscal rubbings that impact the flows existing between a parent company and a subsidiary.

In order to benefit of this system, the holding company, called “parent company”, must hold an important and lasting participation in the subsidiary’s capital.

Article 166 L.I.R. (income tax law) in its latest version as modified by the law of November 17, 2006, contains the conditions to be fulfilled for a group of companies to profit of this system. The designations of SOPARFI and subsidiary are reserved for specific juridical forms of companies and the participation must respect precise criteria to be considered important and lasting.

A) The SOPARFI

The SOPARFI is a fully taxable finance company established in Luxembourg.

Article 159 L.I.R. considers as finance companies the stock company (SA), the limited partnership company with a share capital (SCA) and the limited company (Sàrl).

The main characteristics of these companies are the following:

	Share capital (euros)	Paid-up at the incorporation	Minimum number of associates	Minimal administration
Sàrl	12 500	entirely	1	1 manager
SA	31 000	¼	1	1 administrator
SCA	31 000	¼	2	3 administrators

The condition of establishment in Luxembourg is appreciated with regards to the site of the statutory registered office foreseen in the by-laws of the company. However a company will be considered as established in Luxembourg if the site of its main establishment is located in Luxembourg.

Finally the companies that benefit from a general tax exemption, like the holding companies in the sense of the law of 1929, are excluded from the field of application parent company/ subsidiary system whereas the companies which benefit from a subjective exemption are eligible for it.

B) The subsidiary

Three kinds of companies are considered as subsidiaries within the parent company/ subsidiary framework:

- the fully taxed finance companies established in Luxembourg
- the companies that fulfil the criteria of article 2 of the directive 90/435/CEE,
- the finance companies not established in Luxembourg that are taxable by a tax corresponding to the income tax on collectivities. The corresponding tax is defined by reference to three criteria:
 - o to be an obligation at the expense of the company and to the benefit of a national collectivity,
 - o a similarity in the rules of determination of the tax base,
 - o the actual tax rate must be superior or equal to 11%.

A law of January 1st, 2002 has extended the notion of subsidiary. Henceforward the use of an intermediary private company between the parent company and the subsidiary is no more an obstacle to benefit by the parent company/ subsidiary system.

The evolution is justified by the fiscal transparency of the private companies. Consequently the parent company is considered as directly holding the participation in the subsidiary and thus is eligible under the system of the directive 90/435/CEE.

Furthermore are also aimed at by this system certain stable Luxembourg establishments in application of a law of December 23rd, 1997.

The companies holding the concerned stable establishments are:

- the companies fulfilling the criteria of article 2 of the directive 90/435/CEE
- the finance companies established in a country that has signed an international tax convention with Luxembourg.

Consequently the income from floating capital is exempted from withholding tax if it is distributed by a fully taxable finance company established in Luxembourg.

Finally the law of December 17, 2006 has extended the notion of subsidiary to many organisms. The following are concerned: the co-operative company organized like a stock company, the pension-savings association, the mutual insurance association, the commercial, industrial or mining enterprise of the State, the municipalities, the associations of municipal corporation, the public establishments and the other corporate bodies under public law as well as the companies incorporated according to Luxembourg law and submitted to the corporation tax in Luxembourg.

C) An important and lasting participation

The important participation results either from holding 10% of the subsidiary's capital stock, or from the acquisition price of the participations exceeding 1,200,000 euros. It is considered as lasting if the securities are held since more than 12 months.

The participation is most frequently evaluated in units held in the stock capital. It is then suitable to first define the outlines of this concept before examining its characteristics.

The stock capital corresponds to the subscribed and paid-up capital, exclusive of the reserves and the share premiums. However the tax law provides for a larger definition than company law as it includes besides the stock capital also the concealed assets brought in and the concealed capital.

The dismemberment of the securities causes a particular problem. The dividend is perceived by the usufructuary. As the latter is not the owner of the securities, the dividend cannot be considered as a participation income, thus excluding the exemption offered to a bearer of a participation securities.

In return, the liquidation bonus and the increased values obtained from the transfer of participation securities go to the bare owner and thus benefit by the exemption.

The participation must exist when the company solicits the application of the system. Possible future participations, even if they are certain, thus cannot be considered for calculating the stock capital.

Finally the appearance of juridical property always wears off in favour of the economic property. Consequently only the real holder in the economic sense can avail of the provisions of the parent company/ subsidiary system.

Two alternative criteria allow to define the participation of importance. They are:

- a holding of more than 10% of the subsidiary's stock capital. In the great majority of cases this criteria is used,

- an acquisition price of the participations exceeding 1,200,000 euros. However this amount is increased to 6,000,000 euros for the exemption of increased values obtained from the transfer of participation securities

The acquisition price is equal to the buying price of the securities, plus the fees that are accessory to this operation.

If similar securities are acquired at different prices, various methods can be used to calculate the acquisition price:

- the price can be calculated according to the real value of the securities at each acquisition,
- the price can be obtained by applying a weighted average price.

The participation is considered to be lasting if the securities are held since an uninterrupted period of time of 12 months or if the company commits itself to keep the securities for an uninterrupted period of time of 12 months.

The criteria of the lasting holding can in addition be appreciated a posteriori. Consequently distributions can benefit of the tax advantages before the expiration of the entire period of 12 months.

II. The tax effects of the application of the parent company/ subsidiary system on the SOPARFI.

The main effect consists in the tax exemption on the participation income, on the liquidation bonus and on the increased values obtained from the transfer of participation securities. Furthermore the system is not without incidence on other taxes.

A) The exemption of income from securities management

1) The participation income. This group covers the dividends, the parts in the profit as well as any other product distributed as a counterpart to the participation in the subsidiary's stock capital.

Furthermore the tax law assimilates the liquidation bonus perceived by its subsidiaries to a dividend. It is equal to the net benefit to which are added the reserves constituted prior to the liquidation.

Article 166 L.I.R. thus allows an exemption of this income if the afore-mentioned conditions are fulfilled.

This has a double consequence for the parent company :

- if the result of the fiscal year is positive, the exemption allows not to increase the taxable income,
- however if the fiscal year's result is negative, the participation income is not deducted from the fiscal loss.

2) The increased values obtained from the transfer of participation securities. The system of this second category of revenues is provided for by the grand-ducal decree of December 21, 2001.

The assignment is any act which has as consequence the transfer of the property of the securities and thus their exit from the parent company., i.e. the sale, the assets brought into a company, the exchange etc.

The system leads to a complete exemption of any tax as soon as the conditions of the important and lasting participation are fulfilled. Furthermore, and by fiscal favour, if a decreased value is realized, it remains deductible from the other income of the company. The increased value is obtained by subtracting the acquisition value corresponding to the historical price from the sales value.

3) The liquidation boni. There is no deduction at source for the distribution of the liquidation's product to the former shareholders of the company, regardless of their juridical status or their place of residence.

Two hypotheses however prevent an exemption.

First of all, if a depreciation is at the origin of the increased value, the latter remains taxable up to the amount of the historical price. Only the excess benefits from the exemption.

Then, if the securities have been brought as assets into the company, the amount of the latent increased values at the moment of the realization of the assets brought in is not exempted. Only the increased value that took place during the holding period of the securities by the transferring company is exempted from taxation.

In principle the expenses closely related to an exempted product do not correspond to charges that are deductible for a company. However the application of the parent company/ subsidiary system tempers this strict rule in two ways:

- the corrections of values performed on participation securities are tax deductible,
- the operating expenses that originated from the financing and management of participation securities are deductible if the amount exceeds the generated exempted income.

B) The impact of the system on the other taxes

The municipal trade tax is affected in the same way by the parent company/ subsidiary system. However it is necessary to point out some differences.

The benefit of the tax exemptions is not limited to the sole finance companies established in Luxembourg, but is extended to any company submitted to the trade tax which has the participation securities inscribed in their operating capital. However as it is compulsory for the SOPARFI to be a finance company, it is not concerned by this alleviation.

Furthermore the participation rate is the only criterion that allows to evaluate the importance of the participation. It must simply be 10% at the beginning of the fiscal year and thus can freely evolve the rest of the time.

Finally the increased values on transfers of the securities remain taxable for the calculation of this tax despite the application of the parent company/ subsidiary system.

The property tax is also concerned by this system. Indeed, §60 of the law regarding the evaluation of assets and securities for the determination of the property tax allows to exclude the important participations from the calculation of the unit value of the operating property of the company.

The law of December 23, 1997 has furthermore facilitated the access to this privilege as the exemption is applied immediately if the importance of the participation is established. The lasting character of the participation is in this case no longer required to benefit by the advantages of the parent company/ subsidiary system.

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