Luxembourg

Negotiated M&A Guide 2022

Corporate and M&A Law Committee

Contacts

Guy Harles

Arendt & Medernach, *Luxembourg*

guy.harles@arendt.com

1. LEGAL BACKGROUND

Acquisitions of private companies in Luxembourg are primarily governed by the law of 10 August 1915 on commercial companies, as amended. Other laws that may be relevant in this context are:

a) the law of 31 May 1999 on the domicile of companies;
b) the law of 19 December 2002 on the trade and companies register, accounting and annual accounts of companies; and
c) the law of 12 November 2004 on the fight against money laundering and the financing of terrorism (all as amended from time to time).

2. STRUCTURE OF THE TRANSACTION

2.1 Asset or share deal

The acquisition of a private company may take the form of either an asset deal, under which all or some of the assets of the target will be purchased; or a share deal, consisting of the transfer of all or the majority of the shares of the target.

The advantages and drawbacks of an asset versus a share deal under Luxembourg law can be summarised as follows:

2.1.1 Additional flexibility for the purchase

On a sale of shares there is no statutory protection for the purchaser. When acquiring the target shares, the purchaser will take on the entire entity, including any existing liabilities. An asset deal will offer substantially more flexibility and security for the purchaser, who may specifically identify in the purchase agreement those liabilities it is prepared to take on and those which shall be excluded from the scope of the sale.

2.1.2 Unfavourable tax treatment

Share deals are exempt from registration tax, as they are considered to qualify as movable property, and no VAT will be triggered at transfer. Assets may, on the contrary, qualify as movable or immovable property. The transfer of immovable property triggers a registration tax between 7–10 per cent, depending on the location of the property. The transfer of movable property triggers VAT, unless the transfer qualifies as a transfer of going concern.

2.1.3 Cumbersome process

Asset transfers may require specific formalities such as filing the transfer in respect of trademarks and patents or real estate, with the execution of the purchase agreement, in front of a public notary in Luxembourg.

The assignment or assumption of contracts under an asset deal usually also raises the additional issue of third parties' consent for each individual contract whereas, in a share deal, the third parties' consent is typically limited to agreements with change of control provisions. Asset deals are therefore typically more cumbersome.

2.2 Tax

Luxembourg has been a prime jurisdiction in international M&A transactions for several decades. The acquisition of targets or their assets may be structured in different ways (eg, acquisition and holding of shares, upstream or downstream mergers, contributions of assets and liabilities, liquidations) for which Luxembourg may provide an appropriate tax environment.

Luxembourg is traditionally known for its participation exemption regime that offers an exemption on three levels:

a) At the level of a Luxembourg company, an exemption from corporate income tax and municipal business tax is available on dividends, liquidation proceeds and capital gains derived on participations of at least 10 per cent that the Luxembourg company holds, or commits itself to hold, for an uninterrupted period of at least 12 months, in an eligible subsidiary. If the 10 per cent threshold is not reached, the participation exemption may nevertheless apply if, during the aforementioned 12 month holding period, the acquisition price of the eligible participation always amounted to at least €1.2m (for the exemption of dividends and liquidation proceeds) or €6m (for the exemption on capital gains). Eligible companies include:
   i. other EU-resident companies listed in EU Directive 2011/96/EU on the common system applicable in the case of parent companies and subsidiaries of different Member States;
   ii. non-resident companies limited by shares that are subject to a tax that corresponds to the Luxembourg corporate income tax; and
   iii. other Luxembourg resident fully taxable companies limited by shares.

b) Shareholdings in eligible subsidiaries are further exempt from the net worth tax under the same conditions as for the dividend exemption. There is however no minimum holding period.

c) Finally, dividend distributions made by Luxembourg companies to eligible parent companies are exempt from dividend withholding tax, provided the eligible parent has held, or has committed itself to hold, for an uninterrupted period of 12 months, a participation of 10 per cent or of an acquisition price of €1.2m in the distributing company. Eligible parents include:
   i. other EU resident companies listed in the aforementioned EU Directive 2011/96/EU or a Luxembourg permanent establishment thereof;
   ii. companies which are resident in a state that has concluded a double tax treaty with Luxembourg and which are subject to a tax corresponding to Luxembourg corporate income tax, as well as their permanent establishments;
   iii. Swiss companies limited by shares which are effectively subject to corporate income tax in Switzerland without benefiting from an exemption;
   iv. companies resident in a State member of the European Economic Area fully liable to a tax corresponding to Luxembourg corporate income tax and their Luxembourg permanent establishments; and
   v. other Luxembourg resident fully taxable companies limited by shares.

In the case of leveraged acquisitions, Luxembourg companies are generally not subject to withholding tax on interest payments except in very limited cases (eg, profit-sharing bonds or notes), or if the payment falls within the scope of the amended Luxembourg law dated 23 December 2005. Under this law, payments of interest or similar income made by a paying agent established in Luxembourg to or for the immediate benefit of an individual beneficial owner who is resident of Luxembourg, may be subject to a withholding tax of 20 per cent.

Interest expenses are as a rule tax deductible, subject to the application of (1) transfer pricing rules, (2) interest limitation rules,[1] (3) anti-hybrid rules,[2] (4) the non-tax deductibility of interest payments made to entities located in non-cooperative jurisdictions (the EU blacklist), and (5) the nontax deductibility of interest expenses in relation to tax-exempt income.

Pursuant to the implementation of the interest deductibility limitation rules of ATAD I, the net exceeding borrowing costs incurred during a financial year by a taxpayer may only be deducted up to higher of either (1) 30 per cent of the taxpayer's EBITDA (earnings before interest, taxes, depreciation, and amortisation) or (2) €3m, whichever is higher.

The borrowing costs correspond to (1) interest expenses on all forms of debt, (2) other costs economically equivalent to interest and (3) expenses in relation to financing. The interest limitation rules include various exclusions and exemptions, such as the full deduction of exceeding borrowing costs if the taxpayer is a financial undertaking or a standalone entity.

Upstream or downstream mergers between Luxembourg and EU resident companies may be performed under certain conditions under a tax neutrality regime for the merging companies, as well as for their shareholders. Although the absorbed company is considered for Luxembourg tax purposes as being liquidated, which generally triggers the realisation of hidden capital gains (exempt in the case of shareholdings that benefit from the participation exemption), the transfer of the assets within the context of a merger may, however, be made at book value provided:

- the transfer is remunerated exclusively by shares issued by the absorbing company to the shareholders of the absorbed company (a cash payment not exceeding 10 per cent of the nominal value, or, if no nominal value exists, the accounting par value of the securities issued is further tolerated); and
- the unrealised capital gains remain exposed to a future taxation in Luxembourg.

In the case of an upstream merger, any gains realised by the parent company may be exempt under the conditions of the participation exemption. Should the condition in relation to the 12-month holding period not be fulfilled, the gain may nevertheless be exempt if the parent has held at least 10 per cent in the absorbed subsidiary. At the level of the shareholders, the exchange of shares of the absorbed company against shares of the absorbing company is considered as a sale at fair market value of the shares of the absorbed company, followed by the acquisition of the shares of the absorbing company. This generally triggers the realisation of hidden capital gains. However, a share-for-share exchange within a merger of EU-resident and Luxembourg companies will benefit from a tax neutral rollover regime, unless the shareholders renounce to apply such regime.

Post-acquisition, Luxembourg share capital companies that are held at, directly or indirectly, at least 95 per cent by another Luxembourg company, or a Luxembourg permanent establishment of a non-resident company limited by share capital that is subject to a tax that

[1] Implementation 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 I).

[2] Implementation of COUNCIL DIRECTIVE (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (ATAD II).

corresponds to the Luxembourg corporate income tax, may further opt for a fiscal consolidation regime for the purposes of income taxes. When Luxembourg companies have common EU/EEA parent company, a horizontal consolidation is also available. Under certain circumstances, the 95 per cent threshold may be reduced to 75 per cent by the Ministry of Finances. During the fiscal consolidation, which is granted for a period of at least five years, taxable results of the members are offset against those of the parent company.

In terms of repatriation, liquidation proceeds are not subject to any withholding tax in Luxembourg and dividends may be paid free of withholding tax under the participation exemption. Capital gains are generally not taxable in the hands of non-residents, except in very limited cases which are generally waived by double tax treaties. In this respect, Luxembourg has double tax treaties in force with 84 other states; treaties with a further 14 states are under negotiation or pending ratification.

Finally, regarding transactional taxes, share transfers made under private seal are not subject to any registration or stamp duties (unless voluntarily registered). Depending on the assets involved, share deals may thus be preferable to asset deals, particularly in the case of real estate transfers which are subject to registration duties of up to 10 per cent. A fixed registration duty of €75 is due upon the incorporation of a Luxembourg company. The same registration duty will apply in the event of a future amendment to its articles of incorporation.

3. PRE-AGREEMENT

It may be of interest to the parties, notably in important transactions, to enter into one or more preliminary agreements prior to the signature of the final sale and purchase agreement. This may streamline the precontractual negotiations and ensure that the parties pursue negotiations in good faith.

3.1 Exclusivity agreements

Although not common practice in Luxembourg, exclusivity agreements are valid and binding. On the basis of the principle of contractual freedom, the parties may freely agree on the content and scope of such agreements. The parties must however comply with the general principle of good faith at all times during their pre-contractual negotiations.

3.2 Letters of intent

Letters of intent are not used in the majority of Luxembourg law transactions but are nonetheless valid. The parties may structure the letters as appropriate, provided that the principle of good faith is respected. Parties may also choose to limit the binding nature of the terms to certain provisions of the letter of intent.

3.3 Confidentiality agreements

Agreements or clauses pursuant to which the parties agree not to disclose any confidential information without the other party’s prior consent are valid and common practice in Luxembourg. They may however not be enforceable under certain circumstances, such as where the confidential information is required by a governmental entity. Proof of breach of a confidentiality provision is usually difficult to establish.

3.4 Voting agreements with majority shareholders

Voting agreements are common practice and valid in Luxembourg provided that:

a) they are not contrary to the company's corporate interest or do not seek to circumvent the law;
b) they do not result in a shareholder undertaking to vote in accordance with the directions given by the company, by a subsidiary or by any of the corporate bodies of such companies; and
c) they do not result in a shareholder undertaking towards those same companies or those same corporate bodies to approve the proposals made by the corporate bodies of the company whose general meeting is being held.

Votes cast in a general meeting pursuant to an invalid agreement shall be void. Such votes shall invalidate any resolutions passed unless such votes have no impact on the result of the vote. The action for nullity shall lapse six months after the vote.

4. PURCHASE AGREEMENT

No specific form of agreement is required under Luxembourg law for the transfer of shares or, except in certain particular cases, of assets. Standardised purchase agreements are however often used as a negotiation basis.

It should be noted that Luxembourg law may be the favoured choice of law but, given the predominantly international character of acquisitions, the choice of a foreign law to govern the purchase agreement (mostly English and United States) is very common.

The general liability which may be incurred by the parties under the purchase agreement can be summarised as follows.

4.1 Liability of the purchaser

The key exposure for purchasers, and consequently the key area of concern for vendors, is the payment of the purchase price. In the event that the purchase price is structured as deferred earn-out consideration, the vendor will need to be diligent in its assessment of the purchaser's creditworthiness and negotiate contractual protections such as parent company guarantees or escrow payments.[3]

Where a completion accounts mechanism is used in the calculation of the purchase price, the purchaser will typically be under a strict obligation to produce accurate completion accounts.[4]

4.2 Liability of the vendor

The vendor typically incurs liability through misrepresentation, breach of warranties and, sometimes, for ongoing covenants.

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[3] An earn-out is a mechanism whereby part of the purchase price is determined by reference to earnings generated by the target company, post-acquisition.

[4] Completion accounts are prepared when the parties have agreed to a post-closing (or post-completion) adjustment to the purchase price. For example, the purchase price for shares of a company may assume that the purchaser will acquire the target company with a specified level of working capital. As a result, parties must determine the amount of working capital at closing (completion), through completion accounts, in accordance with the terms of the acquisition agreement.

4.3 Determination of purchase price

Acquisitions of shares or assets under Luxembourg law are valid only insofar as the acquisition price is determined or determinable. Parties are therefore required to agree on a price or at least a clear formula for establishing the price.

Although shares in a Luxembourg company may have a nominal or par value representing a fraction of the share capital, the purchase price will typically not correspond to this value. In the absence of benchmarks or comparable companies against which the market value of the shares can be evaluated, the determination of the purchase price is a delicate operation including extensive due diligence.

Determination of an approximate price usually results from the combined use of:

- an existing fair price evaluation model taking into account (1) the net asset value of the company; (2) the turnover value; or (3) both values cumulatively; and
- legal, financial and accounting due diligence.

Goodwill –the difference between the contractual value and the net value of the company – is another element which will be taken into consideration in determining the purchase price.

Parties will either agree on a purchase price through joint efforts or rely on a third party's final determination.

4.4 Representations and warranties

4.4.1 Purpose

As mentioned above, a purchaser will not benefit from statutory protections in a share deal. Liabilities determined in the due diligence exercise will therefore need to be reflected in the representations, warranties and indemnities of the purchase agreement, in order to provide the purchaser with an adequate level of contractual protection. The purpose of representations and warranties is threefold:

- to provide the purchaser with contractual protection to serve as a basis for a claim in the case of the breach of a representation or warranty and to recover damages;
- to allocate the risk between the parties so that the parties agree in the purchase agreement on, for example, who bears the risk of the accounts not having been prepared in accordance with generally accepted accounting principles (usually the vendor), or who bears the risk of a debt owed to the company not being fully recoverable (usually the purchaser); and
- to provide information – it is in the vendor's interest to disclose any potential issues. This will allow the purchaser to assess the issue and, if necessary, walk away, adjust the purchase price or seek an adequate indemnity.

It is common for representations and warranties to be requested and provided in the context of the purchase of a business. Given that, on an asset sale, the purchaser will limit the scope of the liabilities to be assumed to those specifically mentioned in the purchase agreement. Representations and warranties are generally less extensive than on a share sale, in particular in relation to tax matters, where any liability will remain with the vendor. It may, however, still be useful for a purchaser to request representations and warranties to obtain additional information about the business, as well as further comfort on the assets and liabilities it is assuming.

4.4.2 Survival

In case of a gap between signing and closing, the representations and warranties are usually repeated at closing.

The parties may freely determine the survival period of the representations and warranties after the closing date. If not governed by a shorter contractual term, the obligations under the purchase agreement will remain in force for a period of ten years.

4.4.3 Consequences of breach

Indemnification for breach of representations and/or warranties is governed by the general statutory provisions on contractual liability – ie, subject to proof of breach of a precisely identified contractual obligation and the existence of an indemnifiable loss. The content and scope of the contractual duty must be assessed prior to establishing a potential breach. In this connection, the following distinction must be made:

- obligations which are deemed to be obligations of strict performance, further to which a result must be provided; and
- best endeavours obligations.

The distinction between both sets of obligations lies in the burden of proof in the event of an alleged breach. A claim for breach of a best endeavours obligation must be made on the basis of proof of negligence. In contrast, a claimant under an obligation of strict performance simply needs to establish that the agreement contained a specific commitment for its benefit and that this commitment has not been fulfilled.

If the purchase agreement is silent on the point, and if the envisaged result should normally be obtainable with the means that were or should have been at the disposal of the debtor, then such obligation is likely to constitute an obligation of strict performance. In most cases, it is reasonable to assume that the obligations resulting from representations and warranties constitute obligations of strict performance. By applying this principle to, say, the purchase price, this will mean that, should the purchaser establish that the value of the underlying business of the target is lower than the value as represented in the purchase agreement, the vendor will need to indemnify the purchaser.

A loss resulting from a breach of a contractual obligation can only be indemnified if it is legal, actual, direct, personal and reasonably foreseeable.

4.5 Knowledge qualifications and limitations

Subject to the principle of good faith, buyer's or seller's best knowledge qualifications in representations and/or warranties are valid under Luxembourg law.

In addition to the 10-year statutory limitation set out under section 4.4.2, the parties often agree on a limitation in value so that their liability will either be capped or only incurred above a certain *de minimis* threshold. In the absence of any provision to this effect, the courts will assess the amount of liability at their sole discretion.

4.6 Conditions for closing

Although the set of conditions to closing varies from case to case, the standard conditions one would normally expect to see are:

- correctness and accuracy of seller's and buyer's representations and warranties as at closing;
- due incorporation and existence of seller and buyer, due authorisation, non-encumbrance of target shares, non-bankruptcy of seller and buyer, and enforceability of purchase agreement; and
- satisfaction of closing deliverables.

In the case of the non-satisfaction of the conditions for closing, the purchase agreement will usually provide for a mutual right to walk away as well as a contractual indemnity.

4.7 Post-closing covenants

Typical post-closing covenants include:

- Confidentiality (refer to section 3.3).
- Non-competition – from a Luxembourg corporate law perspective, the use of non-compete clauses is valid. They are generally enforceable against the vendor and the target's employees. It may be that such clauses must comply with certain limitations, such as timing, geographical area or limitations regarding business activity. Such limitations should be proportional to the benefits they procure to the purchaser.
- Remittance by the vendor of corporate books and other documents relating to the target.
- Amendments to the target's board of directors, auditors and change of corporate name.

4.8 Remedies

Although not mandatory, both the nature and the amount of remedies are often contractually agreed between the parties. In the absence of a contractual remedy, the courts will apply such remedies as are available under general law.

Penalty clauses are a commonly used remedy in Luxembourg law purchase agreements. Their purpose is to oblige the defaulting party to pay a predetermined lump sum in the event of delay or final failure to fulfil an obligation. Courts may however decide to moderate or increase a penalty clause which they hold to be excessive or derisory.

As a general rule, the enforcement of obligations before Luxembourg courts is subject to the nature of the remedies available. Traditional remedies for breach of contract are specific performance and/or damages. Luxembourg courts may, but are not obliged to, order specific performance, irrespective of any specific performance provision in the purchase agreement. In practice, cases where specific performance was granted by a Luxembourg court are very rare, which leads to assume that the typical remedy is damages.

Unless the value of the loss can easily be established, the assessment of the amount of damages is made through an evaluation by the courts or, if necessary, an independent expert.

4.9 Dispute resolution

Although disputes relating to a Luxembourg law purchase agreement are most frequently entrusted to the jurisdiction of the competent courts of Luxembourg, the choice of arbitration (International Chamber of Commerce or domestic) is a possible alternative. The enforceability of a foreign arbitration clause before a Luxembourg court will be examined in accordance with the United Nations convention on the recognition and enforcement of foreign arbitral awards of 10 June 1958.

5. DISCLOSURE REQUIREMENTS

Acquisitions of shares in a private *société anonyme* or *société en commandite* par actions do not require any governmental filing. Acquisitions of shares in a private *société à responsabilité limitée* must be notified to or accepted by the company. In practice this will usually be achieved by making the company a party to the purchase agreement. If the acquisition does not concern 100 per cent of the shares of the private *société à responsabilité limitée*, the share purchase agreement will need to include a statement from the sellers confirming that, for the purposes of article 710-12 of the law of 10 August 1915 on commercial companies as amended, they approve the purchaser under the share purchase agreement as new shareholder of the company. Such acquisitions must also be filed with the Luxembourg Trade and Companies' Register within one month from the transfer date, and published in RESA (*Recueil Electronique des Sociétés et Associations*), the Luxembourg official gazette.

Governmental filings are required for certain assets. The acquisition of real estate must, for example, be made in front of a notary who will file the acquisition deed and any related mortgage with the mortgage registry. Another example is the acquisition of a trademark or a patent, which will only be valid against third parties once filed with the relevant register.

If applicable, specific regulations must be considered, such as antitrust or special sector regulations (financial, insurance, telecommunications etc.).

In some cases (eg, transport of goods by waterways, sale of trips and tours) the transfer of a business may require the amendment of an existing establishment authorisation or the delivery of a new establishment authorisation by the relevant governmental authority.