Luxembourg Administrative Tribunal decision on the redemption of classes of shares

On January 27, 2023 the Luxembourg Administrative Tribunal has issued a decision (n. 42443) on the tax treatment of the redemption of the so-called alphabet shares.

This case gives clarity and guidance on the tax treatment of the repurchase of a class of shares (in presence of various classes), followed by its cancellation. It is relevant for many Luxembourg companies that have issued alphabet shares, with the aim of giving the shareholders/investors the possibility to redeem a class of shares as a mean of repatriation, without triggering the application of the withholding tax.

The decision concerns a Luxembourg limited liability company which had issued 10 classes of shares (Class A to J). The 10 classes of shares represented 5% of the share capital of the company and were owned by the same shareholder. In the following year, the company repurchased class J shares at a price significantly higher compared to the nominal book value. The company has considered the repurchase of the class J shares as a partial liquidation, therefore not subject to withholding tax. The tax authorities have challenged the approach on the ground of abuse of law and requalified the excess of the repurchase price over the nominal value of the repurchased class of shares as a hidden distribution, subject to 15% withholding tax.

The Luxembourg Administrative Tribunal has concluded that the redemption of shares does not have to be considered as a distribution of dividends (as established by the tax authorities) therefore it does not trigger the application of a withholding tax. Instead, the Tribunal has stated that, in the case of a redemption of shares (and a consequent reduction of share capital), any difference between the shares' book value and the repurchase price is deemed to be taxed as a capital gain.

Nevertheless, the Tribunal has affirmed that if the repurchase price exceeds the fair market value of the shares and the excess is not justified by any valid economic reason (other than the shareholder relationship), the surplus should constitute a hidden distribution of profits, subject to withholding tax. The case has been referred back to the tax authorities to determine the fair market value of the class J shares, in order to conclude whether this case triggers a hidden distribution of profits.

Taxpayers welcome the confirmation of the Tribunal with respect to the qualification of the redemption of shares for tax purposes, as class of shares' structures are widely used in Luxembourg. However, the decision has not given yet an indication whether alphabet shares are in general considered abusive or not.

For further information do not hesitate to contact one of our team members who will be glad to assist you at any time:

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