

# Changes proposed to Luxembourg draft law implementing ATAD 1 effective January 1, 2019

December 18, 2018

## In brief

Under the EU anti-tax avoidance directive ('ATAD 1') published in July 2016, EU Member States have until December 31, 2018 to transpose ATAD 1 into their domestic laws. On June 19, 2018, the Luxembourg government tabled a draft bill (n°7318) (the 'draft law') before the Luxembourg Parliament (Chambre des Députés) that would implement ATAD 1 as Luxembourg domestic law.

On October 5, 2018, the Chamber of Commerce issued extensive comments to the draft law. The State Council also published, on November 13, its comments on the text and expressed a view on areas needing changes or more clarification.

Amendments to the draft law now have been released to meet the modifications required by the State Council. These amendments are minimal, and most of the prior questions and comments remain. This Insight briefly covers significant clarifications or changes versus clerical amendments.

The draft law needs to go through the Luxembourg legislative process. Although changes are not expected, the law may be subject to further amendments before the Luxembourg Parliament final vote.

## In detail

### Interest limitation rules

The draft law introduces a new Article 168bis into the text of the principal legislation (the Income Tax Law of December 4, 1967 ('LITL')), setting out new interest deduction limitation rules in line with Article 4 of ATAD 1.

The limitation will apply to 'exceeding' borrowing costs. These are defined as the tax-deductible borrowing costs that exceed the taxpayer's taxable interest revenues and other

economically equivalent taxable income.

A taxpayer's exceeding borrowing costs will be deductible in a tax period only up to the higher of 1) 30% of the taxpayer's net revenues before interest, tax, depreciation and amortization ('EBITDA'), or 2) three million euros.

The initial draft law provided for grandfathering of loans concluded before June 17, 2016. The amendments revert to the exact wording of ATAD 1,

and thus clarify that said exclusion will not extend to any subsequent loan modifications.

The tax unity option has not been included; thus, it is not possible to apply those limitations on a consolidated basis for companies that are part of a tax unity.

However, Luxembourg's Finance Minister, Pierre Gramegna, announced on December 12, 2018 at a public event that an additional bill (the 'new bill') should be

submitted to the Luxembourg Parliament early next year. The new bill would amend the draft law.

**Observation:** This new bill should amend the interest limitation rules to bring in the option of Article 4 (1)(a) of ATAD 1, thus allowing Luxembourg taxpayers in a tax unity to apply the interest limitation rule on a consolidated basis. This amendment should be effective on January 1, 2019, even if the new bill is not voted into law until later in 2019.

The public announcement did not provide details on either the amendment or the content of the proposed provisions.

No other prior questions have been addressed — e.g., the definition of stand-alone entities (relevant for securitization vehicles) or clarification of definitions for interest-equivalent income and borrowing costs.

### Controlled foreign company measures

The draft law introduces Article 164ter into the LITL, setting out new controlled foreign company (CFC) rules in line with Articles 7 and 8 of ATAD 1.

Luxembourg has opted for option B, as foreseen by Article 7 (2) (b) of ATAD 1, thus targeting a CFC's non-distributed income arising from non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage.

The amendments clarify that the notion of non-distributed income must be assessed by referencing the taxpayer (i.e., the entity that must have the inclusion). Distributions from

the CFC to a subsidiary of the taxpayer (not a CFC itself) therefore would not be relevant.

### Hybrid mismatches

The draft law contains ATAD 1 anti-hybrid provisions (i.e., covering only intra-EU hybrid instruments and hybrid entity mismatches) in a new Article 168ter LITL.

The hybrid mismatch measures of ATAD 2, covering a wider range of intra-EU mismatches and also mismatches with third countries, should be included in a subsequent law expected in 2019, with a January 1, 2020 effective date. Therefore, the subsequent law is expected to replace, on January 1, 2020, the provisions that will apply on January 1, 2019).

Article 168ter LITL closely follows Article 9 of ATAD 1. A 'hybrid mismatch' is defined as arising when differences in the legal characterization of a financial instrument or entity in an arrangement structured between the taxpayer and a party in another Member State, or when the commercial or financial relations between a taxpayer and a party in another Member State, give rise to the following consequences:

- a deduction of the same expenses or losses occurs both in Luxembourg and in another Member State where the expenses or losses originated ('double deduction'), or
- there is a payment in Luxembourg in which the deduction has its source, without a corresponding

inclusion of the corresponding income in the total net revenues in the other Member State ('deduction without inclusion').

Item 2 above was amended to revert to the wording of ATAD 1, thus clarifying that this type of mismatch may arise from payments.

### Entry into force

For taxpayers within its scope, the draft law will apply for tax years beginning January 1, 2019, except for provisions relating to:

- the exit tax, which applies to tax years beginning January 1, 2020
- modifications to §6 (general anti-abuse rules) of the Luxembourg Adaption Law, which applies effective with the 2019 tax year to the extent that the taxpayer realizes certain types of income (i.e., salary, pension, income from movable assets, rental income, and income listed in article 99 LITL).

**Observation:** Only the second bullet is a change from the initial draft law.

### The takeaway

These amendments indicate the new Luxembourg government's willingness to formally adopt the draft law before year-end in order to comply with EU requirements.

Companies should consider the upcoming changes, as they may need to take action immediately in order to be effective on January 1, 2019.

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**Let's talk**

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For a deeper discussion of how this issue might affect your business, please contact:

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