Significant changes for treasury activities as from 2019:

Luxembourg’s implementation of the EU Anti-Tax Avoidance Directive

Elmar Schwickerath

Building a better working world

Introduction: International taxation throughout the years

22 June 1899:

The first DTT between Austria-Hungary and Prussia

After 1918:

- Facilitation of conclusion of DTTs by League of Nations
- Establishment of a group of experts working on international taxation

1956:

- The OECD launches works on the first model DTT
- **1961: the first OECD Model enters into force**

20th century, early 21st:

- DDTs are created in order to **facilitate international investment and cross-border business activities**
- Early 2000s: more than **2000 DTTs** around the world
- 1995: OECD published the first draft of TP Guidelines

Financial Crisis, 2008:

- Burst of the property bubble
- European debt crisis
- Public impression: multinationals not paying their 'fair' share of taxes'

Change of approach: focus on multinational enterprises, tax avoidance and anti-abuse measures

Base Erosion and Profit Shifting (BEPS), 2013:

- Initiative of the OECD, aimed at multinational companies carrying on international business
- 15 Actions, encompassing various anti-avoidance and anti-abuse measures
- **Main goals:** combating tax avoidance, taxing profits where value is created and activities performed

Now: ATAD I and ATAD II

(implementation of BEPS in the EU)

EY

European Union (EU) Anti-Tax Avoidance Directive (ATAD) – making BEPS real

What's going to come and when?

Tax years starting on or after

1 January 2019

- **ATAD :**
  - Interest limitation rule (30% EBITDA)
  - GAAR: similarities to PPT (already in P/S Dir. re dividend and dividend WHT exemptions)
  - Controlled Foreign Corporation (CFC) rules
  - Hybrid mismatches (EU only)

Tax years starting on or after

1 January 2020

- **ATAD:** Exit taxation
- **ATAD II (wider anti-hybrid mismatches rules):**
  - Hybrid instruments
  - "Reverse hybrid" partnership
  - Disregarded foreign branch of an EU company
  - Checked EU company
  - Notional payments by an EU branch of a foreign head office

1 January 2022

- **ATAD II:**
  - Taxation of EU reverse hybrid in EU country of organization

Main change for financing activities: Interest limitation rule

Interest limitation – applicable rules

2019

Current legislation

Full deduction of interest expenses if

(i) determined according to the arm's length principle, and

(ii) not linked to tax exempt income (article 45(2) LIR).

(iii) debt/equity ratio for holding activities of 85/15 based on administrative practice

New provision

The 30% EBITDA rule limits the deduction of net borrowing costs to the higher of

30% of the taxable EBITDA ↔ **EUR 3 million**

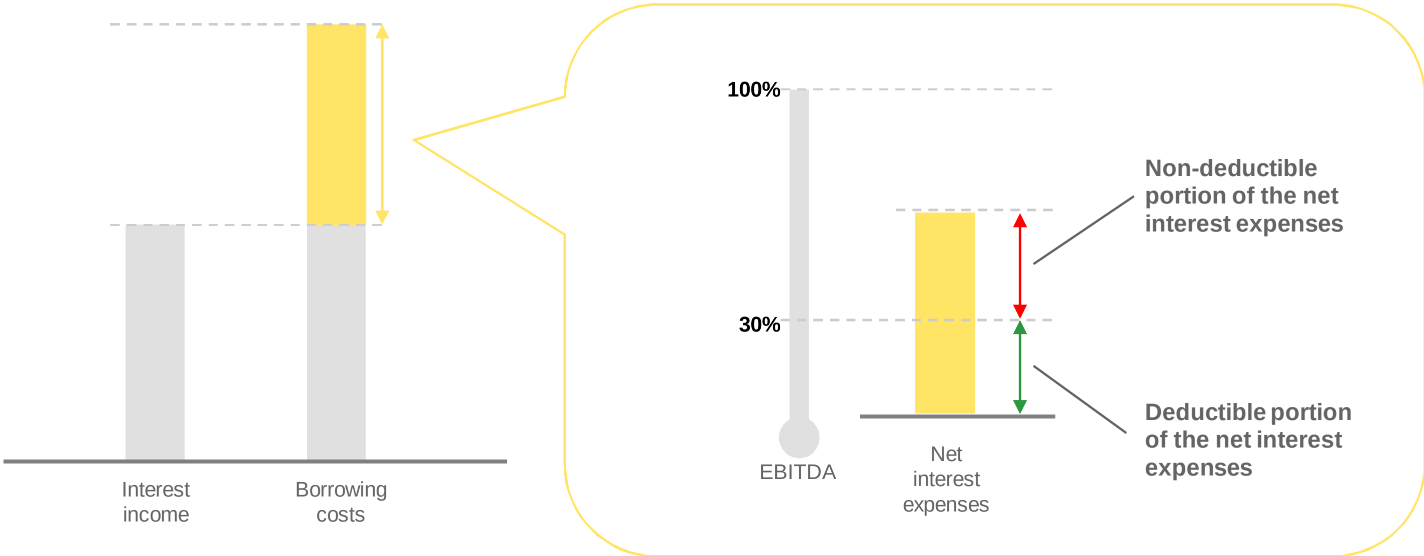
EY

Interest limitation – new provision

2019

The 30% EBITDA rule limits the deduction of net borrowing costs to the higher of

30% of the taxable EBITDA ⟷ **EUR 3 million**



Practical challenges?

- New rules may lead to **additional tax costs**, have **cash tax implications** at borrower level and may also have a **negative impact on the group's ETR**.
- New (EU-wide) limitations will be EBITDA based. Effect needs to be predicted based on **EBITDA forecasts** and on an **entity-by-entity basis**.

à Significant **planning and monitoring complexity**.

à **Deviations from the EBITDA forecasts** could lead to tax costs.

Interest limitation – options taken

2019

Luxembourg has taken the following options:

- **EUR 3 million de minimis rule:** exceeding borrowing costs below EUR 3 million remain deductible => a taxpayer is in any case allowed to deduct exceeding borrowing costs up EUR 3 million
- **Exclusion of stand-alone entities:** interest limitation rules do not apply to entities that are not part of a consolidated group and that do not have affiliated entities
- **Grand-fathering rule:** exclusion of loans concluded before 17 June 2016, provided they are not subsequently modified
- **Long-term public infrastructure projects:** loans funding such projects are excluded where the operator, borrowing costs, assets and income are all located in the European Union
- **Equity ratio rule:** deduction of entire amount of exceeding borrowing costs if the ratio of equity over total assets is equal or higher than the equivalent ration of the group
- **Carry forward of exceeding borrowing costs and unused interest capacity:** Exceeding borrowing costs that cannot be deducted in a given tax period can be carried forward indefinitely. Unused interest capacity exceeding €3 million can be carried forward for five years
- **Exclusion of financial undertakings:** among which credit institutions, AIFMs, AIFs managed by AIFMs, securitization vehicles covered by EU Regulation 2017/2402

Option to apply interest limitation on fiscal unity basis not taken (art 164bis LIR): interest limitation is calculated on a stand-alone basis and not at the level of the fiscal unity

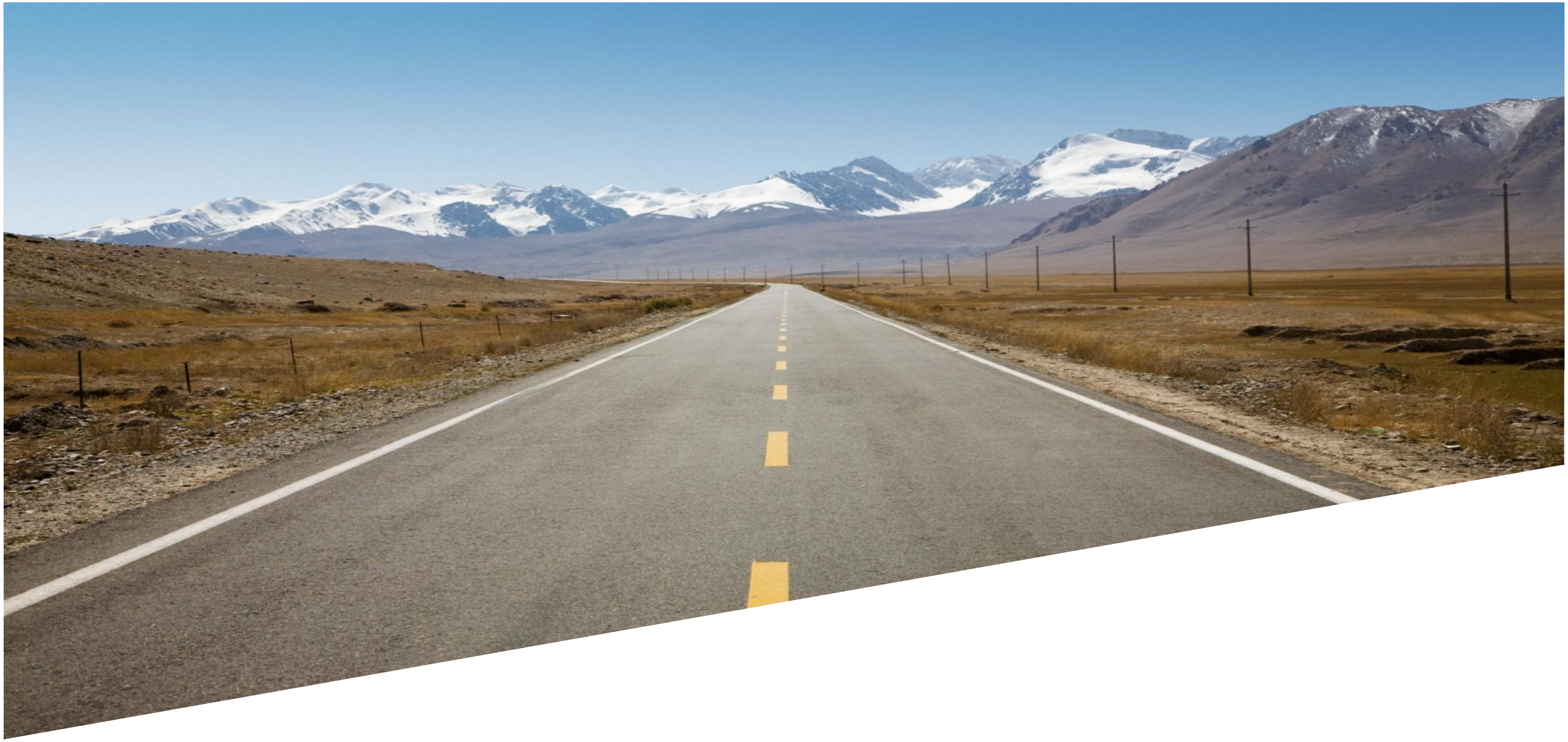
EY

Other measures

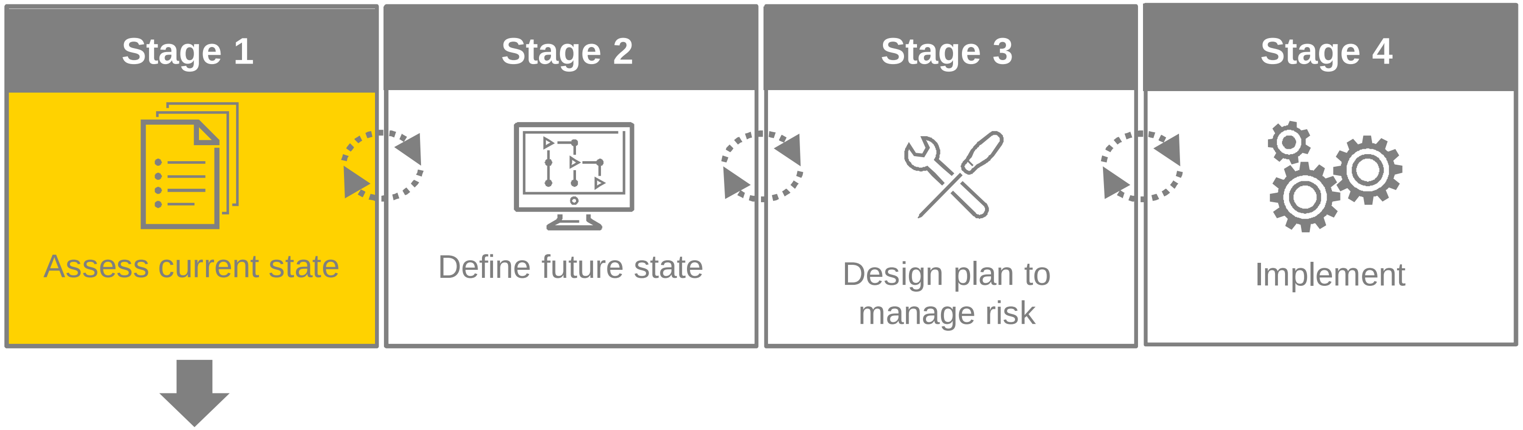
Other ATAD related measures

- ► Controlled Foreign Company (CFC) rules (2019)
- ► Anti-hybrid rules (EU only) (2019)
- ► General Anti-Abuse Rule (GAAR) (2019)
- ► Exit taxation (2020)
- ► Anti-hybrid rules (ATAD II – hybrid mismatches involving 3rd countries) (2020 / 2022)

What does this mean in practice?



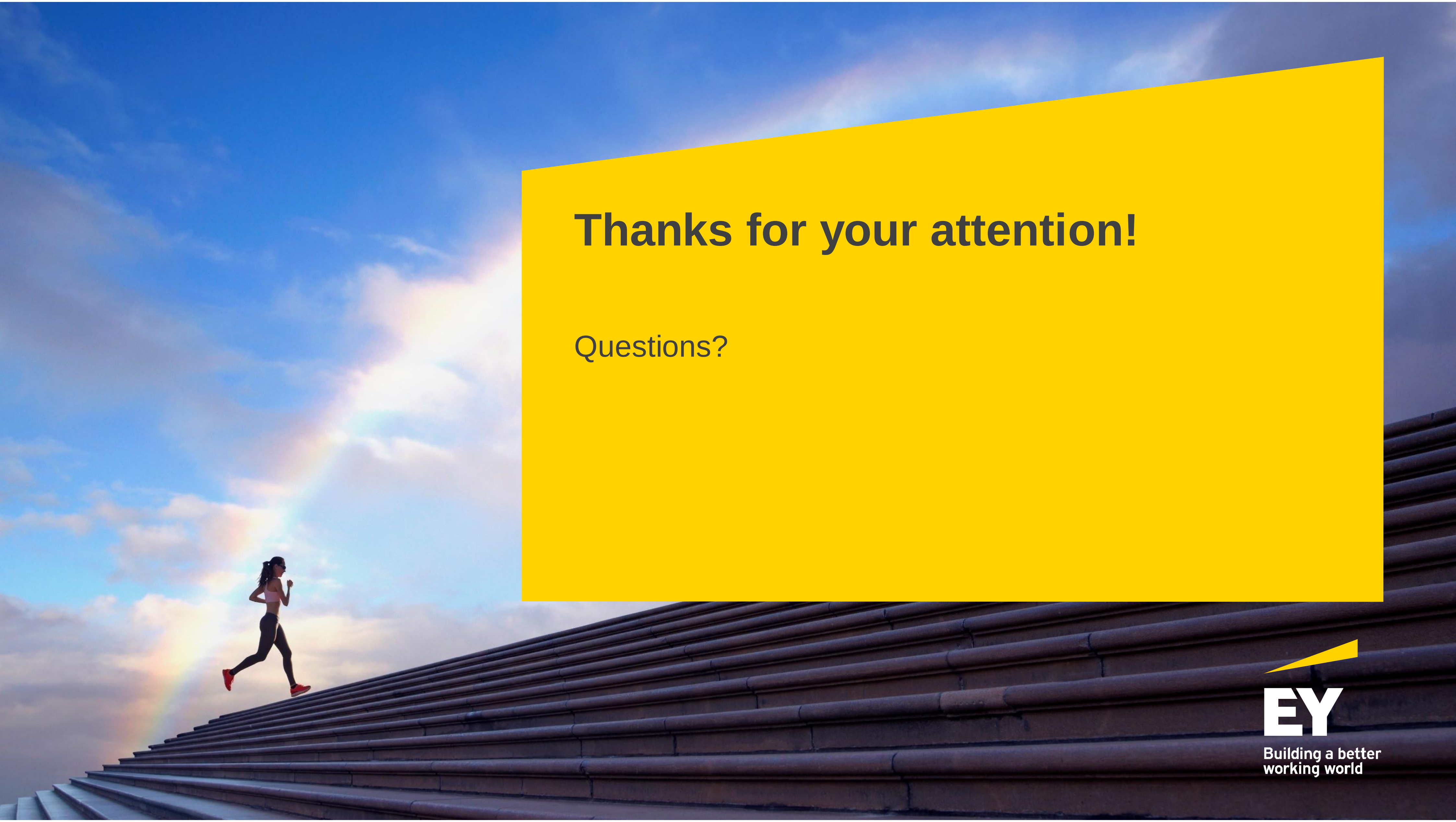
What does this mean in practice?



HEALTH CHECK

For example with regard to new interest limitation, this means…

- Impact assessment needed: Will interest expenses still be tax-deductible in the future?
- Benefit from grandfathering? Attention to be paid if existing loans are modified
- Feasible alternative structures to mitigate effect of new rules? E.g. “transform” group-internal financing into group-internal operational leasing



Thanks for your attention!

Questions?

EY
Building a better
working world

The information in this presentation is intended to provide only a general outline of the subjects covered. It should not be regarded as comprehensive or sufficient for making decisions, nor does it replace professional advice. Accordingly, Ernst & Young Tax Advisory Services Luxembourg S.à r.l. accepts no responsibility for loss arising from any action taken or not taken by anyone using this information. The information herein will have been supplemented by explanations arising from any oral presentation by us and should be considered in the light of this additional information. If you require any further information or explanations, or specific advice, please contact us and we will be happy to discuss matters further.

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.