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Luxembourg Publishes Clarifying Circular on Application of ATAD Interest Limitation Rule

Luxembourg has provided clarifications on the application of the group escape rule as part of the interest expense deduction limitation rules included in article 168bis of the Income Tax Law (ITL).

(a) Background. With effect from 1 January 2019, the interest deduction limitation rule was implemented in Luxembourg domestic law in line with the European Union Anti-Tax Avoidance Directive (EU) 2016/1164 (2016). Under this rule, net interest (interest income minus interest expense) is deductible up to 30% of a taxpayer's earnings before interest, tax, depreciation and amortization (EBITDA), or, alternatively, up to an amount of EUR 3 million, whichever is higher.
(b) Clarification. The relevant circular clarifies the group escape rule applicable to companies that are members of a fiscally integrated group (article 164bis (9) (no.9) of the Income Tax Law (ITL)). Under this rule, an integrating parent company or integrating subsidiary company can, on request, deduct all additional borrowing costs incurred by the integrated group if it is able to prove that the ratio between the sum of the equity of all the members of the integrated group and the sum of all the assets of all members of the integrated group is higher than or equal to the equivalent ratio of the consolidated group of which all the members of the integrated group belong. The ratio is deemed to be equal if a group can demonstrate that the ratio of its equity to its total assets does not fall more than 2 percentage points below the equivalent ratio of the group.

The group escape rule applies if the following cumulative conditions are met:

- all members of the integrated group must be members of the same consolidated group, i.e. fully integrated in the consolidated financial statements established by the parent company of the consolidated group;
- these financial statements must be drawn up in accordance with one of the eligible accounting standards, i.e. the International Financial Reporting Standards (IFRS) or the domestic Generally Accepted Accounting Principles (GAAP); and
- the accounts must be properly audited by an accountant.

If no legal obligation to prepare consolidated financial statements exists, such statements may be prepared on a voluntary basis to benefit from the group escape rule.

For the application of the rule, various adjustments must be made, the most important ones being the elimination of:

- internal transactions between group companies; and
- direct or indirect participations held between companies of the integrated group.

When filing the request for the application of the group escape rule, information must be added that all conditions are met, how the group ratio is calculated and how the integrated ratio is calculated based on equity and assets.

After the application of the group escape rule, no unused deduction capacity of previous years can be carried forward, and excessive borrowing costs, which were not deductible in previous years, do not become deductible.

We would be glad to help if this is something that affects your business.