

Tax administrative guidelines on the equity escape clause

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The Luxembourg Tax Authorities updated twice the circular of 8 January 2021 dealing with certain aspects of the interest deduction limitation rule (“**IDLR**”) laid down in Article 168bis of the Luxembourg tax law (“**LITL**”). To gain insight into this circular, please refer to our previous newsletter.

With a first update made on 2 June 2021, the Luxembourg tax authorities provided additional guidance on the IDLR with respect to the so-called "equity escape clause" (Article 168bis (6) LITL). The equity escape clause foresees the possibility for a member of a consolidated group for accounting purposes to deduct its entire exceeding borrowing costs if the taxpayer can demonstrate that the ratio between its equity to its total assets is equal to or higher than the same ratio of the consolidated group. On 28 July 2021, the Luxembourg tax authorities completed their guidance a second time in order to address the application of the equity escape clause in the context of a fiscal consolidation. The ultimate fiscal consolidated entity or a member of fiscal consolidated group could, indeed, deduct the entire exceeding borrowing costs of the fiscal consolidated group if the ratio between the equity to the total assets of the fiscal consolidated group is equal to or higher than the same ratio of the consolidated group to which all the members of the fiscal consolidated group must belong.

In light of the Luxembourg tax authorities' guidance, the conditions to be met in order to benefit from the equity escape clause can be summarised as follows:

- The taxpayer must be fully consolidated (i.e. full line-by-line integration) and proportional consolidation or equity method are excluded.
- The consolidation for financial accounting purposes could be either undertaken based on a legal requirement or on a voluntary basis.
- The consolidated financial statements must be drawn up in accordance with eligible accounting standards, i.e. International Financial Reporting Standards (IFRS) or with the

national financial reporting framework of a Member State (which includes the accounting standards applicable in each Member State and those whose conformity or equivalence is officially recognised or demonstrated by official accounting procedures).

- The accounting standards to be used is determined based on the legal consolidation requirements applicable to the ultimate consolidating entity. In the case of voluntary consolidation, the accounting standards to be used is determined based on the legislation that would be applicable in the jurisdiction of the ultimate consolidating entity, if the latter was legally required to prepare consolidated financial statements. However, IFRS is always accepted even if such legislation does not provide with such a possibility.
- The consolidated financial statements must be audited by an expert officially authorised to carry out audits of consolidated financial accounts under the national law of the ultimate consolidating entity.
- The application of the equity escape clause is subject to a request to be made for each financial year for which the taxpayer wishes to apply the equity escape clause.

Taxpayers need to carefully review their position for the application of the equity escape clause in light of the numerous conditions set forth by the Luxembourg tax authorities.

For any further information please contact us or visit our website at www.elvingerhoss.lu.

The information contained herein is not intended to be a comprehensive study or to provide legal advice and should not be treated as a substitute for specific legal advice concerning particular situations.

We undertake no responsibility to notify any change in law or practice after the date of this newsletter

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