

Luxembourg Tax Authorities Issue Guidance on EU Interest Limitation Rules

The first official guidance on the interest deduction limitation rules ("IDLR") provided by Article 168bis of the Luxembourg Income Tax Law ("LITL") was published in the tax circular (the "Circular") by the Director of Luxembourg Taxation, dated 8 January 2021¹.

The Circular provides detailed clarifications on how to interpret certain definitions and apply the rules in practice with several examples. However, further clarifications are expected, in particular on the notion of "interest income and other economically equivalent taxable revenues".

This update summarises the main points of the Circular².

Background

Pursuant to ATAD I³, Luxembourg implemented the IDLR with effect as of 1 January 2019. The IDLR states that the deduction of exceeding borrowing costs of a taxpayer is limited to 30% of taxable EBITDA⁴ or EUR 3,000,000, whichever is higher.

The exceeding borrowing costs correspond to the amount by which the deductible borrowing costs of a taxpayer exceeds taxable interest revenues and other economically equivalent taxable revenues.

Clarification on Certain Types of Borrowing Costs

The borrowing costs are broadly defined as:

- (a) Interest expense on all forms of debt;
- (b) Other costs economically equivalent to interest; and
- (c) Expenses incurred in connection with the raising of finance.

The Circular includes a detailed expansion and clarification of the examples of borrowing costs listed by the law.

It also specifies in particular, that only foreign exchange gains or losses relating to the interest of a debt are included in the definition of borrowing costs (foreign exchange gains and losses arising from the principal amount are not taken into account) and that the deduction for impairment of receivables does not trigger any borrowing costs for the creditor.

What is Interest and Economically Equivalent Income?

The IDLR does not define the notion of taxable interest income and other economically equivalent taxable revenues, however the Circular now confirms that this concept should be interpreted consistently and symmetrically with the notion of borrowing costs. From this perspective, at least in a pure domestic context,

¹ [January 8, 2021 Newsletter](#)

² [Circulaire du directeur des contributions L.I.R. n° 168bis/1 du](#)

³ The Anti-Tax Avoidance Directive EU 2016/1164.

⁴ Earnings Before Interest, Tax, Depreciation and Amortisation.

amounts that are not considered as borrowing costs at the level of the borrower are in principle not to be considered as interest income and other economically equivalent taxable revenues.

Exclusion of Certain Exceeding Borrowing Costs - Grandfathering Rule

The IDLR provides a grandfathering clause which states that exceeding borrowing costs related to loans contracted before 17 June 2016 are excluded from the IDLR. However, this exclusion does not extend to any subsequent changes in these loans.

The Circular specifies that in case of the subsequent amendment of a loan concluded before 17 June 2016, the grandfathering rule will continue to apply to borrowing costs incurred on the basis of the initial conditions of the loan, and the IDLR will only apply to the exceeding borrowing costs related to the modification.

The Circular provides guidance on what would constitute a disqualifying subsequent modification. For example, it clarifies that subsequent modifications of the debt instruments terms and conditions would constitute a disqualifying amendment, whereas simply calling for additional drawdowns of an existing facility loan would not.

Interaction with Other Rules

The Circular confirms that the other provisions of the law denying the tax deductibility of expenses (e.g., interest expense in relation to exempt dividend or expenses no longer deductible under anti-hybrid rules) have to apply before the IDLR to identify deductible borrowing costs. Similarly, tax adjustment of profits (up and down) under transfer pricing rules also have to apply first.

EUR 3,000,000 Limit

The Circular confirms that the EUR 3,000,000 alternative is available per each 12 month accounting year, though for short accounting years the entire EUR 3,000,000 is still available (i.e. no pro-rata deduction).

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