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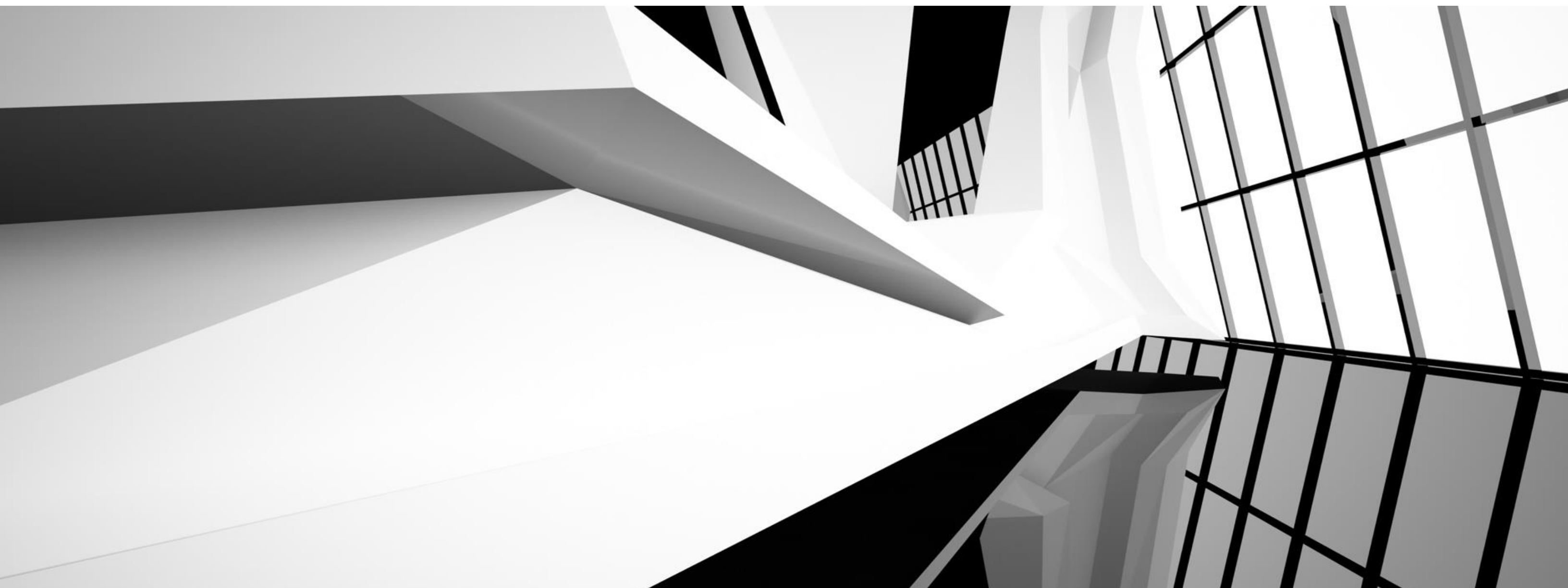
Luxembourg launched the implementation process of ATAD 2



Creativity

Efficiency

Sophistication

Knowledge

On 8 August 2019, the Luxembourg Government submitted bill n°7466 to the Parliament (the "**Bill**") to implement Council Directive (EU) 2017/952 of 29 May 2017 ("**ATAD 2**" or the "**Directive**") into Luxembourg law. Council Directive (EU) 2016/1164 of 12 July 2016, commonly referred to as "ATAD 1", already included measures dealing with hybrid mismatches in an EU context, in force in Luxembourg since 1 January 2019. The aim of the Directive ATAD 2 is mainly to take a step further by replacing the former measures set up by ATAD 1 and extend their scope, notably to transactions involving non-EU countries.

Background

ATAD 2 follows the recommendations of the OECD with regard to Action 2 (Hybrid mismatch arrangements) of the Base Erosion and Profit Shifting (BEPS) project and covers various type of hybrid mismatches.

In this context, EU countries have until 1 January 2020 to implement ATAD 2 into their national laws. Luxembourg has chosen to stick closely to the text of the Directive and to apply the exceptions granted by ATAD 2. However, the Bill still needs to go through the legislative process and may be still subject to amendments before the final vote at the *Chambre des Députés*.

The main objective of ATAD 2 is to neutralize hybrid mismatches resulting in mismatch outcomes between associated enterprises (broadly, situations with a double deduction or a deduction without inclusion).

The new rules will enter into force as from 1 January 2020, except for the provision on reverse hybrid mismatches, applicable as from tax year 2022.

Overview

Luxembourg corporate income taxpayers, including Luxembourg permanent establishments ("**PE**") of foreign entities would fall under the scope of the the new measures proposed by the Bill.

The provisions of the Bill would apply whenever there is a "hybrid mismatch":

- under a "structured arrangement";
- between "associated enterprises";
- between a head office of an entity and a PE;
- between two or more PE of the same entity; or
- in cases of dual tax residence.

The Bill covers *inter alia* the following hybrid mismatches scenari:

- **Deduction without inclusion:** Refers to a situation where a deduction of a payment is realized at the level of the paying entity without a corresponding inclusion of such payment in the taxable income of the payee entity. In such a case the deduction on the hybrid payment may be denied for Luxembourg tax purposes.

- **Double deduction:** May occur if a Luxembourg entity deducts the same payment in two different countries or if two taxpayers, including a Luxembourg entity, deduct the same payment in two different jurisdictions.

- **Double non-taxation or double tax credit:** May often occur when neither a PE nor the head office of a Luxembourg entity includes the income in its taxable base or the same income allows for a foreign tax credit to two different taxpayers.

The Bill should particularly impact hybrid instruments such as PECs (Preferred Equity Certificates) and CPECs (Convertible Preferred Equity Certificates) used by Luxembourg entities with US tax resident shareholders or investors. Any structure which includes a Luxembourg entity that has issued any PECs or CPECS should be reviewed as soon as possible with the upcoming legislation in mind.

The reverse hybrid rules, which will enter in force in 2022, will not be applicable to collective investment vehicles that are widely held, have a diversified portfolio, and are subject to investor-protection regulations, such as UCITs, Part II UCIs, SIFs and RAIFs.

Limitation provided by the Bill

The Bill provides that the new legislation should only apply to "deductible payments". Which means that, unless otherwise mentioned, the rules only apply to payments and not for example to provisions recorded in relation to financing instruments.

Non-deductible payments are excluded from the scope of the Bill.

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