

# Interest Limitation Rules: Extended to Luxembourg EU Regulated Securitisation Vehicles

On 9 March 2022, the Luxembourg Parliament published a draft law<sup>1</sup>, which proposes to revoke an exemption available for EU regulated Luxembourg securitisation vehicles ("SVs") from Luxembourg's interest limitation rules ("ILRs"). The draft law is expected to enter into force as of 1 January 2023.

If the draft law is enacted in the form published, these Luxembourg SVs will be subject to the ILRs and may be at risk of increasing their Luxembourg corporate tax exposure, in light of potential deductibility limitations on payments made to SV investors.

The draft law stems from a formal notice letter sent by the European Commission ("EC") in 2020 advising Luxembourg to remove the ILRs exemption applicable to EU regulated Luxembourg SVs<sup>2</sup>.

## Interest Limitation Rules and the Luxembourg SV Exemption

Pursuant to ATAD I, Luxembourg implemented its ILRs, which generally limit tax deductibility of 'excess borrowing costs' to 30% of EBITDA or EUR 3,000,000 (whichever is higher)<sup>3</sup>.

Excess borrowing costs are generally defined as the amount of tax deductible borrowing costs incurred by a taxpayer, which exceed

taxable interest income and other economically equivalent income.

Both ATAD I and relevant Luxembourg legislation provide for several exemptions from ILRs for financial undertakings, as specifically defined and listed including alternative investment funds ("AIFs"), insurance companies and banking institutions.

However, Luxembourg's ILRs also provide for an additional exemption for financial undertakings for Luxembourg SVs, which qualify as 'securitisation special purpose entities' within the meaning of Regulation (EU) 2017/2402. This imposes, *inter alia*, certain disclosure and transparency obligations, as well as restrictions regarding retail investors.

This exemption is particularly advantageous for Luxembourg SVs because under Luxembourg's securitisation regime all payments to commitment holders, whether in the form of dividends or interest, are deemed to be interest expenses for Luxembourg tax purposes and thus, tax deductible.

Conversely, the EC in its notice letter took the position that these SVs do not qualify as financial undertakings as defined under ATAD I, and therefore requested Luxembourg to

<sup>1</sup> Projet de loi N° 7974 portant modification de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu

<sup>2</sup> On 4 May 2020, the EC issued a formal notice letter. For more information on this letter please see our legal [update](#)

<sup>3</sup> Luxembourg Income Tax Law article 168bis

remove this specific additional exemption from its legislation.

## Impact on Exemptions to AIFs and Other Financial Undertakings

The eventual removal of the SV exemption from ILRs will not impact the exemptions available to other financial undertakings such as AIFs, UCITS, insurance and reinsurance companies and credit institutions.

## Impact on Existing Luxembourg SVs

Luxembourg SVs in corporate form that earn income other than interest (or its economic equivalent), could be impacted by this development. The removal of the exemption could result in a limitation of tax-deductible commitment payments to 30% of EBITDA or EUR 3,000,000 (whichever is higher). The limitation applies by entity and not by compartment.

Affected SVs should have until 1 January 2023 (the expected enforcement date) to amend their operations in anticipation of the new proposal.

Conversely, Luxembourg securitisation funds and Luxembourg securitisation undertakings that are formed as limited partnerships should not be impacted by the removal of the exemption because they are tax transparent and thus, outside the scope of the ILRs.

In addition, Luxembourg SVs in corporate form with income in the form of interest (or its economic equivalent) should also generally not be impacted. The ILRs only apply to such SVs with excess borrowing costs, i.e. SVs in a negative net interest expense position.

For more information on Luxembourg's ILRs, please see our prior update, *Luxembourg Tax Authorities Issue Guidance on EU Interest Limitation Rules* as well as our webinar, *The*

## *EU Interest Limitation Rules Impact on Investment and Fund Structures.*

For further information or advice as to how this development may affect current structures with Luxembourg SVs, please reach out to any of the persons listed below or your usual Maples Group contact.

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