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Luxembourg Newsflash - 08 August 2023

Pillar 2 implementation in Luxembourg: Bill submitted to Parliament

On 4 August 2023, the Luxembourg government presented Bill of law no. 8292_ implementing Council Directive (EU) 2022/2523_ of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

To read our newsflash on the Pillar 2 Directive, click here_

The proposed measures in the Bill are largely in line with the provisions of the Pillar 2 Directive. Continue reading for a summary of the main features and a focus on some key points.

General application

The proposed measures will apply to constituent entities located in Luxembourg that are members of an MNE group or a large-scale domestic group which had an annual revenue equal to or above EUR 750,000,000, including the revenue of excluded entities, in its ultimate parent entity's (UPE) consolidated financial statements for at least two of the four fiscal years immediately preceding the tested fiscal year.

In-scope MNE groups and large-scale domestic groups will pay a top-up tax whenever the effective tax rate (ETR) of constituent entities determined on a jurisdictional basis is below the minimum rate of 15% ("low-taxed constituent entities").

The top-up tax will take the form of an income inclusion rule (IIR) and an undertaxed profit rule (UTPR).

The (Luxembourg) parent entity of an MNE group will apply the IIR in relation to a top-up tax that has been determined for the low-taxed constituent entities of the MNE group. The UTPR is a back-up mechanism, the purpose of which is to ensure that any residual amount of top-up tax that has not been subject to the application of an IIR is reallocated to the relevant jurisdiction(s) on the basis of a specific formula. The UTPR may, for example, apply in Luxembourg when the UPE is located in a jurisdiction that does not have a qualified IIR, or when the UPE is an excluded entity.

Introduction of a QDMTT

Furthermore, Luxembourg **has opted to include a qualified domestic minimum top-up tax** (QDMTT), according to which a domestic top-up tax will apply with priority over the IIR and the UTPR to all low-taxed constituent entities located in Luxembourg (this also includes Luxembourg joint ventures within the meaning of Pillar 2 and their Luxembourg affiliates). The amount of any top-up tax due by a foreign UPE

will be reduced to zero by the amount of Luxembourg QDMTT due from the Luxembourg constituent entities of the MNE group. The QDMTT will be determined and administered in accordance with the Pillar 2 rules detailed in the Bill, in particular for the determination of the ETR and of the top-up tax amount.

Calculation of ETR

The ETR will be calculated by dividing the amount of adjusted covered taxes of the constituent entities in the jurisdiction by their net qualifying income or loss, as reported in the financial accounts used for consolidation purposes, with certain adjustments. Those adjustments are largely in line with the Pillar 2 Directive, with a small exception. The financial accounting net income or loss of a constituent entity may be adjusted by the amount of a debt waiver (which is normally recorded as an exceptional profit by the debtor) in certain circumstances (for example in the context of insolvency proceedings, or in certain cases involving third-party creditors). The Bill clarifies that Luxembourg covered taxes include *inter alia* corporate income tax, municipal business tax and net worth tax. A current tax expense that is not expected to be paid within three years after the end of the fiscal year is adjusted (deducted) from the amount of covered taxes. The commentary to the Bill clarifies that filing a tax return will normally be considered as triggering an expectation on the part of the taxpayer that the corresponding taxes are due to be paid within three years.

The Bill confirms in line with Recital 24 of the Pillar 2 Directive that taxpayers should use the **GloBE Rules, the Pillar 2 Commentary and the GloBE administrative guidance of February 2023 as sources of illustration or interpretation**. The bill does not include any reference *inter alia* to the OECD's detailed guidance on QDMTT or to the QDMTT safe harbour rules, both of which were included in the GloBE administrative guidance of July 2023. They may have been omitted due to time constraints.

Safe Harbour Rules

The Bill implements a **transitional country-by-country report (CbCR) safe harbour**, which aims to provide transitional relief (with a top-up tax equal to zero) for MNE groups operating in low-risk jurisdictions in the initial years during which the rules come into effect (the transition period). In line with the **GloBE Safe Harbours and Penalty Relief_** released in December 2022, the safe harbour will apply in three cases:

- where the MNE group (or the large-scale domestic group) reports total revenue of less than EUR 10 million and profit before income tax of less than EUR 1 million in the jurisdiction on its qualified CbCR for the fiscal year (*de minimis test*), or

- the MNE group has a simplified ETR that is equal to or greater than the transition rate (15% for financial years starting in 2023 and 2024, 16% for financial years starting in 2025, 17% for financial years starting in 2026) in the jurisdiction for the fiscal year (*simplified ETR test*), or

- the MNE group's profit before income tax in such jurisdiction is equal to or less than the substance-based income exclusion amount for constituent entities resident in that jurisdiction under the CbCR, as calculated under the proposed rules.

If an MNE group has not applied the transitional CbCR safe harbour with respect to a jurisdiction in a fiscal year in which the MNE group was subject to the above rules, the MNE group will not qualify for that safe harbour for that jurisdiction in a subsequent year. The proposed rules include specific rules that apply *inter alia* to joint ventures and their affiliates, UPEs that are tax transparent entities and investment entities, as well as certain exclusions.

Administrative domestic provisions and penalties

Each Luxembourg constituent entity (as well as joint ventures within the meaning of Pillar 2) of the MNE group or large-scale domestic group will, in addition to their filing obligations, be required to register with the Luxembourg direct tax authorities within 15 months after the last day of the reporting fiscal year (or 18 months for the transition year) and provide information on the UPE and the filing constituent entities. Filing obligations are generally in line with the Pillar 2 Directive, but any Luxembourg tax due on the basis of either the IIR, UTPR or the QDMTT is payable within one month after the filing of the Pillar 2 returns. None of those taxes will be creditable or deductible against any other tax.

In addition, the Bill includes penalties for constituent entities that do not meet their registration and filing obligations. In particular a fine of up to EUR 250,000 may apply for late filing and filing incomplete or inaccurate information. The information file will be subject to an automatic exchange of information with jurisdictions that have signed an agreement with Luxembourg (list to be provided in a Grand Ducal regulation).

The Bill also introduces joint and several liability for the payment of any Luxembourg top-up tax due between the Luxembourg members of the MNE group or large-scale domestic group.

The provisions will apply from the 2024 tax year, except for the provisions on UTPR, which will apply from the 2025 tax year (unless the UPE is located in a jurisdiction that has opted for the deferred application of the IIR and UTPR rules).

Conclusion and next steps

As expected, the proposed measures are very similar to the Pillar 2 Directive. It is confirmed that the solutions identified at OECD level in relation to the OECD model rules will likely remain relevant for the application of the Luxembourg Pillar 2 rules. As the proposed rules (including a QDMTT) will apply from the 2024 tax year, taxpayers are advised to promptly assess whether they fall within the scope of the proposed rules and/or whether there will be any practical impact on their operations. The application of any safe harbour or transition rule will need to be monitored.

The Bill will now follow the usual legislative process through Parliament.

How can we help?

The Tax Law Partners and your usual contacts at Arendt & Medernach are at your disposal to assess and advise on the Bill’s impact on your operations in Luxembourg.

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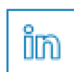
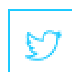
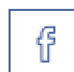

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