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Tax implications with the use of IFRS accounts in Luxembourg



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Contents

1. Law of 10 December 2010 on IFRS for undertakings
2. Calculation of profits for tax purposes
3. Valuation principles
4. Tax neutrality of the bill for IFRS account

1. Law of 10 December 2010 on IFRS for undertakings

Executive summary on the law of December 2010

- Entry into force of the law on 20 December 2010
- Possibility not to apply the law for those financial periods/year ends still open on 20 December
- Three-fold objective
 - Introduction of IFRS
 - Confirmation of the fair value accounting option for financial instruments under LuxGAAP
 - Modernisation and simplification of accounting

Executive summary on the law of December 2010

Before the new law

		IFRS (EU)	Lux GAAP +FV option	Lux GAAP
Listed companies	Annual accounts	Individual exemption from Ministry of Justice (CNC)		Obligation
	Conso accounts	Obligation		
Banks, (re-)insurance companies	Annual accounts	Optional	Optional	Common regime
	Conso accounts	Optional	Optional	Common regime
Other companies	Annual accounts	Individual exemption from Ministry of Justice (CNC)		Obligation
	Conso accounts		Optional	Common regime

Executive summary on the law of December 2010

After the new law

Free options

No permission from Ministry of Justice needed

		IFRS (EU)	Lux GAAP +FV option	Lux GAAP
Listed Companies	Annual accounts	Optional	Optional	Common regime
	Conso accounts	Obligation		
Other Companies	Annual accounts	Optional	Optional	Common regime
	Conso accounts	Optional	Optional	Common regime

Executive summary on the law of December 2010

Confirmation of fair value accounting option

Scope

1. Financial instruments, including derivatives
2. Assets other than financial instruments

Methods for determining fair value

Change in fair values

1. Either in equity or profit & loss account
2. Ruled by the law based on current IAS 39

Additional disclosure required in both the annual and the consolidated accounts

1. When fair value is used
2. When fair value is NOT used
 - FV, nature and extent of derivatives
 - information about financial fixed assets carried at an amount in excess of their FV

Executive summary on the law of December 2010

Tax consequences

Tax aspects not addressed by draft law

1. First time adoption of IFRS
2. IFRS / FV considerations
3. Current taxes / deferred taxes

Current situation

1. “IFRS Pillar” of draft law 5924 deposited on 1 October 2008 with Luxembourg Parliament, withdrawn and not reintroduced yet
2. No tax final assessments until now...
3. Discussions with tax administration on a case by case basis
4. Preparation of corporate tax returns
 - based on diverging tax accounts including adjustments to IFRS commercial accounts
 - based on IFRS commercial accounts without separate diverging tax accounts, with or without specific adjustments

2. Calculation of profits for tax purposes

Calculation of profits for tax purposes

Article 18 LITL

- According to article 18 LITL, profit is defined by comparison of the net assets at the end of the year and the beginning of the year
- For the time being, rather a balance sheet approach than a P&L approach

Equity (“actif net investi”) at the end of the accounting period

- Equity (“actif net investi”) at the beginning of the accounting period

+ Personal drawing / Dividend Distribution

- Private capital contribution / Equity Contribution

Taxable Profit (according to article 18 LITL)

Introduction - Key messages of the bill (1/2)

- Bill presented before the Luxembourg Parliament on 1 October 2008 to amend the Luxembourg Income Tax Law (“**LITL**”)
- Recognition of IFRS as a basis for the determination of profits for corporate tax purposes
- Companies would continue to determine their taxable profit on the basis of the commercial accounts based on IFRS or LuxGAAP
 - no need to prepare a second set of accounts
- General principle provided by article 40 LITL would remain applicable with adjustments where necessary (“accrochement”, “Massgeblichkeit”)
- New rules would allow partial divergence between commercial and tax balance sheet (“décrochage ponctuel”)

Introduction - Key messages of the bill (2/2)

- Clarification how to calculate the taxable base and determine the “fiscal” profit
- Adoptions and amendments to the rules for calculating the commercial income for tax purposes (new article 18 LITL and Grand-Ducal Decree)
- Adoptions and amendments to valuation principles (article 23 LITL and Grand-Ducal Decree)
- Neutralisation of non-desired tax implications

Calculation of profits for tax purposes

Amendments to article 18 LITL (1/3)

- Draft Law and Grand-Ducal Decree provided the legal basis for the switch from LuxGAAP to IFRS for tax purposes.
- The bill provides clarification on
 - the taxable basis; and
 - the profit for tax purposes.
 - Increase of profits by non-deductible expenses
 - Decrease of profits by tax-exempt income items

Calculation of profits for tax purposes

Amendments to article 18 LITL (2/3)

- Determination of Profit according to the bill N°5924:

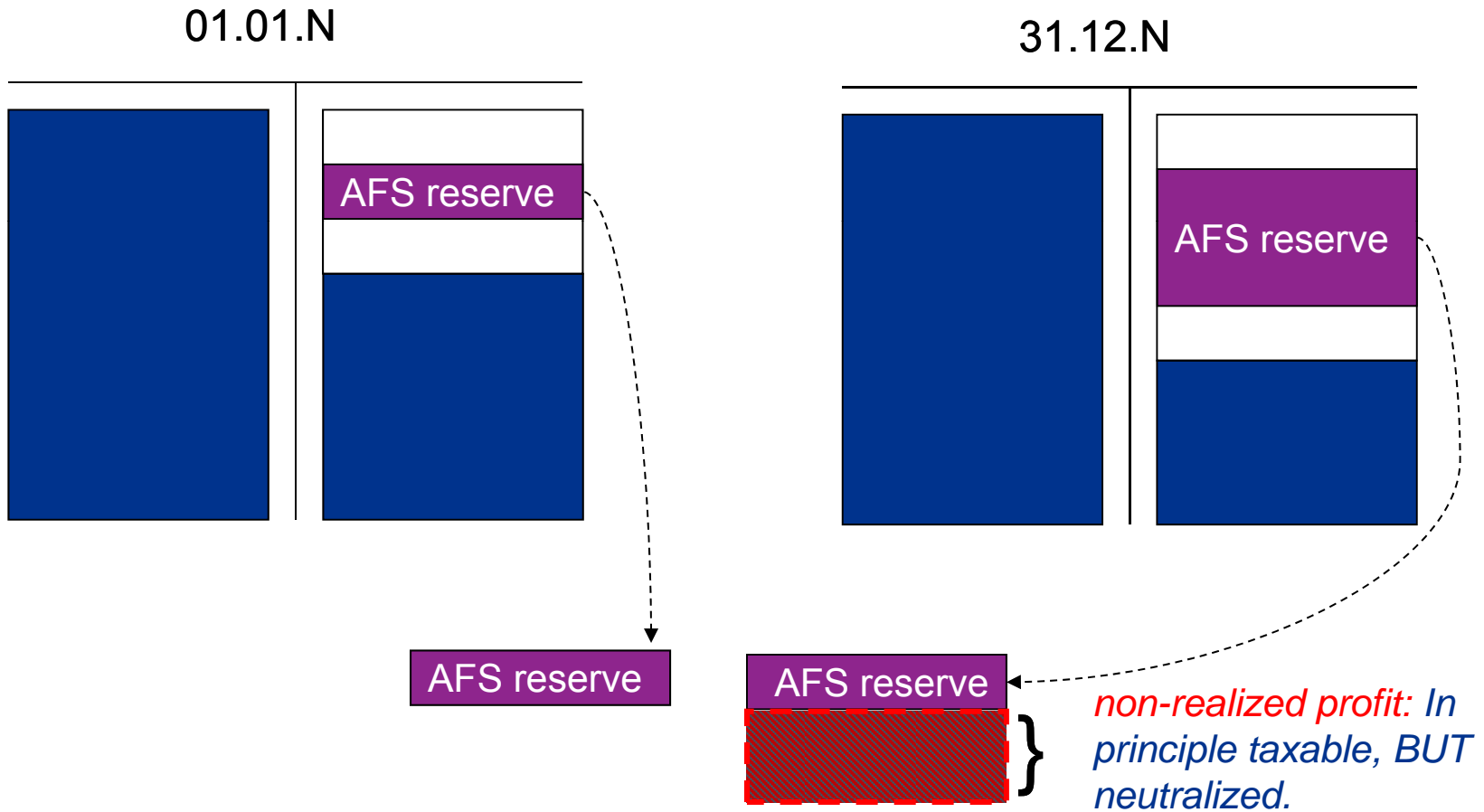
	Equity (“actif net investi”) at the end of the accounting period
-	Equity (actif net investi) at the beginning of the accounting period
+	Dividend Distribution
-	Equity Contribution

	Profit
+	Revaluation surplus at the beginning of the accounting period
-	Revaluation surplus at the end of the accounting period

Taxable profit (according to the amended article 18 LITL)

Calculation of profits for tax purposes

Amendments to article 18 LITL (3/3)



3. Valuation principles

Valuation principles

Article 23 LITL

- Article 23 LITL fixes the valuation of fixed assets and other assets as follows:
 - if the current-value is below the book value n / acquisition price (“AP”), valuation at the current value is optional;
 - If the current value is above the book value n / AP, valuation at the current value is not possible. The acquisition price constitutes the maximum. The “Beibehaltungsprinzip” is applicable.
- However, in practice, the Luxembourg Tax Authorities interpret article 23 (2) LITL in a more strict sense in the way that any real depreciation of a fixed asset has to be taken into account in the respective balance sheet

Example 1	Value Decrease	Value Increase
Book Value n / AP	100	100
Current Value	80	120
Book Value n+1	80 / 90 / 100	100

Valuation principles

Amendments to Article 23 LITL

- The new article 23 LITL introduced by the bill would not profoundly amended the existing applicable valuation principles.
- However, valuation at current value (“valeur d’exploitation”, “Teilwert”) remains no longer optional but becomes mandatory.
- Applicable to both fixed assets (amortisable) and other assets (special rules for financial instruments!)
- Only if current value below acquisition price (upper limit)

	N+1	N+2
Acquisition price	100	100
Current value	100	80
Valuation for tax Purposes	100	80

Mandatory, no longer an option

Valuation principles

Amendments to Article 23 LITL: Beibehaltungsprinzip

- The so-called “Beibehaltungsprinzip” would be maintained:

→ A value adjustment could be maintained, even if the current value was above the book value

	N + 1	N + 2
Acquisition price	100	100
Current value	80	110
Valuation for tax purposes	80	80

- However, this is not available for financial instruments under IFRS (see article 23 (3a) LITL)

Valuation principles

Amendments to Article 23 LITL: Valuation of financial instruments

- Important changes regarding the valuation of financial instruments (article 23 (3a) LITL)
- Financial instruments had to be valued at a value exceeding their acquisition price
 - Only to the extent that such a valuation is required by accounting standards

Acquisition price	100	} Valuation at fair value for accounting purposes
Fair value	120	
Book value	120	

→ Valuation at fair value (120) would also be used for tax purposes

Valuation principles

Article 40 LITL and “décrochage ponctuel”

- Article 40 LITL foresees that the tax balance sheet is based on the commercial balance sheet with adjustments where necessary.
- General principle of article 40 LITL remains applicable
 - Financial statements = basis for the tax computation with adjustments where necessary (“accrochement”, “Massgeblichkeit”)
- However, the bill N°5924 allows partial divergence between the accounting and tax balance sheets (“décrochage ponctuel”)
 - General objective: make sure that companies will continue to benefit from any tax measure, including the various exemption mechanisms provided by the LITL

4. Tax neutrality of the bill for IFRS account

Tax neutrality of the bill for IFRS account

Roll-over provisions (articles 53, 54 and 54bis LITL) (1/4)

- General objective of the bill N°5924
 - maintain the benefits of these provisions for all companies irrespective of accounting method chosen (IFRS or LuxGAAP)
- Current rules for transfer of gains would remain applicable (including permissible reinvestment period)
- Roll-over provision not disclosed in the commercial balance sheet under IFRS
- BUT possibility to disclose in separate tax balance sheet

Tax neutrality of the bill for IFRS account

Roll-over provisions – example article 54 LITL (2/4)

LuxGaap

Year N: Sale of an asset which is eligible according to article 54 LITL

Asset	100
Sale	<u>150</u>
Capital gain	50

Year N+1

Purchase of new asset	150
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Accounting B/S – 31.12.N			
Asset	100	Equity	100
	<u>-100</u>	Profit	50
	0		
Cash	150		
Total	150	Total	150

Accounting B/S – 31.12.N+1			
Asset	150	Equity	100
		Article 54 LITL	50
Cash	0		
Total	150	Total	150

Tax neutrality of the bill for IFRS account

Roll-over provisions – example article 54 LITL (3/4)

IFRS

Year N: Sale of an asset which is eligible according to article 54 LITL

Asset	100
Sale	150
Capital gain	<u>50</u>

Accounting B/S – 31.12.N			
Asset	150	Equity	100
	<u>-150</u>	Profit	50
	0		
Cash	150		
Total	150	Total	150

Tax B/S – 31.12.N			
Asset	150	Equity	100
	<u>-150</u>	Art 54 LITL	50
	0		
Cash	150		
Total	150	Total	150

Tax neutrality of the bill for IFRS account

Roll-over provisions – example article 54 LITL (4/4)

IFRS

Year N+1

Purchase of new asset 150

Accounting B/S – Year N+1			
New Asset	150	Equity	150
Cash	0		
Total	150	Total	150

Tax B/S – Year N+1			
NewAsset	150	Equity Art 54 LITL	100 50
Cash	0		
Total	150	Total	150

Attention: Deferred Tax Liability to be considered

Tax neutrality of the bill for IFRS account

Participation exemption regime

- Exemption of fair value movements taxed in a year prior the sale of a participation provided that the conditions are met at the moment of the sale of a participation valued on the basis of new article 23 (3a) LITL
- Full global capital gain exempt if:
 - the gain is realised on the sale; and
 - the gain is generated during the previous accounting years by the reevaluation of the participation.

Acquisition price	100
Fair value	120 20
Sale price	150
Exempt amount	50

Tax neutrality of the bill for IFRS account

AGDL provision = AGDL reserve

- Not possible to set up AGDL provision under IFRS
- Amendments to article 167 (1) LITL and the law of 5 April 1993 on the financial sector (articles 62-2bis et. sub.); abolition of Grand-Ducal Decree dated 21 December 1991
- AGDL provision could have been “converted” to AGDL reserve (“réserves de garantie des dépôts”)
- Allocations to AGDL reserve remained deductible for tax purposes (new article 167 (1) n° 5 LITL)



Discussion

Q&A

Thank you

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