Financial restructuring and tax implications in Luxembourg

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In times of financial uncertainties, and the subsequent distress that may follow, companies may have to look for ways to soften the financial burden they bear during this particular period.

The following options (a non-exhaustive list of "out of court" options) are usually put on the table:

- Conversion of debt into equity
- Amendment of the loan financing conditions
- Refinancing by a new lender
- Debt waiver/forgiveness
- Asset sale/transfer

All these techniques, provided that they are allowed by the company's articles of association and other agreements, may require the consent of the relevant creditors but also, in some cases, of other stakeholders. Therefore a complete review of financing instruments or other contracts may be needed.

Importantly, it is likely that these changes will carry some tax consequences.

As a reminder, a tax cost (i.e. corporate tax) may occur as soon as a transaction or operation triggers or is deemed triggering a variation of the net asset value of the company. And accounting rules provide for a large set of situations where this may occur. Besides, Luxembourg tax rules are driven by important principles, such as substance over form principle, economic reality and arm's length principle.

All of this put together, it means that a company's restructuring should also be analysed from a tax perspective, otherwise the tax effects may offset the financial relief granted by the operation. Below, we have indicated some of the tax consequences which may occur.

What might be the tax consequences?

First, any situation where a Luxembourg debtor is granted a (full or partial) forgiveness or waiver on its existing liabilities should be monitored as this results mechanically in an increase of its nets assets value, therefore a potential taxable profit. This could be offset though the utilisation of tax losses, assimilation to a shareholder's contribution, *gain d'assainissement*, but these tools require careful analysis too. The inclusion of a "best fortune" clause may not change this tax analysis.

Also, the conversion of debt into equity is analysed from a Luxembourg tax standpoint as a disposal by the creditor of its receivable at its fair market value, followed by the acquisition of the shares of debtor. From the debtor's perspective, one should pay attention to the conversion value: indeed, if by reason of the conversion, the debtor ends up being definitely relieved of a portion of its liability, this could be treated as a debt waiver, which consequences are treated in the paragraph above.

Amending the financing documentation can also trigger unexpected tax consequences. For instance, Luxembourg law introduced interest limitation rules in 2018 (effective as from 2019). And the law provides for grand-fathering rules for loans concluded before 17 June 2016, meaning that the deduction of interest therefrom will not be limited under article 168 bis of Luxembourg income tax law (**LITL**) However, as clarified by an administrative circular a modification of substantial features of the loan would terminate the benefit of the grandfathering clause. In addition, any change in intercompany financing should follow the principles given by articles 56 and 56bis LITL and therefore be driven by arm's length considerations. Otherwise, interest therefrom may (partially) not be deductible from the debtor's tax basis and in some cases be subject to withholding tax.

As for asset sale, any gain thereof will be a taxable income. Available exemptions exist but they relate mainly to capital gain on substantial participations, under the participation exemption regime. The conditions for such exemption, holding period requirement and size of the participation among other should be checked prior to the transaction. It is also important to remember that an asset swap would trigger the taxation of latent capital gain, irrespective of any cash proceeds received by the company.

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