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Law & Tax

**Weil**

# Tax in Distressed Situations **LUXEMBOURG**

## GENERAL

### 1. Does debt have a specific meaning for tax purposes?

The notion of debt is not specifically defined for Luxembourg tax purposes.

Instead, the general principle of substance over form applies to determine the tax classification of an instrument as debt or equity, requiring an economic and financial analysis of each transaction. Based on parliamentary documents and case law, certain features of a loan such as, for instance, the absence of an interest rate and absent or unclear repayment modalities, could justify a requalification of the loan as an equity instrument for tax purposes. While the accounting and legal treatment of the instrument is technically not decisive, in practice an instrument that legally and accounting wise does not qualify as debt is more likely to also not qualify as debt from a tax perspective. Because of the considerations above, the tax qualification of debt instruments is subject to a case-by-case analysis.

Unless specified otherwise, the remainder of this commentary assumes that the instrument is treated as debt for Luxembourg tax purposes and does not have particular equity-like features (e.g., profit participation).

### 2. Do derivatives have a specific meaning for tax purposes?

The notion of derivative is not specifically defined for tax purposes.

In application of the general principle of substance over form, the tax treatment of derivatives should be determined on a case-by-case basis.

### 3. Generally, are intra-group debts treated differently to external debt for tax purposes?

In principle, intra-group debt is treated in the same manner as external debt. However, in an intragroup context, specifically where the debt is contracted between "associated enterprises", additional tax considerations should be taken into account.

The creditor and the debtor will be considered to be "associated enterprises" if one company participates, directly or indirectly, to the management, control or capital of another company, or if the same persons participate, directly or indirectly, to the management, control or capital of the same two companies and that in one or the other case, the two companies are in their commercial or financial relations related by conditions which are different from those which would be agreed among third-parties.

In such cases, key tax considerations are the arm's length character of the debt, as well as, in case of any challenge to the debt qualification of the instrument, the application of withholding tax or exemptions thereof and interest deductibility rules.

### 4. Does it make a difference if debt is owed by a partnership or other pass-through entity in distress to third parties versus to its partners?

The tax consequences applicable in case debt is owed by a partnership are different depending on whether the partnership is treated as opaque or transparent for tax purposes.

In the case of a tax transparent partnership, the debt payable by the partnership (regardless of whether the debt is distressed or not) to one of its partners is disregarded with respect to this partner for tax purposes. The debt payable by the partnership to a third-party is considered (for tax purposes) payable pro-rata by each of the partners of the partnership to the third-party.

## DEBT IMPAIRMENT

### 1. What are the key tax considerations on a debt impairment for the creditor?

For tax purposes, receivables are in principle valued at their cost price, unless their market value is lower than the cost price, in which case the tax balance sheet can reflect such lower market value and an impairment can be booked.

If economically justified, the impairment of a debt receivable is deductible from the corporate tax base of a Luxembourg creditor. However, it is noted that such impairments must be reversed if the reasons having motivated the impairment cease to exist, i.e., if the debtor's economic situation subsequently improves. The reversal of such impairments is fully taxable in the hands of the creditor.

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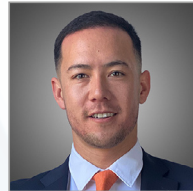
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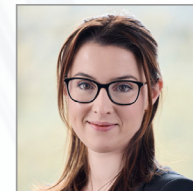
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