# Transformation of the international tax landscape

The international tax landscape is in constant motion and constitutes a real challenge for loan fund actors and, more generally, alternative investment players — who must work to ensure their continuous compliance with evolving tax requirements, while remaining efficient and sustainable in the market.

The forthcoming entry into force of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the "Multilateral Instrument", or MLI) — expected in 2019/2020 in Luxembourg — as well as the Anti-Tax Avoidance Directive (ATAD) — effective from January 2019 for the first directive and January 2020 for the second directive — will significantly alter Luxembourg's tax framework.

For example, with the MLI, the concept of substance will evolve with the principal purpose test (PPT) introduced in Action 6 of the BEPS reports. The PPT is an anti-treaty abuse clause that allows contracting states to "deny the application of the provisions of their treaties when transactions or arrangements are entered into in order to obtain the benefits of these provisions in inappropriate circumstances". An example of such a transaction could be the setting up of a special purpose vehicle (SPV) in Luxembourg, with the main purpose of obtaining the benefit of a treaty.

Such a provision will require alternative investment funds (AIFs) to reconsider their substance levels, holding structures and operational models, in order to comply with the new international standards and ensure double tax treaty access for their investment platforms.

The ATAD is intended to provide a minimum level of protection for the internal market and to strengthen the average level of protection against aggressive tax planning. Member States of the EU will have until 31 December 2018 to transpose the ATAD into their national laws and regulations, which should be applicable from 1 January 2019. On 19 June 2018, the Luxembourg government released its draft law implementing the ATAD, providing for new rules on: limitation of interest deduction, exit taxation, general anti-abuse rules, controlled foreign company rules and rules against hybrid mismatches.

The limitation on interest deduction and the anti-hybrid provisions should be particularly relevant for SOPARFIs engaged in the loan fund market, since regulated investment funds are generally exempt from corporate income tax and net wealth tax, and thus would not need debt financing of their loan receivables.

Luxembourg's draft ATAD law provides for a limitation of the deductibility of net interest expenses — i.e. taxable interest income less deductible interest expenses — of up to 30% of the taxpayer's adjusted EBITDA or €3,000,000, whichever is higher (calculated yearly).

For SOPARFIs engaged in the back-to-back intragroup financing of plain vanilla loans, this provision should not trigger adverse tax implications since the company would realise an arm's length margin on this financing activity. Furthermore, assuming that a gain on distressed debt/non-performing loans is included in the definition of interest (or equivalent), this new rule should not adversely affect SOPARFIs.

The anti-hybrid provision contained in the draft ATAD law foresees a non-deductibility of interest charges under a debt instrument in cases where the payment on the instrument gives rise to a deduction without inclusion (or a double deduction), and where the mismatch is attributable to differences in the characterisation of the instrument or the payment — for example, if the payment is seen as an interest payment in the payer's country and as a dividend payment in the recipient's country.

At the European level, hybrid instruments are already targeted by the current wording of the EU parent-subsidiary directive, which foresees taxation at the level of the recipient of the hybrid interest income (i.e. dividend) in cases where such charges have been deducted at the level of the subsidiary.

Hybrid instruments with third countries will be affected by "ATAD 2", which extends the scope of the anti-hybrid provision to third countries. ATAD 2 should be implemented and applicable in EU Member States from 1 January 2020. It foresees a non-deduction of the expenses in relation to the hybrid instrument at the level of the subsidiary. Loan fund players will thus have to take these new rules into account in structuring their debt investments going forward.