



IFRS and their tax impact in Luxembourg

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Agenda

- ◆ Key messages of the bill
- ◆ Consolidated / statutory accounts
- ◆ Financial instruments under IAS 39 and classification of participations
- ◆ Calculation of profits for tax purposes
- ◆ Valuation principles
- ◆ First year of IFRS adoption
- ◆ Tax neutrality of the bill for IFRS accounts – Overview
- ◆ Participation exemption regime
- ◆ Impact for international corporates
- ◆ Open issues
- ◆ Q & A

Key messages of the bill (1/2)

- ◆ Bill presented before the Luxembourg Parliament on October 1, 2008 to amend the Luxembourg income tax law
- ◆ New law would be applicable as at January 1, 2009; (retroactive application of the law on demand?)
- ◆ Determination their taxable profit on the basis of the commercial accounts based on IFRS or LuxGAAP; no need to prepare a second set of accounts



Key messages of the bill (2/2)

- ◆ General principle of “relevance” provided by article 40 LITL remains applicable with adjustments where necessary (“accrochement”, “Massgeblichkeit”)
- ◆ New rules allow partial divergence between commercial and tax balance sheet (“décrochage ponctuel”)
- ◆ New rules for calculating the commercial income for tax purposes
- ◆ New valuation principles
- ◆ Neutralization of non-desired tax implications



IFRS – Consolidated/statutory accounts (1/2)

Overview

◆ Consolidated accounts

- Listed companies: IFRS mandatory as from 01.01.2005
- Non-listed companies: Lux GAAP mandatory
(but IFRS possible if approved by Ministry of Justice)

◆ Statutory accounts:

- Banks or insurance companies:
 - Lux GAAP
 - IFRS
 - “mixed” regime
- Other companies:
 - Lux GAAP mandatory (but IFRS possible if approved by Ministry of Justice; bill giving free choice and “mixed” regime in process of being drafted)

IFRS – Consolidated/statutory accounts (2/2)

Overview

- ◆ **Statutory accounts will be the basis for taxation:**
 - LuxGAAP
 - IFRS
 - “Mixed” regime

- ◆ **No basis for taxation:**
 - CSSF FINREP: IFRS with prudential specificities
 - Consolidated accounts

IAS 39 – Financial instruments

Classification

<i>Category</i>	<i>Measurement method</i>	<i>Changes in value (without FOREX)</i>	<i>FOREX if Monetary Item</i>
Held for Trading	Fair value	P&L	P&L
Available for sale	Fair value	Equity (Option for P&L)	P&L (no shares!)
Held to Maturity	Amortised cost (initial recognition at fair value)	P&L (e.g. impairment, amortisation)	P&L
Loans and receivables	Amortised cost (initial recognition at fair value)	P&L (e.g. impairment, amortisation)	P&L

Classification of shares/participation into companies in separate financial statements

◆ Investments into:

- Subsidiary
- Jointly controlled entities
- Associates
 - That are not classified as held for sale (IFRS 5)

- Classified as held for sale in accordance with IFRS 5

◆ IAS 27.37:

- Alternatively
 - At cost or
 - In accordance with IAS 39 (IAS 27.37)

◆ IFRS 5.15:

- Lower of its
 - Carrying amount and
 - Fair Value less costs (IFRS 5.15)

Classification of shares/participation into companies in separate financial statements (continued)

◆ Investments into:

- All other shares

◆ Alternatively

– IAS 39.9:

- Basically Fair Value
 - Available for sale
 - Held for trading
- Exception (IAS 39.46 (c)): no quoted market price in an active market and fair value cannot be reliably measured
 - At cost

IFRS update: Reclassification of Financial Assets (IAS 39) (issued on 13 October 2008) endorsed on 16 October 2008

Current Classification	Can you reclassify?	Reclassification Options		
		AFS	L+R	HTM
Fair Value Through Profit and Loss				
Derivatives	No (IAS 39.50 (a))	n/a	n/a	n/a
Assets / liabilities designated und Fair Value Option (FVO)	No (IAS 39.50 (b))	n/a	n/a	n/a
Liabilities classified as held for trading	No	n/a	n/a	n/a
Asset Held for Trading ◆ Would have met the definition of loans and receivables (if had not been classified as Trading)	Yes if meet conditions of IAS 39.50(c) and 50D	Yes – no restriction specified in the Standard	Yes – no restriction specified in the Standard	No – definition of HTM (IAS 39.9) scopes out assets that meet the definition of L+R from HTM category

IFRS update: Reclassification of Financial Assets (IAS 39) (issued on 13 October 2008) endorsed on 16 October 2008 (continued)

Current Classification	Can you reclassify?	Reclassification Options		
		AFS	L+R	HTM
Fair Value Through Profit and Loss				
Asset Held for Trading ♦ Would not have met the definition of loans and receivables	Yes, if meet conditions in 50(c) and rare circumstances IAS 39.50B	Yes – no restriction specified in the Standard	No, as still don't meet definition of L+R (if did would apply 50D as above)	Yes – if meet the definition of HTM asset (see below)
Asset in AFS ♦ Would have met the definition of loans and receivables (if had not been designated as AFS)	Yes, if conditions of IAS 39.50 (E) met	n/a	Yes	n/a
Debt asset in AFS ♦ Does not meet the definition of loans and receivables	Yes, if conditions of IAS 39.54 are met. Can only be HTM asset	n/a	n/a	Yes – if meet the definition of HTM asset (not retroactively possible)

Valuation principles (1/3)

Valuation at current value no longer optional

- ◆ Valuation at current value (“valeur d’exploitation”, “Teilwert”) no longer optional but becomes mandatory
 - Applicable to amortizable fixed assets
 - Only if current value below acquisition price (upper limit)

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

Mandatory, no longer an option


Valuation principles (2/3)

“Beibehaltungsprinzip” maintained

◆ The so-called “Beibehaltungsprinzip” is maintained:

=> A value adjustment can be maintained, even if the current value is above the book value

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



Valuation principles (3/3)

Valuation of financial instruments

- ◆ Financial instruments have to be valued at a value exceeding their acquisition price

→ Only to the extent that such a valuation is required by accounting standards

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

Calculation of profits for tax purposes (1/3)

Amendments to article 18 LITL

◆ Determination of Profit according to draft definition:

- 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
-

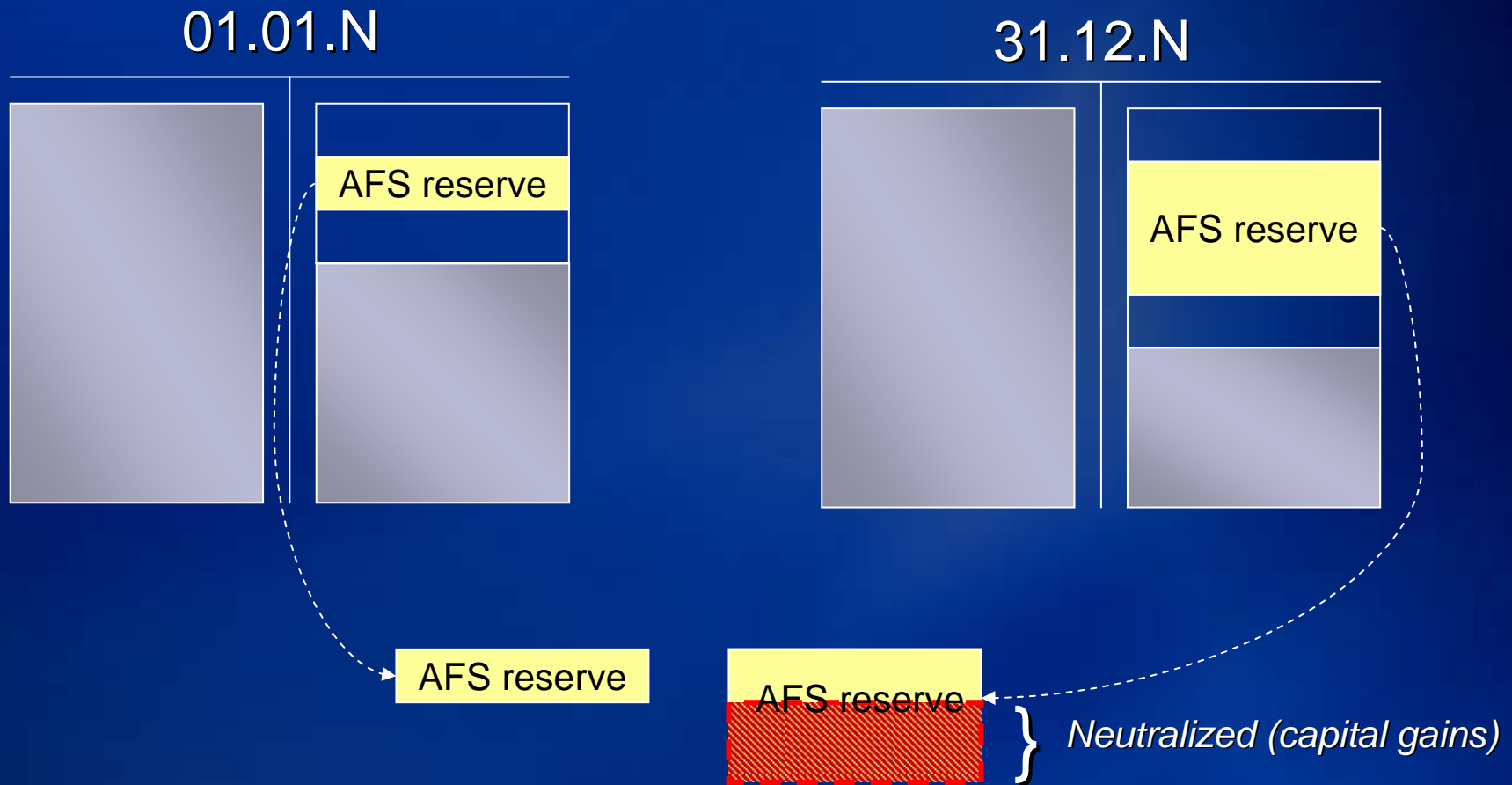
Profit

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

Taxable profit (according to Art. 18 LITL)

Calculation of profits for tax purposes (2/3)

Amendments to article 18 LITL



Calculation of profits for tax purposes (3/3)

Fair value movements

- ◆ Imparity principle maintained for Fair value through equity movements

<i>Financial instruments</i>	<i>Unrealised capital gain</i>	<i>Unrealised capital loss</i>
Booked through Equity	Neutralised*	Deductible
Booked through P&L	Taxable	Deductible

* Taxable in case of prior deduction

First year of IFRS adoption (1/2)

Example: fair value booked through P&L

Switch to IFRS

	31.12.2008	01.01.2009
Acquisition price	100	100
Fair value	120	120
Book value	100	120
GAIN ARISING FROM THE SWITCH		20
ADD TO PROFIT IN 2009		4*

**Assumption: the company chooses to spread the gain over 5 years
(20 / 5 = 4)*

First year of IFRS adoption (2/2)

Principle

<i>Financial instruments</i>	<i>Unrealised capital gain</i>	<i>Unrealised capital loss</i>
Booked through Equity	Neutralised	Deductible (immediately)
Booked through P&L*	Taxable** (over 1-5 years)	Deductible (immediately)

* In practise, 1st adoption should always go through equity and not P&L (!)

** Would include items that would normally be tax exempt (!)

Tax neutrality of the bill for IFRS accounts

Overview (1/2)

◆ Rules also applicable for IFRS accounts (new article 18 LITL and Grand-Ducal Decree):

- Exchange of securities operations (article 22bis LITL)
- “Beibehaltungsprinzip” (article 23 (3) LITL)
- Special amortization (article 32bis LITL)
- Accelerated amortization (article 32ter LITL)
- Roll-over provisions (articles 53, 54 and 54bis LITL)
- Valuation at book value of contributions (articles 58, 59, 59bis, 60 LITL)
- Determination of the taxable profit in case of merger-type operations (articles 170, 170bis and 170ter LITL)



Tax neutrality of the bill for IFRS accounts

Overview (2/2)

- ◆ Rules also applicable for IFRS accounts (new article 18 LITL and Grand-Ducal Decree):
 - Partial exemption of income derived from certain IP rights (article 50bis LITL)
 - Fiscal unity regime (article 164bis LITL)
 - Deductibility of certain expenses proper to corporations (article 167 LITL)
 - Transfer of registered office from Luxembourg at book value (article 172)



Participation exemption regime (1/2)

Amendment

- ◆ If participation is booked as Financial instrument and Fair value movements booked through P&L
- ◆ If 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:
 - gain realized on the sale and
 - gain 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

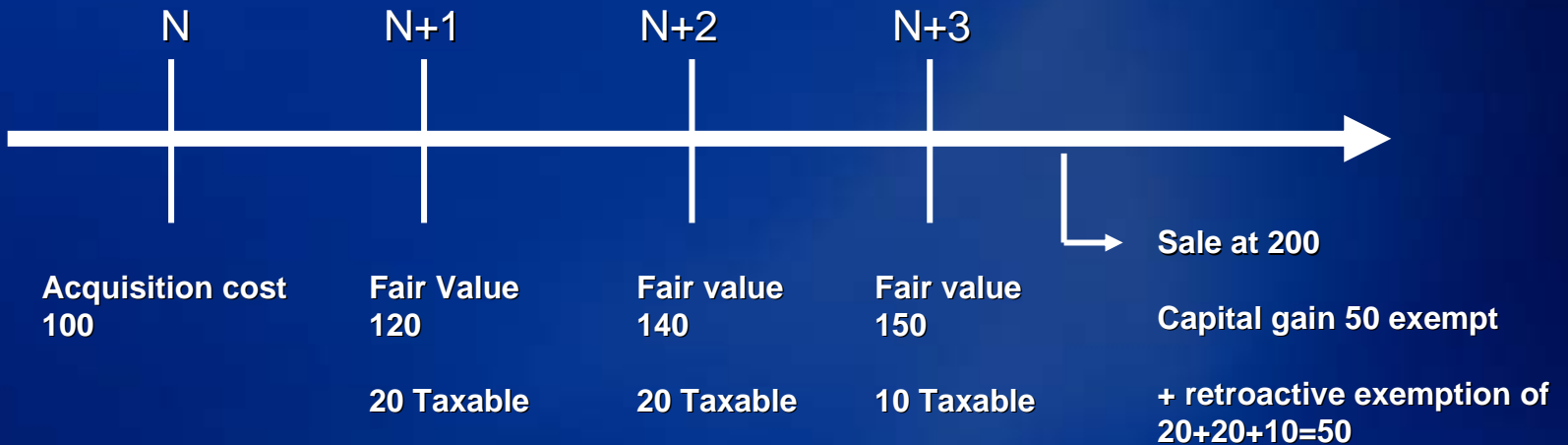
- ◆ Grand-Ducal Decree of 21 December 2001 to be amended accordingly

Participation exemption regime (2/2)

Example

◆ Issues

- Cash flow problem



- Bullet dividend problem

Other open issues

- ◆ AGDL Provision
- ◆ Lump-sum provision
- ◆ Treatment of pensions
- ◆ Hedge accounting / Forex accounting
- ◆ Leasing

International Corporate Tax

Categories relevant for ICT

<i>Category</i>	<i>Measurement method</i>	<i>Changes in value (without FOREX)</i>	<i>FOREX if Monetary Item</i>
Held for Trading (unlikely for Soparfi's)	Fair value	P&L	P&L
Available for sale (Participations < 20%)	Fair value	Equity (Option for P&L)	P&L (no shares!)
Held to Maturity (e.g. bonds)	Amortised cost (initial recognition at fair value)	P&L (e.g. impairment, amortisation)	P&L
Loans and receivables (e.g. normal loans)	Amortised cost (initial recognition at fair value)	P&L (e.g. impairment, amortisation)	P&L
Derivatives (e.g. loans with interest on underlying, hybrids, but...)	Fair value	P&L	P&L

International Corporate Tax

Shareholdings/Participations

- ◆ Application of IFRS should generally not result in negative impacts because:
 - Economic participation:
 - Art. 23 (5) LIR applies => amortized costs in fiscal balance sheet)
 - If no economic participation: financial instrument
 - Held for Trading:
 - P&L impact, but
 - Generally not applicable for Soparfi's, as no short-term trading activity
 - Available for Sale:
 - Unrealized gains (including Forex) booked through equity => subject to neutralization in fiscal balance sheet

International Corporate Tax

Other issues

- ◆ Hybrids: fiscal qualification “substance over form” prevails
- ◆ Convertible bonds / 0% loans at 100% nominal/hybrids : tax wise no split of instruments

International Corporate Tax

Differences IFRS/Tax

<i>Possible corrections for tax purposes:</i>	<i>Value in fiscal balance sheet</i>	<i>Difference in value IFRS/TAX first year + future years</i>
<u>Financial Instruments</u>		
Hybrids	Fiscal approach: - Substance over form + no split debt/equity	Track per category to neutralize effects on result in tax balance sheets or off-B/S
Convertibles	No split debt/equity possible: 100% debt	Track per category to neutralize effects on result in tax balance sheets
Loans - interest rate not at arm's length	No split debt/equity possible: 100% debt	Track per category to neutralize effects on result in tax balance sheets
<u>Other categories</u>	Amortized cost	Total difference to be determined each year and deducted from total fiscal equity

Thank you

Discussion

Q&A

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Presenter's contact details

Georges Bock
Tax Partner
KPMG Luxembourg
+352 22 51 51 – 5522
georges.bock@kpmg.lu

Christian Bruene
Audit Director
KPMG Luxembourg
+352 22 51 51 – 6520
christian.bruene@kpmg.lu

G rard Laures
Tax Partner
KPMG Luxembourg
+352 22 51 51 – 5549
gerard.laures@kpmg.lu

Birgit Hofer
Tax Partner
KPMG Luxembourg
+352 22 51 51 – 5505
birgit.hofer@kpmg.lu

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