



# Germany, Italy and Luxembourg: Changes in the Making

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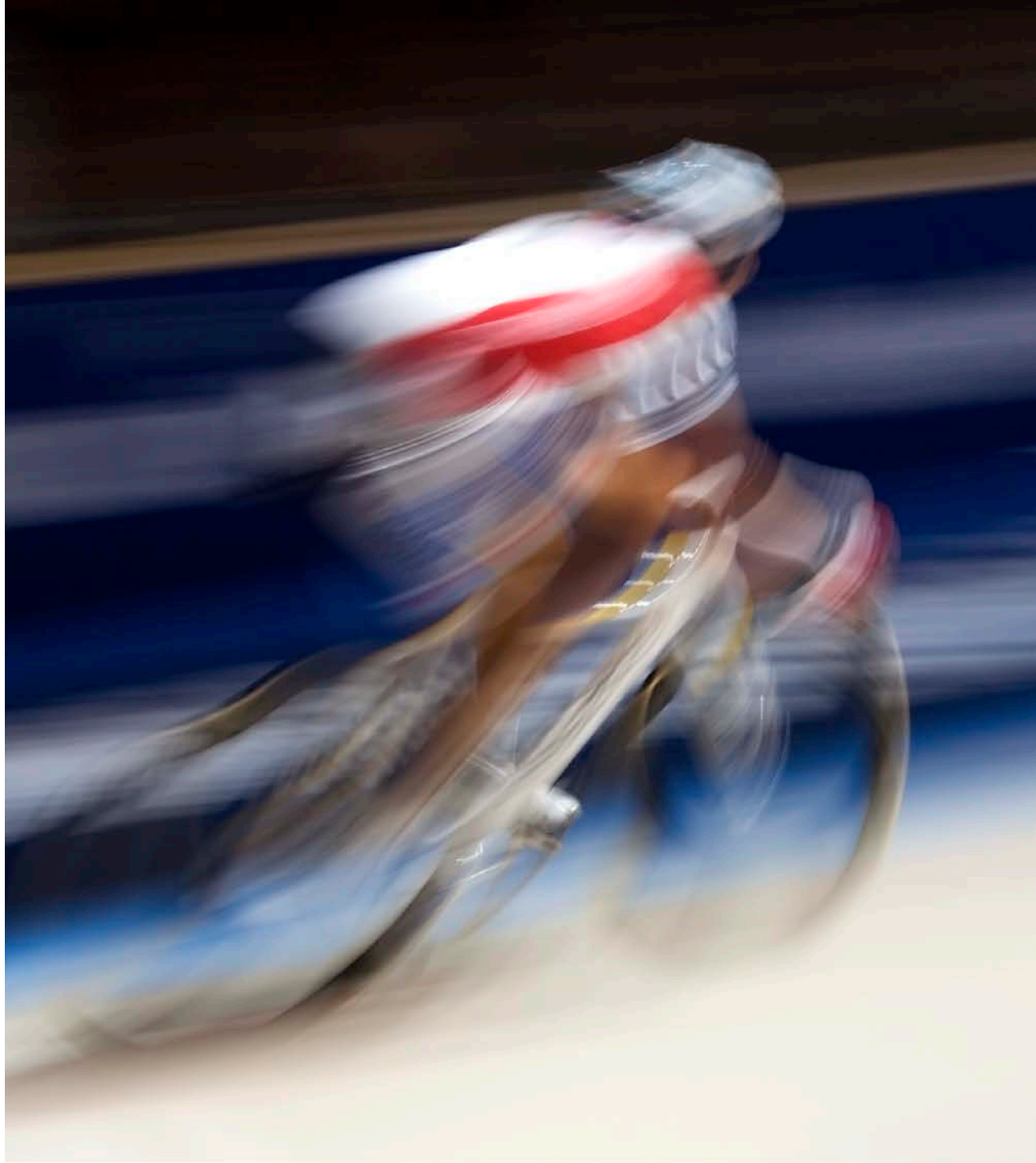
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Luxembourg

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March 1 - 4, 2015



# Agenda

Current Tax environment

German Tax developments

Italian Tax developments

Luxembourg Tax developments

Questions and answers

# Global Tax [r]Evolution

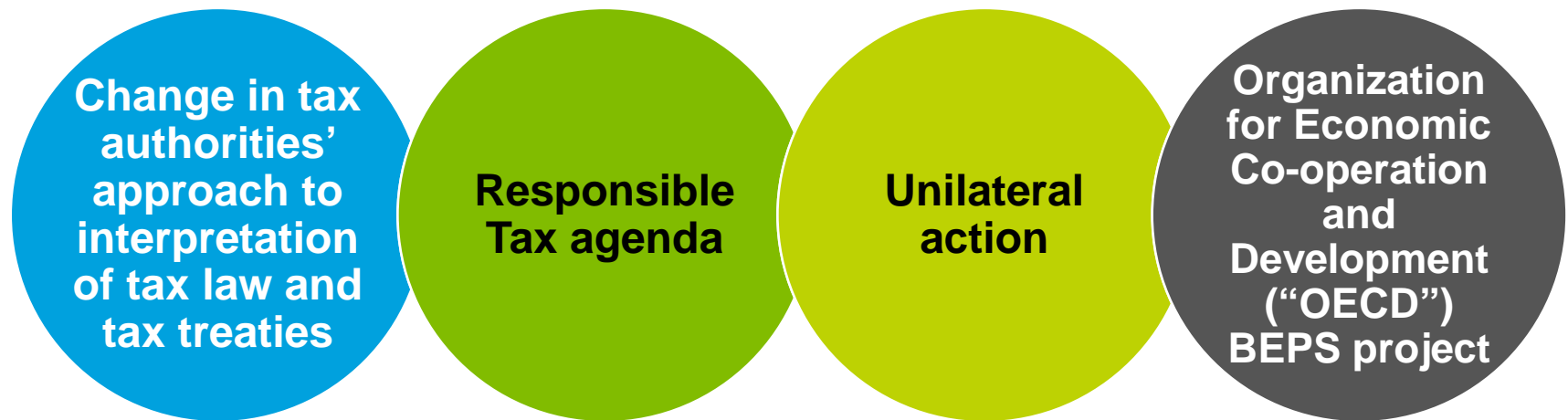
Multinational companies are facing a number of new tax-related challenges



Government deficits and related cut-backs, media attention and activist group interest has resulted in political interest in tax reform

# Global Tax [r]Evolution

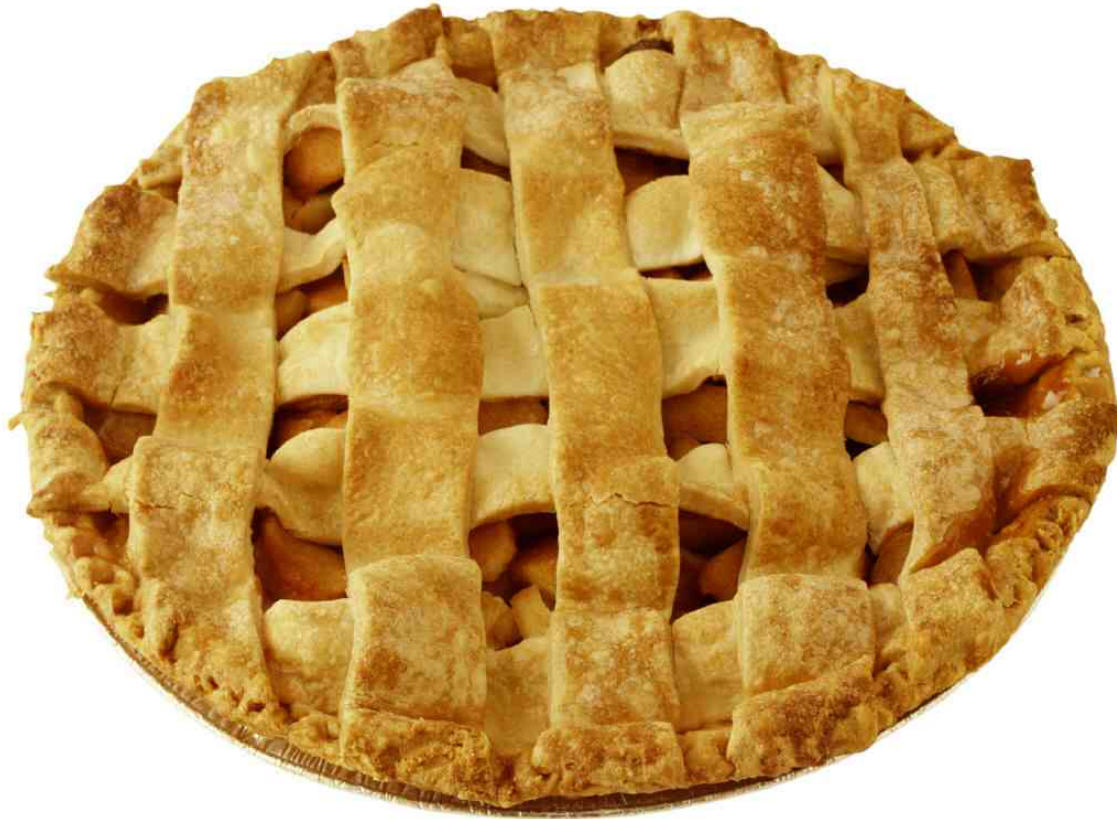
This new global tax environment has resulted in the following actions –  
A Global Tax [r]Evolution



**Base Erosion and Profit Shifting ("BEPS") is part of the bigger picture**

# Every country seems to want a bigger piece of the “profit” pie

Changes in tax authorities' approach to interpretation of existing tax law and treaties



**In an increasingly globalized digitalized world, what is the proper amount of income that should be allocated between countries for multinationals with cross-border trade?**



# Germany



# Agenda

Approach of the German government

Anti-hybrid rule and anti-double-dip rule

Potential shape of a future rule set

# Approach of the German government



# Approach of the German government

Document issued in 2013 includes the following policies

- Combatting of international double nontaxation/double deductions; strengthening of automatic information exchange on a global basis to promote transparency
- Introduction of country-by-country reporting requirements for multinational companies
- Introduction of unilateral measures, if OECD BEPS action items are not implemented on a timely basis

Law approved by the upper house of parliament in November 2014 had an anti-hybrid and anti-double dip clause

- The government did not support the provisions so they finally did not go through
- The government intends to wait until the final BEPS reports are published and coordinated measures are taken

# Anti-hybrid rule and anti-double-dip rule

# 2014 initiative: Anti-hybrid rule and anti-double-dip rule

## Future framework



- The federal government is appointing a task force to discuss the results of the final BEPS reports to be published in 2015 and to come up with a proposal on how to implement the final recommendations into German law. Legislative action is expected in late 2015 or in 2016

Proposal of the upper house of parliament could qualify as a measure that “eliminates the ability of a taxpayer to rely on existing law,” which could be the basis for the retroactive effect of a future proposal to 2014

High likelihood that a future set of rules will be based on the 2014 proposal for the anti-hybrid and anti-double-dip rule and that a future rule is intended to capture even more scenarios

# 2014 initiative: Anti-hybrid rule

## 2014 draft anti-hybrid rule

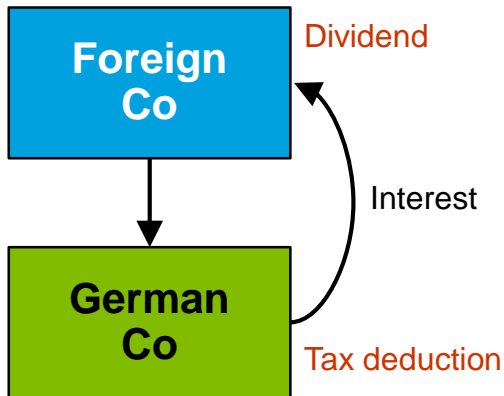
- Anti-hybrid rule
  - Deduction of business expenses would be disallowed to the extent the corresponding income
    - Was not recognized as taxable income
    - Was treated as tax-exempt at the level of the direct or indirect recipient
  - In both cases, due to a mismatch of the debt/equity classification of the underlying instrument (e.g., debt for German tax purposes and equity for foreign tax purposes)
  - Rule could also apply where the underlying instrument was ignored for foreign tax purposes (e.g., disregarded loans)



- Anti-hybrid rule would have had a significant effect on foreign investment into Germany, particularly where shareholder loans were granted that qualified as equity for foreign tax purposes
- The anti-hybrid rule would not have been limited to related party transactions

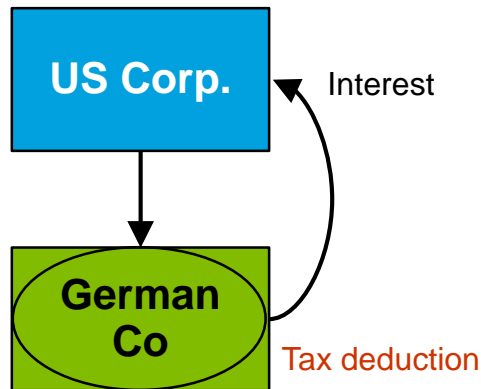
# Examples

## 1 Hybrid instrument



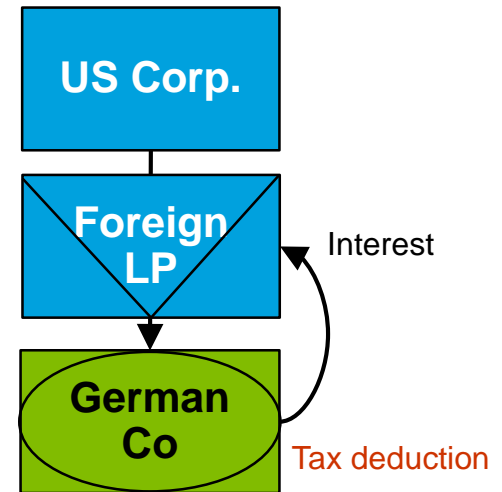
- Payment qualifies as tax exempt dividend at the level of the recipient

## 2 Disregarded loan



- Interest payment is disregarded for purposes of the taxation of the US-Corp.

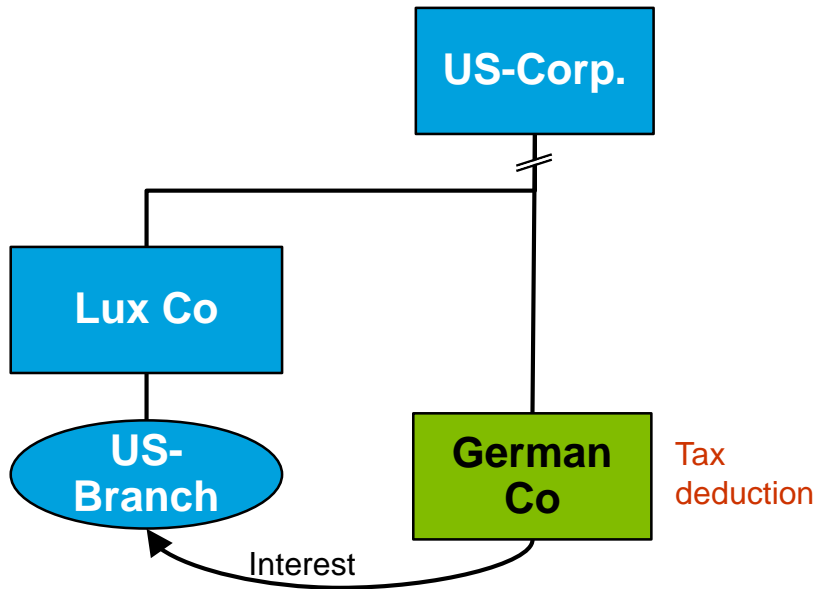
## 3 Indirect recipient



- Interest payment is disregarded for purposes of the taxation of the US-Corp.

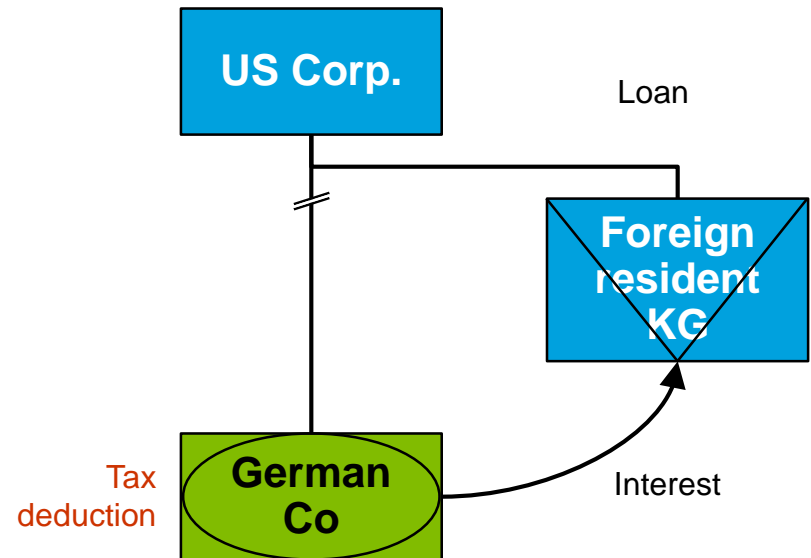
# Examples (cont'd)

## 4 U.S. finance branch



- Structure should not have been captured by the anti-hybrid rule but is the focus of German tax authorities

## 5 Foreign resident reverse hybrid



- Anti-hybrid rule should not apply to this structure

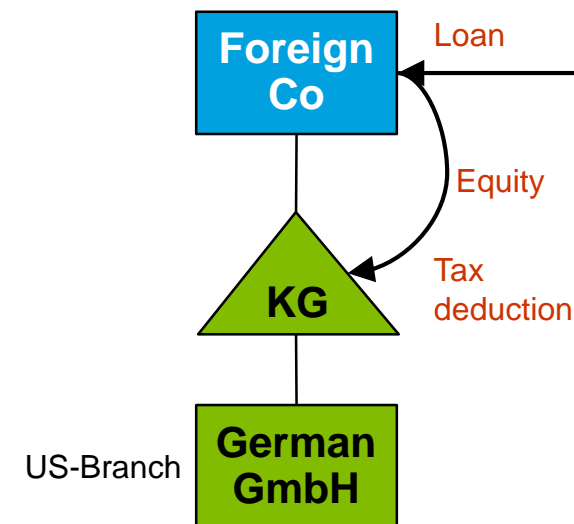
# 2014 initiative: Anti-double-dip rule

## 2014 draft anti-double-dip rule

- Anti-double dip rule
    - Deduction of business expenses would be disallowed to the extent such expenses also were tax deductible in a foreign jurisdiction
- 
- The anti-double-dip rule was aimed at structures involving a German limited partnership (KG), where refinancing expenses of foreign partners were tax deductible as special business expenses for both German tax purposes and foreign tax purposes
  - Anti-double-dip rule would not be limited to KG structures

**NOT  
IMPLEMENTED**

## German KG structure



- Interest paid by the foreign partner in the KG is deductible at the KG level for German tax purposes



# Potential shape of a future rule set

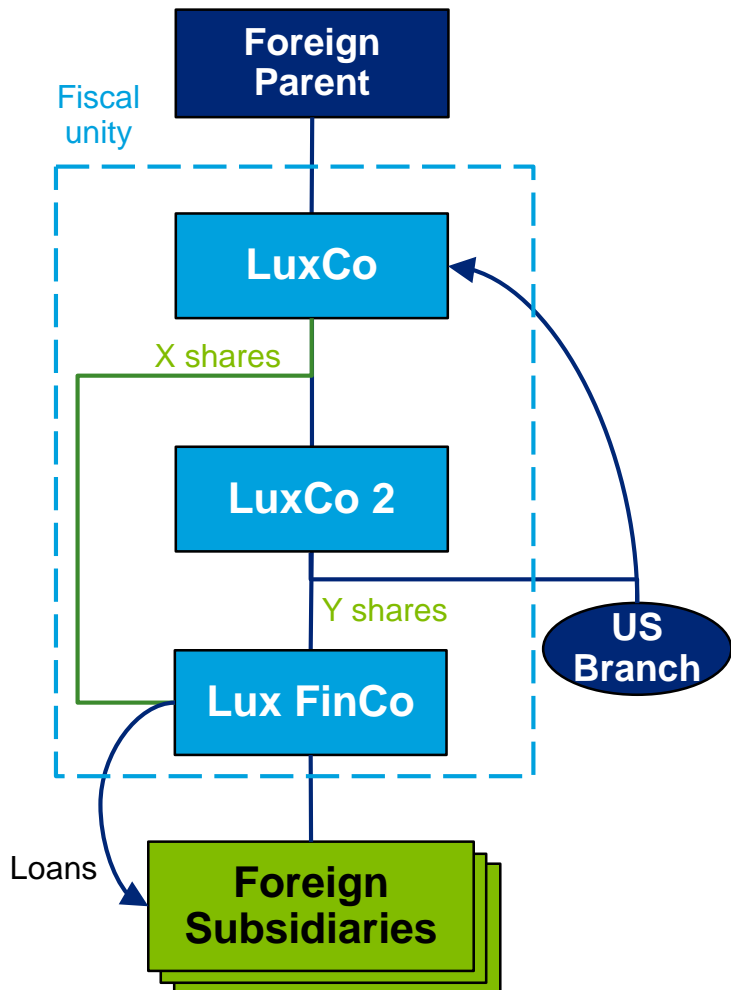
# Potential shape of a future rule set

## Consideration of key elements for a potential anti-hybrid rule

- Concept of a potential new rule is still unknown
- It can be expected that new rules may condition interest deduction on taxation of interest income at the level of the lender
- Potential key points of a structure to be considered
  - Lender should be resident in a jurisdiction raising taxes on a reasonable basis
  - Interest income should not be tax exempt in the jurisdiction of the lender
  - Straight forward interest bearing loan to German entity (no hybrid elements included)
  - Interest income at the level of the lender should be reported in the financial statements and in the tax returns
  - Interest income should not be sheltered by back-to-back loan at the level of lender

# Alternative (under development)

Structure taking into consideration the shape of a potential future anti-hybrid rule



## Implementation steps

1. LuxCo incorporates a new Luxembourg company ("LuxCo 2") and contributes Lux FinCo to it in exchange for shares under the rollover provision
2. LuxCo 2 sells X shares of Lux FinCo to LuxCo in exchange for a loan (representing up to 85% of the Group's value) bearing an arm's length interest ("IBL")
3. LuxCo 2 allocates the IBL to its newly created US Branch
4. LuxCos apply for the fiscal unity regime

## Highlights

### A. BEPS

- Avoids the use of cross-border hybrid instrument
- No treaty abuse considerations as pure Luxembourg structure (no third jurisdiction involved)
- Straight loan at arm's length
- Luxembourg tax unity allows to offset profit of Lux FinCo against deduction on the IBL on a consolidated basis but for an arm's length taxable margin

### B. RECAPTURE

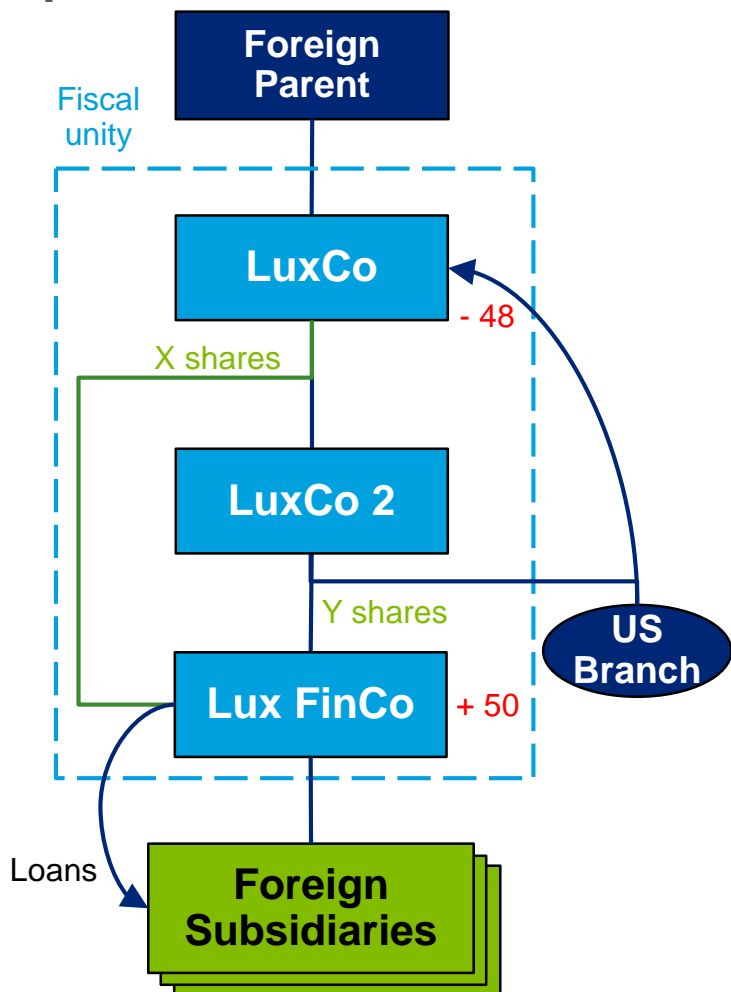
- Manages impact of possible existing recapture account
- Mitigates recapture of future expenses - Going forward
  - No recapture triggered on dividends paid to Luxco 2 and upwards
  - Recapture on dividends flowing directly to Luxco
  - Dividend policy/sizing of the split of shares/features of the shares to be monitored

### C. OTHER

- NWT at the level of Lux FinCo

# Alternative (under development)

Structure taking into consideration the shape of a potential future anti-hybrid rule (cont'd)



## Details

- Tax consolidation must be maintained for at least five fiscal years
- The integrated entities have to open and close their accounting periods on the same date and have the same functional currency
- Interest expenses accrued on the IBL by LuxCo can be offset against the interest income of Lux FinCo on the tax consolidated basis but limited to an arm's length taxable margin (here, +2)

Tax Return of LuxCo	Amount
Profit according to commercial balance sheet	(48)
Non-Deductible expenses	0
Non-taxable income	0
Taxable result	(48)
Transfer of the fiscal result of the subsidiary (Lux FinCo)	+50
Income subject to taxation at LuxCo level	+2

Tax Return of Lux FinCo	Amount
Profit according to commercial balance sheet	+50
Non-Deductible expenses	0
Non-taxable income	0
Taxable result	+50
Transfer of the fiscal result to the parent company (LuxCo)	(50)
Income subject to taxation at Lux FinCo level	0

# Italy



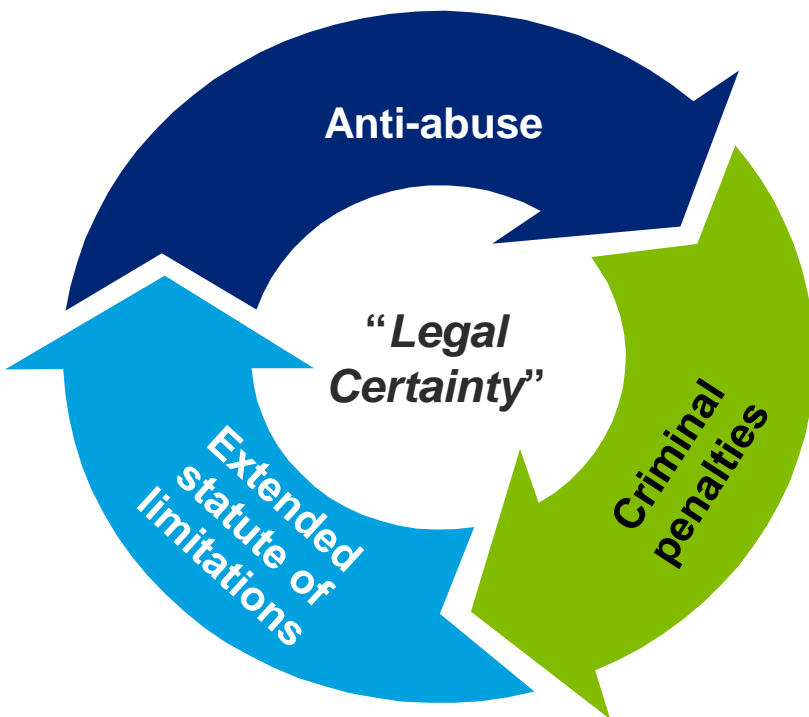
# Agenda

- Anti-abuse and tax penalties
- Patent Box Regime
- R&D credit
- Italian Tax Reform – work in progress

# Anti-abuse and tax penalties



# Anti-abuse and tax penalties (draft legislation)



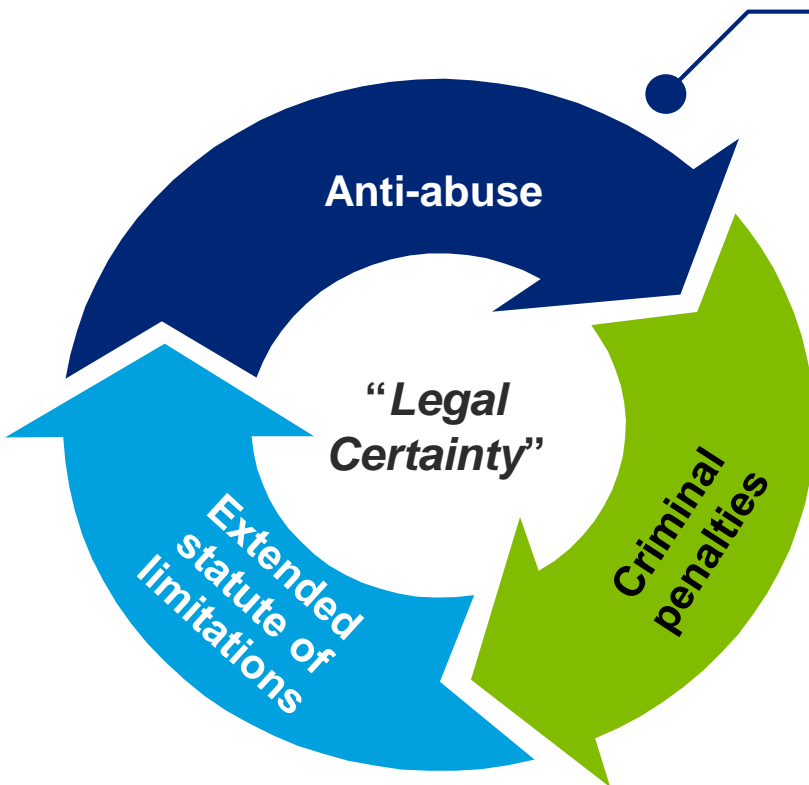
The draft legislation was expected to be finalized by the end of February, but the deadline has been extended to May

## Draft Decree issued on December 24, 2014

The new legislation, which is part of the broader reform of the Italian tax system, will have a relevant impact on three issues that are core concerns for foreign investors

- The current domestic anti-abuse provision (art. 37-bis DPR 600/73) will be repealed and substituted with a **broader GAAR** that will incorporate the principles of the “abuse of law” doctrine of the Italian Supreme Court, as well as the EU Commission Recommendation on aggressive tax planning
- The **tax criminal penalties** will be relaxed (some violations will lose criminal relevance or the thresholds amounts for such relevance will be increased)
- Stricter rules for the tax authorities to enforce the **longer statute of limitations in case of tax criminal violations**

# Anti-abuse and tax penalties (draft legislation)



## New anti-abuse rules

- New GAAR applicable to direct and indirect taxes and not limited to a list of specific transactions
- An arrangement is abusive if
  - Lacks **economic substance**
  - Is carried out to obtain an **undue tax advantage**
  - The undue tax advantage is its **main purpose**
- An arrangement is not abusive if it has a non-marginal business purpose (internal business reorganizations)
- The choice for the alternative with the lowest tax burden (merger vs. liquidation) is legitimate ... unless abusive
- Anti-abuse challenges will not be relevant for criminal tax purposes (favor rei?) but administrative penalties will apply
- Procedural rules will be introduced to provide a certain level of protection for the taxpayers

The draft legislation was expected to be finalized by the end of February, but the deadline has been extended to May

# Anti-abuse and tax penalties (draft legislation)



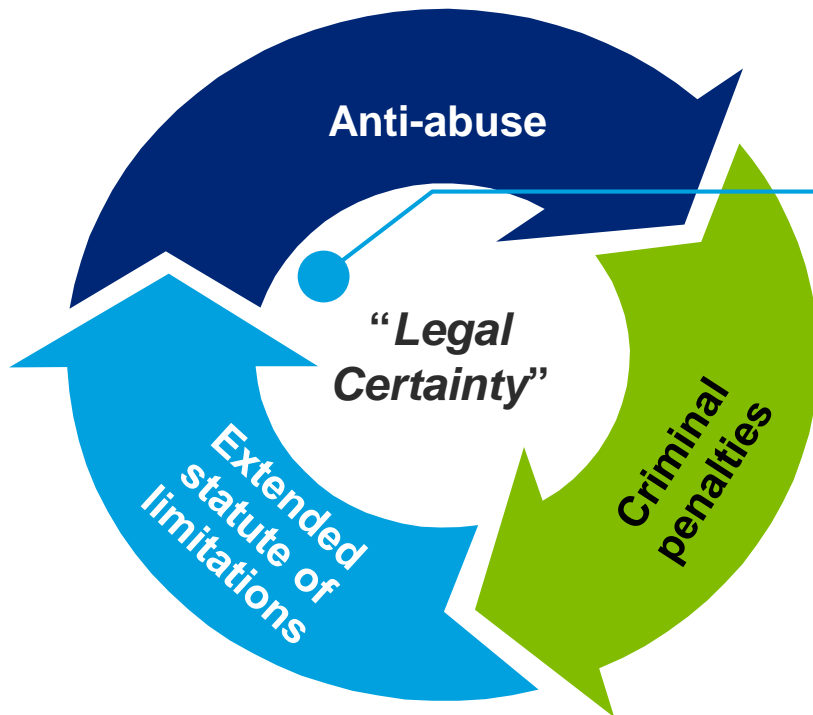
## New criminal penalties

- Higher thresholds for the **criminal liability of the directors of Italian companies** in case of tax violations by these latter
- In particular, new thresholds for the criminal relevance of an «unfaithful tax return»

	Current rules	Proposed rules
Underreported taxes	50k euro	150k euro
Underreported taxable basis	10% of total or 2M EUR	10% of total or 3M euro

The draft legislation was expected to be finalized by the end of February, but the deadline has been extended to May

# Anti-abuse and tax penalties (draft legislation)



## Extended statute of limitations

- Stricter rules for the tax authorities to enforce the **longer statute of limitations in case of tax criminal violations** (the ordinary five years' term is doubled only if the tax criminal violation will be notified to the prosecutor before the expiration of the ordinary term)

The draft legislation was expected to be finalized by the end of February, but the deadline has been extended to May

# Patent Box Regime

# Italian Tax reform – Patent Box Regime

Main features of the Patent Box Regime introduced by the 2015 Stability Law, as amended by the “Fiscal Compact” Decree (to be converted into law by end of March)

- Five years' elective regime, applicable as of January 1, 2015, granting a partial tax exemption on income derived from qualifying intangible assets (patents, know-how, trademarks, etc.) as long as the Italian company (or Italian PE of a company resident in a white-listed country) performs R&D activities
- **Exemption up to 50% as from 2017** (30% in 2015 and 40% in 2016) on the income deriving from the licensing (“indirect use”) or direct exploitation (“direct use”) of the IP
- In case of “direct use”, the relevant income will have to be determined through a specific advance ruling procedure (no ruling is required in case of “indirect use”)
- **100% exemption for capital gains** arising from the disposal of the IP **as long as 90% of the proceeds is reinvested in R&D** activities on relevant IP, within the end of the second year following the disposal of the IP

# Italian Tax reform – Patent Box Regime (cont'd)

## Formula

In order to guarantee the link between the expenditure incurred in Italy and the amount of income that can benefit from the preferential regime, in line with the OECD “nexus approach”, the portion of income eligible for the 50% exemption is determined through the following ratio

- Numerator
  - i. **R&D costs directly incurred for the development, maintenance and improvement of the IP**
  - ii. Up to 30% of the amount under (i) above, **acquisition cost of the IP plus R&D costs incurred from related companies**
- Denominator
  - iii. **Overall costs incurred to create the IP**



# Italian Tax Reform – Patent Box Regime (cont'd)

## Case 1

Internal R&D costs = 100

Intercompany R&D costs = 30

$$\frac{100 + 30}{100 + 30} = 1 \times 50\% = 50\%$$

## Case 2

Internal R&D costs = 100

Intercompany R&D costs = 100

$$\frac{100 + 30}{100 + 100} = 0,650 \times 50\% = 33\%$$

# R&D credit

# Italian Tax reform – R&D credit

## Main features of the new R&D tax credit introduced by the 2015 Stability Law

- Applicable for FY 2015 through FY 2019
- Elimination of any access limitation based on turnover (it was 500M euro at group level) and a doubled cap amount (from 2.5M to 5M euro per year)
- The tax credit ranges from 25% to 50% of the exceeding qualified expenditures in a given FY in respect of the average of the 2012-2014 period

	25%	50%
Costs for highly qualified personnel		X
Depreciation of laboratory equipment	X	
Costs for R&D activities outsourced to universities and similar bodies	X	
Costs for technical expertise related to industrial or biotech IP		X

# Italian Tax reform – Work in progress

# Italian Tax reform – in progress

## Pending reform

1. On March 27, 2014 the Parliament approved a broad reform of the Italian tax system, *“for a balanced, transparent and pro-growth tax environment”*
2. The areas that the Government will reform (by September 2015) include the following
  - Revision of anti-abuse rules (draft legislation)
  - Simplification of tax compliance (final legislation)
  - Revision of tax penalties (draft legislation)
  - Rationalization of corporate tax rules, including deductibility of specific costs and cross-border operations (in progress)
  - Revision of tax expenditures (in progress)
  - Rationalization of VAT and other indirect taxes (in progress)
  - Tutoring and tax risk management programs; new tax ruling procedures (in progress)
  - Strengthening intelligence and tax audit activities (in progress)

# Luxembourg



# Agenda

Codification of the ruling process in Luxembourg

Exchange of information

New Transfer Pricing regime in Luxembourg

Tentative conclusion



# Approach of the Luxembourg government

## Transparency

- Luxembourg is a constructive, reliable player in the move towards greater transparency in tax matters
- Luxembourg is among the Early Adopters of the Common Reporting Standard for the automatic exchange of information at OECD level from 2017

## BEPS Action Plan

- Luxembourg participate pro-actively to the works of the OECD, specifically the BEPS-procedure with its 15 working groups
- Finance Minister sees OECD recommendations as an opportunity for the growth of Luxembourg's economy and its financial market
- Luxembourg has always advocated a level playing field in tax matters and actively supports all initiatives to this end

## Ruling practice

- In December 2014, Finance Minister confirmed that Luxembourg government is willing to be an actor in clarifying the ruling issue
- Luxembourg legislated to provide an enhanced framework for tax rulings, aiming at making the procedure clearer and more transparent. Consequently, the administrative practice is now anchored in Luxembourg Law

# Advance Tax decision

# Enquiry on tax ruling practice to all Member States



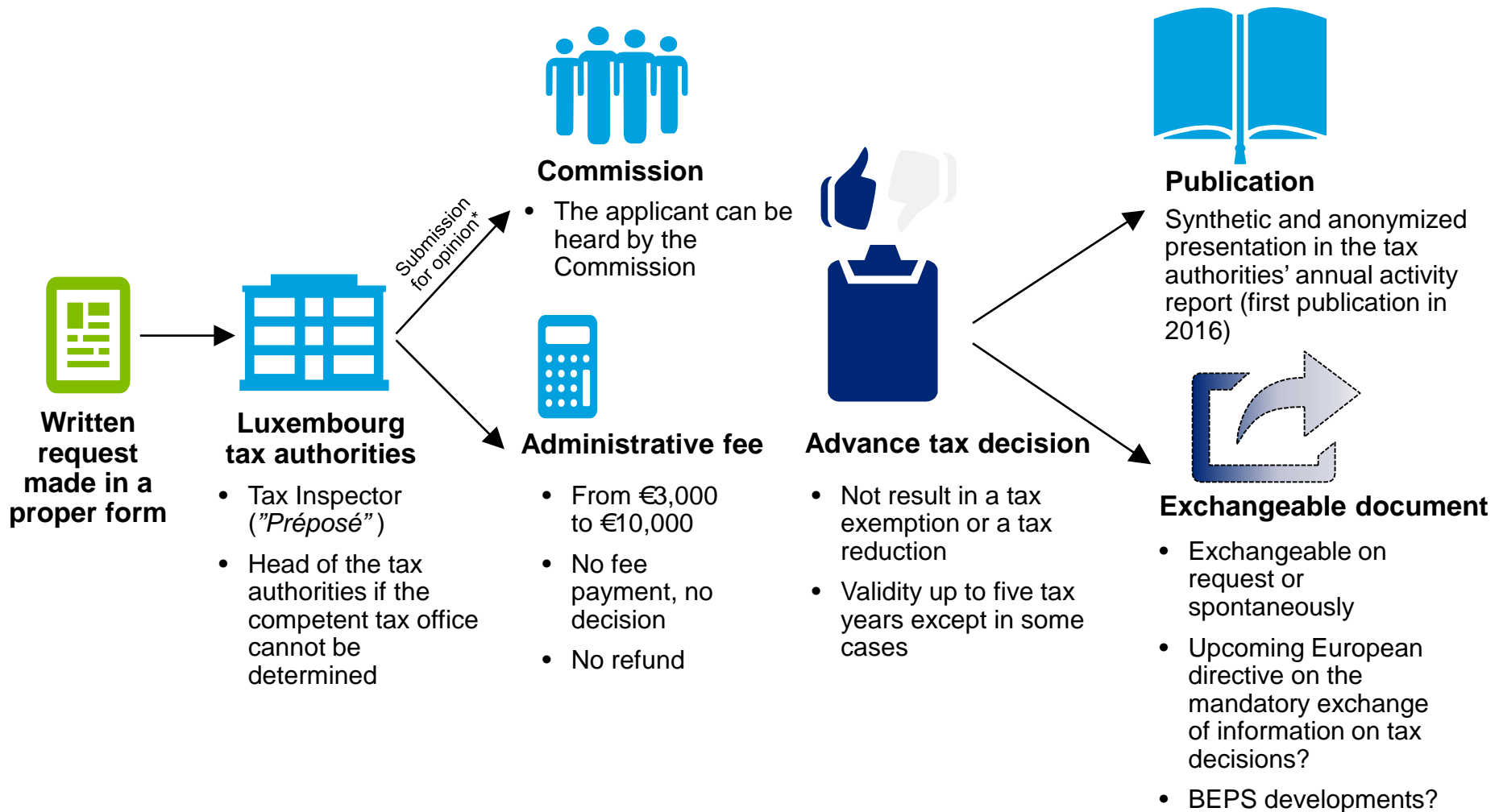
The EU Commission officially ordered Luxembourg to give information on both its advance decisions practice and its IP box regime

Luxembourg referred this issue to the EU jurisdictions level

Besides the actions mentioned above, the EU Commission opened four in-depth investigations concerning transfer pricing arrangements

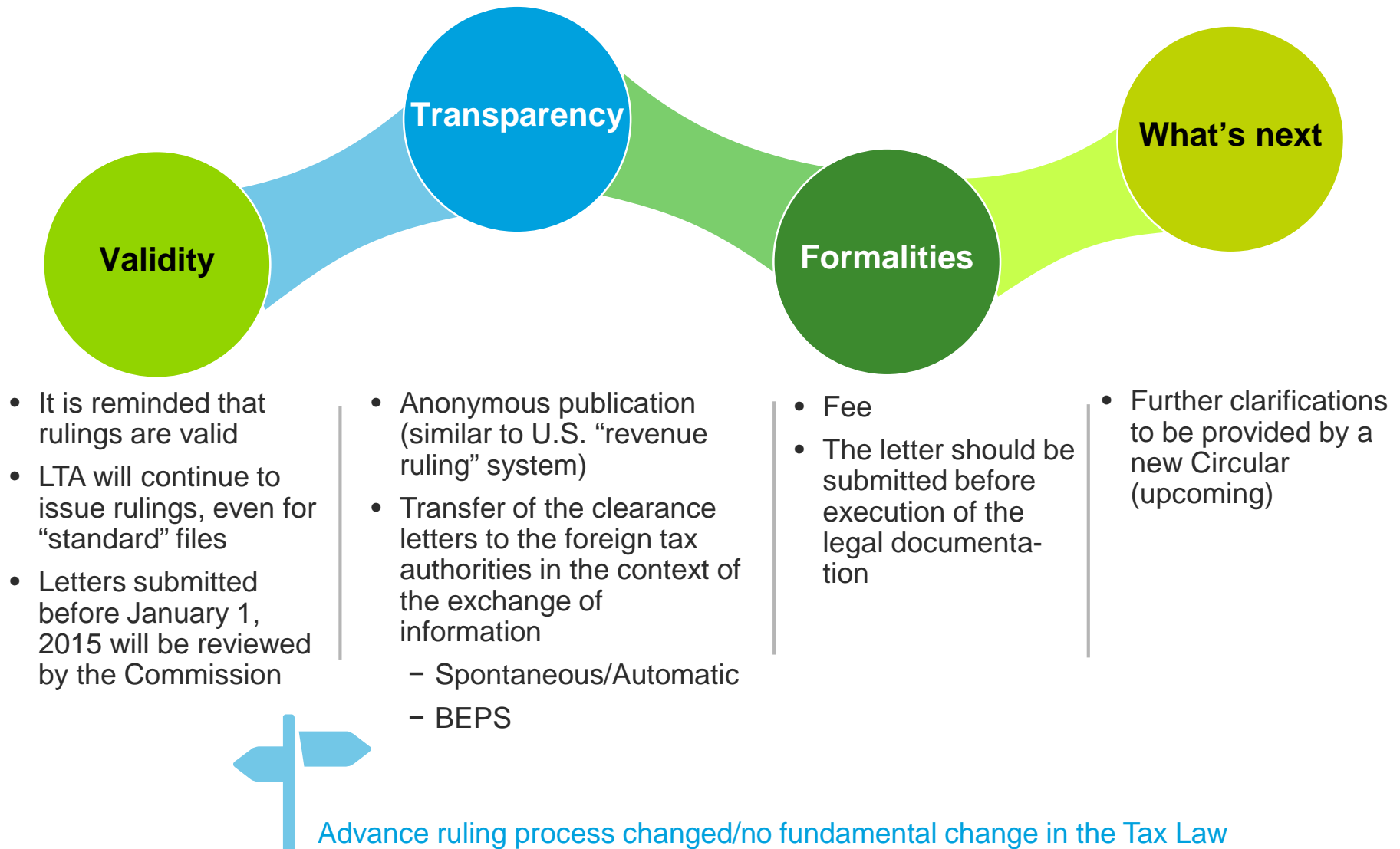
- Luxembourg Leaks
- The EU Commission has enlarged its enquiry into the tax decisions practice **of all EU Member States**. Luxembourg decides to provide with the list of the tax decisions as well as with the list of the beneficiaries of the IP box regime as officially requested in March 2014. Luxembourg withdraws the actions before the EU jurisdictions
- The EU Commission expects to complete its investigations in connection with the four transfer pricing arrangements mentioned above in the second quarter of 2015...
- Upcoming European directive on the automatic exchange of information on advance tax decisions?

# Advance tax decision process



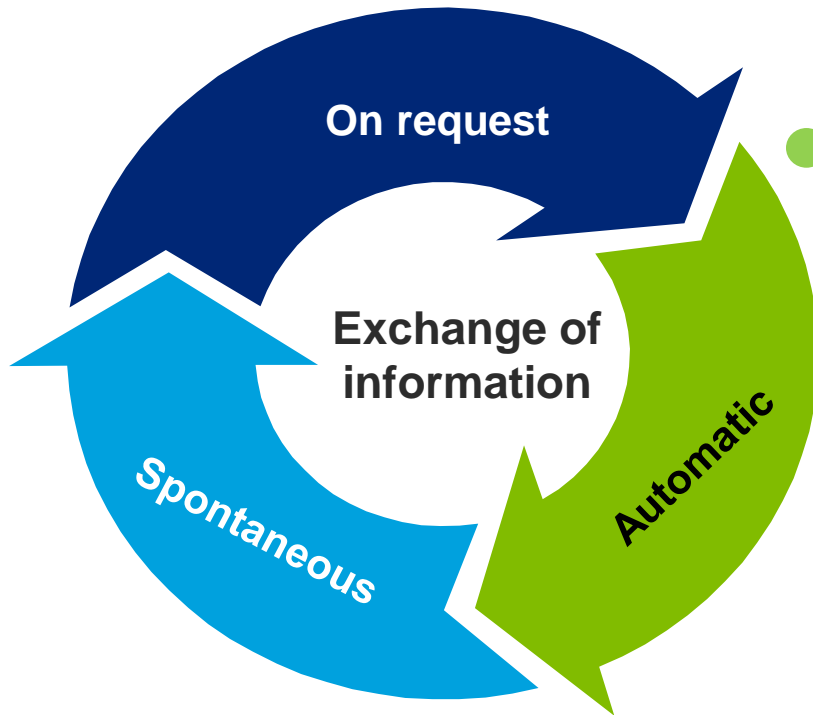
\* Written requests that were submitted before the end of 2014 and that still are being processed by the tax authorities will be submitted to the new Commission

# Advance tax decision process



# Exchange of information

# What is relevant?



**On request:** A State shall request from another State to provide with information on a case-by-case basis

**Automatic:** States shall automatically exchange information agreed (format, revenue....)

**Spontaneous:** A state shall, without prior request, forward to another State information of which it has knowledge under a number of circumstances.

## Extension of the automatic exchange of information

### As from January 1, 2015

- Salaries, director's fees and pensions between EU countries
- Interest under the Savings Directive

### Upcoming at European level

- Additional types of income automatically exchanged: Dividends, capital gains, royalties...
- Upcoming European directive on the automatic exchange of information on advance tax decisions

### Upcoming at international level

- FATCA
- OECD Common Reporting Standard (CRS)
- Extension of the scope of income and tax information which will be exchanged automatically

# New TP regime in Luxembourg



# Transfer Pricing – Luxembourg legislative update

## General transfer pricing legislation

### Background

Recent EU Commission investigations focused on transfer pricing arrangements validated in tax rulings

### Article 56

**New !**

“Where

- a. An enterprise participates, directly or indirectly, in the management, control or capital of another enterprise, or where
- b. The same individuals participate, directly or indirectly, in the management, control or capital of two enterprises

In either instance, the two enterprises are, within their commercial or financial relations, subject to conditions made or imposed which differ from those which would be agreed between independent enterprises, **the profits of these enterprises are to be determined under the conditions prevailing between independent enterprises and taxed accordingly.**”

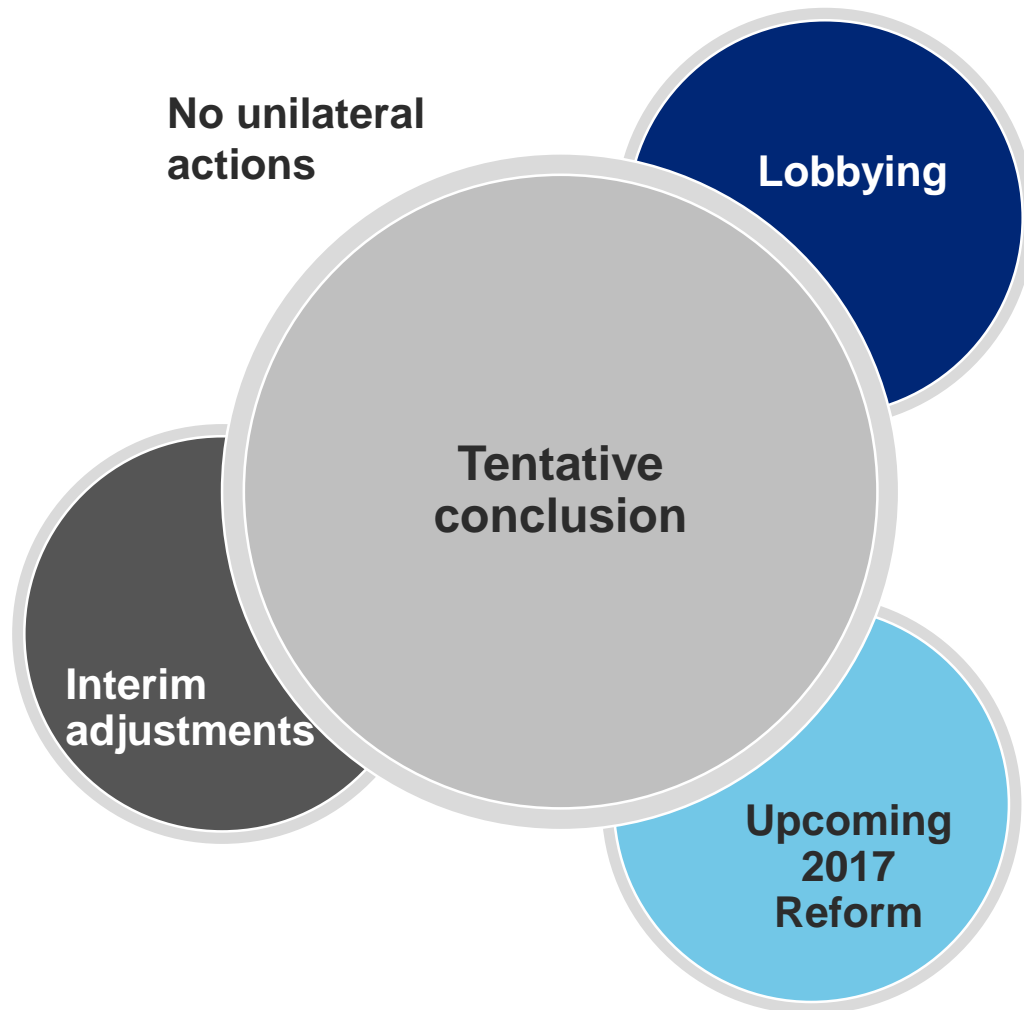
# Transfer Pricing – Luxembourg legislative update

## New Article 56 LITL in the light of article 9 OECD

Luxembourg Domestic legislation	T r a n s f e r  P r i c i n g	OECD standards
<b>Arm's length principle</b> (✓) No explicit reference in the LITL <b>New Art. 56 LITL consecrated to arm's length principle</b>		<b>Arm's length principle</b> ✓ Article 9 OECD MC ✓ Chapter I OECD Guidelines
<b>TP adjustment</b> ✓ Art.164 (3) LITL <b>New Art. 56 LITL aligned on Article 9 OECD MC</b>		<b>Upward TP adjustment</b> ✓ Recognized in OECD (✓) No detailed guidance
<b>Associated enterprise</b> (✓) Circular follows definition of Article 9 OECD MC <b>New Article 56 LITL includes the definition</b>		<b>Associated enterprise</b> ✓ Article 9 OECD MC
<b>Comparability analysis and methods</b> (✓) No detailed TP regulations but indirectly addressed by the Circular		<b>Comparability analysis and methods</b> ✓ Chapter II and III OECD Guidelines
<b>Documentation requirements</b> (✓) General provision in §171 AO ✗ No specific documentation requirement (✓) Only for APA on intra-group financing <b>New Article 171 AO expressly stipulates transfer pricing documentation upon request</b> <ul style="list-style-type: none"> <li>• Further development by Circular</li> </ul>		<b>Documentation requirements</b> ✓ Chapter V OECD Guidelines ✓ Action 13 BEPS
<b>Penalties</b> ? non specific penalties		<b>Penalties</b> ✓ Recognized in OECD (✓) No detailed guidance

# Tentative conclusion

# Tentative conclusion



Please remember  
to complete your  
evaluation

# Speaker bios

**Jeff Clegg** is a partner in the International Tax practice for Deloitte Tax LLP. He has more than 17 years of experience providing services to multinational companies in industry sectors such as technology, telecommunications, financial services, energy, consumer business, distribution, and others.

A leading advisor in international tax restructuring, Jeff advises clients on acquisitions, dispositions, joint ventures, and other corporate restructurings in jurisdictions around the world. Other specialties: tax-efficient supply chain transformation, intellectual property structures, sales leaseback transactions in Latin America, procurement structures in Asia, financing structures, treasury structures, and foreign currency management transactions, global intellectual property, foreign tax credit management, holding company structures, and other planning.

A regional leader of Deloitte's ASC 740 management team, Jeff has experience with tax compliance and other data management projects such as large international tax outsourcing engagements and multinational ASC 740 calculations, auditing tax provisions for multinational companies, accounting for unrecognized tax benefits, testing tax provision key controls and activities under SOX 404, and assisting non-attest clients in assessing, developing, and documenting key controls for the tax provision process and other tax functions.

Jeff received a BS in Accounting from University of Richmond, Robins School of Business, a JD from The Catholic University of America School of Law, and an LLM in Taxation from Georgetown University Law Center.

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**Bernard David** is the partner-in-charge of the Deloitte & Touche Luxembourg international tax corporate practice dedicated to the U.S. market. Bernard has a focus on compliance support and advice in implementing international tax planning techniques, international private equity investment structures, international assignments related to Mergers and Acquisitions, and international reorganizations.

Bernard has deep knowledge in relation with the international tax planning needs of its U.S. clients. He successfully spent two years with the Luxembourg desk located in New York and helped Deloitte Luxembourg develop an important client database. Prior to joining Deloitte Luxembourg in 1999, Bernard worked as an international tax advisor with another Big 4 firm for two years.

Bernard received a Bachelor's degree in Applied Economic Sciences from the University of Louvain (Belgium). In addition, Bernard is a Chartered Accountant in Luxembourg and a member of the Luxembourg American Chamber of Commerce tax committee.

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# Speaker bios

**Stefan Grube** is a tax partner in of Deloitte & Touche GmbH in Düsseldorf. Stefan joined Deloitte from Arthur Andersen in 2002 and has more than 16 years of experience in international tax law and M&A transactions.

His experience covers all fields of (inter)national corporate tax related to (re)structuring, reorganizations, mergers, acquisitions and joint ventures.

Stefan serves primarily U.S. investments into Germany by both corporates and private equity. He works across a variety of industries. In this context he is as well specialized on tax related post acquisition projects such as tax accounting, tax efficient restructurings, tax department implementation, etc. His engagements include buy side and vendor due diligence assistance.

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**Stefano Schiavello** is the leader of the Italy desk in the International Core of Excellence (“ICE”) program for Deloitte Tax LLP in New York. He focuses on serving U.S. groups doing business in Italy/Europe and assists Italian clients with operations in the U.S.

Stefano is a partner from our Italian firm with 18 years’ experience in corporate tax, during which he advised both Italian and international clients. He has extensive corporate tax experience, from tax compliance to tax planning and corporate structuring, and has also worked extensively on Italian and international M&A projects as well as BMO structures.

Stefano is author and coauthor of several articles published on Italian and international tax newspapers and magazines (like Il Sole 24 Ore and Tax Notes International) and regularly invited to present at seminars and conferences on Italian and international tax topics.

Stefano received a Bachelor of Business Administration from the University of Genoa, Italy. In addition, he is a member of the Italian Institute of Chartered Accountants and the International Fiscal Association.

Stefano currently serves as member of the Board of the Italy-America Chamber of Commerce in New York.

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