

Luxembourg

Luxembourg tax authorities release circular on the use of a foreign functional currency for tax purposes



Samantha Merle,
ATOZ – Taxand Luxembourg

In a recent circular, the Luxembourg tax authorities defined the rules applicable upon request to undertakings with a share capital and accounts in the same foreign currency, which wish to determine their taxable income by simply converting their commercial result in foreign currency into EUR. The release of this circular is motivated by the fact that strict application of the Luxembourg valuation rules to these undertakings may in certain cases create artificial taxable exchange profits, which appear when preparing a tax balance sheet in EUR and thus do not reflect the economic reality. To avoid this kind of situation, the tax authorities have defined the rules and conditions to apply the foreign functional currency for tax purposes. We present the main aspects.

The possibility to use the functional currency applies, upon request, to undertakings with share capital and accounts in the same foreign currency. Once an undertaking has opted for the regime, it will have to use its functional currency as long as its share capital remains denominated in this currency. A request has to be filed with the Luxembourg tax authorities at the latest three months before the end of the tax year in which the undertaking intends to benefit from the regime (September 30 at the latest, if the tax year corresponds to the calendar year).

The commercial result in foreign currency is increased by the amounts which are not tax deductible for tax purposes (in foreign currency), decreased by the amounts exempt (in foreign currency as well) and then converted into EUR based on exchange rates determined by the European Central Bank. The taxpayer can choose between the year-end rate or the average rate of the year. Once the choice has been made, the taxpayer will have to apply the rate chosen to all future tax years. This exchange rate will apply to all amounts in foreign currency as well as to tax losses of previous years which are carried forward and will be converted at the rate of the tax year for which they are taken into account. The determined amounts in EUR are then reported in the tax returns of the undertaking and the

related tax assessments issued by the tax authorities are in EUR as well.

To check whether a shareholding qualifies for the participation exemption regime according to which dividends, liquidation proceeds and capital gains can be exempt under certain conditions, the value of the participation (which must reach a certain value in EUR for the exemption regime to apply) has to be converted into EUR by using the historical exchange rate (the rate as of the date of acquisition of the participation). This approach is justified, as the participation might otherwise qualify for the participation exemption regime in one tax year and no longer qualify in another, if the exchange rate varies significantly from one year to another.

To determine the amount of minimum CIT due by Luxembourg companies, reference has to be made to the total balance sheet, converted into EUR by using the exchange rate applicable to the related tax year (year-end exchange rate or average rate of the year).

Lastly, the circular clarifies the rules applicable for municipal business tax (MBT) and net wealth tax (NWT) purposes and the implications on the determination of the amount of NWT reduction, which is available under certain conditions to taxpayers. Furthermore, it expands on the rules which will apply during the transitory year for a taxpayer who until now has prepared a tax balance sheet in EUR and now opts for the future use of the functional currency for tax purposes.

[Samantha Merle \(samantha.merle@atoz.lu\)](mailto:samantha.merle@atoz.lu)

ATOZ – Taxand Luxembourg

Tel: +352 26 940 235

Website: www.atoz.lu