

Luxembourg Implementation of Pillar Two Directive

On 4 August 2023, the Luxembourg Deputies Chamber released the draft law (n. 8292) (hereinafter, “**the Draft Law**”) that transposes the EU Council Directive 2022/2523 of 15 December 2022, known as the **EU Pillar Two Directive**.

The aim of the EU Pillar Two Directive, which is based on the Pillar Two model rules of the OECD BEPS framework, is to achieve **a global minimum effective tax rate (ETR) of 15%** for multinational and domestic groups with annual consolidated revenue of at least EUR 750 million. The minimum 15% ETR is tested on profits derived in each jurisdiction where they operate.

Certain entities are excluded from the scope of the Draft Law:

- Governmental entities
- International organizations
- Non-profit organizations
- Pension or investment funds
- Real estate investment vehicles

The Draft Law will operate separate from the Luxembourg Income Tax Law and it introduces three new rules, which result in three new top-up taxes:

1. **Income Inclusion Rule (IIR):** A tax to be paid by the group’s ultimate parent company to the tax authority in its country of residence. The tax due would be the “top-up” amount needed to bring the overall tax on the profits in each country where the group operates, up to the minimum ETR of 15%. It will be effective for financial years starting after 31 December 2023.
2. **A Qualified Domestic Minimum Top-up tax (QDMTT).** A tax to be paid by all the Luxembourg entities of a group in-scope of the Draft Law. It will apply in priority to any other rule like the IIR or the UTPR in order to prevent other jurisdictions from taxing the undertaxed Luxembourg profits. It will be effective for financial years starting after 31 December 2023.
3. **An Undertaxed Profits Rule (UTPR).** It operates as a backstop for cases in which the IIR is not applied, by allocating the top-up tax to countries where the group operates. The allocation is made through a formula based on number of employees and net book value of the tangible assets. It will be effective for financial years starting after 31 December 2024.



Taxable income: The income subject to the new rules and taxes mentioned above corresponds to the financial accounting net income as per group consolidation purposes (under adjusted IFRS or local GAAP rules), before any intra-group transaction adjustment.

Tax rate: When the ETR paid by an entity in scope of the Draft Law is lower than 15%, a top-up tax will apply following the rules mentioned above. This is in order to recover the difference. The top-up tax corresponds to the result of the **top-up percentage** (i.e. the difference between the effective tax rate and 15%) multiplied by the income as described above.

Filing obligations and penalties: Luxembourg entities in scope of the Pillar Two Directive (“the constituent entities”) must file a tax return¹, unless a designated Luxembourg filing entity is appointed for the submission. Alternatively, the foreign group ultimate parent entity or a foreign group entity could be designated to file the return together with the Luxembourg entities, under the condition that the foreign entity is located in a country with which Luxembourg has an eligible agreement for the automatic exchange of information. In such cases, the Luxembourg constituent entities have the obligation to notify the Luxembourg tax authorities of the identity and the country of the designated foreign entity. Non-compliance with such notification obligation would be fined up to EUR 5.000 per constituent entity. Non-compliance with the filing obligations could be fined up to EUR 250.000 per constituent entity.

Next steps: The Draft Law will be reviewed by the Luxembourg Council of the State. Andersen Luxembourg will monitor closely any relevant updates.

For further information do not hesitate to contact one of our team members who will be glad to assist you at any time:

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¹ Global Anti-base erosion (GloBE) return, or “GIR”.

