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Law & Tax

Weil

Tax in Distressed Situations

LUXEMBOURG

DEBT RESTRUCTURINGS

GENERAL

1. Does debt have a specific meaning for tax purposes?

The notion of debt is not specifically defined for Luxembourg tax purposes.

Instead, the general principle of substance over form applies to determine the tax classification of an instrument as debt or equity, requiring an economic and financial analysis of each transaction. Based on parliamentary documents and case law, certain features of a loan such as, for instance, the absence of an interest rate and absent or unclear repayment modalities, could justify a requalification of the loan as an equity instrument for tax purposes. While the accounting and legal treatment of the instrument is technically not decisive, in practice an instrument that legally and accounting wise does not qualify as debt is more likely to also not qualify as debt from a tax perspective. Because of the considerations above, the tax qualification of debt instruments is subject to a case-by-case analysis.

Unless specified otherwise, the remainder of this commentary assumes that the instrument is treated as debt for Luxembourg tax purposes and does not have particular equity-like features (e.g., profit participation).

2. Do derivatives have a specific meaning for tax purposes?

The notion of derivative is not specifically defined for tax purposes.

In application of the general principle of substance over form, the tax treatment of derivatives should be determined on a case-by-case basis.

3. Generally, are intra-group debts treated differently to external debt for tax purposes?

In principle, intra-group debt is treated in the same manner as external debt. However, in an intragroup context, specifically where the debt is contracted between "associated enterprises", additional tax considerations should be taken into account.

The creditor and the debtor will be considered to be "associated enterprises" if one company participates, directly or indirectly, to the management, control or capital of another company, or if the same persons participate, directly or indirectly, to the management, control or capital of the same two companies.

In such cases, key tax considerations are the arm's length character of the debt, as well as, in case of any challenge to the debt qualification of the instrument, the application of withholding tax or exemptions thereof and interest deductibility rules.

4. Does it make a difference if debt is owed by a partnership or other pass-through entity in distress to third parties versus to its partners?

The tax consequences applicable in case debt is owed by a partnership are different depending on whether the partnership is treated as opaque or transparent for tax purposes.

In the case of a tax transparent partnership, the debt payable by the partnership (regardless of whether the debt is distressed or not) to one of its partners is disregarded with respect to this partner for tax purposes. The debt payable by the partnership to a third-party is considered (for tax purposes) payable pro-rata by each of the partners of the partnership to the third-party.

DEBT IMPAIRMENT

1. What are the key tax considerations on a debt impairment for the creditor?

For tax purposes, receivables are in principle valued at their cost price, unless their market value is lower than the cost price, in which case the tax balance sheet can reflect such lower market value and an impairment can be booked.

If economically justified, the impairment of a debt receivable is deductible from the corporate tax base of a Luxembourg creditor. However, it is noted that such impairments must be reversed if the reasons having motivated the impairment cease to exist, i.e., if the debtor's economic situation subsequently improves. The reversal of such impairments is fully taxable in the hands of the creditor.

2. What are the key tax considerations on a debt impairment for the debtor?

The impairment of a debt receivable by the creditor should generally not trigger adverse tax consequences at the level of the debtor.

However, the position of the tax position of the debtor could in certain situations be impacted. This would be the case if the impairment is followed by an actual debt waiver to the benefit of the Luxembourg debtor (see below under "*Does the release of debt trigger taxable income for the debtor? If so are there any reliefs or exemptions?*"). If the terms of the instrument are such that the repayment obligation is adjusted on a periodic basis prior to maturity, this could also have an impact on the tax position of the debtor.

DEBT AMENDMENT, REFINANCING AND NOVATION

1. What are the key tax considerations on a debt amendment?

Unless it qualifies as a novation or refinancing, a debt amendment should generally not give rise to adverse tax consequences at the level of a Luxembourg debtor or creditor. Key tax issues to be considered in the context of a debt amendment are transfer pricing principles (in case of an intercompany debt amendment), as well as more specifically from the perspective of the debtor, any impact on the withholding tax position and tax deductibility of interest payments.

2. Does the deferral of any payments of interest or repayments of principal trigger tax consequences?

For Luxembourg corporate tax purposes, interest income and expenses are generally accounted on an accrual (rather than a cash) basis. Therefore, only the deferral of interest accrual can have a tax impact, notably on the timing of recognition of any interest income and expenses, as opposed to the deferral of actual interest payments.

Unless the deferral has the effect of giving rise to accounting adjustments (see above), the deferral of any repayment of principal should in principle not trigger adverse Luxembourg corporate income tax consequences for the debtor.

The deferral of any repayment of principal should not trigger adverse Luxembourg corporate tax consequences, unless no interest would be applied during the deferral period (which could be considered non-arm's length).

Assuming the debt was not discounted and has not been impaired by the creditor, repayment of principal should not give rise to any adverse Luxembourg corporate income tax consequences for a Luxembourg debtor or creditor. Where a debt was issued or acquired at a discount (or impaired), any repayment of principal which exceeds the tax value thereof, would be taxable in the hands of the creditor.

3. What are the key tax considerations on a debt refinancing?

The repayment of the existing debt should neither give rise to withholding tax, nor impact the deductibility of interest payments. For new debt, the general tax considerations for debt instruments apply. If a debt refinancing results in a formal or economic waiver of debt, this may give rise to taxable debt waiver income at the level of the debtor (see below under "*Does the release of debt trigger taxable income for the debtor? If so are there any reliefs or exemptions?*").

Furthermore, the refinancing of foreign currency denominated debt may trigger a taxable foreign exchange result. When debt is refinanced in intra-group situations the arm's length character of the debt refinancing (and the terms and conditions of the debt itself) should be analysed.

4. Does rolling up interest or satisfying interest through issuing "payment in kind" notes give rise to any tax consequences?

For Luxembourg corporate tax purposes, interest income and expenses are accounted generally on an accrual (rather than a cash) basis. Accordingly, neither the capitalisation, nor issuance of payment-in-kind ("PIK") notes should *per se* have adverse Luxembourg corporate tax consequences for either a Luxembourg creditor or a Luxembourg debtor.

As a principle, no withholding tax is levied on arm's length interest payments made to corporate Luxembourg resident or non-resident creditors, thus it should be irrelevant for Luxembourg (withholding) tax purposes whether interest is paid in cash, is accrued to the principal amount or is paid in kind. Withholding tax may still be applicable in specific cases, e.g., where the debt instrument is requalified as an equity instrument, or where the interest payment is made to an individual beneficial owner resident in Luxembourg.

5. Does the novation of debt by a debtor to another group company trigger any adverse tax consequences?

The novation of debt involving a change of the debtor should trigger the realisation of any unrealised capital gains or losses at the moment of the novation.

Assuming that the novation to the new debtor is carried out in compliance with arm's length conditions, it should not trigger adverse Luxembourg tax consequences at the level of the initial Luxembourg debtor. Upon the novation of debt, the original debtor will ordinarily owe the new debtor an amount equal to the debt assumed by the new debtor. Generally, this will take the form of a new intercompany balance between the two entities. With respect to the new intercompany balance and the new debtor, the general points to consider in respect of intercompany debt would be equally applicable (e.g., arm's length conditions, debt/equity treatment, interest deductibility).

6. Are there any specific tax considerations to bear in mind where the security / guarantee package is amended as part of the debt amendment / refinancing?

For a Luxembourg debtor benefitting from a guarantee, no adverse Luxembourg tax consequences should arise on entry into, or amendments to, a guarantee by a Luxembourg guarantor or on the taking of security over a Luxembourg-based asset.

However, where a guarantee is provided by a Luxembourg guarantor in an intra-group context, applying transfer pricing principles, it should be determined whether the Luxembourg guarantor should be remunerated for having provided that guarantee for the benefit of the borrower. In particular, in case the guarantee increases the borrowing capacity of the debtor, it should be analysed (in light of OECD guidance) whether for transfer pricing purposes a portion of the loan (corresponding to the increased borrowing capacity) should rather be considered as a loan from the lender to the guarantor, followed by a capital contribution from the guarantor into the borrowing entity.

DEBT RELEASES

1. Does the release of debt trigger taxable income for the debtor? If so are there any reliefs or exemptions?

At the level of a Luxembourg debtor, the release of debt triggers accounting profit, which as a principle is fully taxable to corporate taxes at a combined current rate of approximately 24%. An exemption may apply where the debt release is granted in view of the financial recovery of a debtor that is in a distressed financial situation ("*gain d'assainissement*"). The application of this exemption is subject to several conditions, some of which are expressly stated in the law and others which have been set-out by case law (i.e., the debt release must be (i) definitive in nature, (ii) granted by at least a majority of the creditors, and (iii) granted exclusively in the interest of the financial recovery of the debtor). The tax treatment of debt waivers motivated by the shareholder relationship is subject to different considerations. In such situations, a debt waiver could be requalified, subject to certain conditions, into a "hidden" capital contribution, which is tax neutral. Depending on the value of such "hidden" contribution, the waiver gain could however remain partially taxable.

Where the debtor is within the scope of Pillar 2, it will be important to consider whether the release gives rise to any Pillar 2 impact (see "*Are there any Pillar 2 considerations to take into account specifically in distressed situations?*").

2. Does the release of debt trigger any withholding or indirect tax? If so, are there any reliefs or exemptions?

The release of debt as such should not trigger withholding tax or indirect Luxembourg tax consequences.

In the case of a release of debt between related parties (e.g., in case of debt release by a subsidiary to its parent or to a sister company), the tax authorities could requalify the debt release into a "hidden" dividend distribution, on which a 15% withholding tax is in principle due, unless a domestic or treaty exemption is available.

3. Can a creditor claim a deduction in respect of any debt that is released?

If the debt release results in an accounting loss for Lux GAAP purposes (typically for the portion of the debt that was not yet impaired), this accounting loss would in principle give rise to a tax-deductible loss for the Luxembourg creditor.

In a related party situation, where the creditor is the shareholder of the debtor, the debt release could be requalified into either a non-deductible hidden contribution at the level of the debtor (for a debt release in favour of a direct or indirect subsidiary) or a non-deductible hidden dividend distribution (in case of debt release by a subsidiary in favour of its parent or to a sister company).

4. Is the position different if the debt being released is a trade debt?

The waiver of a trade debt is treated in the same manner as any other debt (e.g., a formally documented loan). Hence any loss realized on the waiver of a trade debt should generally be tax-deductible at the level of the Luxembourg creditor (see above under “*Can a creditor claim a deduction in respect of any debt that is released?*”).

5. Does the release of an uncalled guarantee obligation trigger any adverse tax consequences? Is the position different if the guarantee has been called?

Assuming the uncalled guarantee is not recorded as a liability for accounting purposes (but only appears in the off-balance sheet commitments of the guarantor), the release of an uncalled guarantee should not have adverse tax consequences.

Conversely, where the borrower has defaulted and the guarantee has been called, this would generally give rise to a liability being recorded for tax purposes. Furthermore, in an intra-group context, not calling a guarantee obligation which can contractually be called could be requalified into either a deemed debt release or a hidden contribution/distribution (depending whether the entity benefiting from the guarantee is an (in)direct parent, sister company or an (in)direct subsidiary). The tax implications set out in sections “*Does the release of debt trigger taxable income for the debtor? If so are there any reliefs or exemptions?*” and “*Can a creditor claim a deduction in respect of any debt that is released?*” are relevant in such cases.

6. Do any adverse tax consequences arise on the release of liabilities owed under a derivative contract?

Luxembourg tax law does not prescribe for specific rules applying to derivative contracts. The tax consequences attached to the release of liabilities owed under a derivative contract should therefore follow the tax treatment of debt release in general (see above “*Does the release of debt trigger taxable income for the debtor? If so are there any reliefs or exemptions?*”).

7. Are there any Pillar 2 considerations to take into account specifically in distressed situations?

Luxembourg has implemented the Pillar 2 Model Rules in domestic legislation, as well as various pieces of additional OECD guidance, including the part on debt releases.

The optional Pillar 2 exclusion of ‘cancellation of debt income’ (**CODI**) from the GloBE tax base is more restrictive than the corresponding Luxembourg domestic tax provision on the *gain d’assainissement* (reference to section “*Does the release of debt trigger taxable income for the debtor? If so are there any reliefs or exemptions?*”) and applies only in one of the following fact patterns:

- There are ongoing statutory insolvency or bankruptcy proceedings supervised by independent parties. In such case, the CODI from the release of both third-party and related party debt is excluded from the GloBE tax base.
- There is an arrangement with creditors (which must include third parties) to avoid a reasonably likely bankruptcy within 12 months if third-party debt is not released. In this case as well, the CODI from the release of both third-party and related party debt is excluded from the GloBE tax base.
- The debtor’s liabilities exceed the fair market value of its assets immediately before the debt release. The CODI exclusion only applies to the release from third-party debt and only up to the lower of (i) the difference between the debtor’s liabilities and the fair market value of its assets and (ii) the reduction in the debtor’s attributes under the tax laws of the debtor’s jurisdiction resulting from the debt release.

Where a group is in scope of Pillar 2, it is therefore key to assess whether debt releases and equitisations can be structured in such a way as to comply with one of the above fact patterns, especially where the domestic tax law provisions would enable a non-recognition of CODI or would entail a deviation between commercial accounts and tax accounts. The application of Pillar 2 in a restructuring context remains moreover subject to the more general transfer pricing principle (which also exists under Pillar 2). The alternatives available to mitigate recognition of

debt waiver income upon debt-for-equity exchange (e.g. requalification into hidden contribution, contribution at face value; we refer to section “*What are the key tax considerations on a debt-for-equity exchange for the creditor?*”) should thus be carefully assessed from a Pillar 2 perspective.

DEBT FOR EQUITY EXCHANGE

1. What are the key tax considerations on a debt-for-equity exchange for the creditor?

The debt-for-equity exchange typically takes the form of a contribution, by the creditor, of the debt receivable, in exchange for shares in the debtor. Upon the contribution, the contributed receivable will disappear from the creditor's balance sheet and will in principle be replaced by shares in the debtor. If the debt is not (entirely) collectible and the contribution occurs at the collectible value, the creditor will recognize an accounting loss (to the extent the debt had not been impaired to fair market value prior to the contribution). If the contribution occurs at nominal value, the creditor would generally not recognize an accounting loss since the debt receivable is simply replaced by a (or an increased) participation in the debtor. Such participation may be impaired, if economically justified, which may give rise to a deductible expense.

For tax purposes the contribution (including hidden contributions) must be valued at going concern value. It is debated whether such value should be assessed from the creditor's perspective (lower than nominal, if the debt is distressed) or the debtor's perspective (which should be equal to at least the nominal value). To this date there is no case law dealing with this specific question.

From a tax perspective, the debtor will generally prefer a contribution at nominal value whereas the creditor will prefer the contribution to occur at real economic value, as the loss on the debt is crystallized and appreciation of the shares could, realized only upon future (deemed) alienation could benefit from an exemption under a participation exemption regime.

A potential way to mitigate the risks of discussions on valuation is for the debtor to issue shares (for a total amount equal to the amount of the debt to be swapped for equity) and for the creditor to leave the subscription price outstanding. This creates a payable of the creditor towards the debtor. This payable can then be set-off against the debt owed by the debtor to the creditor (which has the same nominal value), such that the debt is in effect repaid at nominal, avoiding the realisation of a gain at debtor level. The creditor may thereafter deem it appropriate to book an impairment on the shares.

Following a debt-for-equity exchange, the creditor is exposed to the tax consequences of holding equity in the debtor instead of merely holding a debt instrument.

In particular, the repatriation of profits under a debt instrument and under an equity instrument are subject to different tax considerations. A withholding tax of 15% applies as a principle to distributions made by a Luxembourg corporate entity under an equity instrument, unless the shareholder qualifies for a treaty or a domestic exemption. On the other hand, no withholding tax is levied as a principle on genuine, arm's length, interest payments made under a debt instrument.

Similarly, it should be considered whether the newly acquired equity will be held as a long-term or a short-term investment. Subject to treaty protection, a non-resident shareholder of a Luxembourg company is taxable on the disposal of an important participation within 6 months of acquiring it. An important participation is a participation of more than 10% in the capital of the Luxembourg company held by the seller, alone or, in case of an individual, with his spouse or partner and underage children, at any time during the five years preceding the disposal.

2. What are the key tax considerations on a debt-for-equity exchange for the debtor?

We refer to section “*What are the key tax considerations on a debt-for-equity exchange for the creditor?*” for further background. In case the debt is not (entirely) collectible, the debt-for-equity swap could result in the realization of a taxable debt waiver gain for the Luxembourg debtor, irrespective of the accounting treatment. In case the creditor is already a shareholder, and the debt is contributed at its collectible value, the creditor could argue that the accounting profit realized is to be requalified into a non-taxable hidden contribution, but there is a risk that the tax authorities disagree with this treatment in case the collectible amount of the debt was below the nominal value. In case the contribution is done at nominal value, there is also a risk that the tax authorities would consider a contribution at nominal value as a deemed waiver.

Where the debtor is within the scope of Pillar 2, it will be important to consider whether the exchange gives rise to any Pillar 2 impact (see above “Are there any Pillar 2 considerations to take into account specifically in distressed situations?”).

3. Where warrants or similar instruments are issued as part of a debt restructuring does this trigger any adverse tax consequences?

The rules applying to warrants and similar instruments (such as preferential subscription rights) are particularly complex and the tax consequences of such instruments depend on a case-by-case analysis.

Generally, the mere issuance of warrants or similar instruments in the context of a debt restructuring should not *per se* trigger adverse tax consequences. If the debtor issues warrants as repayment in kind of an existing debt, and insofar the market value of the warrants is lower than the nominal amount of the initial debt claim, this could be considered as a partial debt waiver, for which we refer to questions “Does the release of debt trigger taxable income for the debtor? If so are there any reliefs or exemptions?” and “Can a creditor claim a deduction in respect of any debt that is released?”.

Depending on the particular features of the instrument, the exercise of warrants and similar instruments may result in adverse tax consequences. A case-by-case analysis is required.

4. What are the key tax consequences of capital contributions by a parent company into its subsidiary?

A capital contribution to a subsidiary by a parent company is in principle tax neutral from a Luxembourg tax perspective. While under Luxembourg tax rules, in principle, tax follows accounting, for contributions, the Luxembourg income tax law provides that contributions (including hidden contributions) must be valued at the “going concern value” which generally corresponds to the fair market value.

If the shareholder is investing alongside other investors, particular care should be given to the structuring of the capital contribution. According to case law, a contribution to a special premium account (so-called “115 account”), which does not involve the issuance of shares, is not sufficient to meet participation exemption thresholds that are based on the cost price of the participation.

FEES AND TRANSACTION COSTS

1. Is there any adverse tax impact in respect of common restructuring fees, for example, consent fees?

Common restructuring fees such as consent fees or backstop fees paid by a Luxembourg debtor should be treated as regular expenses deductible from the Luxembourg tax base, to the extent they are at arm’s length. The impact of the payment of such restructuring fees on the interest deduction limitation rule should also be considered.

Backstop fees should generally not attract Luxembourg VAT, whereas consent fees may as a principle attract Luxembourg VAT at 17% (subject to VAT localisation rules).

2. Are transaction costs deductible for tax purposes and is any VAT recoverable?

Transaction costs are in principle deductible from the corporate tax base of a Luxembourg taxpayer, provided that they are incurred in the corporate interest of the payor. It is noted that such corporate interest may be lacking where the payment is made in place of a related entity. In such cases, the deductibility of the transaction costs may be challenged (unless the payor receives an appropriate compensation and merely acts as an intermediary).

The recoverability of Luxembourg VAT on the transaction costs chiefly depends on the activities of the entity requiring the underlying services / goods. As a general rule, if the entity performs activities granting the right to recover input VAT incurred (e.g., non-EU financing), input VAT on transaction costs can be at least partially deductible. If it does not perform any activity within the scope of VAT (e.g., pure holding entity) or solely performs an activity not granting the right to deduct input VAT (e.g., EU financing), all input VAT should constitute a final cost.

DEBT ENFORCEMENT

1. Aside from insolvency proceedings, what are the key methods of enforcement and their tax impact?

For movable property, the most frequently used security are financial collateral arrangements governed by the Luxembourg Collateral Law of 2005, as amended. The Collateral Law permits the enforcement of a pledge over shares, accounts, and claims upon the occurrence of a trigger event (contractually determinable by the parties and which does not have to be a payment default) without prior notice.

Furthermore, upon enforcement, it provides for a variety of in and out of court enforcement processes. In practice, the two most commonly used enforcement procedures are (i) the appropriation of the collateral (either by the pledgee or a third party) using a contractually determined valuation method and at a valuation that usually occurs after the appropriation has taken place and (ii) the private sale at “normal commercial conditions”.

Under Luxembourg law, a person who satisfies (whether in part or fully) the debt obligation of another person has a right of recourse against such person in the amount of the satisfied debt. In a situation where a person has granted financial collateral securing liabilities of another person, the discharge of such secured liabilities in principle gives rise to a right of recourse. The Luxembourg Collateral Law expressly allows the provider of the financial collateral to waive, even at the time of the granting of the security, its right of recourse arising under or in connection with the enforcement of the financial collateral. In such situation, in case a Luxembourg borrower is discharged of its debt without having a recourse payable, it would realize a taxable debt waiver income.

In case of enforcement by way of appropriation, if the pledgee subsequently realizes a gain on such asset, the latter will be taxable as ordinary taxable income of the pledgee, except if a specific exemption applies (e.g., in the case of an enforced pledge on shares, participation exemption on the capital gain upon disposal of the shares). Please also refer to our considerations below under “*If the enforcement results in the creditor taking ownership of equity or assets, what are the key tax considerations to bear in mind?*”.

2. If the enforcement results in the creditor taking ownership of equity or assets, what are the key tax considerations to bear in mind?

If the enforcement results in the creditor taking ownership of equity or assets, the tax considerations will depend on the type of asset acquired (e.g., shares, bank accounts, IP assets).

In the case of enforcement of a share pledge over the shares of a Luxembourg company by way of appropriation, some of the key tax considerations to keep in mind are the following:

- Upon appropriation, the creditor should book the newly acquired participation at its fair market value. This may trigger a taxable gain or a tax deductible loss depending on the book value of the assets in the hands of the debtor (except with respect to shares for which the gain may be exempt).
- If real estate is transferred to the creditor, registration duties generally apply.
- The withholding tax position should be re-considered. Interest payments made by a Luxembourg company are in principle not subject to withholding tax, whereas dividends are in principle subject to 15% withholding tax, unless a treaty or domestic exemption applies.
- In case of change of control, this may result in the end of a fiscal unity or, under certain conditions, the Luxembourg company may lose its right to carry forward of tax losses.

3. Are any specific tax considerations arising on payments or transferring security under guarantees as opposed to the debt?

As mentioned in the section “*Aside from insolvency proceedings, what are the key methods of enforcement and their tax impact?*”, the payment by the guarantor will trigger a right of recourse claim against the debtor. In case such right of recourse has been waived, and a Luxembourg borrower is discharged of its debt without having a recourse payable, it would realize a taxable debt waiver income.

If the guarantee in itself is not at arm's length, the guarantee payment may give rise to a hidden contribution (if the guarantee was granted to a direct or indirect subsidiary) or hidden distribution possibly subject to 15% withholding tax (if the guarantee was granted to a parent or sister company).

With respect to the release of guarantees see above "*Does the release of an uncalled guarantee obligation trigger any adverse tax consequences? Is the position different if the guarantee has been called?*"

With respect to Luxembourg tax issues arising on the transfer of security see above "*If the enforcement results in the creditor taking ownership of equity or assets, what are the key tax considerations to bear in mind?*"

4. Are there any adverse tax consequences arising from a change of control or break of a tax group?

The mere change of control does not impact the possibility to use the tax losses carried forward of the Luxembourg acquired entity. However, if such change of control is coupled with other elements such as, for instance, a discontinuation of the current activity of the company and exercise of a new profitable activity, an abuse of law may be characterised, and the use of tax losses carried forward may be refused on these grounds. In a genuine third-party debt restructuring context, where the exercise of a pledge and the change of control is not driven by the availability of losses carried forward, the risk of challenge should be remote. In case the acquired entity is part of a fiscal unity (other than in quality of head of the fiscal unity), the change of ownership results in the exit of that entity from the fiscal unity. If this change occurs before the expiration of a minimum 5-year period as from the constitution of the fiscal unity, the group companies are re-assessed retroactively to disregard any adjustments related to the fiscal unity regime. If this change occurs after the expiration of the minimum 5-year period, any adjustments related to the fiscal unity regime are refused only as from the beginning of the tax year in which the change of ownership occurred.

If the new (indirect) shareholder is part of a multinational group in scope of Pillar Two (or if, as a result of the change of control, the Luxembourg company ceases to be a constituent entity of an in-scope multinational group), Pillar Two tax aspects should be considered.

5. Where equity / assets are indirectly transferred as part of an enforcement, does that trigger adverse tax consequences?

If there is an indirect change of control of a Luxembourg company because of an enforcement taking place higher up in the structure, there should be no adverse Luxembourg tax impact (assuming the enforcement is not driven by the desire of the new shareholder to use the tax losses carried forward of the Luxembourg subsidiary to shelter otherwise taxable income).

If the new (indirect) shareholder is part of a multinational group in scope of Pillar Two (or if, as a result of the change of control, the Luxembourg company ceases to be a constituent entity of an in-scope multinational group), Pillar Two tax aspects should be considered.

6. Is any claw back permissible where a distressed company pays taxes for which a solvent shareholder is liable?

Under Luxembourg tax law, there are no such specific clawbacks.

However, under Luxembourg insolvency law, a debtor's pre-insolvency transactions and corporate acts can be affected by bankruptcy proceedings if they were concluded during the claw-back period (*période suspecte*), which dates back to a maximum of six months from the bankruptcy judgement. In case the payment of tax on behalf of the shareholder is considered not to be in the corporate interest of the distressed subsidiary, it cannot be excluded that there would be a claw-back on such payment.

ACQUISITION OF DEBT

1. Does the acquisition of a creditor's interest in distressed debt trigger any adverse direct tax consequences for the debtor?

Where the creditor changes or in the presence of an additional new creditor, the main tax consequences to be considered by a Luxembourg debtor relate to the interest deductibility. Depending on the jurisdiction of establishment of the new creditor and whether the new creditor is an associated enterprise or not, the tax deduction of interest expenses may be refused.

2. Does the acquisition of distressed debt trigger any adverse withholding or indirect tax consequences for the debtor?

The change of creditor under a distressed debt should not *per se* have an impact on the withholding tax position of the debtor, assuming that the terms and conditions of the debt remain the same.

3. What are the key tax considerations for the purchaser of a creditor's interest on the acquisition of distressed debt?

Any gains realized by a Luxembourg company acquiring distressed debt constitute regularly taxable income. In case the gain is offset against interest expenses, the application of the interest deduction limitation rule (at the level of the acquirer) should be considered. Where the acquirer of distressed debt issued by a Luxembourg debtor is not a resident of Luxembourg, the acquisition of distressed debt should not give rise to specific adverse Luxembourg tax consequences. From the perspective of the Luxembourg debtor, the withholding tax position with respect to the new creditor should be verified.

The acquisition of distressed debt may attract VAT, unless the distressed debt is acquired at a price below its face value.

4. Are there any particular beneficial regimes accessible to a purchaser of a distressed debt portfolio?

Under Luxembourg tax law, there are no tax regimes widely accessible to a purchaser of a distressed debt portfolio. Luxembourg law provides however for a beneficial tax regime applicable to securitisation companies, whereby distributions and other payments made to shareholders and investors are not subject to Luxembourg withholding tax and commitments towards investors as well as other creditors are in principle deductible for tax purposes. The latter deductibility can, however, be curtailed under anti-hybrid rules or interest limitation rules, like for any other regular corporate taxpayer.

INSOLVENCY PROCEEDINGS

1. What are the key insolvency procedures?

Traditionally, under Luxembourg insolvency laws, three types of proceedings may be opened against a Luxembourg company:

- bankruptcy proceedings (*faillite*),
- controlled management proceedings (*gestion contrôlée*), and
- composition proceedings (*concordat préventif de la faillite*).

Luxembourg has recently modernized its insolvency law through the addition of a new in-court procedure, the judicial reorganisation procedure (*procédure de réorganisation judiciaire*).

2. What are the key tax considerations arising upon entry into an insolvency procedure?

Upon bankruptcy, the company remains subject to the ordinary corporate income tax regime implying, *inter alia*, the obligation to annually file a corporate income tax return. This obligation rests on the directors of the company, who can be held liable in case of fault or negligence in the filing of the tax return (please refer also to the considerations below under “*Are directors or other managers personally liable for tax debts in an insolvency?*”).

Under certain conditions, debt waivers granted in view of the financial recovery of the debtor may benefit from a preferential tax treatment (see above under “*Does the release of debt trigger taxable income for the debtor? If so are there any reliefs or exemptions?*”).

3. Does entry into an insolvency procedure impact tax groupings?

The mere entry into an insolvency procedure does not *per se* have an impact on the fiscal unity.

However, if the insolvency procedure results in the liquidation of one of the members of the fiscal unity, this could potentially have a significant and sometimes retroactive tax impact. Two conditions of the fiscal unity regime are particularly relevant in this context:

- The members of the fiscal unity must commit to stay in the fiscal unity for a minimal period of five accounting years. In line with this condition, if the fiscal unity has validly been in place for at least five years, broadly speaking any potential tax impact should be limited in time to the first accounting period in which the conditions of the fiscal unity regime are no longer met (either by the integrating company or an applicable integrated company). On the contrary, if the fiscal unity has not been in place during this minimal period, the fiscal unity would be retroactively “broken”.
- All the members of the fiscal unity must open and close their accounting year at the same date. It follows from this that in case one of the members of the fiscal unity closes its liquidation the fiscal unity conditions are no longer met as from that year. If this happens during the minimal five-year period, the fiscal unity is retroactively “broken”.

4. Are there any specific tax set offs available in an insolvency?

Luxembourg tax law does not provide for any specific tax compensation or set-off mechanisms in case of insolvency. However, it can generally be expected that the insolvent company has tax losses carried forward which could be used to offset, e.g., taxable debt waiver gains.

5. Is the tax authority a preferential creditor in an insolvency?

The tax authority is a preferential creditor in case of insolvency, benefitting from both a general first ranking security on all the movable assets of the debtor (“*privilège du trésor*”) as well as a legal mortgage (*hypothèque*) on the (current and future) real estate assets of the debtor.

In addition to this, the tax authorities have certain special prerogatives to recover the tax debt in an insolvency procedure compared to unsecured creditors, such as for instance the absence of an obligation to register their claim with the receiver and the absence (at least during a certain amount of time) of an obligation to register their mortgage.

6. Are directors or other managers personally liable for tax debts in an insolvency?

In certain circumstances, including during insolvency procedures, directors and other managers can be held jointly and personally liable towards the tax authorities for the payment of the company's taxes. The tax authorities can in these cases issue a guarantee call tax assessment ("*bulletin d'appel en garantie*") to a director. In cases of plurality of directors, the tax authorities may address the guarantee to any of the directors.

The issuance of a guarantee call assessment is subject to certain conditions. In particular the tax authorities should be able to prove a serious misconduct of the director and a link between such serious misconduct and the nonpayment of taxes by the company.

According to case law, directors and managers could be liable to pay the tax debts of the company if they have not taken appropriate action, or have taken action too late, prior to the company becoming insolvent. In that case, the serious misconduct was characterised by the negligence of the director in filing the annual accounts and the tax returns of the company during 14 years prior to the company becoming insolvent.



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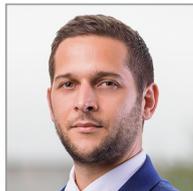
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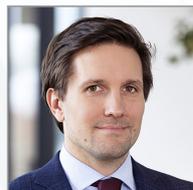
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