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Luxembourg Tax Alert

2018 budget law approved

27 December 2017

Luxembourg's 2018 budget law (for previous coverage please refer here) was approved by the parliament and officially published on 21 December 2017, with the tax measures applying as from 1 January 2018. The main tax measures from the budget law are summarized in this alert, along with certain other tax developments not covered in the budget law, most notably the reduction in the corporate income tax rate as from 2018.

- **Corporate income tax**

In addition to the corporate income tax rate reduction that was introduced through the 2017 tax reform, the 2018 budget law introduces two additional investment tax credits for companies—one for investments in purchased software, and the other for electric cars with zero emissions or hydrogen fuel cell cars.

- **Tax rate reduction**

The corporate income tax rate will reduce from 19 percent to 18 percent. As a result, the effective combined income tax rate for a company in Luxembourg City will be 26.01 percent for 2018 (including the corporate income tax, municipal business tax and the contribution for the unemployment fund).

- **Credit for investment in purchased software**

A tax credit is introduced for investments in purchased software (the credit will not apply to software created by the company, which would be able to benefit from the proposed intellectual property [IP] regime that is still under discussion by the parliament). Within a single corporate group, each software purchase will be able to benefit from the credit regime only once, and no credit will be allowed for software purchased from another group entity. Once a taxpayer requests the tax credit for the purchase of software, it would not be allowed to request the application of the IP regime for the income generated by such software.

The amount of the investment tax credit granted will be calculated in two tranches: for the portion of purchases up to EUR 150,000, it will be 8 percent of the cost, and for the portion above EUR 150,000, it will be 2 percent of the cost. The tax benefit from the regime may not exceed 10 percent of the tax due for the year of the software acquisition.

- **Credit for zero-emission electric cars or hydrogen fuel cell cars**

A 13 percent investment tax credit will apply to the purchase of new electric cars with zero emissions or hydrogen fuel cell cars registered after 31 December 2017, calculated on the acquisition price (after the deduction of possible subsidies) up to EUR 50,000 per eligible vehicle.

- **Other corporate developments**

Other developments for corporations include:

- The draft law on the new IP regime that was published on 7 August 2017 (which is not covered in the 2018 budget law) has been amended to clarify that R&D expenses incurred by a permanent establishment in another country within the European Economic Area can constitute "eligible expenses" of the taxpayer only if specific conditions are fulfilled. The parliament is expected to vote on the draft law during the first trimester of 2018 and, if approved, the new rules are expected to apply as from 2018.
- The provisions relating to the exchange of information on request procedures were removed from the budget law for 2018. A separate draft law that would amend the exchange of information on request procedures has been submitted to parliament on 19 December and is expected to be voted on during 2018.

- **Value added tax**

The following are the main budget law provisions and other developments relating to VAT:

- **Exemption for certain insurance funds:** The VAT law is modified to expand the list of funds that will benefit from the VAT exemption applicable to management services of investment funds. As from 2018, the list will include collective internal insurance funds that are subject to the supervision of the Luxembourg Insurance Commission and whose investment risks are borne by policyholders. The exemption also will apply to services rendered to equivalent insurance funds established in other EU member states that are subject to similar supervision.

- **Rate for forestry products:** The VAT rate applicable to forestry products is increased from 4 percent to 12 percent.

- **Other VAT developments:** In addition to the VAT measures in the 2018 budget law, the following VAT developments should be noted:

  - The draft law presented on 9 August 2017 that would introduce new rules relating to the VAT treatment of vouchers was expected to become effective on 1 January 2018; however, the draft law has not yet been voted on by parliament and the parliamentary sessions are now closed. The law is expected to be voted on in 2018. This draft law also would amend the VAT law to provide for the taxation of goods retained by a taxpayer (or its legal successors) after the termination of its economic activity, when the VAT incurred on the goods has been partially or fully deducted before the termination of the activity.
  - A Grand Ducal decree was enacted on 23 November 2017 that repeals the exemption of services rendered by independent groups of persons to their members with effect from 31 December 2017. The new decree is in response to the decision of the Court of Justice of the European Union on 4 May 2017 (C-274/15), in which the court held that certain provisions of the existing decree were incompatible with the EU VAT directive.

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- **Personal income tax**

  The provisions in the budget law that affect individuals include the following:

  - A new tax allowance amounting to EUR 2,500 for sustainable mobility is introduced for rechargeable hybrid electric cars for individual use with CO2 emissions not exceeding 50 grams of CO2 per kilometer.
  - The choice of filing status for married resident taxpayers for the 2018 income tax return (i.e., among joint taxation and two new types of filing status—pure separate taxation and separate free allocation taxation) will need to be communicated to the tax authorities before 31 March 2019 through a joint application (the choice made will be irrevocable for the 2018 income tax year).
  - The "assimilation" of married nonresident taxpayers to be treated as resident taxpayers to benefit from "tax class 2" (the class for married taxpayers) will be simplified and, as from 2018, will be subject to the following conditions:
    - At least 90 percent of the worldwide income of the nonresident taxpayer working in Luxembourg must be taxable in Luxembourg
    - Additional flexibility will be provided for professional income derived when working outside of Luxembourg, i.e., the income for the first 50 days worked abroad will be regarded as taxable in Luxembourg for the purpose of assimilation
    - Net income considered nontaxable in Luxembourg can be disregarded provided it does not exceed EUR 13,000 in total

    These rules will not apply to Belgian residents—according to the tax treaty with Belgium, tax class 2 in Luxembourg will remain applicable where at least 50 percent of the professional income of the household is taxable in Luxembourg.
  - The inheritance tax regime for couples without common descendants—either married or in a registered partnership for at least three years—will be aligned with the exemption regime currently applicable for married couples with common descendants.

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