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Luxembourg Tax Alert

Luxembourg 2021 budget law

28 December 2020

On 19 December 2020, Luxembourg's 2021 budget law was adopted by the Chamber of Deputies and it was published in the Official Journal on 23 December 2020.

Due to the COVID-19 situation, the Finance minister announced that the main focus of the measures is to contain the economic effects of the virus; therefore, there will not be a general tax reform for the 2021 budget year. Instead, the measures include various corporate, individual, and indirect tax changes and administrative simplifications.

The budget law will enter into force on 1 January 2021 and apply as from that date, except for certain tax measures, as further discussed below.

1. Corporate tax measures

The budget law introduces the following new corporate tax measures:

- Measures regarding the ownership of real estate located in Luxembourg by some Luxembourg investment vehicles;
- An amendment to the fiscal unity regime to change from a vertical to a horizontal consolidation regime; and
- A modification of the accelerated depreciation rules.

1.1. Measures regarding the ownership of real estate located in Luxembourg by some Luxembourg investment vehicles

The 2018-2023 coalition agreement for the formation of a new government stated that the government would introduce measures to counter tax abuses in the real estate sector. The 2021 budget law introduces a new real estate levy that will apply to a select number of Luxembourg investment vehicles owning real estate located in Luxembourg in some limited situations. Therefore, the holding of pan-European (other than Luxembourg) or pan-Asian real estate by Luxembourg investment vehicles, for example, will not be impacted.

The newly introduced levy, which enters into force on 1 January 2021, will apply only to the following Luxembourg investment vehicles:

- Alternative investment funds (AIFs) falling under part II of the amended law of 17 December 2010 concerning undertakings for collective investment (UCIs);
- Specialized investment funds (SIFs) referred to in the amended law of 13 February 2007; and
- Reserved alternative investment funds (RAIFs) referred to in article 1 of the amended law of 23 July 2016.

The real estate levy will not apply when a vehicle is organized as a tax transparent legal entity, such as a Luxembourg SCS/SCSp (limited partnership) or a contractual fund regime such as a Luxembourg *Fond Commun de Placemen*t (FCP). This limitation is intended to continue allowing the use of legal forms or contractual fund regimes that provide transparency between the investment and investor.

The real estate levy will apply at a rate of 20% on rental income (excluding VAT), capital gains resulting from the alienation of the real estate assets, and capital gains resulting from the alienation of units in certain types of entities (under certain conditions). This will apply if (i) all income is sourced from real estate assets located in the Grand-Duchy of Luxembourg and (ii) the income is received or realized directly from the real estate asset or indirectly through any other interposed tax transparent entity (such as a Luxembourg *société civile immobilière* (SCI), SCS, SCSp, etc.) or an FCP.

The 2021 budget law further states that such a levy will not be deductible from overall taxable real estate revenue. Furthermore, it will not be available as a deduction nor creditable by any corporate or individual investor.

The measure aims to target very specific cases while maintaining the current tax regime for Luxembourg investment vehicles; therefore, it will only impact a very limited number of players.

Additionally, according to the 2021 budget law, a Luxembourg private wealth management company (SPF, *société de gestion de patrimoine familial*), governed by the Law of 11 May 2007, will no longer be authorized to indirectly hold real estate assets through one or more partnerships (established in Luxembourg or abroad), FCPs, or foreign undertakings benefiting from an equivalent tax and legal regime as a Luxembourg FCP. However, SPFs indirectly holding real estate through joint-stock companies will still be allowed to do so. Further clarification would be welcome to understand the measure's exact scope and further assess whether and when existing SPFs in this situation may want to restructure.

This measure will apply as from 1 July 2021.

1.2. Amendment to the fiscal unity regime to change from a vertical to a horizontal consolidation regime

The budget law introduces a temporary measure related to the fiscal unity regime to align it with a 2020 decision of the Court of Justice of the European Union (CJEU) (C-749/18).

In 2015, Luxembourgish legislation was amended to be aligned with CJEU case law allowing a group whose parent company is based in another European Economic Area (EEA) state or who has a permanent establishment there to form a "horizontal tax consolidation" with its resident (first- or lower-tier) subsidiaries.

The purpose of this measure is to allow vertically consolidated groups to convert to a horizontal form without the consequences flowing from the tax dissolution of the tax group. If the conversion happens during the minimum period of five fiscal years, it will not result in a tax rectification of the group's members. Instead, the tax authorities will treat the transaction as if the conversion had not taken place.

The temporary measure will be subject to the following conditions:

- The integrating parent of the previous integrated group will become the integrating subsidiary of the new integrated group;
- The change will increase the scope of the new integrated group compared to the previous integrated group; and
- The entities will have to be bound for at least five fiscal years before benefitting from the tax consolidation regime, unless they were already part of the previous integrated group.

This regime change, upon a joint request by all group members, will apply as from the 2020 tax year and until the 2022 tax year.

1.3. Modification of the accelerated depreciation rules

The budget law modifies article 32ter of the income tax law (LIR) as from the 2021 tax year. The allowed accelerated depreciation rate for renovated rental real property will be reduced to 4% (from 6% currently). The 4% rate will only apply if the renovation is completed within five instead of six years as from the beginning of the operating year.

Likewise, a 4% rate will apply to capital expenditures incurred when renovating an old building (provided they exceed 20% of the building's purchase price) if the renovation is completed within five years as from the beginning of the operating year.

A definition of the concept of "sustainable energy renovation" is added. Under certain conditions, a 6% depreciation rate will be allowed for capital expenditures relating to a sustainable energy renovation of rental real property.

A grandfathering rule will allow a taxpayer who acquired or incorporated rental real property prior to 1 January 2021 to take advantage of the current 6% accelerated depreciation rate if all conditions are met. Similarly, regarding the renovation of an old building completed before 1 January 2021, the taxpayer will still be able to benefit from the 6% rate on capital expenditures if all conditions are met.

These measures will apply as from the 2021 tax year.

2. Individual tax measures

The budget law introduces several changes to the individual income tax rules aimed at increasing tax fairness while keeping the country competitive to attract and retain key talent. More specifically, the budget law includes the following individual income tax measures:

- Abolition of the current “stock option” regime, which represents a substantial change from the current remuneration models in Luxembourg;
- Introduction of a profit-sharing bonus (*prime participative*) for some employees based on an employer's profits;
- Modernization of the current tax system for "inpatriates;”
- Measures for rental real estate: modification of the accelerated depreciation rates and introduction of a depreciation rate for energy-related renovations;
- Introduction of multi-year electronic withholding tax cards for wages and salaries; and
- Other measures.

2.1. Abolition of the current “stock option” regime

In its 2018 coalition agreement, the Luxembourg government announced the creation of a future legal framework allowing employees to participate in their employer's value creation. However, the long-term existing stock option regime was intended to be abolished gradually.

In line with this announcement, the Luxembourg tax authorities completely repealed, on 14 December 2020, tax circular LIR No. 104/2 dated 29 November 2017 relating to stock option plans with effect from tax year 2021.

This repeal requires affected Luxembourg employers to rethink their remuneration strategy and to refocus on the fundamental elements of the Luxembourg individual income tax law.

2.2. Introduction of a profit-sharing bonus (*prime participative*)

To help attract and retain key employees (as announced in the coalition agreement), the Luxembourg government introduced a tax measure allowing employees to participate in corporate profits. The measure will allow employers to grant a profit-sharing bonus to some of their employees, based on the employer's financial results (i.e., profits).

This discretionary bonus will (i) be considered a corporate tax deductible operating expense at the level of the employer, (ii) qualify as employment income at the employee level, and (iii) benefit from a 50% individual income tax exemption (applicable on the amount subject to the 25% limit mentioned below under "Employee level criteria").

The granting of the bonus will be subject to certain criteria at both the employer and employee levels, as follows:

Employer level criteria:

- The employer will have to make a profit (from commercial, agricultural, or forestry operations, or from the practice of a liberal profession) in the relevant tax year.
- The employer will have to keep regular accounts during the tax year the bonus is granted (i.e., 2021 at the earliest), as well as during the year immediately preceding the tax year the bonus is granted (i.e., 2020).
- The total amount of bonus that may be granted to employees will be limited to 5% of the employer's profits for the fiscal year immediately preceding the fiscal year in which the bonuses are granted (i.e., 2020 profits in case of a bonus granted in 2021). It is implied that the employer will only be able to grant a bonus to employees if the financial year results are positive in the immediately preceding fiscal year. Moreover, for companies with activities in EU member states other than Luxembourg, the bonus will not be determined based on global commercial profits (i.e., at the group level) but will be limited to profits made in Luxembourg by a company that employs workers in Luxembourg.

Employee level criteria:

- The bonus will not exceed 25% of the employee's gross ordinary annual remuneration (i.e., excluding any cash, and/or in-kind benefits, bonuses, premiums, etc.) for any given tax year. This percentage should be assessed for each beneficiary on a case-by-case basis. When determining an employee's gross ordinary annual remuneration, the employer will have to take into account the deemed gross annual salary based on all facts and data available, as well as potential deviations likely to affect the amount during the year. No remuneration other than the ordinary remuneration of the employee should be taken into account in determining this 25% limit.
- The employee will have to be affiliated either with the Luxembourg social security system or a foreign social security scheme covered by a bi- or multilateral social security agreement.

The bonus will enable employers to share some of their profits with select employees at the employer's sole discretion.

Employers wishing to use this new regime will have to send a detailed communication to the appropriate wage tax office (i.e., RTS) responsible for verifying payroll tax deductions at the time the bonus is granted to the chosen employees. Communications will have to be made in the form prescribed by the tax authorities.

These provisions will apply as from the 2021 tax year. Therefore, it is important to note that an employer can consider implementing the new regime as early as 2021, based on the closing of its accounts for the 2020 calendar year, to the extent all conditions are met.

2.3. Modernization of the current tax system for inpatriates

The current inpatriate regime, based on a 2014 circular, will be codified with a few adjustments. The main difference will be a change to the lump sum allowance for recurring expenses related to the cost-of-living differential between the home and host member states. The new rule will take into account certain moving expenses, both the one-time move to Luxembourg and costs associated with moving to Luxembourg, for inpatriates and their families covered by the 2014 circular.

In particular, the addition of an inpatriation premium will modernize the current regime, which sets the lump sum allowance at 8% of executives' fixed monthly remuneration and caps it at EUR 1,500 per month (although this may be doubled when inpatriates share a common home or residence with a spouse or partner, provided that the spouse or partner does not carry out a specific professional activity).

Up to 50% of the inpatriation premium will be exempt from individual income tax as long as the premium amount does not exceed 30% of the inpatriate's annual remuneration.

In addition, recurring costs incurred as a result of moving to Luxembourg (e.g., housing, tuition, etc.) and that are paid by the employer also will be exempt from Luxembourg individual income tax, up to a limit of EUR 50,000 (or EUR 80,000 for a couple).

Inpatriates will benefit from these tax exemptions for a period of up to eight consecutive years following the year they move to and start to work in Luxembourg, instead of a maximum of five years currently, provided that all conditions are met. In particular, inpatriates will have to never have been tax domiciled in the Grand Duchy, nor been subject to Luxembourg individual income tax on their professional income, nor have lived less than 150 kilometers from the Luxembourg border, during the previous five tax years.

The new legal framework will omit some of the conditions required by the 2014 circular, such as the company having to employ 20 or more full-time equivalent employees in the medium-term, or the inpatriate possessing special know-how to benefit the company's staff or being recruited from a sector or profession deemed difficult to recruit for in Luxembourg.

However, to qualify for the premium exemption, each inpatriate will have to derive a minimum annual remuneration of EUR 100,000 (currently EUR 50,000).

This measure will apply as from the 2021 tax year. To that end, the Luxembourg tax authorities already repealed the 2014 Circular on 14 December 2020 with effect from tax year 2021. However, they specified that the tax regime described in the circular continues to apply to inpatriate workers who started their activity in Luxembourg during tax years 2016 through 2020 (within the limits and under the conditions stated in the circular and provided that the employees concerned do not benefit from the provisions of article 115, number 13b of the individual income tax law (LITL)). This does not apply to inpatriate workers whose tax regime ended, for one reason or another, during the same period covering tax years 2016 through 2020.

2.4. Rental real property measures

Individual taxpayers eligible for the accelerated depreciation regime will be entitled to an annual individual income tax allowance classified as a special property allowance.

To obtain this benefit, they will have to derive net profits and/or income within the meaning of article 10, numbers 1, 2, 3, or 7 of the LITL (i.e., income from commercial, agricultural, or forestry activities, income from the practice of a liberal profession, and/or rental income) taxable in the Grand Duchy. They will determine their allowance based on the accelerated depreciation applicable to a building (or part of a building) purchased after 31 December 2020, rented out, and less than five years old as at 1 January of the tax year.

In the case of joint taxation, each spouse or partner will receive the special property allowance under the conditions discussed above.

Furthermore, to promote a sustainable housing policy designed to combat climate change, and to encourage owners of rental accommodations to carry out sustainable renovations of their existing property, the budget law introduces an accelerated depreciation rate of 6% for 10 years for capital expenditure incurred for such renovations.

These measures will apply as from the 2021 tax year.

2.5. Introduction of multi-year electronic withholding tax cards for wages and salaries

The budget law gives employers direct access to the electronic tax cards of their employees (tax cards are issued to employees by the tax authorities and are remitted to and used by employers for wage tax withholding purposes).

The relevant platform will first be made available to employers sometime in 2021 on an optional testing basis. As from 1 January 2022, employers will be required to use the new tool and to consult the files electronically.

Employers will be required at least once a month to access the wage tax forms and consult all the forms not yet reviewed at the time of access. In case of non-compliance, the tax office responsible for verifying an employer's payroll and wage tax deductions could request that the employer consult the unchecked records. It is important to note that employers will be subject to potential financial sanctions in such cases.

2.6. Other measures

Landlords who have reduced the rent on their commercial leases in the 2020 calendar year will be eligible for a tax allowance equal to twice the amount of the rent reduction, up to EUR 15,000 per building (or part of a building) and per commercial lease agreement. This measure will apply as from the 2020 tax year.

The budget law also repeals a special tax regime for venture capital investment certificates introduced some time ago to revive investment in the interest of economic development, due to the scheme’s limited take-up.

3. Indirect tax measures

The budget law introduces the following indirect tax measures:

- Substantial increase of duties applicable to the contribution of a Luxembourg property to a company;
- Attribution of a property to a partner of a company;
- Reduction of the subscription tax rate for funds investing in sustainable investments;
- VAT - Renovation work;
- VAT - Small businesses;
- CO2 tax; and
- Tax on insurance premiums.

3.1. Substantial increase of duties applicable to the contribution of a Luxembourg property to a company

The registration and transcription duties due on the contribution of a Luxembourg property to a civil or joint-stock company will substantially increase, i.e., around three times more than currently due. The measure aims to partly align the tax treatment of a contribution of Luxembourg property to the tax treatment of a sale of Luxembourg property.

In practice, the registration duty will increase from 0.6% (i.e., 0.5% + 2/10) to 2.4% (i.e., 2% + 2/10) and the transcription duty from 0.5% to 1%. Therefore, the combined duties will increase from 1.1% to 3.4%.

For a nonresidential property located in Luxembourg City, the 50% surcharge that applies to registration duties should be taken into account. The registration duty will increase from 0.9% (i.e., 0.6% + 0.3%) to 3.6% (i.e., 2.4% + 1.2%). Therefore, the combined duties will increase from 1.4% to 4.6%.

This should be compared with the duties due for the direct sale of a property, which are 7% (i.e., 6% registration duty + 1% transcription duty) or 10% (i.e., 9% registration duty + 1% transcription duty) for a nonresidential property located in Luxembourg City.

3.2. Attribution of a property to a partner of a company

The budget law amends the anti-abuse measure under which registration and transcription duties are due when a Luxembourg property is attributed to a partner of a company other than the one who contributed the property to the company as a result of the dissolution, liquidation, or reduction in capital of a civil or joint-stock company. The time limit for this measure to apply will increase from five to 10 years. As mentioned above, the registration duty is 6% or 9% for a nonresidential property located in Luxembourg City and the transcription duty is 1%. Therefore, the total combined duties will be 7% or 10%.

3.3. Reduction of the subscription tax rate for funds investing in sustainable investments

The subscription tax rate to be paid by Luxembourg investment funds will be reduced for sustainable investments (as defined by the EU taxonomy) made by these funds. This rate depends on the level of sustainable investments made. In principle, the annual basic subscription tax rate amounts to 0.05% of net assets under management. Sustainable investments will benefit from a 0.04% rate when the fund invests at least 5% of its total net assets in sustainable investments. The rate applicable to sustainable investments will be reduced to 0.03%, 0.02%, or 0.01% when sustainable investments exceed, respectively, 20%, 35%, or 50% of the total assets of the fund.

3.4. VAT - Renovation work

The Luxembourg VAT law provides that the renovation of a main dwelling could, under some conditions, benefit from the super-reduced rate of 3% instead of the standard VAT rate of 17%. To encourage homeowners to perform a sustainable energy retrofit, the building's minimum age to qualify for the 3% VAT rate will be reduced from 20 to 10 years.

3.5. VAT - Small businesses

The Luxembourg VAT law provides that transactions performed by small businesses can benefit from a franchise (non-application of VAT) if their turnover does not exceed a certain threshold. This threshold, which is currently EUR 30,000 per year and ex-VAT, will be raised to EUR 35,000.

3.6. CO2 tax

Luxembourg will introduce, as from 1 January 2021, a CO_2 tax of EUR 20 per ton of CO_2 emitted. The tax will gradually increase over the next few years, i.e., EUR 25 per ton of CO_2 emitted in 2022 and EUR 30 per ton of CO_2 emitted in 2023. In practical terms, the government anticipates that retail prices (prices at the pump) should increase by about EUR 0.05 per liter of gasoline or diesel. Some social compensation measures will be implemented—some tax credits will increase from EUR 600 to EUR 696 and the allocation for expensive living will be increased by 10%.

3.7. Tax on insurance premiums

Electronic filing will become mandatory for the different taxes that apply to insurance premiums (insurance tax, fire department taxes, and emergency service taxes).

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