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Luxembourg Tax Alert

Luxembourg draft 2021 budget law

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On 14 October 2020, Luxembourg's Finance Minister presented the measures in connection with the 2021 budget law to the Chamber of Deputies.

Due to the COVID-19 pandemic, it was announced that the main focus will be to contain the effects of the crisis; therefore, there will not be a general tax reform for the 2021 budget year. Instead, various corporate, individual and indirect tax changes and administrative simplifications will be addressed. The draft law would enter into force and be applicable on 1 January 2021, except for the applicability of some tax measures that may be determined otherwise.

The parliament will review, potentially modify, and vote on the draft budget law before the end of 2020.

1. Corporate tax measures

The draft law proposes to introduce the following corporate tax measures:

- Measures regarding the ownership of real estate located in Luxembourg by some Luxembourg investment vehicles;
- Amendment to the fiscal unity regime to change from a vertical to a horizontal consolidation regime; and
- An adjustment of the accelerated amortizations.

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

The 2018-2023 coalition program stated that the government would introduce measures to counter tax abuses in the real estate sector. The draft 2021 budget law foresees the introduction of a new real estate levy that would apply to a selected number of Luxembourg investment vehicles owning real estate located in Luxembourg in some limited situations. Therefore, the holding of pan-European (outside of Luxembourg real estate) / pan –Asian real estate by Luxembourg investment vehicles for example would not be impacted.

The proposed levy, intended to enter into force as of 1 January 2021, would 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 would not apply when the vehicles are incorporated under a “tax transparent” legal form such as Luxembourg SCS/SCSp (Luxembourg limited partnerships) or a contractual fund regime such as a Luxembourg Fond Commun de Placement (FCP). This limitation is intended to continue allowing (as before) the use of legal forms or contractual fund regimes that provide a transparency veil between the investment and investor.

The real estate levy would apply at a rate of 20 percent on rental income (excluding VAT) and 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 is provided that (i) all income is sourced from real estate assets located in the Grand-Duchy of Luxembourg and that (ii) it 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], a SCS, a SCSp, etc.) or a FCP.

The draft 2021 budget law further states that such a levy would not be able to be deducted to determine its overall taxable real estate revenue. Furthermore, this cost would not be available as a deduction nor creditable by any corporate or individual investor.

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

Additionally, the draft 2021 budget foresees that a Luxembourg private wealth management company (SPF—société de gestion de patrimoine familial), governed by the Law of 11 May 2007, would 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 would still be allowed to do so. Further clarifications should be sought to understand the measure’s exact scope and further assess the timing for the restructuring of existing SPFs in this situation. This measure would apply as of 1 July 2021.

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

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

In 2015, Luxembourgish legislation was amended to align it with the case-law of the Court of Justice of the European Union to allow a group—whose parent company is based in another State of the European Economic Area (EEA) or has a permanent establishment in another EEA State—to form a “horizontal tax consolidation” with its resident subsidiaries or sub-subsidiaries.

The planned new measure’s purpose is to allow vertical tax consolidation group to form a new horizontal tax consolidation group, without requiring the existing group to be dissolved beforehand. In the case where the minimum period of five fiscal years is not met, the change would not result in a tax rectification of the group’s members. Instead, they would be treated as if the dissolution had not taken place.

The temporary measure would be subject to the following conditions:

- The integrating parent of the dissolved integrated group would become the integrating subsidiary of the new integrated group;
- The change would increase the scope of the new integrated group compared to the previous integrated group;
- The entities would be bound for at least 5 fiscal years, except if they were already part of the previous integrated group.

This regime change, upon a joint request, would be applicable as from the 2020 tax year until the 2022 tax year.

1.3. Adjustment of the accelerated amortizations

The draft law foresees the complete rewording of article 32ter LIR as from the 2021 tax year. The allowed accelerated depreciation rate for real estate assigned to rental housing would be reduced to 4 percent (instead of 6 percent). This 4 percent rate only applies if the renovation was completed within five instead of six years as from the beginning of the operating year.

On the same note, regarding capital expenditures incurred when renovating an old building (provided they exceed 20 percent of the building's purchase price), a 4 percent rate could apply if the renovation was completed within five years as from the beginning of the operating year.

A definition of the "sustainable energy renovation" concept is also planned. Under certain conditions, a 6 percent depreciation rate may be allowed for capital expenditures relating to a sustainable energy renovation of real estate used for rental housing.

The draft budget law foresees a grandfather rule where a taxpayer who acquired or incorporated real estate for rental housing prior to 1 January 2021 could still take advantage of the accelerated depreciation rate of 6 percent (as currently applicable) if all conditions are met. Similarly, regarding the renovation of an old building completed before 1 January 2021, the taxpayer would still be able to benefit from the 6 percent rate on capital expenditures if all conditions are met.

These measures would be applicable as from the 2021 tax year.

2. Individual tax measures

The budget draft law proposes several changes regarding personal income tax with the intention of creating tax fairness while remaining competitive to attract and retain key talent. Subsequently, the draft law would introduce the following "personal" income tax measures:

- Abolition of the current "stock option" regime, leading to a substantial change to currently prevailing remuneration models on the Luxembourg market;
- Introduction of a "prime participative" for some employees, based on positive results (profits) generated by the employer;
- Modernization of the current tax framework for "impatriates";
- Measures for rented-out real estate: adaptation of the accelerated depreciation rate for rented-out properties and introduction of a depreciation rate in case of "energy"-related renovations for buildings assigned for rental purposes;
- Introduction of multi-year electronic withholding tax cards on wages and salaries, and
- Other measures.

2.1. Abolition of the current “stock option” regime, leading to a substantial change to currently prevailing remuneration models on the Luxembourg market

In 2018, under its “coalition agreement”, the Luxembourg government announced the creation of a legal basis that allowed employees to participate in (and from) their employers' value creation. As a result, the current stock option regime was intended to be gradually abolished.

In line with this announcement, the tax circular L.I.R. No. 104/2 dated 29 November 2017 relating to the "stock option plans" would be repealed as of 1 January 2021.

The repeal of this tax circular would introduce the need for Luxembourg market players to rethink their remuneration strategy (potentially impacted by this change), and to refocus on the fundamental elements of the Luxembourg personal tax law.

2.2. Introduction of a participative premium “prime participative”

To help attract and retain key employees (i.e., as announced in the coalition agreement), the Luxembourg government proposes to introduce a tax measure that aims to allow employees to benefit from a participation in corporate profits. The proposed measure would allow employers to grant a "participative premium” to some of their employees, based on the employer's financial results (i.e., profits).

This discretionary premium would (i) be considered as an operating expense at the level of the employer, (ii) qualify as income from employment at the level of each employee receiving the premium, and (iii) be exempted at 50 percent from the employees' personal income tax.

The granting of the participative premium would be subject to certain criteria, notably at both the level of the employer and the level of the employee.

Employer level criteria:

- The employer would need to make a profit (commercial, agricultural and forestry profit, or from the practice of a liberal profession).
- The employer would need to keep regular accounts during the tax year in which the premium is granted (i.e., 2021 at the earliest), as well as during the year preceding the tax year in which the premium is granted (i.e., 2020).
- The total amount of the “profit-sharing” premium that may be allocated to employees is limited to 5 percent of the positive financial results (i.e., profits) for the fiscal year immediately preceding the fiscal year in respect of which the premium would be allocated to employees (i.e., positive results for 2020 in case of a premium allocation in 2021). It is implied that the employer may only allocate this premium to employees if the result of the financial year is positive, i.e., the employer has generated a taxable profit in the year preceding the year in respect of which it allocates the premium to employees. Moreover, for companies with activities in Member States other than Luxembourg, the premium would not be determined based on global commercial profits (i.e., at group level), but is limited only to the profits made in Luxembourg by a company that employs workers in Luxembourg.

Employee level criteria:

- The premium would not exceed 25 percent of the employee's gross ordinary annual remuneration (i.e., excluding any cash, and/or in-kind benefits, bonuses, premiums, etc.) of the tax year in which it would be allocated to the concerned employees. This

percentage shall be assessed for each beneficiary on a case-by-case basis. When determining the gross ordinary annual remuneration, the employer would need 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 shall be taken into account in determining this 25 percent threshold.

- The employee would be affiliated, on a compulsory basis, with the Luxembourg social security, or under a foreign social security scheme covered by a bi- or multilateral social security instrument.

Subsequently, the premium would enable employers to share some of their profits with some selected employees of the entity to a certain extent. To this end, the choice of whom would benefit from this premium and its payment, or not, would be at the sole discretion of the employer.

Finally, the employer that would set up this new regime would have to send a detailed communication to the respective wage tax office (i.e., RTS) responsible for verifying payroll tax deductions at the time of the allocation of the premium to the benefiting employees. Communications would have to be made in the form prescribed by the tax authorities.

The provisions above would apply as of the 2021 tax year. Therefore, it is important to note that an employer could consider setting this up 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 "impatriates”

The current regime, based on a 2014 circular, would be codified with a few adjustments. The main difference would be the replacement of the lump sum allowance for repetitive expenses relating to the cost of living differential between the home and host Member States, by taking into account certain moving costs related to impatriates and their families covered by the 2014 circular.

In particular, the addition of an impatriation premium would modernize the current regime, which to date sets the lump sum allowance at 8 percent of executives’ fixed monthly remuneration that cannot exceed a monthly cap of EUR1,500 (possibly doubled when impatriates share a common home or residence with their spouse or partner, provided that the spouse or partner does not carry out a specific professional activity).

The impatriation premium would benefit from a tax exemption of up to 50 percent of an amount not exceeding 30 percent of the impatriate’s annual remuneration.

It is also foreseen that the costs of moving to Luxembourg that correspond to repetitive costs (housing, tuition, etc.) and are paid by the employer would also be exempt from Luxembourg personal income tax at the level of the impatriate up to a limit of EUR50,000 (or EUR80,000 for a couple).

Impatriates would benefit from this tax-exempt premium as well as on other eligible expenses for a period of up to eight years, consecutive to the year of their entry into Luxembourg, instead of the current maximum of five years, provided that all conditions are met. In particular, impatriates must never have been tax domiciled in the Grand Duchy, nor been subject to Luxembourg personal income tax on their professional income during the previous five tax years, nor have lived less than 150km from the Luxembourg border.

Some of the conditions required by the 2014 circular with respect to the company (a medium-term occupation of at least 20 or more full-time equivalent employees), or the employee (the impatriate's special know-how to benefit the company's staff, or recruited in a

sector or a profession characterized as being difficult to recruit for in Luxembourg) would be omitted in the new legal framework.

A new requirement of the impatriate premium would be that each impatriate derives a minimum annual remuneration of at least EUR100,000 (currently EUR50,000) to qualify for the corresponding tax exemption.

This measure would be applicable as from the 2021 tax year.

2.4. Measures for rented out real estate: adaptation of the accelerated depreciation rate for properties rented out, introduction of a depreciation rate in case of energy renovation for buildings assigned to rental housing

Individual taxpayers, to whom an accelerated depreciation would be granted, would be entitled to an annual personal income tax allowance classified as a special property allowance.

As such, they would have to derive net profits and/or income within the meaning of article 10, numbers 1, 2, 3 or 7 LITL (i.e., commercial agricultural and forestry, from the practice of a liberal profession, and/or rental income) taxable in the Grand Duchy, and determined by the accelerated depreciation applied to a building (or part of a building) purchased after 31 December 2020, rented out, and is less than five years old at 1 January of the tax year.

In the case of joint taxation, each spouse or partner would receive this special property allowance benefit under the conditions defined above.

Furthermore, to promote a sustainable housing policy to combat climate change, and to encourage owners of rented accommodation to carry out sustainable renovation of their existing, it is proposed to introduce an accelerated depreciation rate of 6 percent for 10 years of capital expenditure incurred for this renovation.

These measures would be applicable as from the 2021 tax year.

2.5. Introducing multi-year electronic withholding tax cards on wages and salaries

It is proposed that employers would have direct access to the electronic tax cards of their employees.

The platform would be first made available to employers during 2021 on an optional testing basis. Only from 1 January 2022 would employers be obliged to use the new tool and to consult the files electronically.

The employer would be required at least once a month to access the wage tax forms and to consult all the forms not yet reviewed at the time of access. If the employer would not fulfil their duty of consultation, the tax office responsible for verifying the employer's payroll and wage tax deductions may request that the employer consults the unchecked records. It is important to note that employers would be exposed to potential financial sanctions if they would not meet their obligations in that respect.

2.6. Other measures

Landlords who have reduced the rent of their commercial leases in the 2020 calendar year would be entitled to a tax allowance equal to twice the amount of the rent reduction granted

of up to EUR15,000 per building (or part of the building) and by commercial lease agreement. This measure applies as of the 2020 tax year.

It is also proposed to repeal the tax regime for venture capital investment certificates that were introduced some time ago to revive investments in the interest of economic development, due to the limited take-up of this scheme.

3. Indirect tax measures

The draft law proposes to introduce 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 in case of a contribution of a Luxembourg property to a civil or joint-stock company would substantially increase, i.e., around three times more than currently due. The measure is aimed to partly align the tax treatment of a contribution of a Luxembourg property to the tax treatment of a sale of a Luxembourg property.

In practice, the registration duty would increase from 0.6 percent (0.5 percent + 2/10) to 2.4 percent (2 percent + 2/10) and the transcription duty from 0.50 percent to 1 percent. Therefore, the combined duties would increase from 1.1 percent to 3.4 percent.

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

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

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

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

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

3.4. VAT - Renovation work

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

3.5. VAT - Small businesses

The Luxembourg VAT law foresees 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 EUR30,000 per year and ex-VAT, would be raised to EUR35,000.

3.6. CO2 tax

Luxembourg plans to introduce a CO2 tax from 2021 of EUR20 per ton of CO2 issued. The tax would gradually increase over the next few years, i.e., EUR25 per ton of CO2 emitted in 2022 and 30 per ton of CO2 emitted in 2023.

In practical terms, the government foresees that retail prices (price at the pump) should increase by about EUR0.05 per liter of gasoline or diesel. Some social compensation measures would be implemented—some tax credits would increase from EUR600 to EUR696 and the allocation for expensive living would be increased by 10 percent.

3.7. Tax on insurance premiums

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

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