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Luxembourg Tax Alert

Luxembourg draft 2018 Budget Law

17 October 2017

On 11 October 2017, Luxembourg's Finance Minister, Pierre Gramegna presented the draft 2018 Budget Law to the Luxembourg Parliament.

The Finance Minister mentioned that Luxembourg respects all of the criteria of the EU Stability and Growth Pact and that 2018 budget will focus on quality of life, competitiveness and continuity. The priorities for public investment are mainly education, housing and public transport.

One aspect of the draft law would be the amendment of the exchange of information on request procedure in order to comply with the CJEU's decision of 16 May 2017 relating to Berlioz case. The changes proposed are as follows:

- the tax administration would ensure that the information requested is foreseeably relevant, taking into account the identity of the taxpayer, the holder of information, and the requirements of the tax investigation itself;
- An appeal before the administrative jurisdiction, with a suspensive effect, would be admissible against the decision of the Luxembourg Tax Authorities (not only against the fine, as it is currently the case following the 2014 modification) within the specified time limits. This draft law also proposes some changes in connection with direct and indirect taxation.

Below you will find a brief summary of the main tax measures proposed by this draft budget law (project 7200). Would you require more details in this respect, please do not hesitate to refer to your usual contacts for more information.

VAT

The draft 2018 Budget Law foresees a modification of article 44.1.d) of the VAT law. The list of funds that could benefit from the VAT exemption applicable to management services of investment funds would now be extended to include collective internal insurance funds whose investment risks are borne by policyholders and which are subject to the supervision of the Luxembourg Insurance Commission ("Commissariat aux Assurances").

This long awaited change meets the request of the Luxembourg insurance sector to be aligned with some other Member States who, under specific conditions and limitations, already apply this exemption to insurance funds (e.g. Italy). It is worth noting that the exemption would not apply to services rendered to equivalent insurance funds established in other EU Member States, while the list of funds and equivalents would generally include Luxembourg funds and their equivalents established in other EU member states subjected to similar supervision.

The other VAT-related change introduced by the draft 2018 Budget Law would be the increase of the VAT rate applicable to forestry products, from 4 percent to 12 percent. This increase is justified by the level of VAT on costs suffered by the forest undertakings and would allow these undertakings a more favorable recovery of this input VAT.

It should be noted that on 9 August 2017, the Luxembourg government presented a draft law introducing new rules related to the VAT treatment of vouchers. The law should enter into force as from 1 January 2018 and apply to vouchers issued as from that date, however it has not yet been voted.

The same draft law introduces a modification of article 13 of the VAT law to include taxation of goods retained by a taxpayer (or his legal successors) after the termination of his economic activity, when the VAT incurred on these goods has been partly or fully deducted before this termination of activity.

In addition, a draft Grand Ducal decree repealing the Grand Ducal decree of 21 January 2004 related to the exemption of services rendered by independent groups of persons to their members (article 44.1.y) of the Luxembourg VAT law) with effect as from 31 December 2017 has been prepared by the government as a response to the judgment released by the Court of Justice of the European Union on 4 May 2017 in Commission v Luxembourg case (C-274/15). This Grand Ducal decree has not yet been enacted.

As a reminder, the Court has considered the following dispositions of the Grand Ducal decree as not compliant with the Directive:

1. The possibility for the members to have up to 30 percent taxable turnover (45 percent in some specific circumstances);
2. The possibility for the members to deduct the VAT incurred by the IGP on its costs up to their deduction right and their share in the services received by the members;
3. The treatment of the contribution of resources from members to the independent group of persons as transactions out of VAT scope.

Moreover, on 21 September 2017, the Court has limited the benefit of this VAT exemption only to activities performed in public interest, therefore excluding the financial and insurance sectors from this regime.

Corporate tax

The additional reduction of corporate income tax rate from 19 percent to 18 percent, introduced through the last year's tax reform, will become effective as from 1 January 2018. Therefore, the effective combined income tax rate will amount to 26,01 percent next year (including corporate income tax, municipal business tax for Luxembourg city and the contribution for the unemployment fund).

The long-awaited draft law on the new IP regime has already been issued on 4 August 2017 and at the time of this newsletter has not yet been voted (for more information, please refer to the Deloitte Luxembourg Tax Alert on this matter).

The proposed draft budget law only includes few changes for the corporate entities. First, it aims at rectifying some material and linguistic inexactitudes in the wording of Luxembourg law. It would also introduce two additional investment tax credits – one for electric cars with zero emission or hydrogen fuel cell cars and the other one for investing in purchased software.

Tax subsidies would be introduced for investing in purchased software, subject to certain limitations aimed at controlling their budgetary impact and at preventing the same software from benefitting from this regime more than once. The subsidies would be applicable only for purchases of software (i.e. they could not be used for software created by the company, as it would be able to benefit from the IP regime, still under discussions by the Parliament). Within one group, each software could benefit from this regime only once and no subsidies would be applicable for software purchased from another entity of the group. Once the taxpayer requests this tax credit for the purchase of software, he is no longer allowed to request application of IP regime for the income generated by such software.

The amount of tax credit granted in this respect would be calculated in two tranches – for the part up to €150,000 it amounts to 8 percent and for the part above €150,000 it amounts to 2 percent. The tax advantage from this regime cannot exceed 10percent of tax due for the year of software acquisition.

Electromobility is one of the main priorities of the Luxembourg Government. In scope of the EU goal to reduce greenhouse gas emission by 60 percent by 2050 in comparison to the emission in 1990, the government would introduce tax incentives for companies (and for individuals – see below).

The investment tax credit for companies would be applicable at the purchase of new electric cars with zero emission or hydrogen fuel cell cars. It would come into force as from taxable year 2018 for all qualifying cars registered after 31 December 2017. Based on the project of law, at the time of calculating the overall investment, the acquisition price (after the deduction of possible subsidies) could be taken into account up to the amount of €50,000 per eligible vehicle. There would be no limits at the level of additional investments, all of which could benefit from 13 percent investment tax credit.

Personal tax

- A new tax allowance amounting to €2,500 for sustainable mobility (“Abattement pour mobilité durable”) would be introduced for rechargeable hybrid electric cars for individual use with CO_2 emission not exceeding 50g CO_2/km.
- The choice for married resident taxpayers between three types of taxation (i.e. joint taxation, pure separate taxation and separate free allocation taxation) would be as follows:
  - taxpayers would have to communicate their choice for the 2018 tax card before 31 October 2017;
  - taxpayers would have to communicate their choice for 2018 income tax return before 31 March 2019 through a joint application (choice made would be irrevocable for the 2018 income tax year).

- The assimilation of married non-resident taxpayers to resident taxpayers in order to benefit from tax class 2 would be simplified and as from 2018 would be subject to the following conditions:
  - At least 90 percent of the worldwide income of the taxpayer working in Luxembourg should be taxable in Luxembourg;
  - Additional flexibility would be foreseen for professional income acquired when working outside of Luxembourg, i.e. the income for the first 50 days worked abroad would be regarded as taxable in Luxembourg for the purpose of assimilation;
  - For the purpose of assimilation, it would be possible to disregard the net income non-taxable in Luxembourg as long as it would not exceed €13,000 in total.
  - The above-listed conditions would not apply to Belgian residents – according to the double tax treaty with Belgium, tax class 2 in Luxembourg will remain applicable where at least 50 percent of professional income of the household is taxable in Luxembourg.

These conditions would have a direct impact on the applicable tax class, tax rate and obligation to file a tax return.

- Inheritance tax regime for couples without common descendants – either married or in a registered partnership for at least 3 years - would be aligned with the exemption regime currently applicable for married couples with common descendants.

One final modification announced in the framework of the draft 2018 Budget Law relating to personal taxation is the adjustment of stock-option (warrants) plans regime, however so far no details have yet been specified in this respect. We will keep you updated on future developments in connection with this matter.

In terms of process, the Luxembourg Parliament will debate the proposed measures of the draft 2018 Budget Law, potentially amend them and vote on the final version before the end of the year.

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