Tax

Luxembourg's 2021 Draft Budget Law

Tax News Alert – October 2020

On 14 October 2020, the Luxembourg Ministry of Finance presented the 2021 Draft Budget Law (n°7666) ("**Draft Law**") to the Chamber of Deputies, setting out a number of tax measures. It was announced that, due to the COVID-19 pandemic, the main focus will be put on containing the effects of the crisis. Therefore, instead of increasing taxes and conducting a general tax reform, a number of amendments which aim at restoring tax justice and improving economic sustainability were addressed.

Background

The Draft Law contains new tax measures that can broadly be divided into corporate, individual and indirect tax measures. The most notable proposed changes are related to the Luxembourg real estate sector, as well as the current stock-option regime.

Overall, the Draft Law aims at increasing tax and social equity as well as economic sustainability. In this context, it should be noted that the existing corporate and personal income tax rates will not be changed.

The Luxembourg Parliament is expected to review, modify (if necessary), and vote on the Draft Law before the end of 2020.

This Tax News Alert will further provide an overview of some of the measures proposed by the Draft Law:

1. Corporate tax measures
2. Individual tax measures
3. Indirect tax measures

Finally, we will provide our observations on the Draft Law.

Corporate tax measures

Firstly, as of 1 January 2021, a new annual 20% real estate tax is proposed to be levied on income arising from real estate assets situated in Luxembourg and realised directly or indirectly by certain investment vehicles, namely:

- Undertakings for Collective Investment ("**UCI**") within the meaning of Part II of the law of 17 December 2010;
- Specialised Investment Funds ("**SIF**") within the meaning of the law of 13 February 2007; and
- Reserved Alternative Investment Funds ("**RAIF**") within the meaning of article 1 of the law of 23 July 2016.

It is important to note that the abovementioned tax would not apply when the investment vehicle is tax transparent, such as a Luxembourg SCS/SCSp, or to a contractual fund regime, such as a Luxembourg *Fond Commun de Placement* ("**FCP**").

As for the types of income involved, three types would be subject to the real estate levy:

- Capital gains derived from the transfer of properties located in Luxembourg;
- Rental income (excluding VAT) derived from properties located in Luxembourg; and
- Gains derived from the sale of shares or units in partnerships or contractual funds holding real estate in Luxembourg.

The Draft Law specifies that the 20% levy should not be deductible to determine companies' overall taxable real estate revenue.

Additionally, the Draft Law foresees certain amendments to the law on private asset management companies (*société de gestion de patrimoine familial* – "**SPF**"). The amendments propose to prohibit the holding of real estate properties by the SPF through one or more tax transparent entities or FCPs. However, SPFs will still be allowed to invest in real estate through joint-stock companies.

The Draft Law introduces another substantial change by amending the rules on accelerated depreciation rate for real estate. The current article 32ter of the Luxembourg Income Tax Law ("**LITL**") states that buildings used for rental housing can benefit from an accelerated depreciation rate of 6%, under certain conditions. The Draft Law lowers this rate to 4%. In addition, according to the Draft Law, the real estate must not be older than five years (instead of the current six years), to be considered as a new real estate investment, and thus benefit from the preferential regime.

Related to this, a tax-deductible depreciation at the rate of 6% over 10 years is proposed to be granted for certain sustainable energy renovation expenses to the owners of real estate used for rental purposes.

In order to comply with the case law of the Court of Justice of the European Union ("**CJEU**"), the Draft Law further foresees a measure related to the tax unity regime. According to this measure, it will be possible to switch from an existing vertical fiscal unity to a horizontal one without requiring its dissolution, and therefore without any retroactive taxation for the existing members of the consolidated group, if the change occurred within the minimum five-year period from the existence of the fiscal unity.

Individual tax measures

First of all, the Circular n° 104/2 dated 29 November 2017 relating to the taxation of stock options and warrants is planned to be repealed. As a result, it will no longer be possible to apply a lump-sum valuation method to unlisted stock options and warrants. Instead, taxpayers will have to apply general valuation principles applicable to benefits in kind.

Another proposed measure refers to allowing the employer to grant a participative premium to certain employees, based on the employer's financial results. Such premium, payable in the form of a bonus, will be limited in its amount – the company will not be able to pay more than 5% of its profits, and each bonus will not exceed 25% of the employee's annual salary. The bonuses paid under this scheme will be tax deductible at the level of the employer (notwithstanding the fact that they will be computed on the after-tax profits of the previous year) and will be 50% exempted from wages tax.

Furthermore, an amendment to the current system of tax cards is proposed. Namely, electronic tax cards will be introduced during 2021 and made obligatory for employers as of 1 January 2022. In the new system, employees will no longer have to deposit their tax cards to the employer each year.

Finally, the tax regime applicable to impatriates is proposed to be codified into a new article of the LITL (so far, it was governed by Circular n° 95/2 dated 27 January 2014). The main change would be the introduction of an impatriation allowance, for an amount not exceeding 30% of the annual remuneration of the impatriate that would be exempt from taxation. Such allowance would be paid by the employer to the impatriate to compensate for the differential in the cost of living.

Indirect tax measures

Currently, each person established in Luxembourg who undertakes a taxable activity and assumes an annual turnover that exceeds EUR 30,000 must register for VAT. With the Draft Law, it is proposed to raise this threshold to EUR 35,000, in order to extend the benefits of the VAT franchise regime.

It is also proposed that the subscription tax rate of 0.05% paid by Luxembourg investment funds be lowered for sustainable investments made by these funds, the final rate depending on the level of sustainable investments made. Thus, a 0.04% rate would apply to sustainable investments when the fund invests in the same at least 5% of its total net assets. The rate applicable would be further reduced to 0.03%, 0.02% or 0.01% if the sustainable investments exceed 20%, 35% or 50% of the total net assets of the fund, respectively.

In order to align the tax treatment of the purchase of shares in a real estate holding company and the purchase of the real estate itself, the Draft Law further proposes to increase registration taxes in case of capital contributions of real estate assets to a civil or commercial company. They will be increased from 0.5% and 2/10th of the value of the assets to 2% and 2/10th, while the transfer tax will be increased from 0.5% to 1% of the value of the asset.

Moreover, it is planned to introduce a CO_2 tax on certain energy products (e.g. fuel, natural gas). The tax will amount to EUR 20 per ton of CO_2 emitted, and is proposed to gradually increase over the course of the next few years.

Finally, it is suggested for the VAT rate on the renovation of the main dwelling to be lowered from 17% to 3% for renovation expenses aimed at using more sustainable energy.

Our observations

The Draft Law as presented in this Tax News Alert is not definitive and will have to follow the usual legislative process before a final analysis of the measures taken for the year 2021 can be laid out. However, it already draws a relatively reliable line on the direction taken by the Luxembourg Government.

Despite the Prime Minister's stated desire to promote the country's economic sustainability in the wake of the COVID-19 crisis, certain measures might have (limited) impact on Luxembourg's financial players. The most important of these measures is the planned reform of the real estate tax regime for certain funds. However, it should be kept in mind that this measure only applies where the funds invest in real estate located in Luxembourg.

Finally, it appears a good initiative to favour the country's smallest economic players (e.g. VAT franchise threshold) and develop the green tax system (e.g. CO_2 tax), in line with the European Union's objectives. Overall, even though some taxes will be introduced or increased, it is worth noting that the Luxembourg Government is ensuring that the majority of taxpayers will not be subject to a higher tax burden.

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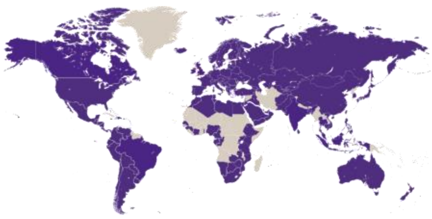

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