

ATOZ ALERT

2021 Budget - Tax measures

15 October 2020

On 14 October 2020, the 2021 budget draft law was presented to Parliament. The Government decided that the time was not right to increase taxes and/or perform a big tax reform and decided to postpone the introduction of some expected tax measures such as the reform of the tax class system for individuals. However, the draft budget still introduces a number of important tax measures, some of which were already announced in the 2018 coalition agreement: changes in the taxation of Luxembourg real estate investments held by investment funds, repeal of the “warrant” regime and reform of the impatriate regime. This tax alert provides an overview of the main tax measures to be introduced as from 2021. However, the proposed rules may still evolve throughout the legislative process.

Real estate taxation

Taxation of Luxembourg real estate investments held by certain investment funds

With effect as from 1 January 2021, a new annual 20% real estate tax (*Prélèvement immobilier*) will be levied on income and gains arising from real estate assets situated in Luxembourg and realised directly or indirectly by certain investment vehicles (hereafter “Investment Vehicles”).

The new tax will apply to the following Investment Vehicles:

- Undertakings for Collective Investment (“UCI”) within the meaning of Part II of the law of 17 December 2010 (except Luxembourg partnerships, *sociétés en commandite simple*, “SCS”);
- Specialised Investment Funds (“SIF”) within the meaning of the law of 13 February 2007 (except Luxembourg partnerships, *sociétés en commandite simple*, “SCS”); and
- Reserved Alternative Investment Funds (“RAIF”) within the meaning of article 1 of the law of 23 July 2016 (except Luxembourg partnerships, *sociétés en commandite simple*, “SCS”). Since the draft law specifies that the new tax is an exception to the provisions of article 45 of the RAIF law, it is our understanding that the new tax will only apply to those RAIFs which are exempt from corporate income tax based on article 45 of the RAIF Law and not to the fully taxable ones only investing in risk capital and subject to the specific tax rules of article 48 of the RAIF law.

The new tax will only apply to the extent that the Investment Vehicles have a personality separate from those of their partners. In addition, as mentioned above, Investment Vehicles set up as an SCS are expressly out of the scope of the measure.

The Investment Vehicles will be subject to an annual real estate tax of 20% on income arising from Luxembourg real estate assets (rental income and capital gains) held directly or indirectly through tax transparent entities within the meaning of article 175-1 of the Income Tax Law (“ITL”) or through FCPs.

The tax will also apply to gains realised by the Investment Vehicle on the disposal of an interest in the 175-1 ITL tax transparent entity or of units in the FCP but only up to the portion of the gain corresponding to the value increase of the Luxembourg real estate asset.

In addition, when a Luxembourg real estate asset is held by the Investment Vehicle through a chain of several tax transparent entities within the meaning of article 175-1 ITL or FCPs, the Luxembourg Investment Vehicle will also be subject to the 20% tax on the gains realised on the disposal of any indirect interest through the chain but only up to the portion of the gain corresponding to the value increase of the Luxembourg real estate asset.

When income or gains are realised indirectly, the taxable income or gain is computed in proportion with the interest held in the entity(ies) holding the Luxembourg real estate.

Real estate registration taxes on “share deals”

The tax treatment of share deals (in the context of real estate investments) will be amended to reduce the unequal tax treatment between share deals and asset deals for registration taxes. In the case of capital contributions of real estate assets (*Apports pur et simple*) to a civil or commercial company, the registration duties will be increased from 0.5% + 2/10 to 2% + 2/10 and the transcription tax will be increased from 0.5% to 1%. As a consequence, registration taxes applicable to such capital contributions will become 3 times higher (3.4% instead of 1.1%).

SPF regime & real estate investments

Private wealth management companies (“SPF”) will not be allowed to hold real estate investments indirectly via one or more (Luxembourg or foreign) partnerships or FCPs (direct investments into real estate are already prohibited by the SPF law of 11 May 2007).

New amortisation and deduction rules for residential investments

The accelerated amortisation rules applicable to rental housing investments will be amended. The amortisation rate for new real estate investments allocated to rental housing will be brought down from 6 to 4% as from tax year 2021. To be considered as a new residential investment, the real estate cannot be older than 5 years (instead of 6 years currently).

These new rules will also apply to expenditures made for the renovation of old dwellings, provided that they do not exceed 20% of the acquisition price or cost of the building. However, for renovation of rental accommodation to allow use of sustainable energy, an amortisation rate of 6% of the expenses (instead of the current 4% of 20% of the renovation expenses) will apply.

In addition to the amendment of the amortisation rules, the draft law introduces a special deduction for investments in real estate not older than 5 years and allocated to rental housing (*abattement immobilier spécial*). This deduction amounts to 1% of the value used as a basis for the calculation of the accelerated depreciation of 4%, without however being able to exceed EUR 10,000 (i.e. 1% of EUR 1,000,000).

As a result, real estate investments in rental housing not older than 5 years will benefit from a combined amortisation and deduction as follows:

Value

<1,000,000: 5%

≥1,000,000: 4% plus a deduction of EUR 10,000.

Employee taxation

Stock options/warrants

The so called “warrant regime”, which evolved from a circular introduced in 2002, will be repealed as from 1 January 2021.

Employee profit share

A new profit share (*prime participative*) will be introduced for employees and will be 50% exempt. The profit share 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 in the form of these bonuses and each bonus will not be able to exceed 25% of the annual salary of the employee concerned. The bonus will be tax deductible at the level of the employer.

Impatriate regime amended

The tax regime of impatriates will be amended. It will no longer be governed by a circular but, instead, by a new article of the Luxembourg income tax law. A 50% exempt impatriate premium will be introduced which an employer will be able to grant under certain conditions to its employees during a maximum time period of 8 years.

Green taxation

Investment funds & subscription tax

Sustainable funds will benefit from a subscription tax (*taxe d'abonnement*) at a lower rate varying from 0.04 to 0.01% of NAV, depending on the level of sustainable activity of the vehicle or its compartments).

Environmental taxation

A CO2 tax will be introduced which should add around 5 cents per litre to the cost of petrol and diesel.

Tax credits

As a measure to counterbalance the effects of environmental taxation on Luxembourg households, the income tax credits available to employees, self-employed and retired persons which vary progressively depending on the level of annual income will be increased by EUR 96.

Other measures

Tax consolidation regime amended to reflect latest CJEU case law

The provisions of the Luxembourg corporate income tax law dealing with the tax consolidation regime will be amended to reflect the recent decision of the CJEU regarding the consequences of the change from “vertical” to

“horizontal” tax consolidation. The new provision confirms that the change will not entail any negative tax consequences for the members of the tax consolidated group, provided certain conditions are met.

Vat exemption for small businesses extended

The VAT exemption (*franchise*) regime which applies in accordance with article 57 of the Luxembourg VAT law to small businesses currently defined as businesses with an annual turnover not exceeding EUR 30,000, will now apply to businesses with a turnover not exceeding an annual turnover of EUR 35,000.

Implications

With the tax measures included in its 2021 budget, the Luxembourg Government gives a positive message that increasing taxes now is not the right way to recover from the crisis. This is consistent with international recommendations. The majority of taxpayers should not suffer a higher tax burden and should be able to keep on investing to achieve a financial recovery in the longer term.

While it is true that some taxes will be increased (e.g. taxation of income and gains on Luxembourg real estate assets held by exempt investment funds, taxation of certain real estate transfers, bonuses paid by “warrants”), the reasons of such tax increases are different: it is more about removing inappropriate or anomalous tax treatments that developed over time, rather than collecting additional tax revenues. In particular, the 20% new tax on income and gains arising from Luxembourg real estate should have a limited financial impact for the investment fund industry, given that only very few Luxembourg funds invest in Luxembourg real estate assets.

Do you have further questions?



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