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Investment tax credit regime to be modernised as from 2024

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On 13 July 2023, a draft law was presented to Parliament which introduces a major reform of the current investment tax credit framework, with effect as from tax year 2024. The draft law not only implements the investment tax credit modifications agreed upon in the tripartite agreement of 28 September 2022, but also completely reforms the current regime.

First, it increases the rates of the global investment tax credit. Further, it replaces the current additional investment tax credit by an additional tax credit for investments and operating expenses linked to the digital transformation or the ecological and energy transition and introduces a new system to certify the nature and reality of such investments and operating expenses.

We provide an overview of the key aspects of the new framework to be introduced, which might evolve over the legislative process.

Background: Why is the current investment tax credit framework being modernised?

Currently, based on Article 152bis of the Luxembourg Income Tax Law ("**LITL**"), provided certain conditions are met and upon request, Luxembourg businesses (companies and individuals) may benefit from the following investment tax credits ("**ITC**"):

- Global ITC: an income tax credit equal to 8% of the total acquisition price of investments in qualifying assets (in particular, tangible depreciable assets other than buildings, livestock and mineral and fossil deposits) acquired during the tax year. The global ITC amounts to 8% for the first tranche of EUR 150,000 and 2% for the tranche exceeding EUR 150,000. Investment in fixed assets approved to be eligible for the special depreciation referred to in Article 32bis of the LITL can apply for a tax credit of up to 9%.

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- Additional ITC (which may be applied in addition to the first type of credit): an income tax credit equal to 13% of the increase in investments carried out during the tax year in qualifying assets — that are tangible depreciable assets, other than buildings, livestock and mineral and fossil deposits. The amount of 'additional investments' corresponds to the difference between the net book value of the qualifying assets at the end of the financial year increased by the depreciation on the qualifying assets acquired and a reference value corresponding to the average value of qualifying assets at the end of the five preceding financial years.

The ITC framework currently in force is therefore limited to investments in tangible depreciable assets and excludes operating expenses, including those linked to the digital transformation and the ecological and energy transition.

To accelerate the digital transformation as well as the ecological and energy transition of Luxembourg businesses and strengthen the competitiveness of Luxembourg companies, by stimulating more innovation, while promoting the development of knowledge and skills in digital transformation and ecological and energy transition, the draft law introduces major amendments to Article 152bis of the LITL.

The new ITC framework in brief

- Global ITC rate increased for investments in tangible depreciable assets

First, the draft law increases the existing tax credit for global investments from 8% to 12% and removes the condition of the investment bracket of EUR 150,000. In other words, based on the acquisition price or cost price of investments made during a financial year, a global ITC of 12% will be granted on investments in tangible depreciable assets other than buildings, livestock and mineral and fossil deposits, and for the acquisition of software. In addition, for investments in fixed assets approved to be eligible for the special depreciation referred to in Article 32bis of the LITL, the current tax credit is increased to 14%.

- Additional ITC repealed and replaced by new tax credit for investments and expenses linked to digital transformation or ecological and energy transition

The current additional ITC will be repealed and replaced by a new specific income tax credit for investments and operating expenses linked to the digital transformation or ecological and energy transition. The rate of the new tax credit will be either 18% or 6% depending on whether investments are made in tangible depreciable assets or not.

Operating expenses and investments incurred within the framework of a digital transformation, or an ecological and energy transition project will be eligible for the new additional ITC at a rate of 18%. However, if these investments are made in tangible depreciable assets, the applicable rate will be limited to 6%. This is because such investments would already be eligible for the 12% global ITC (so a total of 12% + 6%, i.e. 18% of tax credits).

The new additional ITC will be computed on the acquisition (or the cost) price of investments made during the financial year. However, if during the first three years from the first establishment, the acquisition price of investments considered as being invested as part of the first establishment exceeds the amount of EUR 250,000, the basis for calculating the respective ITC are to be reduced by the amount exceeding the threshold of EUR 250,000. The LITL provides a list of investments not to be considered as being invested as part of the first establishment. For operating expenses, the new additional ITC will be computed on the deductible operating expenses of the financial year.

Digital transformation is to be understood as the realisation of a process innovation or an organisational innovation by means of the implementation and use of digital technologies. Digital transformation goes thus far beyond the digitisation of data and the digitalisation of a business' activities. While digitisation can be defined as the conversion of information into digital format, digitalisation aims to digitise and automate a specific part of an existing process. Ecological and energy transition refers to any change that reduces the environmental impact, in the production or consumption of energy or use of resources, said change having to be significant and of a technical or material nature.

In order to guide taxpayers in their digital transformation and ecological and energy transition processes, the draft law lists specific objectives which the investments and operating expenses will have to meet in order to fall within the scope of the new additional ITC. Digital transformation must, for example, redefine an entire business process in such a way as to substantially improve its productivity, or implement an innovative business model, including by circular economy, so as to create new value for the stakeholders. As far as the ecological and energy transition is concerned, the draft law also sets out clear objectives to guide taxpayers in their process, such as the objective of significantly improving the energy efficiency of a business' production process, to significantly decarbonise a production process of the businesses, or to produce or store energy produced from renewable non-fossil sources to meet the energy needs of the businesses.

- New system of attestation and certification for investments and operating expenses linked to the digital transformation or ecological and energy transition

To benefit from the new additional ITC, a specific certificate will be required which will attest of the reality of the investments and operating expenses made/incurred during the financial year and the fact that those investments and operating expenses qualify for the new additional ITC. For the purpose of obtaining such certificate, a statement of eligibility will have to be requested from the competent Ministry.

The draft law proposes to introduce the following system of statement and certification:

Statement of eligibility: In a first step, the taxpayer will have to submit an application to obtain a statement of eligibility for a specific project from the Minister of the Economy, detailing, among other things, the description of the project, the desired objective, the expected effect and the steps as well as the investments and operating expenses to be made/incurred within the framework of the digital transformation or ecological and energy transition of the business. After having received the opinion of an inter-ministerial consultative commission, the ministers having in their attributions the Finances, the Economy, the Energy and the Environment will issue a statement of eligibility, formalising their decision on the eligibility of the project and the investments and operating expenses to be made/incurred.

Certificate: For each tax year, to benefit from the new tax credit, the taxpayer will have to send a request to the Ministry of Economy in order to obtain a certificate attesting of the reality of the investments and operating expenses made/incurred during the financial year. The certificate will only be granted to the extent that a statement of eligibility has been obtained previously. This certificate will have to be filed by the taxpayer each year, together with its annual income tax return.

The new procedure of certification should be determined in further detail in a Grand-Ducal Regulation.

Implications and next steps

The reform of the ITC regime is a positive initiative to accelerate the digital transformation as well as the ecological and energy transition of Luxembourg businesses and strengthen their competitiveness. However, since the new procedure of certification (which is only applicable to benefit from the new additional ICT) seems heavy, it remains to be seen how it will work in practice, given the related additional administrative burden for both taxpayers and the administration. For example, without specific deadlines which statements of eligibility have to be issued within, it is doubtful that the new ICT regime will be efficient.

The draft law will now have to be reviewed by the various chambers and the State Council before being able to be voted by the Parliament. Therefore, some changes might still be introduced over the legislative process. As soon as the draft law has been adopted, should the provisions dealing with the entry into force of the amendments remain unchanged, it will apply as from tax year 2024.

Do you have further questions?

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