LUXEMBOURG REAL ESTATE TAXATION UPDATE

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With effect as from 1 January 2021, the Law of 19 December 2020[2] (the "**2021 Budget**") has introduced several important changes to the Luxembourg taxation of real estate income and investments.

Some of the changes were introduced in line with the announcements made by the Luxembourg government and the 2018 coalition agreement and aim at addressing a perceived loophole in the Luxembourg taxation of income and gains from domestic real estate held by Luxembourg residents.

In particular, the 2021 Budget introduced a new levy of 20% on certain gains and income arising from real estate assets situated in Luxembourg and realised by certain tax-exempt investment vehicles. The provisions relating to the new real estate levy are completed by a new series of reporting obligations for such investment vehicles.

Another measure in relation to the new real estate levy is a change to the investments which are allowed for private wealth management companies (SPFs) under Luxembourg law, namely by prohibiting an SPF to invest into Luxembourg properties through tax transparent entities. In addition, aiming at reducing the differential treatment between share deals and asset deals regarding the registration taxes applicable to certain transactions involving Luxembourg properties, the rate applicable to contributions of immovable properties to a company has been increased. Finally, the 2021 Budget also reduced the tax deduction available for certain investments into rental housing by adjusting the special amortisation rate and the conditions under which the investment has to be done to benefit from this accelerated depreciation for tax purposes.

The present article discusses each of the above measures from a legal and technical perspective and looks at the consistency of these measures with the stated objectives of the law.

1. NEW LUXEMBOURG REAL ESTATE LEVY

With effect as from 1 January 2021, Article 4 of the 2021 Budget introduced new provisions specifically targeting situations where real estate investments are made by certain categories of tax-exempt investment funds either directly or indirectly through one or several tax transparent structures. Before looking into the details of the new measures, it is useful to look at some of the fundamental principles of the Luxembourg tax law since these will help explain the mechanisms chosen by the Luxembourg legislator to address this issue.

1.1. Luxembourg tax transparency

One of the core principles under Luxembourg tax law is that Luxembourg tax residents are subject to tax on their worldwide income, while non-resident individuals and companies are only subject to Luxembourg tax on specific categories of Luxembourg source income.

However, not all Luxembourg based entities are subject to tax as some of them do not have a separate personality from a tax perspective. The typical classification between "opaque" entities and "transparent" entities is the simplified expression of the differential tax treatment applied.

1.1.1. Tax opaque entities

Article 159 of the Luxembourg Income Tax Law ("**LITL**") lists the entities which are considered as taxpayers in their own right, if they have their statutory seat or their central administration in Luxembourg, and includes in particular share capital companies (i.e. *Société Anonyme* ("**SA**"), *Société à Responsabilité Limitée* ("**Sàrl**"), *Société en Commandite par Actions* ("**SCA**"), *Société Européenne* ("**SE**")). These entities exist independently from their shareholders for tax purposes.

Unless they have applied for a specific regulatory and tax regime like the Specialised Investment Funds ("**SIF**")

1. The author wishes to thank the ATO Z Knowledge team for their assistance.

2. « Loi du 19 décembre 2020 concernant le budget des recettes et des dépenses de l'État pour l'exercice 2021 », Memorial A n° 1061.

regime[3] or the Reserved Alternative Investment Funds ("**RAIF**") regime[4], when tax resident opaque entities realise capital gains or income from Luxembourg real estate, such income or gain is fully subject to tax at the level of these entities.

1.1.2. Tax transparent entities

Article 175 of the LITL together with §11bis of the Tax Adaptation Law (*Steueranpassungsgesetz*, "**StAnpG**") provides for a list of entities which are considered as having no separate legal personality from their partners for tax purposes. This list includes in particular the *Société en Nom Collectif* ("**SNC**"), the *Société en Commandite Simple* ("**SCS**"), the *Société en Commandite Spéciale* ("**SCSp**") and the *Société Civile* ("**SC**").

Even though some of these entities do have a legal personality under corporate law, the tax law will treat them as tax transparent.

Therefore, partnerships are mainly disregarded by Luxembourg tax law since they are considered as transparent entities. When such partnerships operate a business enterprise, the entities are not subject to corporate income tax, but rather they will be subject to a tax treatment based on the *Bilanzbündeltheorie*.

Under this German concept well recognised and accepted in the Luxembourg doctrine and case law, each partner of the transparent entity will determine its taxable profit based on the fiction that it carries out its single business enterprise separately with the partnership's activity merely being regarded as the sum of all the single enterprises carried out by each partner.

Nevertheless, when the activity of a partnership is limited to private wealth management for its partners, §11bis StAnpG provides that the partners do not realise business income but instead are deemed to directly receive income and gains from the underlying assets.

The partnership's income will be allocated to each partner and subject to tax at the partner's level. Where one or more of the partners are also a tax transparent entity, the same allocation of income is in turn performed at the level of that entity's partners.

In contrast to the tax treatment of opaque entities described above, when income or gains are realised by a tax transparent entity, the effective taxation of such income will therefore depend on the tax status of the partners to which such income is allocated.

The real estate levy introduced by the 2021 Budget applies to income and gains arising from investments in Luxembourg real estate assets held by certain tax-exempt investment vehicles either directly or indirectly through one or more tax transparent entities within the meaning of Article 175 of the LITL or through one or more *fonds communs de placement* ("**FCPs**"). Therefore, the rules introduced by the 2021 Budget rely on the tax qualification of **FCPs** as tax transparent entities. An FCP is a co-ownership organised between its joint owners who leave the fund's assets in custody with a depositary. Since an FCP does not have a legal personality, it must be managed by a Luxembourg management company. Although it is not uncommon for foreign jurisdictions to consider an FCP as an opaque entity[5], the question of the transparency of FCPs for Luxembourg tax purposes appears to be no longer of debate in practice[6].

1.2. Entities in scope of the new real estate levy

The 2021 Budget defines a new levy referred to as a real estate levy ("*prélèvement immobilier*") which applies to certain tax-exempt investment vehicles (referred to in this article as "in scope investment vehicles") and on a limitative list of real estate income and gains.

The real estate levy applies to three different types of vehicles referred to as investment vehicles as defined in Article 4 (2) 7° of the 2021 Budget: (1) Undertakings for Collective Investment ("**UCI**") within the meaning of Part II of the Law of 17 December 2010; (2) Specialised Investment Funds ("**SIF**") within the meaning of the Law of 13 February 2007; and (3) Reserved Alternative Investment Funds ("**RAIF**") within the meaning of article 1 of the Law of 23 July 2016.

The definition of investment vehicle only applies to those entities listed above which have a legal personality separate from their partners. Neither the 2021 Budget nor the related commentary specify whether "having a legal personality separate from their partners" has to be understood from a legal perspective or from a tax

3. Law of 13 February 2007 relating to specialised investment funds, as amended.
4. Law of 23 July 2016 on reserved alternative investment funds, as amended.
5. The tax qualification of entities for foreign tax purposes is based on criteria which vary from one jurisdiction to another. For a complete review of the Luxembourg rules in this respect, see Oliver R. Hoor, Classification of foreign entities for Luxembourg tax purposes: Methodology and tax consequences, European Taxation, 2012, Volume 52, No 4.
6. See Alain Steichen, Précis de droit fiscal de l'entreprise (Legitech 2020), n° 472 for a discussion on the tax transparency of FCPs.

perspective. However, since the 2021 Budget expressly excludes investment vehicles set up as SCSs (which have a separate legal personality from a legal point of view but not from a tax perspective), it can be understood that the real estate levy applies to investment vehicles which have, legally speaking, a legal personality different from their partners, with the exception of the SCS. Still, the method chosen by the legislator to define the scope of application of the new measure is quite curious. Would an exclusion of investment vehicles which are transparent from a tax perspective not bring the same result as this would exclude both the ones with no legal personality from a legal point of view and the SCS from the scope of application of the real estate levy? In addition, having a provision excluding tax transparent entities would seem logical since the objective here is to make sure that the real estate levy only applies to entities which (i) are opaque from a Luxembourg tax perspective and (ii) benefit from a full tax exemption. Finally, to achieve more legal certainty, listing the investment vehicles in the scope/out of scope of the real estate levy in the commentary to the draft 2021 Budget would have been welcome.

1.2.1. UCIs within the meaning of Part II of the Law of 17 December 2010

The definition of investment vehicles in the scope of the new real estate levy includes Part II UCIs with a legal personality different from their partners, but specifically excludes those constituted under the legal form of an SCS.

Part II UCIs are typically "alternative" investment funds, as Part II of the Law of 17 December 2010 covers UCIs which do not fall within the scope of Part I of the same Law. This could arise when investment funds are not Undertakings for Collective Investment in Transferable Securities ("**UCITS**") because the nature of their investments is not eligible for the UCITS regime, or because they are investing in transferrable securities but do not meet certain requirements applicable to Part I funds.

The tax treatment of Part II UCIs is provided by Chapter 23 of the Law of 17 December 2010, as amended. Under this chapter, Part II UCIs are exempt from any corporate income and municipal business tax[7]. Instead, they are subject to an annual subscription tax[8].

As mentioned above, the real estate levy only applies to Part II UCIs which have a legal personality separate from their partners and specifically excludes the Part II UCIs set up as SCSs. Therefore the real estate levy only applies to SICAVs (set up as SAs, *sociétés anonymes*) and SICAFs (*sociétés d'investissement à capital fixe*) set up as corporations and Part II UCIs with no legal personality (i.e. established as *fonds communs de placement*, "**FCP**" or *Sociétés en Commandite Spéciale*, "**SCSp**") are out of the scope of the real estate levy. In addition, Part II UCIs established as SCSs, which are considered as not having a personality separate from their partners for tax purposes, are also out of the scope of the real estate levy. For the latter, because of the tax transparency and the application of the *Bilanzbündeltheorie*, the taxation of income and gains arising from Luxembourg real estate assets will take place directly at the level of their partners.

1.2.2. SIFs within the meaning of the Law of 13 February 2007

SIFs within the meaning of the Law of 13 February 2007 are also in the scope of the new real estate levy. SIFs may invest into real estate directly or through participations into other investment vehicles. SIFs benefit from a specific tax regime attached to the SIF regime itself and the Law of 13 February 2007 provides that "*apart from the subscription tax [of 0.01%], no other tax shall be payable by the specialised investment funds referred to in this Law*". Since they are tax-exempt entities, their inclusion in the scope of the real estate levy is in line with the stated objectives of the 2021 Budget.

However, in the same way as for Part II UCIs, the real estate levy only applies to SIFs which have a personality separate from their partners, thus excluding SIFs set up as FCPs and SCSps. In addition, SCSs are expressly excluded from the scope of application of the real estate levy. Here as well, the objective is to have the real estate levy applying to SIFs which are opaque from a Luxembourg tax perspective while the taxation of rental income and gains realised by tax transparent SIFs will take place directly at the level of their investors.

7. Article 173 of the Law of 17 December 2010 relating to undertakings for collective investment, as amended.

8. Article 174 of the Law of 17 December 2010 relating to undertakings for collective investment, as amended.

1.2.3. RAIFs within the meaning of article 1 of the Law of 23 July 2016

Finally, the real estate levy applies to RAIFs within the meaning of article 1 of the Law of 23 July 2016 ("**RAIF Law**").

Here again, the real estate levy only applies to RAIFs which have a personality separate from their partners, thus excluding RAIFs set up as FCPs and SCSps. In addition, SCSs are expressly excluded from the scope of application of the real estate levy. This, however, does not mean that all RAIFs established as corporations should be subject to the real estate levy. At this point, it is worth mentioning that a RAIF can apply two different types of tax regimes, depending on the types of assets it invests in and its investment strategy.

According to the first tax regime (which applies as a rule), RAIFs are fully exempt from tax on their income, regardless of the nature of the income or gains they realise (so-called subjective exemption)[9]. Instead, RAIFs are subject to subscription tax at a rate of 0,01% annually[10].

However, according to the second tax regime (which applies as an exception), RAIFs investing in risk capital under conditions similar to those applicable to a SICAR (often referred to as the "**RAIF-SICAR**") may be subject, under certain conditions and requirements[11], to a different tax regime which is defined in Article 48 of the RAIF Law. According to Article 48, these RAIFs do not benefit from the general tax exemption but are either subject to tax like any fully taxable corporation or are considered tax transparent, depending on their legal form. However, Article 48 (2) and (3) of the RAIF Law provide for an exemption of certain items of income realised by a RAIF-SICAR, namely gains and income on risk capital securities, and on cash kept with the objective of being invested in risk capital. Since this objective exemption only covers certain items of income and does not apply to the RAIF-SICAR as a person, such entity does not benefit from a subjective exemption and it could be argued that it should therefore not be in the scope of the real estate levy, but rather that the levy only applies to RAIFs which are fully exempt from Luxembourg corporate tax on their income.

This interpretation is supported by the fact that the 2021 Budget also specifies that the real estate levy is an exception to the provisions of Article 45 of the RAIF Law, and it therefore seems consistent to consider that the real estate levy should only apply to RAIFs which are fully exempt from corporate income tax based on Article 45 of the RAIF Law and not to the ones subject to the specific tax rules of Article 48 of the RAIF Law. However, a clarification in this respect would have been welcome to provide more legal certainty to taxpayers.

1.3. Real estate levy computation

The new levy introduced by the 2021 Budget is computed and levied annually on income from real estate situated in Luxembourg and its rate is fixed at 20%.

The provision includes a reference to Articles 517 to 526 of the civil code as a definition of real estate to ensure consistency.

The 2021 Budget further defines income from real estate as a) gross rental income from a Luxembourg property, b) capital gains deriving from the disposal of a Luxembourg property, and c) income from the disposal of shares. Somewhat counter-intuitive, this last item is also subject to a separate definition in the 2021 Budget, and covers income from the transfer of shares or units in a tax transparent entity covered by Article 175 of the LITL or an FCP.

The clear objective of the provision is that the real estate levy should be collected on income and gains arising from Luxembourg real estate assets realised by investment vehicles, either directly or indirectly via one or more tax transparent entities within the meaning of Article 175 of the LITL, or through one or more FCPs.

The real estate levy will also be levied on gains realised from the disposal of participations or interests held by in scope investment vehicles in tax transparent entities (i.e. entities under Article 175 of the LITL or FCPs) that ultimately hold Luxembourg properties.

Contrary to the typical immovable property clause found in most double tax treaties and the OECD Model Tax Convention on Income and on Capital[12], there is no threshold required to trigger the application of the real estate levy. This means that the real estate levy applies to income and gains without regards to the relative value of the real estate assets in proportion to the other assets held by the investment vehicle. Any investment vehicle in scope with even a small exposure to Luxembourg real

9. Article 45 of the Law of 23 July 2016 on reserved alternative investment funds, as amended.
10. Article 46 of the Law of 23 July 2016 on reserved alternative investment funds, as amended.
11. Including among others that their investment strategy has to be reviewed every year by an auditor to qualify for this provision.
12. Article 13 of the OECD Model Tax Convention on Income and on Capital.

estate may therefore be subject to the real estate levy. While this may be considered as a very strict approach since it means that all investment vehicles in the scope of the provision may potentially become subject to the levy (not only real estate investment vehicles), one should keep in mind that the aim of the new levy is to make sure that any Luxembourg real estate income and gains are taxed. Still, it means that a careful review of the portfolio of investment vehicles, transparent entities and FCPs which hold Luxembourg real estate will have to be performed on a regular basis in order to assess the potential application of the real estate levy. In particular, the presence of an in scope investment vehicle in the investor register of a widely held transparent entity can trigger the levy.

Income and gains covered by the real estate levy

Having defined the investment vehicles covered by the provision and the types of income subject to the levy when realised by such investment vehicles, the 2021 Budget further details how the levy must apply. In particular, the income or gains realised through a tax transparent entity will be allocated to the investment vehicle in the same proportion as its participation in such transparent entity. In this respect, Article 4 (3) 2 of the 2021 Budget provides for a proportional allocation of income deriving from Luxembourg real estate assets and realised by a tax transparent entity (either covered by Article 175 of the LITL or because such entity is an FCP) to the investment vehicle holding an interest in such tax transparent entity. This provision therefore provides for consistency and coherence in the application of the tax transparency principle to the real estate levy.

As a result, the real estate levy applies to the three following categories of income and gains:

A) Gross rental income arising from immovable properties situated in Luxembourg and realised by covered investment vehicles either directly or indirectly through one or more tax transparent entities in which such investment vehicle holds an interest.

B) Gains on the disposal of real estate assets situated in Luxembourg and realised during operations such as a sale, exchange, contribution, merger, demerger, liquidation or dissolution and realised by a covered investment vehicle either directly or indirectly through one or more tax transparent entities in which such investment vehicle holds an interest. The gain is further defined as the positive difference between the price of the immovable property stated in the notarial deed at the time of its disposal and the price at the time of the acquisition, contribution or constitution of the immovable property.

C) Gains resulting from the disposal of interests held by investment vehicles in tax transparent entities (under Article 175 of the LITL or being FCPs) which hold real estate situated in Luxembourg. The gain is defined as the positive difference between the sale price of the interest corresponding to the proportion of the value of the real estate asset located in Luxembourg at the time of the sale of the interest and the acquisition price of the interest corresponding to the proportion of the value of the real estate at the time of the acquisition of such interest. In addition, in application of the tax transparency principle stated above, when a Luxembourg real estate asset is held by an investment vehicle through a chain of several tax transparent entities (under Article 175 of the LITL or being FCPs), such investment vehicle is also subject to the real estate levy 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.

The levy applies to the gross income, without taking into account any deduction for expenses or financial charges. The fact that the real estate levy applies to the gross rental income instead of applying to the net rental income could be criticised as it may be considered as opposed to the principle of taxation in accordance with the ability to pay tax (*principe de l'imposition selon la capacité contributive*). Even though the rate of the real estate levy is slightly lower (20%) than the overall corporate income tax and municipal business tax rate applicable to fully taxable corporations (24.94% in most cases), the fact that the levy applies on the gross income (instead of the net income) will often mean that investment vehicles within the meaning of the real estate levy will (effectively) be taxed more heavily than normally taxable corporations. This issue was raised by the Chamber of Commerce during the legislative procedure related to the 2021 Budget. However, the Luxembourg Council of State only took note of it without commenting on the issue any further so that in the end, no change was made in this respect.[13] .

Although the levy increases the tax bill of some funds on Luxembourg real estate income, it is important to keep in

13. See Comments of the Chamber of Commerce dated 19 November 2020, Parliamentary Document n° 7666-2 on the 2021 Budget, page 46.

mind that the real estate levy will not impact the general tax position of the investment vehicles nor investment funds more generally in Luxembourg. The relevant general corporate income tax exemption applicable to the in scope investment vehicles remains applicable and income and gains other than those listed in the 2021 Budget and relating to immovable property situated in Luxembourg will therefore not be impacted. Most importantly, the structure of the levy is very focussed and avoids disrupting the much larger category of funds in Luxembourg that are favoured by international investors investing in non-Luxembourg assets.

Also, investment vehicles holding real estate indirectly through participations in fully taxable Luxembourg entities (e.g. a property company incorporated under the legal form of a Sàrl) will not be impacted by the new levy. In such a case, the income and gains deriving from the Luxembourg property will already be subject to Luxembourg corporate income taxation at the level of the direct holder (i.e. the Sàrl).

1.4. Reporting and payment requirements

The new real estate levy mechanism is also supported by several reporting and payment obligations.

At the latest on 31 May of the year following the one the real estate income or gain is realised in, investment vehicles have to file a specific tax return with the withholding tax office of the Luxembourg tax authorities (*Administration des Contributions Directes, Bureau de la retenue d'impôt sur les intérêts*) including detailed information on the income subject to the real estate levy, as well as on the amount of levy to be paid.

An external auditor (*réviseur d'entreprise agréé*) must certify in a report that the real estate income has been computed in accordance with the provisions of the 2021 Budget introducing the real estate levy. This report must be filed together with the tax return.

The related real estate levy has to be paid at the latest on 10 June of the same year (i.e. of the year following the one the income or gain is realised in). All investment vehicles must file an additional return including information on whether or not they have held Luxembourg real estate assets directly or indirectly during the calendar years 2020 and 2021. This requirement applies regardless of whether they realise (directly or indirectly) Luxembourg real estate income or not, and regardless of whether they hold (directly or indirectly) Luxembourg real estate assets or not during the years 2020 and 2021. This additional return must be filed by 31 May 2022 at the latest.

Investment vehicles must inform the Luxembourg tax authorities if they change their legal forms and become tax transparent entities within the meaning of Article 175 of the LITL or FCPs during the calendar years 2020 and 2021. This requirement only applies if such investment vehicles hold (directly or indirectly) at least one Luxembourg real estate asset at the time of the change of their legal form.

Finally, given the investment vehicles potentially subject to the new levy are all exempt entities for corporate income tax purposes, it should not come as a surprise that the 2021 Budget includes a provision clarifying that the real estate levy is not deductible from the determination of the income or gains, and is not giving rights to any tax credit or tax deduction to anyone[14].

It is worth noting again that the vastly larger group of Luxembourg funds that have no Luxembourg real estate are not impacted by these changes.

2. PRIVATE WEALTH MANAGEMENT COMPANIES ("SPF")

The private wealth management company (*Société de gestion de patrimoine familial*, "**SPF**") was introduced in Luxembourg by the law of 11 May 2007[15] and followed the repeal of the Luxembourg Holding 29 regime. The objective of the SPF is to provide a tax neutral holding regime for passive investments in line with the EU state aid rules[16]. In this respect, the Luxembourg legislator decided to limit the scope of possible activities of and investors into an SPF.

The SPF benefits from a full exemption from corporate income tax and municipal business tax[17] but is instead subject to an annual subscription tax at a rate of 0.25% applied to the share capital and share premium[18]. To avoid an excessive use of debt, the subscription tax basis is adjusted (increased) by the amount of leverage exceeding eight times the sum of the share capital and share premium.

An SPF can only carry out private wealth management activities, and can therefore only hold financial assets which meet this criterion (e.g. participations and cash). In addition, shares of an SPF are reserved to eligible investors, including individual investors managing their private

14. Article 4 (7) 9 of the 2021 Budget.
15. « Loi du 11 mai 2007 relative à la création d'une société de gestion de patrimoine familial ("SPF") », Memorial A n° 75.
16. See, parliamentary document n° 5637/00, page 7.
17. Article 4 of the law of 11 May 2007 related to the creation of the SPF.
18. Article 5 of the law of 11 May 2007 related to the creation of the SPF.

wealth, a private wealth management entity (such as a trust) or an intermediary acting for such persons.

The SPF is further prohibited from holding direct investments in real estate assets but can however hold shares in property-owning entities organised as share capital companies. In such a case, the SPF cannot be involved in the management of these companies.

This means that income and capital gains realised by an SPF from an investment in a fund or an exempt vehicle, including exempt vehicles holding directly or indirectly Luxembourg properties, should be fully tax neutral at the level of the SPF.

Impact of the 2021 Budget on the SPF

With effect as from 1 July 2021, Article 11 of the 2021 Budget amends the SPF law of 11 May 2007 by adding a restriction to the assets eligible for an SPF. Specifically, the amendment states that it is prohibited for an SPF to hold real estate assets through a participation in an entity covered by §11bis StAnpG (i.e. a tax transparent entity) or through one or more FCPs.

The objective of this restriction is to avoid situations where an SPF could realise tax-exempt gains or income from a participation into a tax transparent vehicle holding Luxembourg real estate directly or indirectly. This amendment will ensure that such gains are still subject either to corporate income tax at the level of a fully taxable entity or to the new real estate levy.

Since the law of 11 May 2007 already prohibited SPFs to hold real estate assets directly, there was no need to address other risks of full exemption of income and gains on real estate investments of SPFs. Indirect real estate holdings through fully taxable subsidiaries or entities are not a concern here given the full tax liability of the property owner.

3. REAL ESTATE REGISTRATION TAXES

When a property situated in Luxembourg is contributed to a company (domestic or foreign), the transfer must be characterised under the registration duty rules[19]. The characterisation is based on the nature of the remuneration from the company (i.e. shares or other interests).

A contribution of a Luxembourg real estate asset to a Luxembourg or foreign company that is remunerated by shares is considered as a contribution (*apport pur et simple*). Until 1 January 2021, such contributions were subject to a proportional registration tax of 0.5% + 2/10 as well as to 0.5% transcription tax (i.e. a total of 1.1% registration taxes). A surtax of 0.3% also applies when the property is situated in the municipality of Luxembourg City.

Contributions of a real estate asset situated in Luxembourg remunerated by means other than shares are considered as a real estate sale (*apport à titre onéreux*). A sale of a Luxembourg property is subject to a proportional registration tax of 5% + 2/10 as well as to 1% transcription tax (i.e. a total of 7% registration taxes). The surtax for properties located in Luxembourg City also applies.

While the direct sale of real estate attracts registration taxes of 7 to 10%, a sale of shares of a company holding real estate assets is exempt from proportional registration taxes. The 2021 Budget therefore aimed at narrowing the difference between "asset deals" and "share deals".

Therefore, with effect as from 1 January 2021, the tax treatment of contributions of Luxembourg real estate to companies in exchange for shares has been amended[20]. The registration duties have been increased from 0.5% + 2/10 to 2% + 2/10 and the transcription tax has been increased from 0.5% to 1%. As a result, registration taxes applicable to such contributions now reach 3.4% instead of the former 1.1%.

It is noteworthy that the 2021 Budget does not contain any corresponding provisions on registration tax exemptions applicable to restructuring involving companies. Exempt restructurings involve contributions by one or more companies of all their assets and liabilities or of one or several branches of activity, to one or more companies, to the extent that the contribution is in majority in exchange for shares[21]. These restructurings will remain exempt from proportional registration taxes.

4. NEW RULES FOR RESIDENTIAL INVESTMENTS

The Luxembourg domestic tax regime for residential investments includes a favourable provision which is considered as an important factor supporting the Luxembourg real estate market.

Under Luxembourg tax law, income from rental properties is fully taxable at the level of the owner either as rental

19. See Appendix to the amended law of 23 December 1913 on the revision of the law on taxes levied by the Luxembourg Registration and Estates Department (*Administration de l'Enregistrement et des Domaines*) for more details on the rates applicable for registration and transcription tax purposes.

20. Article 10 of the 2021 Budget.

21. Article 6 of the Law of 19 December 2008 ("Loi du 19 décembre 2008 portant révision du régime applicable à certains actes de société en matière de droits d'enregistrement", Mémorial A, N° 207).

income[22] or as business income[23], and financing charges are normally deductible. In addition, the property is amortised annually, and such amortisation is also deductible from the income tax basis of the owner. Buildings are in principle amortised at the rate of 2% or 3%.

However, Article 32ter of the LITL provides for an accelerated amortisation rate of 6% per year for real estate investments allocated to rental housing when the property is no older than six years. This in essence increases the rate of return on rental investments in new properties during the first years of the investment.

With effect as from tax year 2021, Article 3 of the 2021 Budget has amended Article 32ter of the LITL.

The amortisation rate for new real estate investments allocated to rental housing has been decreased from 6% to 4%. To be considered as a new building, the property now must be no older than five years (as opposed to six years under the previous provision).

These new rules will also apply to expenses relating to renovations of old buildings, if they exceed 20% of the acquisition price of the property.

As an exception to the rule, the renovation of rental properties aiming at allowing the use of sustainable energy will benefit from an amortisation rate of 6% of the expenses.

The rules from the new Article 32ter of the LITL are completed by an additional provision. The 2021 Budget also introduces under a new Article 129e of the LITL a special tax deduction for certain properties no older than five years and allocated to rental housing. As a form of consistency, this special deduction ("*abattement immobilier spécial*") is calculated as 1% of the value used as a basis for the accelerated amortisation under Article 32ter of the LITL. The special deduction can however not exceed 10,000 EUR.

As a result of these new rules, the joint impact of new Articles 32ter and 129e of the LITL will be as follows. Rental investments no older than five years will benefit from a combined tax-deductible charge, composed of accelerated rates of depreciation and special deductions, of:

- 5% for investments worth 1,000,000 EUR or less;
- 4% plus 10,000 EUR for investments worth more than 1,000,000 EUR

These new rules applicable to accelerated amortisation have had a direct impact on the net return of rental housing investments in Luxembourg since 1 January 2021. Residential property has increased significantly and consistently in price over the last 10 years to a level where it is seen as unaffordable for many tranches of the population. The accelerated depreciation rules were generally accepted to have contributed to some extent to this increase in price, although it is hard to demonstrate empirically. These new measures may help to reduce this inflationary effect, although it is questionable whether the slight decrease is sufficient in this regard.

CONCLUSION

Real estate was at the core of the tax measures taken under the 2021 Budget. The new provisions primarily seek to counter perceived abuses arising from the use of the tax regime applicable to SIFs and other exempt investment vehicles in the Luxembourg real estate sector, but also to secure more tax revenues from certain real estate transactions.

The registration taxes on contributions of Luxembourg real estate to companies have been increased, and SPFs are now prohibited from holding Luxembourg properties through tax transparent structures. In parallel, the tax deduction available against rental income from new housing investments has been decreased.

The most awaited measure of the 2021 Budget was certainly the introduction of the real estate levy which aims to make sure that investors are taxed on income and gains arising from investments into Luxembourg real estate, even when they structure their investment in an investment fund exempt from all taxes on its income and gains. Instead of amending the tax treatment of Luxembourg real estate investments at the level of the Luxembourg investors, or changing the taxation of funds per se, the Luxembourg Government decided to introduce a new type of tax due and to be paid directly by exempt Luxembourg investment funds on income and gains arising directly or indirectly from Luxembourg real estate investments. While the mechanism chosen increases the effective taxation of Luxembourg real estate investments and the reporting burden of investment vehicles within scope, it has been welcomed more broadly, as it minimises any change for the vast majority of investment funds which do not invest in Luxembourg real estate.

22. Article 98 of the LITL.

23. Article 14 of the LITL.