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Luxembourg 2021 Budget — Tax Measures



BY KEITH O'DONNELL AND SAMANTHA SCHMITZ

Keith O'Donnell and Samantha Schmitz of ATOZ Tax Advisers provide an overview of some significant tax measures introduced in the Luxembourg 2021 budget draft law.

The 2021 budget draft law (the draft law) was presented to the Luxembourg Parliament on October 14, 2020. Given the current context of crisis, the government decided that it was not the right time to increase taxes and/or perform a major 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, reform of the impatriate regime and the introduction of a reduced rate of subscription tax for sustainable funds.

We provide an overview of the main tax measures to be introduced as from 2021. However, the proposed rules may still evolve throughout the legislative process.

1. Real Estate Taxation

1.1. Taxation of Luxembourg Real Estate Investments Held by Certain Investment Funds

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

The new real estate withholding tax will apply to the following Investment Vehicles:

- Undertakings for Collective Investment (UCIs) within the meaning of Part II of the law of

December 17, 2010 (except certain Luxembourg partnerships, sociétés en commandite simple, SCSs);

- Specialized Investment Funds (SIFs) within the meaning of the law of February 13, 2007 (except certain Luxembourg partnerships, SCSs); and
- Reserved Alternative Investment Funds (RAIFs) within the meaning of Article 1 of the law of July 23, 2016 (except certain Luxembourg partnerships, SCSs). 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 real estate withholding tax will only apply to the extent that the Investment Vehicle has a personality separate from those of its partners (typically excluding fonds communs de placement, FCPs, or sociétés en commandite spéciale, SCSp). In addition, as mentioned above, Investment Vehicles set up as an SCS are expressly out of the scope of the measure.

The Investment Vehicle will be subject to an annual real estate withholding 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 real estate withholding tax will also apply to gains realized 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 an 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% real estate withholding tax on the gains realized 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 realized indirectly, the taxable income or gain is computed in proportion to the interest held in the entity(ies) holding the Luxembourg real estate.

The following new reporting and payment obligations will be introduced in respect of the new real estate withholding tax:

- At the latest on May 31 of the year following the one during which the real estate income has been realized, the Investment Vehicle will have to file a 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 tax as well as on the amount of tax to be paid; an external auditor (réviseur d'entreprise agréé) will have to certify in a report that the real estate income has been computed in accordance with the provisions of the law introducing the real estate withholding tax. This report will have to be filed together with the tax return.
- The related real estate withholding tax will have to be paid at the latest on June 10.
- All Investment Vehicles, no matter whether they realize (directly or indirectly) Luxembourg real estate income and no matter whether they hold (directly or indirectly) Luxembourg real estate assets, have to file an additional return including information on whether they have been (or not)

holding (directly or indirectly) Luxembourg real estate assets during the calendar years 2020 and 2021. This tax return must be filed by May 31, 2022 at the latest.

- Finally, Investment Vehicles must inform the Luxembourg tax authorities if they change their legal form and become a tax transparent entity within the meaning of Article 175-1 ITL or an FCP in the course of the calendar years 2020 and 2021. This requirement only applies to the extent that the Investment Vehicles hold (directly or indirectly) at least one Luxembourg real estate asset at the time of the change of their legal form.

1.2. Real Estate Registration Taxes on "Share Deals"

Currently, the contribution remunerated by shares of a real estate asset situated in Luxembourg to a Luxembourg or foreign civil or commercial company upon its incorporation or capital increase (*Apport pur et simple*, so-called share deal) is 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) while the contribution of a real estate asset situated in Luxembourg (so-called asset deal) remunerated by other means than shares (*Apport à titre onéreux*) 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).

With effect as from January 1, 2021, the tax treatment of share deals (in the context of investments in Luxembourg real estate) 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 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%).

1.3. SPF Regime and Real Estate Investments

With effect as from July 1, 2021, private wealth management companies (SPFs) 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 May 11, 2007).

2. New Amortization and Deduction Rules for Residential Investments

The accelerated amortization rules applicable to rental housing investments will be amended with effect as from tax year 2021. The amortization 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 five years (instead of six 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 amortization 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 amortization rules, the draft law introduces a special deduction for investments in real estate not older than five years and allocated to rental housing (abattement immobilier special). 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 10,000 euros (\$11,800) (i.e. 1% of 1 million euros).

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

Value

- <1.000.000: 5%
- >1.000.000: 4% plus a deduction of 10,000 euros.

3. Employee Taxation

3.1. Stock Options/Warrants

The so-called warrant regime, which evolved from a circular introduced in 2002, will be repealed as from January 1, 2021. The repeal of the circular was announced in the commentary to the draft law but it will be necessary to await the release of a repealing circular (most probably before year-end) in order to know more about the impact of the repeal, especially on the stock option plan regime which is also covered in the circular to be repealed.

3.2. Employee Profit Share

With effect as from tax year 2021, a new profit share (*prime participative*) will be introduced for employees and will be 50% exempt under certain conditions.

The amount of profit share payable in the form of a bonus and benefiting from the 50% exemption will be subject to the two following cumulative limits:

- The total amount of profit share paid by the employer to its employees will not be able to exceed 5% of the accounting profits of the employer as of the end of the accounting year preceding the allocation of the profit share; and
- The amount of profit share paid by the employer to an employee will not be able to exceed 25% of the annual salary (excluding the amount of profit share) of the employee concerned.

In our view, these two limits should be interpreted in such a way that should one or two of them be exceeded, only the exceeding part will be fully subject to tax and the part up to the limits will still benefit from the 50% exemption.

This approach should also be true in respect of the tax deduction of the profit share at the level of the employer: while the draft law specifies that the profit share within the meaning of the new draft law article is tax deductible at the level of the employer, the part of the profit share which exceeds the 5% and 25% limits mentioned above should still remain tax deductible at the level of the employer under the standard tax deduction rules applicable to the payment of salary and bonuses.

As soon as the profit share has been put at the disposal of the employees, the employer will have to provide the Luxembourg tax authorities with a list of all employees who benefited from it as well as with all the information needed to evidence that the conditions required to benefit from the 50% exemption are met.

3.3. Impatriate Regime Amended

With effect as from tax year 2021, 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. To benefit from the partial exemption regime, the premium should not exceed 30% of the annual remuneration of the impatriate.

Most of the conditions of the impatriate regime currently in force will remain unchanged. However, to benefit from the regime under the new rules, the impatriate will have to have an annual remuneration of minimum 100,000 euros (instead of 50,000 euros) and he/she will be able to benefit from the regime during a time period of up to eight tax years (instead of currently five tax years).

4. Green Taxation

4.1. Investment Funds and Subscription Tax

As from January 1, 2021, sustainable funds set up as UCIs within the meaning of the law of December 17, 2010 will benefit from a lower rate of subscription tax (taxe d'abonnement)—the standard rate being 0.05%—which will vary from 0.04 to 0.01% of the net asset value (NAV), depending on the level of sustainable activity (within the meaning of article 3 of [EU Regulation 2020/852](#)) of the fund or its individual compartment:

- 0.04% if at least 5% of the NAV of the fund, or of its individual compartment, is invested in sustainable economic activities;
- 0.03% if at least 20% of the NAV of the fund, or of its individual compartment, is invested in sustainable economic activities;

- 0.02% if at least 35% of the NAV of the fund, or of its individual compartment, is invested in sustainable economic activities; and
- 0.01% if at least 50% of the NAV of the fund, or of its individual compartment, is invested in sustainable activities.

Only the portion of the net assets invested in sustainable economic activities will benefit from the reduced rates mentioned above.

The portion of sustainable economic activities will be determined based on the situation as of the last day of the financial year of the UCI and will have to be certified by an external auditor.

4.2. Environmental Taxation

As from January 1, 2021, a CO2 tax will be introduced which should add around 5 cents per liter to the cost of petrol and diesel.

4.3. Tax Credits

As a measure to counterbalance the effects of environmental taxation on Luxembourg households, as from tax year 2021, 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 96 euros.

5. Other Measures

5.1. 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 with effect as from tax year 2020 to reflect the recent decision of the Court of Justice of the European Union (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.

5.2. 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 30,000 euros, will apply as from January 1, 2021 to businesses with a turnover not exceeding an annual turnover of 35,000 euros.

6. Implications

With the tax measures included in its 2021 budget the Luxembourg government is sending 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 for 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.

As a last remark, we are of the view that some of the positive measures introduced could be improved. For example, the new employee profit share regime has a scope of application which is, to us, too restrictive: the limitation to 5% of the profits of the employer means that start-ups, small businesses and companies not aiming at making profits because of the role they play within a group (e.g. cost centers) will often not be able to make their employees benefit from the regime. Therefore, some adjustments to the regime, either in the course of the legislative process or as part of a subsequent reform, would be welcome.

Keith O’Donnell is Managing Partner and Samantha Schmitz is Chief Knowledge Officer within ATOZ Tax Advisers (Taxand Luxembourg).

The authors may be contacted at:

keith.odonnell@atoz.lu
samantha.schmitz@atoz.lu