ATOZ ALERT

New tax package to strengthen Luxembourg's attractiveness

19 July 2024

On 17 July 2024, during a press conference, Finance Minister Roth presented a new tax package titled "Relief Package. Unity. Future. For Everyone". A draft law (the “**Draft Law**”) implementing this new tax package was presented to Parliament on the same day.

One objective announced by the Luxembourg government is to reduce the overall tax charge of individuals and a reform of the tax scale system for individual taxpayers is on the agenda in order to achieve this objective in the medium to long term. The Draft Law already takes a few steps in this direction.

In addition, the Luxembourg government is introducing measures aiming at strengthening Luxembourg's attractiveness, so that Luxembourg remains a suitable jurisdiction for workers, companies and investment funds. Attracting and retaining talent has been defined as one of the priorities of the new government, as reflected in its 2023-2028 coalition agreement. The Draft Law introduces targeted tax measures (impatriate regime, profit share regime) in that respect.

The Draft Law also implements the announced 1% corporate income tax rate cut and the subscription tax exemption for actively managed ETFs.

We present hereafter the main tax measures to be introduced.

MEASURES IN FAVOUR OF INDIVIDUALS

With effect as from 1 January 2025, the Draft Law amends the income tax brackets by 2.5 additional index brackets, which results in an effective reduction of the income tax rate compared with the rate applicable for the 2024 tax year.

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The law of 22 December 2023 already adjusted the income tax brackets by 4 index brackets as from 1 January 2024. Therefore, should the Draft Law be passed in its current form, 6.5 (i.e. the already introduced 4 index brackets increased by the 2.5 additional ones proposed) out of the 8 indexes that have taken place since 2017 and requiring an adjustment of the income tax brackets would be neutralised.

The Draft Law also introduces a more advantageous calculation formula for the income tax rate applicable to single parents, widowers and citizens older than 64 years (Tax class 1a). For these taxpayers, the amount of the tax-free income bracket is increased from 24,876 euros to 26,460 euros due to the neutralisation of the inflation. In addition, the single-parent tax credit increases from 2,505 euros to 3,504 euros and the allowance for extraordinary expenses for dependent children outside the household increases from 4,422 euros to 5,424 euros. The Draft Law also increases the non-qualified minimum social wage tax exemption for all tax classes through a higher tax credit.

Finally, Finance Minister Roth announced, during its press conference[1], the increase of the amount of deductible interest on loans for the purchase of an existing dwelling[2]. As from the 2024 tax year, interest expenses will be fully deductible for the year of purchase of the dwelling and the following years. After four years, 4,000 euros will still be deductible. Thereafter, ceilings of 3,000 euros and 2,000 euros will apply.

MEASURES IN FAVOUR OF EMPLOYEES

A more attractive employee profit-share regime (*prime participative*)

With effect as from tax year 2021, a profit share regime has been introduced for employees. A profit share paid by a Luxembourg company to it employee(s) is 50% exempt from Luxembourg income tax, provided the two following conditions/limitations are met: (1) the total amount of profit share paid by the employer to its employees does not 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 (2) the amount of profit share paid by the employer to the employee does not exceed 25% of the annual gross salary (excluding the amount of profit share) of the employee concerned.

Effective as from tax year 2025, to enable companies to further retain their employees but also to attract talent to Luxembourg, the Draft Law amends the conditions for being able to benefit from the *prime participative* and increases the maximum total amount of *prime participative* an employer can grant to its employee(s) from 5% to 7.5% of the positive result of the employer for the operating year immediately preceding the one for which the profit share is allocated to the employee(s).

In addition, the maximum amount of the partially tax-exempt bonus will be increased from 25% to 30% of the beneficiary's gross annual remuneration, before incorporation of benefits in cash and in kind.

A more favourable impatriate regime

With effect as from tax year 2025, the Draft Law repeals and replaces the current impatriate regime, which currently provides for a 50% partial exemption of the gross annual remuneration paid in the form of a bonus by employers to impatriates and an exemption of certain costs borne by the employer and generated by the expatriate's move to Luxembourg. The new impatriate regime, inspired by the Italian and French regimes, will be simplified and will provide for an exemption of 50% of the gross annual remuneration, including benefits in kind, paid to the impatriate, capped at 400,000 euros. This measure aims at strengthening the attractiveness of Luxembourg for talent and highly specialized profiles and takes into account attractive regimes set up in other countries in the European Union.

[1] To that aim, the Grand Ducal Regulation, as amended, dated 12 July 1968 related to the determination of the rental value dwellings will be amended.
[2] Also applicable to bridging loans.

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For the purpose of the new regime, ‘impatriate’ means (1) an employee who, usually working abroad, is seconded from an undertaking of an international group located outside the Grand Duchy of Luxembourg in order to carry out an activity as an employee in a local undertaking belonging to the same international group; or (2) an employee directly recruited abroad by a local undertaking or by an undertaking established in another State party to the Agreement on the European Economic Area, in order to work as an employee in the undertaking. This regime will not apply to employees hired on the basis of a contract of secondment by a temporary employment agency or within the framework of labour lending.

Most conditions for benefiting from the new regime are identical to the ones applicable under the current regime. To be applicable, the following conditions must be met:

- The impatriate is an individual whose tax domicile or habitual residence is in the Grand Duchy of Luxembourg;
- During the five tax years preceding the year in which the impatriate took up employment in the Grand Duchy of Luxembourg, the impatriate has neither been domiciled for tax purposes in the Grand Duchy of Luxembourg, nor lived at a distance of less than 150 km from the border, nor been subject to personal income tax in the Grand Duchy of Luxembourg on professional income;
- The impatriate carries out the professional activity for benefiting from the exemption for at least 75% of his/her working time (while the current regime requires that the impatriate be employed for a job that is their main professional occupation).
- Like under the current regime, the impatriate earns a fixed annual remuneration of at least 75,000 euros, the fixed remuneration to be taken into consideration being the gross amount before incorporation of benefits in cash and in kind;
- The impatriate does not replace one or more other employees not considered as impatriates meeting all the criteria to benefit from the regime;
- In the case of a secondment, (i) the seconded impatriate has a seniority within the international group of at least five years or has acquired at least five years of specialised professional experience in the sector concerned, (ii) an employment relationship exists between the seconding company and the employee during the period of secondment, (iii) the temporary assignment of the seconded employee provides for a right for the employee to return to the seconding establishment at the end of the period of secondment, and (iv) a contract relating to the secondment of the employee is concluded between the seconding company and the local company;
- In the case of direct recruitment, the impatriate has acquired in-depth specialisation in the sector concerned; and
- The number of impatriates entitled to the exemption does not exceed 30% of the total workforce of the local company in which the impatriate works. Part-time employees, including impatriates, are counted in proportion to their workload. This condition is not required for companies that have been in existence for less than 10 years on 1st of January of the calendar year concerned.

The exemption is applicable during the entire secondment of the impatriate to Luxembourg, respectively the entire time the impatriate is working for the local company, but only until the end of the eighth tax year following the year during which the impatriate started to work in the Grand Duchy of Luxembourg. Employees who have benefitted from the current impatriate regime applicable up to and including 2024 remain subject to this current version of the impatriate regime as long as the conditions for its application are met, unless the employee expressly asks for the application of the new impatriate regime as from 2025. The choice to apply the new impatriate regime needs to be communicated to the Luxembourg tax authorities and is irrevocable. The new impatriate regime is then applicable to the employee until the end of the eighth tax year following the year during which the impatriate started to work in the Grand Duchy of Luxembourg.

A new bonus for young employees

Effective as from tax year 2025, the Draft Law provides for a new bonus aimed at young employees under the age of 30 who have a first permanent employment contract in Luxembourg. The granting of this bonus is at the discretion of the employer and is correlated to the gross remuneration of the employee. It decreases as the salary

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increases and if the gross annual salary of the young employee exceeds 100,000 euros, bonuses are no longer eligible for this new exemption regime.

According to the Draft Law, 75% of this bonus will be tax exempt, with an annual maximum amount[3] of:

- 2,500 euros if the gross remuneration of the young employee exceeds 75,000 euros and is lower than or equal to 100,000 euros;
- 3,750 euros if the gross remuneration of the young employee exceeds 50,000 euros and is lower than or equal to 75,000 euros; and
- 5,000 euros if the gross remuneration of the young employee is lower than or equal to 50,000 euros.

The young employee bonus is exempt if, at the time the employer pays the bonus to the employee, the following conditions are met:

- The employee is under the age of 30 years at the beginning of the tax year;
- The employee is in possession of a first permanent employment contract signed with the employer which is established/incorporated either in the Grand Duchy of Luxembourg or abroad but has a permanent establishment in the Grand Duchy of Luxembourg;
- The first young employee's bonus was paid less than five years before 1 January of the tax year concerned (i.e. the bonus exemption is granted for a period of maximum five years).

In the event of a change of employer, the employee is no longer eligible for the exemption of the young employee bonus. This condition is explained by the twofold desire to encourage young employees to find stable employment and to ensure that young workers remain loyal to the company that trains them. This bonus is designed to attract young talent to the country.

The exemption only applies to permanent employment contracts signed on or after the date the Draft Law enters into force.

This new bonus is introduced as a measure supplementing the rental bonus for young employees introduced by the law of 22 May 2024 introducing a package of measures to revive the housing market. To know more about this law, please read our ATOZ Alert on the topic.

A tax credit for overtime for cross-border workers

With retroactive effect as from tax year 2024, the Draft Law finally introduces a new overtime tax credit of a maximum of 700 euros per year for cross-border workers working in Luxembourg. Employees who work in Luxembourg, but are resident in a country with which Luxembourg has signed a double tax treaty, and who receive gross remuneration for overtime for which the taxing right is attributed to Luxembourg, and who are fully exempt on this remuneration in Luxembourg, may effectively be subject to tax in their state of residence on this overtime remuneration. The purpose of the new overtime tax credit is therefore to provide some compensation for the loss of income suffered by the cross-border worker in such case and therefore, maintain Luxembourg's attractiveness for cross-border workers who are an important source of manpower for local employers.

MEASURES IN FAVOUR OF BUSINESSES AND THE FINANCIAL CENTER

1% CIT (*Impôt sur le revenu des collectivités)* rate cut

In order to pursue the objective of strengthening the competitiveness of businesses in light of the various changes in the international tax environment, and to encourage them to invest, innovate and create jobs, the Luxembourg government proposes to reduce the corporation income tax ("**CIT**") rate.

Thus, in line with the government coalition programme, with effect as from tax year 2025, the Draft Law reduces the CIT rates by 1% as follows:

[3] Determined on the basis of a full-time job.

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- from 17% to 16% for taxable income exceeding 200,000 euros;
- from 26,250 euros plus 31% to 24,500 euros plus 30% of the income exceeding 175,000 euros for taxable income between 175,000 euros and 200,001 euros; and
- from 15% to 14% for taxable income not exceeding 175,000 euros.

As from 2025, taking into consideration the municipal business tax and the solidarity surcharge for the employment fund, the overall CIT rate of companies located in Luxembourg City with taxable income exceeding 200,000 euros will therefore be 23.87% instead of currently 24.94%. For small businesses, the rate will decrease from 22.80% in 2024 to 21.73% in 2025.

This CIT cut will bring Luxembourg's nominal tax rate closer to the average statutory tax rate in force in 2023 both at European Union level (21.2%) and at OECD level (23.6%).

Subscription tax exemption for actively managed ETFs

As a lever for the diversification of the financial centre and for the purpose of developing new activities, actively managed Exchange Traded Funds ("**ETFs**") will be exempt from subscription tax as from the first day of the quarter beginning after the publication of the law, once passed, in the Official Journal of the Grand Duchy of Luxembourg. This measure will therefore most likely be applicable as from 2025.

In the context of a constantly evolving investment fund industry, the objective of the Draft Law is to improve the tax framework of Luxembourg listed undertakings for collective investment in transferable securities ("U**CITS ETFs**"). These investment funds are traded on stock exchanges and thus offer an additional distribution channel for asset managers enabling them to reach additional investors. In recent years, the fast-growing ETF market has developed strongly, particularly in the United States. The aim of the proposed measure is therefore to promote the development and competitiveness of this sector, both on the European and international financial scenes. This measure enables Luxembourg, as the main European centre for traditional investment funds, to position itself in the emerging market for UCITS ETFs.

OTHER MEASURES

The Draft Law finally intends to modernise the procedural framework of the amended law of 11 May 2007 relating to the creation of a family asset management company ("**SPF**").

From a tax point of view, the Draft Law provides that the minimum annual subscription tax of 100 euros will be increased to 1,000 euros. Also, in order to clarify the computation of the tax base for companies that do not have a financial year corresponding to the calendar year, the Draft Law provides that the date on which debts are taken into account for the computation of the tax base of the subscription tax is set at the first day of the financial year instead of 1st of January.

The Draft Law also introduces the obligation to file annual certifications electronically, the same way as the obligation to file tax returns electronically.

Finally, it is proposed to modernise the procedural framework put in place to withdraw the benefit of the tax provisions established by the 2007 law to the SPF when it does not comply with the legal, regulatory or statutory provisions set out in the law. Currently, the law of 11 May 2007 allows the tax authorities to pronounce the withdrawal of the benefit of the tax provisions if the SPF does not comply with the legal, regulatory or statutory provisions of the 2007 law without any further specification.

The Draft Law provides that the withdrawal of the SPF's tax status can only be pronounced if the breach presents a certain kind of gravity and persists for a specified period during which the SPF has not complied with a compliance order issued by the tax authorities. Nevertheless, the Draft Law also allows the tax authorities to impose administrative fines.

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Do you have further questions?

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