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Luxembourg: Trends & Developments

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LUXEMBOURG

Trends and Developments

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ATOZ Tax Advisers

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Introduction

Luxembourg has long been a leading hub for the financial industry, attracting talent and investment from around the world. The challenges posed by the current global economic environment are prompting Luxembourg to take action not only to maintain but also to improve that position. As a result, at the end of 2024, a number of important legislative changes aimed at having a positive impact on Luxembourg's attractiveness and competitiveness were adopted. In this respect, attracting and retaining talent has notably been defined as one of the priorities of the new government, as reflected in its 2023-2028 coalition agreement.

Mainly with effect from the 2025 tax year, Luxembourg introduced targeted tax measures for both businesses (primarily a 1% cut of the corporate income tax rate and a subscription tax exemption for actively managed exchange-traded funds) and individuals (eg, an improved employee profit-share regime, a more favourable impatriate regime, a new bonus for young employees and a new tax credit for cross-border workers), so that Luxembourg remains a suitable jurisdiction for workers, companies and investment funds. They should further stimulate the Luxembourg fund industry.

Talent Attraction to Luxembourg

A more favourable impatriate regime

With effect from the 2025 tax year, Luxembourg repealed its impatriate regime and replaced it with a new one. The repealed impatriate regime provided for a 50% partial exemption of the gross annual remuneration paid in the form of a bonus by employers to impatriates and an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. However, this regime was considered too com-

plex and not sufficiently attractive compared to other foreign impatriate regimes.

The new Luxembourg impatriate regime, inspired by the Italian and French regimes, is thus a simplified one. It provides for an exemption of 50% of the gross annual remuneration, including all benefits in kind, paid to the impatriate, capped at an annual gross amount of EUR400,000. As a result, impatriates with a gross annual remuneration of EUR400,000 will be taxed at a maximum of 50% of the marginal tax rate of 45.78% for the income bracket exceeding EUR220,788, including the solidarity surcharge (ie, a maximum tax rate of 22.89%). This measure aims at strengthening the attractiveness of Luxembourg for talent and highly specialised profiles taking into account attractive regimes set up in other countries in the European Union.

It benefits employees directly recruited from abroad or seconded from an undertaking of an international group located outside Luxembourg to carry out an activity as an employee in Luxembourg.

Most conditions for benefitting from the new regime are identical to the ones already applicable under the repealed regime. To be applicable, the following conditions must notably be met:

- the impatriate must be tax domiciled or have their habitual residence 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 employee has not been subject to personal income tax in the Grand Duchy of Luxembourg on professional income;

- the impatriate carries out the qualifying professional activity for at least 75% of his/her working time; and
- the impatriate earns a fixed annual gross remuneration of at least EUR75,000.

Employee profit-share regime

With effect from the tax year 2021, a profit-share regime (prime participative) has been introduced for Luxembourg employees. As a result of this regime, a profit share paid by a Luxembourg company to its employee(s) benefitted from a 50% income tax exemption, provided the two following conditions/limitations were met: (i) the total amount of profit share paid by the employer to its employees did not exceed 5% of the accounting profit of the employer as of the end of the accounting year preceding the allocation of the profit share and (ii) the amount of profit share paid by the employer to the employee did not exceed 25% of the annual gross salary (excluding the amount of profit share) of the employee concerned.

To retain and attract more talent, Luxembourg has improved its employee profit-share regime. Effective from the 2025 tax year, the maximum total amount of profit share an employer can grant to its employees has been increased 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 employees. Additionally, the maximum amount of the partially tax-exempt bonus has been increased from 25% to 30% of the beneficiary's gross annual remuneration, before incorporation of benefits in cash and in kind.

This employee profit-share regime is in addition to the favourable Luxembourg carried interest regime attracting investment fund executives to Luxembourg, notably private equity funds. In

summary, under the Luxembourg carried interest tax regime, applicable to individuals who are employees of AIFMs, the carried interest is categorised as miscellaneous income, in the sub-category speculative gains (ie, a form of capital gain) and not as employment income. The law then determines under what conditions these speculative gains are taxable at the progressive rate (the marginal tax rate being 45.78%, including the solidarity surcharge) or at a quarter of that rate, or are exempt as a long-term capital gain.

New bonus exemption for young employees

Effective from the 2025 tax year, Luxembourg has also introduced a new bonus exemption aimed at young employees under the age of 30 who conclude a first permanent employment contract in Luxembourg. The granting of the bonus is at the discretion of the employer and the exemption is correlated to the gross remuneration of the employee. The tax-exempt bonus amount decreases as the salary increases, and if the gross annual salary of the young employee exceeds EUR100,000, bonuses are no longer eligible for this new exemption regime.

The bonus exemption is granted for a maximum period of five years, and the benefit of this exemption is lost in case of employment change. This measure is designed to attract young talent to Luxembourg but also encourages stable employment.

Tax credit for cross-border workers

When employees working in Luxembourg are tax resident in a country with which Luxembourg has signed a double tax treaty and receive gross remuneration for overtime work for which the taxing right is attributed to Luxembourg, they may effectively be subject to tax in their state of residence on this overtime remuneration when

they are fully exempt on this remuneration in Luxembourg.

With retroactive effect from the 2024 tax year, Luxembourg has thus introduced a new over-time tax credit of a maximum of EUR700 per year for cross-border workers working in Luxembourg. This measure aims to provide compensation for the loss of income suffered by cross-border workers who are an important source of manpower for local employers. The tax credit is designed to maintain Luxembourg's attractiveness for cross-border workers.

New Tax Measures in Favour of Businesses and the Financial Centre

In 2024, several new tax measures designed to enhance the competitiveness of Luxembourg as a global fund centre were also adopted in favour of Luxembourg businesses in general and the Luxembourg fund industry in particular.

Corporate income tax rate cut

First, from 2025, Luxembourg has introduced a 1% cut in the corporate income tax rate, reducing it from 17% to 16% for taxable income exceeding EUR200,000 and from 15% to 14% for taxable income not exceeding EUR175,000. It also introduced an intermediate rate to smoothen the transition from the minimum rate of 14% to the maximum rate of 16% when taxable income is between EUR175,000 and EUR200,001.

The overall corporate income tax rate for companies located in Luxembourg City with taxable income exceeding EUR200,000 will therefore be 23.87% instead of the current 24.94% (including the solidarity surcharge and the municipal business tax in Luxembourg City). For small businesses, the rate will decrease from 22.80% in 2024 to 21.73% in 2025. This measure aims to strengthen the competitiveness of businesses

and to encourage investment, innovation, and job creation.

Subscription tax exemption for ETFs

Appearing in Europe really only a few years ago, and after its impressive growth in 2024, actively managed exchange-traded funds (ETFs) are rapidly gaining favour with European investors. Some analysts believe that the European active ETF market could expand to USD800 billion in assets under management by 2030.

Recently, Luxembourg shifted its focus towards this rapidly growing sector and introduced a subscription tax exemption for actively managed ETFs, effective from 1 January 2025 (ie, the first day of the quarter following the publication of the law implementing this exemption). This measure aims to promote the development and competitiveness of the ETF sector in Luxembourg. It is designed to improve the tax framework of Luxembourg-listed undertakings for collective investment in transferable securities (UCITS ETFs) and to preserve the position of Luxembourg as a leading centre for traditional investment funds.

Minimum net wealth tax amendments

Luxembourg amended its minimum net wealth tax (NWT) rules to make them compliant with the Luxembourg Constitution, following a ruling from the Constitutional Court stating that the previous regime introduced a non-justified difference of treatment between comparable taxpayers. To address this issue, the new minimum NWT rules remove the distinction based on the types of assets held by the company (ie, whether the company qualifies as a SOPARFI) and provide that the minimum NWT will amount to EUR535, EUR1,605, or EUR4,815, depending only on the size of the total balance sheet of the company. This measure aims to simplify the minimum net

wealth tax system and provide greater legal certainty.

Participation exemption regime

The new tax measures introduce the possibility for a corporate taxpayer to waive the benefits of the Luxembourg participation exemption for dividends and capital gains under certain circumstances. This option will be available where the conditions for the participation exemption are met solely by virtue of the threshold of the acquisition price of the shareholding (ie, if it is at least equal to EUR1.2 million in the case of dividends or EUR6 million in the case of capital gains). In other words, when the conditions for the exemption are met on the basis of a shareholding of at least 10%, it will not be possible to exercise this waiver. The limitation of the waiver to these cases is due to the constraints arising from the Parent-Subsidiary Directive and its interplay with the determination of the taxable base under Pillar Two principles.

The waiver aims to provide greater flexibility for certain entities and align with the participation exemption regime existing in other EU member states.

Luxembourg Pillar Two law

In late 2024, the Luxembourg law of 22 December 2023 implementing the EU Directive of 15 December 2022 on ensuring a global minimum level of taxation for multinational enterprise (MNE) groups and large-scale domestic groups in the Union, known as the Pillar Two Directive, was amended. The amendments incorporate clarifications, interpretations, and additional technical provisions resulting from the OECD/G20 Inclusive Framework on BEPS. These amendments aim to guide taxpayers on how to interpret and apply the rules of the Luxem-

bourg Pillar Two law and ensure compliance with OECD guidelines.

For the application of the “*deemed consolidation test*” under Pillar Two, the OECD Administrative Guidance clarified that certain investment entities (eg, under IFRS 10) that are exempt from line-by-line consolidation and that are merely required to fair value their investments (including where majority stakes are held in subsidiary companies) do not fall within the deemed consolidation rule – ie, such entities do not qualify as parent entities of a group. The commentaries to the Luxembourg Pillar Two law now confirm that Luxembourg-specific exemptions from consolidation for most investment funds based on the respective special laws such as for reserved alternative investment funds (RAIF), specialised investment funds (SIF) or companies in risk capital (SICAR) are consolidation exemptions comparable to the IFRS 10 investment entity exception. This clarification provides legal certainty for Luxembourg investment fund vehicles concerned.

The amended Luxembourg Pillar Two law also clarifies that an investment fund or real estate investment vehicle, which is not an ultimate parent entity for the sole reason that it is not required to prepare consolidated financial statements under the qualifying financial accounting standard or an accepted financial accounting standard, is to be assimilated to an excluded entity. This is intended to clarify that entities held by such investment fund or real estate investment vehicles in the sense of Pillar Two are to be considered excluded entities for the purposes of the Luxembourg Pillar Two law. However, such entities still must be taken into account for verifying whether the EUR750 million group’s annual turnover threshold is met.

In early 2025, the OECD confirmed that the Luxembourg law is considered qualified – ie, to comply with the OECD framework. The recognition of that qualified status is important for determining the order in which global minimum tax rules apply – ie, to ensure co-ordinated outcomes and provide tax certainty for MNE Groups. Additionally, this qualified status also confirms that Luxembourg can benefit from the qualified domestic top-up tax (QDMTT) Safe Harbour, which eases things for MNE groups established in Luxembourg. This allows these groups to perform the necessary QDMTT calculations solely at Luxembourg level, without needing to repeat them in the jurisdiction of the Ultimate Parent Entity – eg, for Income Inclusion Rule purposes.

Securitisation entities

The amended Luxembourg Pillar Two law clarifies that a Securitisation Entity is not excluded from the scope of the Luxembourg QDMTT, but it ensures that a Securitisation Entity that is “*constituent entity*” of MNE group cannot be designated as a top-tier Luxembourg constituent entity for the purposes of the QDMTT and provides that the potential top-up tax calculated for a Securitisation Entity is, in principle, allocated to other Luxembourg constituent entities of the group. However, in the absence of other Luxembourg constituent entities of the group, the Luxembourg QDMTT that has been determined for a Securitisation Entity is levied on that entity. Additionally, Securitisation Entities are exempt from the joint and several liability mechanisms.

On another aspect, Luxembourg also introduced the concept of “*single-entity group*”, exempt from the interest limitation rules, applicable from financial years beginning on or after 1 January 2024. The single-entity group complements the standalone entity exception, and its expected scope is the orphan securitisation structure to

which the standalone entity exception does not apply.

Clarification of the partial liquidation regime applicable to share class redemptions

The new Luxembourg tax measures clarify the tax treatment of share class redemptions under the partial liquidation regime. That regime was already confirmed by the Luxembourg case law, but Luxembourg now has a clear legal framework.

From now on, the Luxembourg law mentions that to be treated as a partial liquidation not subject to Luxembourg withholding tax, the redemption or withdrawal of a class of shares or corporate units must meet the following cumulative conditions:

- The redemption or withdrawal must relate to an entire class of shares or corporate units.
- The classes of shares or corporate units must have been set up at the time of the incorporation or capital increase of the undertaking.
- Each class of shares or corporate units must have distinct economic rights, defined in the undertaking’s articles of association, from those of the other classes of shares or corporate units. A distinct economic right is characterised by a specific right in relation to the rights of other classes of shares or corporate units, such as shares giving entitlement to reference dividends, securities giving an exclusive right to the profits of a specific or determinable period, or securities whose respective financial rights are linked to the performance of one or more direct or indirect assets or activities of the entity.
- The redemption or withdrawal price of a class of shares or corporate units must be determined based on criteria laid down in the undertaking’s articles of association or any

other document referred to in those articles of association, reflecting the estimated market value of the said class of shares or shares at the time of redemption or withdrawal.

The clarification provides greater legal certainty for fund managers and investors by clearly defining the conditions under which the redemption or withdrawal of a class of shares or corporate units will be treated as a partial liquidation. This ensures that fund managers can confidently structure funds and share classes in a way that complies with Luxembourg tax laws, reducing the risk of unexpected tax liabilities. The clarification allows fund managers to invest in classes of shares with distinct economic rights, tailored to the specific needs and preferences of different investors. This flexibility in fund structuring can enhance the appeal of Luxembourg-domiciled funds and their underlying platforms to a broader range of investors, including those seeking specific investment strategies or risk profiles.

The clarification of the partial liquidation regime applicable to share class redemptions enhances the attractiveness of Luxembourg as a domicile for investment funds by providing legal certainty, tax efficiency, flexibility in fund structuring, and a competitive advantage in the global fund industry.

Modernisation of the Luxembourg Tax Procedure

The Luxembourg government is working to introduce measures to modernise the tax procedure, including the digitalisation of the tax procedure, administrative co-operation, and the tax recovery procedure. Luxembourg seems committed to simplifying the direct tax procedure for the tax authorities and providing greater legal certainty for taxpayers.

Conclusion

Luxembourg continues to be a prime destination for talent and investment in the financial industry. The government's proactive approach in implementing initiatives for talent attraction and introducing new tax measures has further strengthened Luxembourg's position as a leading global financial hub. As these trends and developments continue to evolve, Luxembourg is well-positioned to maintain its competitive edge in the global financial market.

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