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Luxembourg: Trends & Developments

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Trends and Developments

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20 YEARS ATOZ TAX ADVISERS LUXEMBOURG

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Introduction

Over the past few years and months, despite the economic impact of the COVID-19 crisis, the Luxembourg government has done its best to continue to introduce measures aiming to ensure that Luxembourg remains a suitable jurisdiction for the management of private wealth and, more generally, for setting up investment platforms. Since talent is a key asset of investment platforms and significantly contributes to the growth of the Luxembourg economy, attracting and retaining talent was defined as one of the top priorities of the previous government and remains on the agenda of the new government, as reflected in its 2023-2028 coalition agreement. Targeted tax measures have been introduced (impatriate regime, profit-sharing bonus), which have been improved over time and are expected to be improved again in the near future.

Access to housing is also an important issue in Luxembourg, not only for Luxembourg citizens but also for attracting foreign talent to Luxembourg. Making housing more accessible by means of various tax measures is the main purpose of a major real estate taxation reform, which is still ongoing after the release of a draft law 18 months ago and is expected to be relaunched by the new government by the end of this year. In the meantime, a law has been adopted which introduces temporary tax measures to increase the supply of housing and support people in purchasing or renting accommodation, but which also offers opportunities for individuals who want to manage their private wealth.

Tax certainty is also a big challenge for taxpayers in an environment of ever increasing complexity, which has de facto led to increased litigation in recent years. To make the rules applicable to the tax procedure clearer and make the tax procedure more accessible for taxpayers, the new government is expected to relaunch and improve an ongoing reform by the end of the year.

Making the taxation of individuals fairer is also an objective of both the former and the new government, and a reform of the tax scale system for individual taxpayers is on the agenda in order to achieve this objective in the medium-long term. Some other measures can be expected in the coming months and years, which the government has committed to implement in its coalition agreement. Lastly, tax measures related to individuals, such as the potential introduction of a net wealth tax for individuals or a direct inheritance tax, have been debated politically over the past few months but there is currently no plan, neither in the short nor in the long term, to take any action in these areas.

Targeted Measures to Attract Talent

In line with its 2023-2028 coalition agreement released in November 2023, on 17 July 2024, the Luxembourg government presented to Parliament a new draft law (the “Draft Law”) which improves the employee profit share (*prime participative*) and the impatriate regime to support the recruitment and retention of talent in Luxembourg. The government also intends to introduce measures aiming at encouraging employee participation in the capital of the companies that employ them.

Employee profit share (prime participative)

With effect from tax year 2021, a profit share scheme has been introduced for employees which is 50% exempt from Luxembourg income tax, provided the two following conditions/limitations are met:

- 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
- the amount of profit share paid by the employer to the employee does not exceed 25% of the gross annual salary (excluding the amount of profit share) of the employee concerned.

The 2023 Budget Law amended the profit share regime in order to take into account the situation of groups which are consolidated for tax purposes. While the amendment introduced by the 2023 Budget Law was welcomed by market players, several improvements were still needed in order to make the regime less restrictive. Given the objective defined by the new government of supporting the recruitment and retention of talent in Luxembourg, it is expected that the scope of application of the regime will be extended in the near future to make it applicable in an increased number of situations, thereby making it more attractive.

To this end, with effect from tax year 2025, the Draft Law proposes to increase the threshold related to the accounting profits of the employer from 5% to 7%, meaning that the total amount of profit share, which an employer can grant to its employees under the partial exemption regime, will be increased. In addition, the Draft Law aims to increase the maximum amount of partially exempt profit share from 25% to 30% of the beneficiary's gross annual salary of the employee concerned. The other conditions of the regime remain unchanged.

Impatriate regime

With effect from tax year 2021, the tax regime for impatriates was amended and incorporated into the Luxembourg Income Tax Law (ITL) (the regime was governed by an administrative circular until 2020).

Based on the impatriate regime currently in force, subject to certain conditions and limitations, certain costs borne by the employer for the relocation and installation of impatriates in Luxembourg are tax exempt. In addition, employers can grant a 50% exemption of the impatriate premium to their employees if certain conditions are met. The regime is available for up to eight tax years. To benefit from the partial exemption regime, the premium cannot exceed 30% of the annual remuneration of the impatriate. In addition, based on the regime in force in 2021, the impatriate had to receive a minimum annual salary of EUR100,000.

To extend the scope of application of the impatriate regime and make it more attractive, with effect from 2023, the 2023 Budget Law reduced the minimum annual salary threshold from EUR100,000 to EUR75,000, thereby allowing more impatriates to benefit from the regime.

Here again, while this amendment was positively received, additional improvements were still needed to make the regime more attractive. For this purpose, the government now proposes to replace the current impatriate regime with a simplified new flat-rate system: with effect from tax year 2025, instead of both an exemption of certain costs borne by the employer and the 50% exemption of the impatriate premium, the Draft Law provides for one single tax exemption of 50% of the gross annual salary (before incorporation of benefits in kind and exempt benefits in cash) of impatriates, which would be capped at EUR400,000.

Most conditions and limitations applicable under the current regime would still apply, such as the minimum annual remuneration of EUR75,000 required to benefit from the regime. Based on the Draft Law, impatriates who currently benefit from the impatriate regime would still remain subject to the "old" regime from 2025, unless they opt to be subject to the new regime.

Tax Treatment of Share Class Redemptions Clarified

On 23 May 2024, a draft law was presented to Parliament which amends Article 101 of the ITL in order to clarify (based on recent case law) the tax treatment of share class redemptions.

Based on the draft law, when a participation in a corporate entity, including classes of shares, is repurchased or withdrawn, and there is a corresponding capital reduction within a short period of time not exceeding six months from the date of the repurchase or withdrawal, the net assets of that entity are deemed to be divided up for the units corresponding to the said participation or class of shares (ie, the redemption or withdrawal qualifies as a partial liquidation).

For the purposes of the application of the partial liquidation regime to share classes, the repurchase or withdrawal of a class of shares must simultaneously meet the following conditions:

- the redemption or withdrawal relates to an entire class of shares;
- the classes of shares are created at the time of the incorporation or upon capital increase of the undertaking;
- each class of shares has economic rights, defined in the undertaking's articles of association, distinct from those of the other classes of shares; and
- the redemption or withdrawal price of the class of shares may be determined on the basis of criteria laid down in the undertaking's articles of association, or in any other document reference is made to in these articles of association, and reflecting the fair market value of the said class of shares at the time of redemption or withdrawal.

A redemption of classes of shares meeting the above conditions will be considered as a partial liquidation within the meaning of Article 101 of the ITL so that the redemption proceeds will be treated as a capital gain and not as a dividend distribution potentially subject to Luxembourg withholding tax. However, the Luxembourg general anti-abuse rule of Section 6 of the Luxembourg Adaptation Law remains applicable in the case of abuse of law.

Where the redemption or withdrawal concerns a class of shares held directly by an individual with a substantial participation in the Luxembourg resident undertaking in question, the latter will have to provide, as part of its annual income tax return, information enabling the identification of the individual.

Tax Measures to Support Luxembourg Real Estate Investments

The Law of 22 May 2024 (the "Law") introduces various measures which have been designed to boost the construction sector that can offer opportunities and advantages for individuals looking to manage their private wealth too. The package of measures includes temporary tax measures, which will only apply in 2024, as well as other tax measures, which will apply for an unlimited period of time.

Tax measures favourable for real estate investments, applicable for 2024 only

New Bëllegen Akt tax credit for investments in rental properties

In addition to a temporary increase of the so-called *Bëllegen Akt* tax credit available to individuals for the purchase of real estate intended for residential use from EUR30,000 to EUR40,000 per individual, a new *Bëllegen Akt* tax credit for investments in rental properties is being introduced. The amount of this tax credit is set at EUR20,000 per individual acquirer. It is intended solely for sales by future state of completion (*ventes en état future d'achèvement*) documented by notarial deeds executed between 1 January 2024 and 31 December 2024. This tax credit can be used for several acquisitions during 2024 but the cumulative amount cannot exceed EUR20,000. The scope of this measure is not limited to Luxembourg residents. To qualify for this new tax credit, the purchaser must undertake to rent out the property for a minimum period of two years, except in cases of force majeure, and the property must be effectively occupied within four years following the date of the notarised deed of acquisition. Since the new tax credit is being introduced in the course of the year, purchasers are allowed to request retroactive application, provided certain formal conditions are met.

Temporary decrease to ¼ of the global rate of the tax rate applicable to non-speculative real estate gains

Under Luxembourg tax law, capital gains realised by individual taxpayers on real estate assets are taxed either at the marginal rate if the gain is speculative (ie, if the assets are sold within a two-year period following their acquisition) or at a rate corresponding to half of the global rate (ie, average rate resulting from the taxation of all the taxpayer's income) if the gain is non-speculative (ie, if the assets are sold more than two years after their acquisition). These provisions do not apply to the extent that the property sold is the taxpayer's principal residence.

In order to mobilise properties, the Law provides that the tax rate for non-speculative capital gains realised on the sale of built and unbuilt real estate property forming part of the private assets of individuals in 2024 are temporarily reduced to ¼ of the global rate. For the purpose of determining the temporal applicability of this measure, net income is taxable in the year of disposal of the real estate property, regardless of the date of payment of the sale price. The realisation date is the date of the notarial deed, the date of the judicial ruling in lieu thereof or the date of the administrative deed in lieu thereof.

To accelerate the incentive effects of the ¼ rate measure in 2024 and to curb speculation, the Law also amends, with effect from tax year 2025, the deadline within which a real estate alienation is considered as speculative and extends it from two years to five years. Thus, as from 2025, any gain realised by an individual upon the sale of a real estate asset will be considered as speculative and taxed at the marginal rate if it is realised within five years following the acquisition of the asset.

Fiscal neutralisation of non-speculative capital gains transferred to property used for social rental management or with a class A+ energy performance

The Law introduces a new tax neutral regime for non-speculative capital gains transferred to specific replacement assets. Non-speculative capital gains realised on real estate during tax year 2024 and reinvested in one or more properties used for social rental management purposes (*gestion locative sociale*), or in accommodation with a class A+ energy performance, are eligible for the tax neutral regime under certain conditions.

Increase of the rate and the duration of accelerated depreciation for real estate investments allocated to rental properties

The Law re-introduces, in terms of the amount and duration of application, a deduction – subject to a ceiling – in the depreciation rate of 6% for a period of six years and for eligible buildings or parts of buildings. The properties in its scope are those which are built for rental purposes and for which the taxpayer has signed a deed of sale in the future state of completion between 1 January 2024 and 31 December 2024. The maximum annual amount that can be deducted in this respect is capped at EUR250,000. This amount is reached when the allowance is calculated on depreciable values of EUR6,250,000. The measure is granted for a maximum of seven tax years.

Tax measures favourable for real estate investments, as from 2024 for an unlimited period of time

As from 2024 and for an unlimited period of time, the Law increases the exemption for net income earned from rental properties through organisations involved in social rental management from 75% to 90%.

The Law also extends the exemption of capital gains (speculative or not) realised by individuals upon the sale of real estate properties (previously, the exemption only applied to sales to the State, municipalities and local authority associations) to capital gains (speculative or not) realised by individuals upon the sale of real estate properties to the Housing Fund (*Fonds du Logement*).

Tax Measures Contained in the Real Estate Tax Reform Pending Before Parliament

On 10 October 2022, a major property tax reform was launched to modernise property tax and introduce two new taxes to mitigate the increasing housing shortage in Luxembourg.

The draft law introduces, for property tax (*impôt foncier*, IFON) purposes, a new valuation model for properties that is designed to be more objective, transparent and fair. It also introduces a tax on the mobilisation of land (*impôt à la mobilisation de terrains*, IMOB), whose purpose is to encourage the effective construction of housing on building land. In parallel, the introduction of a national tax on the non-occupation of housing (*impôt national sur la non-occupation de logements*, INOL) is set to mobilise existing unoccupied housing.

While the deadlines for implementing the reform (ie, on the first day of the first month of September following the completion of 24 months from the publication of the law) does not correspond to the emergency experienced by people seeking to find housing in Luxembourg, the daft law is still pending before Parliament almost two years after its release. However, the Luxembourg government has announced that this project will move forward before the end of the year, meaning that the draft law will most probably be subject to major amendments in the near future in order to respond to the various criticisms raised during the legislative review process. Thus, how the final reform will look remains to be seen.

Modernisation of the Tax Procedure to Increase Tax Certainty for Taxpayers

The Luxembourg government plans to reactivate the draft law aiming at modernising the tax procedure, which was presented to Parliament on 28 March 2023 and has still not been adopted.

Some of the proposals made in the draft law were positive as they would bring more certainty for taxpayers, for example:

- implementation of a procedure to obtain an advance bilateral/multilateral agreement on transfer pricing;
- clarification of the transfer pricing documentation to be provided to the tax administration (LTA) as part of the co-operation duty of taxpayers; and
- clarifications of the formal conditions for initiating a tax claim (*réclamation*) before the director of the LTA.

However, the draft law also raised a lot of criticism from many stakeholders and the State Council made formal objections on many aspects of the proposals. Practically speaking, the draft law would ease the duties of the tax authorities or relieve the tax authorities' congestion (ie, obligation to file an appeal before the Administrative Tribunal within a certain deadline in the case of silence from the director; a 10% threshold to limit the right to file a tax claim in the case of automatic estimated taxation (*taxation d'office*)) rather than increase tax certainty for taxpayers. Since criticism came, among others, from members of the Parliament who are now representatives of the leading political party since the 2023 elections, it is expected that major changes will be introduced by the government, potentially by means of a new draft law, to introduce measures increasing tax certainty for taxpayers. For this purpose, on 18 July 2024, the March 2023 draft law was transformed into two new draft laws (unreleased at the time of writing of this article) reportedly with the aim of accelerating the digitalisation of the tax procedure in Luxembourg.

Individual Taxation Trends Identified in the 2023-2028 Coalition Agreement

According to the 2023-2028 coalition agreement, the government commits not to introduce a personal wealth tax or a direct inheritance tax. The government will also analyse the taxation of inter vivos gifts with the aim of facilitating the transmission of assets in direct line.

The government commits to carrying out a major tax reform in order to implement a single tax scale. This project was introduced by the former government but never materialised; it was first delayed due to the COVID-19 pandemic and ultimately shelved when inflation and the energy crisis hit. Now, the new government plans to present a draft law establishing the single tax scale by 2026. Before then, tax class 1A – which applies to single parents, widows and widowers – will be reviewed to reduce the tax burden of single earners. The government is opposed to the idea of increasing the maximum tax rates for the highest income brackets.

The deductibility of special expenses and extraordinary charges will be made more advantageous and flexible, including the tax treatment of supplementary old-age pensions.

The government will study ways of clarifying and simplifying the tax treatment of benefits in kind granted by companies to their employees.

It further plans to introduce a tax scheme to encourage investment by individuals in young innovative companies in the field of the dual sustainable and digital transition.

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