Unconstitutionality of the minimum net wealth tax regime for companies holding predominantly financial assets: consequences

OUR INSIGHTS AT A GLANCE

- On 10 November 2023, the Constitutional Court concluded that the minimum net wealth tax regime for companies holding predominantly financial assets is unconstitutional.
- Pending a potential legislative reform, taxpayers subject to minimum net wealth tax applicable to companies considered as SOPARFIs for minimum net wealth tax purposes should be subject to the minimum net wealth tax applicable to Non-SOPARFIs whenever this is more favourable.
- The facts leading up to the reference for a preliminary ruling, as well as the Court's reasoning and the consequences of such ruling, are analysed hereafter.

On 10 November 2023, the Constitutional Court (the "**Court**") concluded that the minimum net wealth tax regime ("**minimum NWT**") for companies holding predominantly financial assets is unconstitutional (n° 00185).

As a consequence, a legislative reform of the minimum NWT is possibly to be expected.

Pending the potential reform, taxpayers subject to minimum NWT applicable to companies considered as SOPARFIs for minimum NWT purposes should be subject to the minimum NWT applicable to Non-SOPARFIs whenever this is more favourable.

The facts leading up to the reference for a preliminary ruling, as well as the Court's reasoning and the consequences of such ruling, are analysed below.

Background

The minimum NWT provides that Luxembourg resident companies are, in principle, subject to a minimum NWT which is generally determined according to the nature and size of their balance sheet.

For purposes of determining the amount of minimum NWT due, the Luxembourg NWT law makes a distinction between, on the one hand, companies whose accounts 23, 41, 50 and 51 of the Luxembourg standard chart of accounts (i.e. financial assets, amounts owed by affiliated companies, transferable securities and cash at bank, hereafter referred to as the "**qualifying assets**") exceed both (i) 90% of their total balance sheets and (ii) a threshold of EUR 350,000 ("**SOPARFIs**"), and, on the other hand, the other companies ("**Non-SOPARFIs**"). Usually, holding companies meet the conditions to be treated as SOPARFIs for NWT purposes.

A fixed amount of minimum NWT of EUR 4,815 applies to "SOPARFIs". For the socalled "Non-SOPARFI" companies, the amount of minimum NWT is progressive and can range from EUR 535 to EUR 32,100 depending on the value of their total balance sheets.

In the case leading to the reference for a preliminary ruling, a corporate taxpayer, treated as a SOPARFI under NWT legislation, considered they were discriminated because the NWT provision which sets a minimum wealth tax of EUR 1,605 for a Non-SOPARFI with a total balance sheet greater than EUR 350,000 and less than or equal to EUR 2,000,000 is more favourable than the minimum flatrate tax of EUR 4,815 provided for a SOPARFI with a total balance sheet of more than EUR 350,000.

As a result, the taxpayer decided to appeal against the tax assessments before the Administrative Tribunal on the basis of the differential treatment between companies of equal size solely due to the criterion of the composition

of their balance sheet. In a judgement dated 18 April 2023 (n° 45910), the Administrative Tribunal referred the question of whether the difference in treatment between SOPARFIs and Non-SOPARFIs with regard to minimum NWT complies with article 10bis of the Luxembourg Constitution (i.e. the principle of equality before the law) to the Court.

Ruling of the Constitutional Court

On 10 November 2023, the Court concluded that the minimum NWT applicable to SOPARFIs (§8, (2), (a) VStG) is contrary to article 10bis, §1 of the Constitution (article 15 of the new Constitution applicable as from 1 July 2023).

In the opinion of the Court, the question of the differential treatment raised to its attention by the Administrative Tribunal is not solely based on the 90% threshold, since this is not the cause of the difference in tax regime for taxpayers (i.e. application of either the progressive or flatrate amount of minimum NWT). What distinguishes taxpayers exceeding the 90% threshold is the condition related to the threshold of EUR 350,000 because it is only when accounts 23, 41, 50 and 51 of the standard chart of accounts exceed the 90% threshold in relation to their total balance sheets that taxpayers are distinguished by the addition of the condition relating to the EUR 350,000 threshold.

The Court ruled that the minimum NWT provisions result in a differential treatment between taxpayers in comparable situations. The Court recalled that the legislator may, without violating article 10bis, §1 of the Constitution (i.e. the constitutional principle of equality), subject certain categories of persons to different legal regimes, provided that the difference instituted arises from objective disparities, that it is rationally justified, appropriate and proportionate to its aim.

In the case at hand, the Court noted that no justification could be provided by the government representative or inferred from the parliamentary documents for the differential treatment established and is thus to be regarded as not being rationally justified a priori, to the extent the threshold of EUR 350,000 is concerned.

Furthermore, the Court recalled that the principle of equality before the law is applied in tax matters through the principle of contribution according to the taxpayer's ability to pay. According to the Court, distinguishing between the taxpayers considered as SOPARFIs and Non-SOPARFIs by adding a second criterion based on the threshold of EUR 350,000 fails to take account of the taxpayers' ability to pay.

- **Critical analysis of the reasoning of the Court**

This ruling and the reasoning of the Court raises questions, notably due to a very light and lacunar motivation.

The preliminary ruling referred to by the Administrative Tribunal raised a question related to differential treatment between companies with balance sheets of equal size, and thus comparable, but falling under the scope of the minimum NWT of SOPARFIs or Non-SOPARFIs, the latter being more favourable, solely based on the criterion of the nature of their balance sheets (i.e. the 90% threshold). However, the Court considered, without explaining why it decided to change the comparability criteria to perform its analysis, that companies in a comparable situation were the ones reaching the 90% threshold but treated as SOPARFIs or Non-SOPARFIs whether or not the EUR 350,000 threshold was reached.

As a result, whilst seemingly not calling into question the difference made between SOPARFIs and Non-SOPARFIs based on the 90% threshold criteria (which was at the origin of the question raised by the Administrative Tribunal), the Court found that the additional condition relating to the EUR 350,000 threshold is the criteria making a distinction between taxpayers (and not the 90% threshold criteria).

This change in the comparability criteria between companies is not neutral. Indeed, the taxpayer initially compared companies with a total balance sheet between EUR 350,000 and EUR 2,000,000 on the basis that they reached the 90% threshold, and were thus subject to a minimum NWT of EUR 4,815, or not, thus being subject to a minimum NWT of EUR 1,605. Differently, the Court compared companies reaching the 90% threshold based on the fact that they

reached the EUR 350,000 threshold, and were thus subject to the minimum NWT of EUR 4,815, or not, thus being subject to a minimum NWT of EUR 535 if their total balance sheet was equal to or below EUR 350,000 or EUR 1,605 if the value of their total balance sheet was between EUR 350,000 and approximately EUR 389,000 depending on the percentage of qualifying assets they held (between 100% and 90%, in a manner that is inversely proportional)[1].

According to the Court, no justification was given by the State counsel or could be inferred from the parliamentary documents for the reference to this EUR 350,000 threshold as a criterion distinguishing taxpayers and thus the distinction made between taxpayers based on this threshold is to be looked at as not legally justified *a priori*.

This statement is surprising as in the parliamentary documents related to the law that introduced as from 2015 the EUR 350,000 criterion, it is stated that, "*In the absence of this criterion, small and medium-sized companies that are newly created or in liquidation regularly find themselves in the scope of the minimum IRC* tax [Author's note: the minimum corporate income tax has meanwhile been abolished and replaced by the minimum NWT] *of EUR 3,000* [Author's note: meanwhile increased to EUR 4,815] *because their total financial assets exceed 90% of the balance sheet total. This bill therefore proposes to refine the eligibility criteria to the EUR 3,000 tax rate by excluding entities whose total financial assets are less than or equal to EUR 350,000"*[2] (unofficial translation). It can thus be rather clearly inferred from this that the aim of the legislator was to exclude small and medium entities from the scope of the flat tax rate applicable to SOPARFIs, notably because of their more reduced ability to pay.

The Court finally added that in distinguishing entities that are a priori SOPARFIs (because they reach the 90% threshold) based on the EUR 350,000 threshold, the legal provision disregards the ability to pay taxes of targeted taxpayers.

Again, this conclusion seems counter-intuitive. We have indeed seen that the Court compared companies reaching the 90% threshold, and are thus either subject to the minimum NWT of EUR 4,815 if they reach the EUR 350,000 threshold or subject to a minimum NWT of EUR 535 or EUR 1,605 if the value of their total balance sheets is equal to or below EUR 350,000. Yet, if the ability to pay taxes is not taken into consideration in the same way as it is provided for Non-SOPARFIs (i.e. not based on a progressive scale), the EUR 350,000 threshold makes a distinction between small and medium entities and larger entities, the former paying a lower amount of minimum NWT and the latter paying more (i.e. the flat rate of EUR 4,815). Therefore, to a certain extent, the ability to pay taxes of entities is taken into account, and based on the parliamentary documents, this seems to have been the intention of the legislator.

Consequently, it is not clear without further explanations in the ruling why the Court considers that the EUR 350,000 criterion fails to take account of the taxpayer's ability to pay[3]. Indeed, the fact that the legislator decided to treat a taxpayer that is a priori a SOPARFI because it reaches the 90% threshold of qualifying assets, but is a small company because the value of these assets does not reach the threshold of EUR 350,000, in the same way as a small Non-SOPARFI (total balance sheet below a certain amount), precisely takes into consideration the taxpayers's ability to pay and thus seems to be justified.

The Court concluded that the legal provision applicable to SOPARFIs and providing for a flat tax of EUR 4,815 is unconstitutional because the EUR 350,000 threshold it

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[1] All the other entities with a total balance sheet higher than approx. EUR 389,000 and reaching the 90% threshold are indeed subject to the minimum NWT due by SOPARFIs (because 90% of approx. EUR 389,000 = EUR 350,001).

[2] Projet de loi concernant le budget des recettes et des dépenses de l'Etat pour l'exercice 2015, Commentaire des articles, n°6720, session ordinaire 2014-2015, p. 72 : " En l'absence de ce critère, les petites et moyennes entreprises qui viennent d'être constituées ou qui sont en liquidation tombent régulièrement sous l'I.R.C. minimum de EUR 3,000 parce que le total de leurs actifs financiers dépasse 90% du total du bilan. Le présent projet de loi propose dès lors d'affiner le critère de l'assujettissement au tarif de EUR 3,000 en excluant les collectivités, dont la somme des actifs financiers est inférieure ou égale à 350.000 euros ".

[3] " En distinguant les contribuables visés aux points a) et b) par l'ajout d'un second critère au point a) reposant sur le dépassement de la somme de 350.000 euros par les comptes 23, 41, 50 et 51 du plan comptable normalisé, ladite disposition méconnaît la faculté contributive des contribuables y visés ".

refers to is not rationally justified. As a result, according to the Court, pending a legal reform, taxpayers subject to minimum NWT applicable to companies considered as SOPARFIs for minimum NWT purposes should be subject to the minimum NWT applicable to Non-SOPARFIs whenever this is more favourable. In practice, entities concerned are only the ones that are a priori SOPARFIs because they reach the 90% threshold and have a total balance sheet between EUR 350,000 and EUR 2,000,000.

- **Transposition of the issue to other cases**

Since the Court did not clearly answer the point raised by the Administrative Tribunal, the question remains open as to whether the 90% threshold criteria which differentiates taxpayers with a total balance sheet of the same value is legally justified. In other words, the questions as to whether these two categories of taxpayers are in comparable situations and, if they are in a comparable situation, as to whether the different treatment applied to them is legally justified have not been resolved.

As a consequence, given that it is not clear whether the 90% threshold raises an issue from a constitutional point of view, the argument of the taxpayer leading to the preliminary ruling request of the Administrative Tribunal could be transposed to other cases. Such argument could be transposed notably to the case of Non-SOPARFIs with a total balance sheet above EUR 2,000,000 compared to SOPARFIs with the same amount of total balance sheet because the minimum NWT payable by the Non-SOPARFIs would in such case be (much) higher according to the progressive scale than the minimum NWT payable by the SOPARFIs, while it could still be argued that both taxpayers are in a comparable situation.

Consequences of the unconstitutionality of the minimum net wealth tax regime

In light of this decision, taxpayers subject to minimum NWT applicable to SOPARFIs should be subject to the minimum NWT applicable to Non-SOPARFIs whenever this is more favourable.

- **Effect of the ruling on cases pending before a court or in which appeals are still possible**

According to the recently introduced[4] article 95*ter*, §6 of the Constitution (article 112, §8 of the new Constitution applicable as from 1 July 2023), "*the provisions of laws declared to be unconstitutional by a ruling of the Constitutional Court cease to have legal effect on the day following the publication of that ruling in the form laid down for the law, unless the Constitutional Court has ordered another period. The Constitutional Court shall determine the conditions and limits under which the effects that the provision has produced may be called into question*" (unofficial translation[5]).

In the present case, the ruling was published in the Official Journal of the Grand-Duchy of Luxembourg on 20 November 2023 and contains no indication of the Court's intention to defer its effects. Consequently, the ruling has had legal effect as from 21 November 2023.

This new provision of the Constitution confers general and absolute effect (*erga omnes*) to the rulings of the Constitutional Court. This means that the tax authorities on the one hand and the administrative courts on the other are bound to respect the consequences of the preliminary ruling given by the Constitutional Court.

The parliamentary documents in relation to this new provision of the Constitution state that "*there can be no*

[4] Loi du 15 mai 2020 portant révision de l'article 95ter de la Constitution, Journal officiel du Grand-Duché de Luxembourg, 15 mai 2020 (entered into force on 19 May 2020).

[5] " Les dispositions des lois déclarées non conformes à la Constitution par un arrêt de la Cour Constitutionnelle cessent d'avoir un effet juridique le lendemain de la publication de cet arrêt dans les formes prévues pour la loi, à moins que la Cour Constitutionnelle n'ait ordonné un autre délai. La Cour Constitutionnelle détermine les conditions et limites dans lesquelles les effets que la disposition a produits sont susceptibles d'être remis en cause ".

retroactive effect on fixed legal situations, but the ruling may have an effect on cases pending before a court or in which appeals are still possible"[6]. As a result, an analysis of the practical consequences of this ruling on taxpayers should be made on a case-by-case basis.

- **Which (potential) legislative reform is to be expected?**

By describing the effects of its ruling "pending a legal reform to come"[7], the Court seems to invite the legislator to modify the legal provision at stake, but the legislator is, in theory, not obliged to reform the minimum NWT regime. Various scenarios are possible.

First, as the rulings of the Constitutional Court now have a general and absolute effect, the tax authorities and administrative courts are bound to respect the consequences of such ruling (see above). Therefore, if the legal provision is not modified, it should not have any material adverse consequences for taxpayers.

Second, the legislator could simply remove the EUR 350,000 threshold (which is considered as being problematic according to the Court). As a result, a SOPARFI subject to the flat tax would be an entity meeting the 90% threshold only. Nevertheless, the impact of such modification would be to increase the minimum NWT due by entities that are currently not considered as being SOPARFIs because they do not reach the EUR 350,000 threshold and are thus currently paying either EUR 535 or EUR 1,605 minimum NWT depending on the value of their total balance sheets.

In this case, the decision of the Court would result in an increase of the tax bill for "smaller" taxpayers with a lower ability to pay taxes (i.e. with a total balance sheet below approximately EUR 389,000), which seems to contradict the reasons why this threshold was originally introduced in 2015 (see above). Such modification of the law would, in addition, have a very different result compared to the one prescribed by the ruling itself. Indeed, according to the ruling, only entities that are *a priori* SOPARFIs because they reach the 90% threshold and have a total balance sheet between EUR 350,000 and EUR 2,000,000 are affected by the unconstitutionality and should thus benefit from the most favourable of the two minimum NWT rates.

Finally, the legislator could also modify the provision differently and take the opportunity of a debate over the minimum NWT to analyse its effects on the competitiveness of Luxembourg and, as a result, potentially abolish the minimum NWT regime.

Our teams will continue to monitor closely further developments related to this topic. Please do not hesitate to contact us if you have any questions about the impact of this ruling on your company. In light of this decision, actions to be taken should be analysed on a case-by-case basis.

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[6] Procès-verbal de la réunion du 23 mai 2019 de la Commission des Institutions et de la Révision constitutionnelle, session ordinaire 2018-2019, p. 3.
[7] "En attendant une réforme législative à intervenir et en vue de garder le système opérationnel, il y a lieu d'appliquer au contribuable visé par l'alinéa 2, du paragraphe 8 VStG tombant a priori sous le point a) l'impôt sur la fortune minimum visé par le point b) chaque fois que celui-ci est plus favorable."