Analyzing the contemplated 2017 Corporate Tax Reform : The Good, The Bad and The Ugly

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On 29 February 2016, the Luxembourg Government presented the contemplated changes to the Luxembourg corporate tax system which should be implemented in 2017. The main changes comprise (i) a reduction of the corporate income tax rate, (ii) an increase of the minimum net wealth tax and (iii) limitations to the use of tax losses incurred as from 2017. This article provides a clear and concise overview of these measures and analyses their impact on the competitiveness of Luxembourg as a location of choice for the structuring of international business activities and investments.

I. Introduction

The tax reform comes at a time where the international tax landscape is characterized by extreme uncertainty. On 5 October 2016, the OECD released their final reports on the OECD Base Erosion and Profit Shifting (BEPS) Project which provide for recommendations as to how individual countries should amend their domestic tax laws.

On 28 January 2016, the European Commission presented its Anti-Tax Avoidance Package that aims at the implementation of a number of BEPS measures. One of the core pillars of this package is a Draft EU Anti-Tax Avoidance Directive proposing anti-tax avoidance rules which are meant to be implemented by each EU Member State. In addition, individual countries around the globe started implementing unilateral tax measures aiming at tackling perceived tax avoidance.

In this environment, it is important for Luxembourg to remain attractive for multinational enterprises and international investors. Today, Luxembourg is a financial centre (with a strong fund and banking sector) and a prime holding location.

The competition between European countries for international investments did, however, not decrease over the last years. Whether or not the current proposals would improve the competitiveness of the Grand Duchy is analyzed in the following sections.

II. Analysis of the contemplated tax measures

1. Decrease of the corporate income tax rate

1.1. Proposed measure

The corporate income tax rate is proposed to be reduced in two steps from 21% to 19% (in 2017) and from 19% to 18% (in 2018). The proposed measures do neither foresee a change of the 7% solidarity surcharge levied on the corporate income tax nor a change to the municipal business tax rate due by companies (6.75% in Luxembourg-City). Accordingly, the aggregate corporate tax rate applicable to companies established in Luxembourg-City would be decreased from currently 29.22% to 27.08% (in 2017) and 26.01% (in 2018).

Small and start-up companies with a taxable income which does not exceed EUR 25.000 would benefit from a reduced corporate income tax rate of 15%. Thus, the aggregate corporate tax rate for these companies would be 22.08% in Luxembourg City (including solidarity surcharge and municipal business tax).

1.2. Impact analysis

The corporate tax rate is an important feature of a corporate tax system. Whenever business leaders compare jurisdictions, the tax rate is one of the key criteria that is taken into account. This is hardly surprising given that tax laws are very complex and decision makers are usually not tax experts.

With an aggregate tax rate of currently 29.22% (in Luxembourg City), Luxembourg has currently rather a high tax rate. Other European countries which are competing with Luxembourg for foreign investments have lower tax rates. The most prominent examples include:

Malta:	10% (effective tax rate after tax refund to the shareholder)
Cyprus:	12.5%
Ireland:	12.5%
United Kingdom:	20% (to be decreased to 18%)
Switzerland:	25%
The Netherlands:	25%

In the authors' view, the Luxembourg Government should take a bold step and cut the corporate tax rate more significantly. Even a reduction of the corporate income tax rate by 10% should be considered. This would be a clear signal to international investors that Luxembourg will remain attractive in the post-BEPS era which will be characterized by more harmonized tax rules.

When considering such a measure, the question arises as to how a decrease of the corporate tax rate may impact the Luxembourg tax revenue. The impact of a decrease of tax rates on tax revenues has been analysed in various studies.(1) All these studies come to the conclusion that a fall of corporate tax rates would not give rise to a decrease in corporate income tax revenues relative to GDP. This should encourage the Luxembourg Government to take a step that is more courageous than the small decrease that is currently proposed.

2. Increase of minimum net wealth tax

2.1. Proposed measure

Since 1 January 2016, Luxembourg companies having their statutory seat or central administration in Luxembourg are subject to a minimum net wealth tax. Within the 2017 tax reform, it is planned to increase the amount of minimum tax for holding and finance companies ("SOPARFIs") from EUR 3,210 to EUR 4,815 (including solidarity surcharge).(2)

2.2. Impact analysis

When analysing the impact of the contemplated increase of the minimum net wealth tax, it is vital to remember the previous developments of the minimum tax rules.

The minimum tax has first been introduced in 2011 as a minimum corporate income tax of EUR 1,575 for SOPARFIs Then, in 2013, the minimum corporate income tax for SOPARFIs has been increased to EUR 3,210 together with the introduction of a general minimum tax of up to EUR 21,400 for non-SOPARFI companies (depending on a company's total balance sheet – not the net asset value). In case Luxembourg companies were part of a Luxembourg fiscal unity, the minimum taxation was capped to EUR 21,400 for the entire tax group (for the fiscal years 2013 until 2015).

In 2015, EU Commission expressed their concerns that the minimum corporate income tax rules would not be consistent with the EU Parent-Subsidiary Directive. Therefore, in 2016, the minimum corporate income tax has been converted into a minimum net wealth tax. While the minimum tax for SOPARFIs has been kept at EUR 3,210, the general minimum tax has been increased to an amount of up to EUR 32,100 (depending on a company's total balance sheet – not the net asset value) and extended to securitization companies and SICARs (risk capital companies). The increase of the minimum tax to EUR 32,100 also applies to companies forming part of a fiscal unity. Moreover, in contrast to the previous minimum corporate income tax, the new minimum net wealth tax rules do not provide for a tax credit mechanism. In other words, while the previous minimum corporate income tax was – at least in theory – an advance payment for future corporate income tax, the minimum net wealth tax cannot be credited at all.

Accordingly, the minimum tax rules have been tightened quite a number of times since their introduction in 2011. As part of the 2017 corporate tax reform, it is now planned to further increase the minimum net wealth tax applicable to SOPARFIs to EUR 4,815.

All these changes and proposals shake Luxembourg's image as a stable location for doing business and investors are asking themselves the question when to expect the next increase of minimum taxes. While it might be questioned why levying a minimum tax at all on companies that do not realize taxable income (and that are possibly in financial difficulties), the existing minimum tax rules should at least not be aggravated to sustain a certain level of stability.

The proposed increase of the minimum tax for SOPARFIs would further increase the maintenance costs of Luxembourg structures. The minimum tax is particularly severe for large multinationals and investors with dozens and hundreds of Luxembourg SOPARFIs. Ultimately, the increase of the minimum taxation should result in a reduction of Luxembourg investment structures and a decrease in the number of Luxembourg companies.

3. Restrictions on the use of future tax losses

3.1. Proposed measure

According to the announcement of the Minister of Finance, it is further proposed to limit the use of tax losses generated as from 1 January 2017. The limitation on the use of tax losses is proposed to be twofold:
- Firstly, such losses would only be available to offset 80% of the taxable income realized in subsequent periods;
- Secondly, such losses should only be carried forward for a period of maximum 10 years.

Hence, it would be necessary to track the tax losses incurred until the fiscal year 2016 and tax losses incurred in each year as from 2017.

3.2. Impact analysis

When considering the impact of this proposal, the two restrictions on the use of corporate tax losses have to be analysed separately:

a) 80% limitation

The proposed 80% restriction on the use of tax losses looks at first glance like a reasonable compromise that would lead to an effective tax rate of circa 5.5% (i.e. 27.08% * 20% of the income). However, there exist some systematic issues with regard to such restriction which may entail unintended collateral damage. These issues are depicted in the following examples:

- **The Luxembourg participation exemption regime**

Luxembourg companies benefit from an attractive participation exemption regime according to which dividends, capital gains and liquidation proceeds derived from qualifying participation may benefit from a full tax exemption.

As a beneficial feature of the Luxembourg participation exemption regime, Luxembourg companies may deduct costs incurred in relation to qualifying participations to the extent they exceed tax exempt dividend income realized in a given year. However, such costs are subject to recapture. This means that future capital gains would be taxable up to the total amount of costs deducted in relation to a shareholding.

If the proposed 80% limitation would be applied, a Luxembourg holding company would become subject to tax on 20% of the capital gains that are subject to recapture. Such treatment would not be consistent with the European Parent-Subsidiary Directive and turn a positive feature of the Luxembourg participation exemption into a negative one.

Example: Recapture rule

A Luxembourg holding company (LuxCo) owns a 100% participation in a French subsidiary (FrenchCo) that benefits from the Luxembourg participation exemption regime. For 5 year the Luxembourg holding company realizes 100 of costs whereas no dividends are realized. Thus, 100 of costs are deductible each year and subject to recapture (after 5 years the tax losses and the recapture amount to 500). In year 6, LuxCo disposes of its participation in FrenchCo and realizes a profit of 300 which is taxable in Luxembourg (as it is subject to recapture). Under current Luxembourg tax law, the recapture may be fully offset by the tax losses available (i.e. 500). Under the proposed rule, LuxCo would be subject to tax on 60 of taxable income in year 6 (i.e. 20% of 300).

- **Write-up in value of assets**

Under Luxembourg GAAP, the prudence principle requires that the book value of an asset has to be written down in the financial statements if the fair market value of such asset decreases (under certain conditions). When the value of an asset that has previously been written down increases in subsequent years, a write-back in value has to be recorded up to the amount of the historical acquisition costs (potentially, after depreciation).

While the write-down in value is reflected as expenses, the write-back would be treated as (taxable) income that cannot be fully offset by tax losses. Hence, a company may become taxable on income from a write-back in value (in the absence of any action by the company) on the mere grounds of applying accounting principles.

Example: Loan receivables

A Luxembourg company (LuxCo) owns a loan receivable of 100 owed by a subsidiary that is in financial difficulties. At year end, the accountants recognize a write-down in value of 60 that is treated as a loss for accounting and tax purposes. One year later, the subsidiary is recovering and the accountant corrects the previous value adjustment of 60 which results in taxable income of 60. Under the new rules, LuxCo would be subject to tax on 12 (i.e. 20% of 60) only because of a changes in the fair market value of its asset and the application of the prudence principle.

- **Release of a provision**

From a Luxembourg accounting perspective, companies may (have to) record provisions for future expenses that are generally considered for Luxembourg tax purposes. When the reasons for such provisions disappear, the provisions have to be released resulting in corresponding income. In these circumstances, it may be that tax losses created when the provision has been recorded cannot be used to offset related income when the provision is released.

Example: Provision in regard to a court case

LuxCo records a provision in regard to a court case where a penalty of 200 is expected. The provision of 200 creates a tax loss of 200. One year later, the court case has been won and LuxCo releases the provision which results in taxable income of 200. Under the proposed rules, LuxCo could not fully offset the income of 200 with the losses incurred one year before when the provision has been recorded. Instead, LuxCo would be taxable on an income of 40 (i.e. 20% of 200).

- **Debt waivers**

When a shareholder waives a loan granted to LuxCo, income realized by the company upon the waiver is generally treated as a hidden capital contribution and not subject to Luxembourg taxation. However, in case the shareholder loan is not valuable anymore (for example, because the investments of LuxCo have not been successful), the hidden capital contribution is to be valued at zero and the income should be fully taxable. Hence, a loss-making company may be taxed on 20% of a mere accounting profit that could otherwise be offset by tax losses previously incurred by LuxCo.

Example: Debt waiver

LuxCo financed an investment with a shareholder loan of 100. Unfortunately, the investments of LuxCo have not been successful and losses of 100 have been realized. Before the liquidation of LuxCo, the shareholders waive the outstanding shareholder loan of 100. While this debt waiver should be classified as a hidden capital contribution, the value thereof should be zero. Thus, LuxCo would realize taxable income of 100 which may only be offset as to 80% by tax losses resulting in a tax base of 20. Economically speaking, this would mean that losses on investment create artificially a taxable income.

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• **Summary**

The aforementioned examples make it clear that it would be necessary to introduce special rules that are designed to deal with all these situations in which an 80% restriction on the use of tax losses would be inappropriate. Evidently, such complex set of rules will cause a substantial administrative burden on both taxpayers and the Luxembourg tax authorities. The tracking of all the details would also increase compliance costs.

It should further be considered to introduce a safe haven up to which the losses may be used without restriction. Other countries that introduced such rules (for example, Germany and France) chose an amount of EUR 1m up to which tax losses may be used without restrictions.

b) 10 year limitation

Under current Luxembourg tax law, corporate tax losses may be carried forward for an indefinite period of time. From an economic perspective, the value of losses decreases over time due to inflation.

Accordingly, companies have already an incentive to use tax losses as soon as possible (for example, through the shifting of additional taxable activities to Luxembourg).

The restriction on the use of tax losses to 10 years would not be consistent with fundamental tax principles. Furthermore, why should a company not be able to carry forward its tax losses for an indefinite period until it is liquidated?

III. Conclusions and outlook

The proposed changes to the Luxembourg corporate tax system are a mix of positive and negative measures. In addition, Luxembourg might be forced to implement harsh tax measures in accordance with the anti-BEPS Directive that is currently proposed by the EU Commission (including, limitations on the deductibility of interest, controlled foreign company rules, anti-hybrid mismatch rules, etc.).

Combined with the changes to the Luxembourg income tax law applicable to individuals (which would further increase taxes on higher salaries), the 2017 tax reform has the potential to damage the competitiveness of Luxembourg, at a time, where highly qualified people are needed in order to create more substance in Luxembourg (to respond to requirements from an international tax perspective and to make Luxembourg set-ups fit for the post-BEPS era).

With the right strategy, the current developments in the international tax arena may even be an opportunity for Luxembourg to reinforce its position as a location of choice.

A formula for future growth should, however, rely on improving the tax environment with a view to attract more businesses and investment. This would create more activities, employment and, ultimately, tax revenue in Luxembourg.

Nevertheless, the decrease of the corporate income tax rate is too minor to make an impact, whereas the increase of the minimum tax as well as the proposed limitations on the use of tax losses has the capacity to damage the competitiveness of the country.

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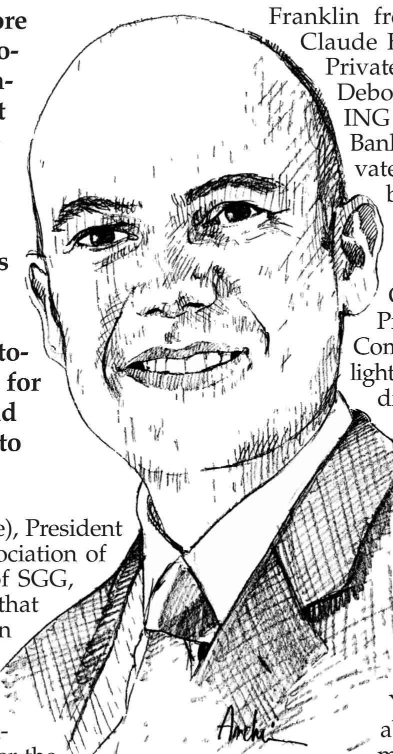
1) The impact of a decrease in tax rates on the amount of tax revenue has, for example, been analysed in the following study: http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_12_en.pdf.
2) For the purposes of the minimum tax, a company is classified as "holding and financing companies" if the fixed financial assets, transferable securities and cash at bank (as reported in the financial statements presented in the standard Luxembourg form) exceed 90% of its total gross assets. As from 2015, when 90% of the qualifying financial assets do not exceed EUR 350,000, holding and financing companies are subject to the general minimum tax rules and would be liable to an annual tax of EUR 535 (for the fiscal years 2013 and 2014, a SOPARFI was always subject to the minimum taxation of EUR 3,210, no matter of its total balance sheet).

PrivateBanker 2016

Digital and transparency to reinvent the business model of banks



On March 23rd, more than 200 professionals from the banking industry gathered at the ECCL for the 7th edition of PrivateBanker. This year's topic focused on the future of private banking with discussions around the disruptive effects of technology on wealth management, customer experience, the need for new business models, and new regulations leading to more transparency.

Serge Krancenblum (picture), President of LAFO (Luxembourg Association of Family Offices) and CEO of SGG, opened the day by stating that "the future is now", and then listed what are, according to him, the main challenges for the private banking industry, the first one being the necessity to deal with its legacy after the crisis it went through. Other challenges are the necessity to adapt to new regulations, and of course, structural changes. As a matter of fact, barriers are falling with new technology.

"Banks and private banks need to be aware of the fact that the new generation was raised with technology. Therefore, technology will eventually replace schmoozing" added Mr. Krancenblum. Disruptive technology to reinvent the economic model of banks The first discussion panel was moderated by Joshua Franklin from Reuters. According to Claude Hirtzig, Senior VP Head of Private Banking, BCEE, and Marc Debois, Head of New Markets, ING Luxembourg Private Banking, the digitalisation of private banking won't be sudden, but is certainly coming as the generation is expecting it from their banks.

Grzegorz Prososwicz, Head of Product Management for Comarch Capital Markets, highlighted the fact that "the situation is different in Europe than in Middle-East Asia, where Private Banking is far more digitalised". He also added that Virtual Reality advice would be the next step.

Mourtaza Asad-Syed, founder & CEO of Yomoni, said that "it's more about innovation diffusion", meaning that Private Banking has to cope with the needs of the clients, and notably with mobile. He added: "we need to use what already exists to actually disrupt and reinvent the economic model of banks".

On the question of client experience, Mr. Asad-Syed compared FinTech to Amazon and its online offers, meaning that if FinTechs could lay a hand on distribution and diffusion, they could have a competitive advantage over banks: "FinTech is the Amazon of Wealth Management".

Claude Hirtzig insisted on the fact that private banks need to show their added value, which is only possible by knowing their clients and providing them with a personalised customer experience.

Mr. Debois reassured the audience: "human relations are still extremely important for HNWIs who look for personal advice, a specific portfolio, and even to be recomforted in times of crisis… which cannot be achieved with standardisation".

Yet, according to Grzegorz Prososwicz, the gap is closing between what HWNI wanted a few years ago and what they want now, as globally - not inEurope -, they tend to prefer digital contact with their advisors. But, the challenge is actually more cultural than anything else, according to Mr. Debois. ING has therefore appointed a Head of FinTech and a Chief Innovation Offier. A deep tranformation of the business is on the way. On the other hand, robo-advisors will have to play a big role, notably when it comes to client management and knowledge.

Mr. Prososwicz added: "digital opens new ways to interact and engage with the client. It also brings operational efficiency". The next steps? The use of social media to create a community and scan interests, but also an increase in video interaction. What also needs to be done, according to Mr. Hirtzig is educating Private Bankers with the use of the new digital tools.

Marc Debois concluded by stating that technology was an opportunity for banks, who need to partner with FinTech companies.

La commission "formation des prix" analyse l'inflation en 2015

La commission "formation des prix" du Conseil de la consommation s'est réunie en date du 17 mars 2016 dans le cadre des travaux de l'Observatoire de la formation des prix du ministère de l'Économie. Composée de représentants des consommateurs, des organisations patronales et du gouvernement, cette commission est chargée d'étudier et de discuter les analyses et rapports de l'Observatoire de la formation des prix.

L'Observatoire de la formation des prix a présenté une nouvelle édition de son rapport semestriel qui comprend, pour le deuxième semestre 2015, une analyse de l'évolution de l'inflation au Luxembourg, une comparaison de l'inflation avec les pays voisins et une analyse de l'évolution des prix administrés.

En 2015, le Luxembourg a connu un relèvement de différents taux de TVA pour la plupart des biens et services consommés (+2 points de pourcentage). Ce changement structurel avait un impact majeur sur les résultats et analyses relatifs à l'évolution des prix à la consommation au Luxembourg pour l'année 2015. Cependant, l'inflation générale a continué de reculer en 2015: le taux moyen était de +0,47% au Luxembourg l'année passée (contre +0,63% en 2014) et ce malgré la hausse de différents taux de TVA. L'explication se trouve dans l'écroulement du cours du pétrole, qui a exercé une forte pression à la baisse sur le taux d'inflation au Luxembourg (comme à l'étranger).

Le niveau de l'inflation a été faible dans toute l'Union européenne en 2015, avec des taux proches de 0% pour l'UE (-0,01%) et pour la zone euro (+0,03%), donc largement en dessous du taux de 2%, correspondant à l'objectif fixé par la Banque centrale européenne (BCE).

Avec +0,47%, l'inflation luxembourgeoise a été plus élevée que celle de l'Allemagne (+0,11%) et de la France (+0,09%), mais elle est restée en dessous de celle de la Belgique (+0,62%).

Huit pays de la zone euro ont eu des taux négatifs en 2015, avec le taux le plus bas observé en Chypre (-1,55%). Toutefois, le rapport indique que, pour des raisons méthodologiques, les comparaisons en termes d'inflation doivent être réalisées et analysées avec prudence.

Source: ministère de l'Économie