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Luxembourg Releases its 2017 Tax Reform

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The draft law on the 2017 Luxembourg tax reform was presented to Parliament on July 26, 2016. This article outlines the main tax changes to be introduced for both companies and individuals based on the provisions of the draft law.

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I. Introduction

The draft law on the 2017 Luxembourg tax reform was presented to Parliament on July 26, 2016. While most of the tax measures to be introduced are in line with the announcements made by the government earlier this year, some measures are new while others have evolved, like the planned limitation to the carry forward of tax losses which is no longer as restrictive as previously announced. In this article, we have outlined the main tax changes to be introduced for both companies and individuals based on the provisions of the draft law. However, these changes may still evolve over the course of the legislative process.

II. Tax Measures for Companies

A. Corporate Income Tax Rate—a Two-step Decrease

The Corporate Income Tax ("CIT") rate applicable to income exceeding 30,0000 euros will be brought down from 21% to 19% in 2017 and finally to 18% in 2018. Taking the Municipal Business Tax ("MBT") and the solidarity surcharge into account, it will bring the global corporate tax rate applicable to companies in Luxembourg-city from currently 29.22% down to 27.08% in 2017 and 26.01% in 2018.

CIT rates applicable to lower amounts will also be amended. Following these changes, CIT will be levied as shown in the table on the next page.

B. Minimum Net Wealth Tax Increased

The minimum Net Wealth Tax ("NWT") applicable to SOPARFIs[1] amounting currently to 3,210 euros will be increased to 4,815 euros as of 2017.

C. Amendments to the Rules Governing the NWT Reduction

According to Section 8a of the NWT Law, Luxembourg companies can, upon request, benefit from a reduction of their NWT liability up to the amount corresponding to the CIT due for the preceding year. In order to benefit from this reduction, a so-called NWT reserve has to be recorded by the company and kept during five tax years.

Amendments have been introduced by the draft law in order to clarify the consequences in regard to the NWT reduction in the case where a company is dissolved before the five-year requirement is met:

- in principle, the NWT is increased for the tax year during which the liquidation of the company is closed;
- however, the NWT is not increased (i.e. the NWT reduction remains unchanged) in the case of an asset transfer to another person within the meaning of Article 170(1) of the Income Tax Law ("ITL") as well as in the case of a transfer of seat of the Luxembourg company within the meaning of Article 172(1) ITL, provided that either the company following its transfer of seat abroad, or the company to which the assets have been transferred, maintains the NWT reserve until the five-year requirement is met.

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Tax year	Taxable Income	CIT Due
2017	≤ EUR 25,000	15%
	EUR 25,000–EUR 30,000	EUR 3,750 (i.e. 15% of EUR 25,000) + 39% of the income exceeding EUR 25,000
	> EUR 30,000	**19%**
2018	≤ EUR 25,000	15%
	EUR 25,000–EUR 30,000	EUR 3,750 (i.e. 15% of EUR 25,000) + 33% of the income exceeding EUR 25,000
	> EUR 30,000	**18%**

D. Limitation to the Carry Forward of Losses

While tax losses generated until 2016 will remain tax deductible without any limitation, the carry forward of tax losses generated as from 2017 will be limited to 17 years. This means that there will be no limitation in the amount which can be used each year in order to offset profits, as initially announced by the government. The oldest losses will have to be used first.

This new limitation applies for both CIT and MBT purposes.

E. 0.24% Tax to be Abolished

As from 2017, deeds including the assignment of receivables will no longer be subject to the 0.24% registration duty.

F. Investment Tax Credit Regime to be Improved

In order to stimulate investments and notably investments in innovation, the investment tax credit regime will be improved: the tax credit for additional investments will be increased from the current 12% to 13% and the tax credit for global investments will be increased from 7% to 8%. Regarding assets which can benefit from the special depreciation, the tax credit will be increased from 8% to 9%.

In addition, the draft law provides that the investment tax credit will be extended to investments in assets which are physically used in a European Economic Area Member State, meaning that it is no longer limited to assets physically used in Luxembourg. This amendment is only a formalization of the current practice applied by the Luxembourg tax authorities (see Circular 152bis/3 of March 31, 2011) since the *Tankreederei* case law of the Court of Justice of the European Union.

G. Neutralization of Exchange Gains Extended to all Companies

In accordance with Article 54bis ITL, exchange gains in euros arising from the disposal of certain assets invested in the foreign currency of the share capital of an entity can be transferred into other assets denominated in the same currency.

This regime of temporary neutralization of exchange gains currently only available to banks, insurance companies and reinsurance companies will be extended to all Luxembourg resident companies retroactively as from 2016.

In addition, a formal request will be required in order to benefit from the tax neutralization. The request will have to be filed at the latest three months before the end of the first tax year in respect of which the taxpayer wishes to benefit from the tax neutralization. As far as the tax year 2016 is concerned, a specific deadline will apply according to which the request can be filed until June 30, 2017.

H. Tax Credit for Hiring Unemployed Persons Extended

The tax credit for hiring unemployed persons will be extended until December 31, 2019.

I. Tax Compliance—Electronic Filing

The filing of electronic tax returns by companies will become mandatory.

III. Tax Measures for Individuals

A. Final Withholding Tax on Interest to be Increased from 10% to 20%

The final withholding tax levied on savings income of Luxembourg residents ("RELIBI") will be increased from the current rate of 10% to 20% as of 2017.

B. Temporary Budget Balancing Tax to be Abolished

The temporary budget balancing tax of 0.5% ("*impôt d'équilibrage temporaire*") which is currently levied on the monthly gross professional income will be abolished in 2017.

C. Tax Scales/Tax Brackets

A new 41% tax bracket will be introduced as of 2017 for taxable income between 150,000–200,004 euros and a new 42% tax bracket will apply to income exceeding 200,004 euros. Currently, the tax rate applicable to the highest tax bracket is 40%.

The lowest tax bracket will also be amended so as to ensure that lower income is taxed less: no taxation will apply on income up to 11,265 euros.

D. Separate Taxation for Married couples as from Tax Year 2018

As of tax year 2018, married couples will be able to opt whether they would like to continue being taxed collectively in tax class 2 or whether they would like to be taxed separately.

E. Nonresident Tax Regime to be Amended as of 2018

The tax regime of cross-border workers will be amended so as to make sure that they will be treated in a very similar way to Luxembourg residents for tax purposes. The objective is to make sure that cross-border workers can benefit from the same tax deductions and the same tax scales as Luxembourg residents.

F. Changes to Tax Credits

The rules on tax credit available to employees, pensioners and independent professionals will be amended. The amounts of tax credit will vary progressively between 0–600 euros depending on the level of income. As from an annual income of 80,000 euros, the tax credit will no longer be granted. Some changes will also be introduced to the single parent tax credit *("crédit d'impôt monoparental")*.

G. Company Car—Taxation Rules of Benefit in Kind to be Amended

In order to encourage the use of low-polluting cars, the amount of benefit in kind to be taxed for the use of a company car (currently equal to 1.5% of the acquisition cost of the car) will become dependent upon the level of CO2 emissions of the car and will vary between 0.5–1.8%.

H. New Tax Deduction for Eco-friendly Vehicles Introduced

A new tax deduction varying between 300–5,000 euros (depending on the type of vehicle) will be introduced for zero-emission cars and bikes (including e-bikes).

I. Increased Tax Deductions for Contributions to Pension Schemes

Tax deductions for contributions to pension schemes *("assurance prévoyance-vieillesse")* will be deductible up to an increased amount of 3,200 euros, irrespective of the age of the individual. Currently, the maximum deductible amount depends on the age of the individual who subscribes to the pension scheme.

J. Deduction of Expenses for Children who are not Dependent

The maximum amount of deductible expenses for children who do not belong to the household of the taxpayer will be increased from currently 3,480 euros to 4,020 euros per child and per year.

K. Expenditures on Domestic Services

The maximum amount of tax deductible expenses for domestic services (costs for childcare, housekeeping, etc.) will be increased from currently 3,600 euros to 5,400 euros per year.

L. Measures to Improve Access to Housing

Several tax measures will be introduced which aim to improve access to housing. These include:

- increased tax deductions for contributions to saving plans for housing under certain conditions, from currently 672 euros to 1,344 euros for individuals until they reach the age of 40;
- the maximum amount of tax deductible interest expenses on mortgage loans will be increased.

Regarding the temporary reduced taxation at a one-quarter rate (compared to the one-half rate applicable so far) on long-term capital gains realized by individuals on the sale of real estate between July 1, 2016 and December 31, 2017, this measure was already implemented by the law of June 29, 2016.

M. Measures for Family Businesses

The taxation of capital gains on the transfer of a real estate or a land asset belonging to the business of an individual may be deferred if the business is transferred to the next generation of the same family or to a third party which takes over the business and uses the real estate to carry on the business.

N. Lunch Vouchers

The value of lunch vouchers will increase from 8.40 euros to 10.80 euros.

IV. Other Measures

A. Tax Crime to Become a Primary Offense on Anti-money Laundering/Know Your Customer Matters

In order to comply with the requirements resulting from the revised Financial Action Task Force standard 2012/2013 and the Directive (EU) 2015/849 on the prevention of the use of the financial system for money laundering or terrorist financing, specific measures have been introduced.

The draft law introduces an additional tax offense with the notion of aggravated tax fraud. Consequently, three forms of tax fraud, namely simple tax fraud, aggravated tax fraud and tax swindling (*"escroquerie fiscale"*) will co-exist. Simple tax fraud will be prosecuted and subject to administrative sanctions by the competent tax authorities while the other two forms of fraud, i.e. aggravated tax fraud and tax swindling will be criminally prosecuted.

In addition, it has been proposed to extend the offense of money laundering to criminal tax offenses, which means to aggravated tax fraud and tax swindling.

Consequently, it is foreseen that these criminal tax offenses, in direct and indirect tax matters but also in inheritance tax matters, will be added as primary offenses in Article 506-1 of the Criminal Code. In direct tax matters, the attempt to commit an offense will also be considered.

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Pursuant to the principle of non-retroactivity of the criminal law, the new Article 506-1 of the Criminal Code will only apply to tax offenses committed after January 1, 2017.

B. Penalties to be Increased

In order to strengthen the coercive power of the Luxembourg tax authorities, the maximum amount of fine will be increased from currently 1,239.47 euros to 25,000 euros.

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NOTES

[1] *Société de participations financières* ("SOPARFI"). This is an ordinary commercial Luxembourg company, whose primary activity is a holding and/or financing activity and which benefits from the so-called participation exemption regime in respect of some or all of its investments.