LEGAL ALERT

BILL N°7020 – LUXEMBOURG TAX REFORM

AUGUST - 2016

I. INTRODUCTION

The Luxembourg bill N°7020 (the "**Bill**") presented and filed on 26 July 2016 by the Luxembourg Minister of Finance with the Luxembourg Parliament foresees the introduction of tax measures affecting both individual and corporate taxpayers. The Bill follows the announcements made by the Luxembourg government on 29 February 2016 and its presentation by Xavier Bettel, the Luxembourg Prime Minister on 26 April 2016. The tax measures are designed to enhance the competitiveness of Luxembourg in complying with the international landscape (including the OECD' BEPS action plan and the anti-tax avoidance Directive released on 21 July 2016), and promoting greater fairness and strengthening employment.

The proposed tax reform, which concerns both direct and indirect taxes should enter into force, once the Bill enacted, on 1st January 2017, with exception to certain measures that would be applicable for the current fiscal year.

As of today the parliamentary approval process of the Bill is on-going and further amendments to the Bill could still be proposed by the Luxembourg Parliament.

II. TAX MEASURES FOR CORPORATE TAXPAYERS

1. Decrease of the corporate income tax

Luxembourg corporate taxpayers are currently subject to corporate income tax ("**CIT**") at a rate of (i) 20% for annual taxable profit amount not exceeding EUR 15,000 and (ii) 21% for annual taxable profit amount above this threshold. The CIT is increased by a contribution to the unemployment fund of 7%. In addition, corporate taxpayers are liable for municipal business tax ("**MBT**") the rate of which depends on where the company is located (companies located in Luxembourg city are subject to MBT at a rate of 6.75%). As a result, the aggregate income tax rate (CIT and MBT) is of 29.22% for the 2016 fiscal year for corporate taxpayers having their registered office in Luxembourg city.

With a view of strengthening Luxembourg's competitiveness, it is intended to lower the CIT as follows:

- For taxable profits not exceeding EUR 25,000 (instead of EUR 15,000 currently) the CIT rate will be decreased from 20% to 15% for the 2017 fiscal year onwards;
- An intermediate bracket is to be introduced for taxable profit between EUR 25,000 and EUR 30,000 which should be taxed at EUR 3,750 plus 39% of

taxable income exceeding EUR 25,000 for the 2017 fiscal year, to be decreased to EUR 3,750 plus 33% for the 2018 fiscal year.

- For taxable profits in excess of EUR 30,000 the CIT will be reduced to (i) 19% for the 2017 fiscal year, and (ii) 18% for the 2018 fiscal year onwards, leading to an aggregate income tax rate (CIT and MBT) of 27.08% as from January 1st 2016 (including solidarity surcharge), respectively 26.01% as from 1 January 2018 onwards (including solidarity surcharge)

Tax Year	Tax rate category	Taxable base	Corporate income tax due	Aggregate tax rate **(1)**
2017	Minimum tax rate	≤ EUR 25,000	15%	22,80%
	Intermediary tax rate	EUR 25,000 - EUR 30,000	EUR 3,750 + 39% of the income exceeding EUR 25,000	22,80% - 27,08%
	Maximum tax rate	≥ EUR 30,000	19%	27,08%
2018	Minimum tax rate	≤ EUR 25,000	15%	22,80%
	Intermediary tax rate	EUR 25,000 - EUR 30,000	EUR 3,750 + 33% of the income exceeding EUR 25,000	22,80% - 26,01%
	Maximum tax rate	≥ EUR 30,000	18%	26,01%

(*1*) *these aggregate tax rate does not consider the allowance for MBT purposes of EUR 40,000 for taxpayers not subject to CIT and the EUR 17,500 allowance for the others.*

2. The minimum net wealth tax

Luxembourg corporate taxpayers are liable for an annual net wealth tax ("**NWT**") of 0.5% on their total net assets (based on their financial statements as at 31 December of the preceding year) up to EUR 500 million, and at the rate of 0.05% on the portion of their total assets exceeding EUR 500 million.

As from 1 January 2016, a minimum net wealth tax (replacing the minimum corporate income tax) (the "**Minimum NWT**") applies. Such Minimum NWT is either (i) a fixed amount of EUR 3,210 for Luxembourg corporate taxpayers holding financial fixed assets representing more than 90% of their total balance sheet and a total balance sheet of more than EUR 350,000 (i.e. the so-called "**SOPARFIs**"), or (ii) a progressive amount ranging from EUR 535 up to EUR 32,100 (contingent to their balance sheet).

The Bill foresees an increase of the fixed Minimum NWT applicable to SOPARFIs from EUR 3,210 to EUR 4,815 for fiscal year 2017.

3. Reduction of net wealth tax

Under the NWT regime, corporate taxpayers are entitled to reduce their NWT liability by creating a special NWT reserve to be maintained for 5 years. The Bill aims at clarifying that the constitution of this special NWT reserve for a determined tax year is to be agreed upon the allocation of the annual profit of the previous tax year. As a result, the special NWT reserve should be recorded in the financial statements of the corporate taxpayer no later than the end of the year for which the reduction is requested.

Furthermore, the Bill clarifies the consequences resulting from a dissolution, migration or merger of the corporate taxpayer within the 5 years' period.

Finally, since the Bill contemplates the introduction of the option to defer the annual depreciation of assets leading in certain cases to a higher CIT base that could be partially offset by the special NWT reserve, it is intended to submit this special NWT reserve to certain conditions should the corporate taxpayer opt for the deferral of depreciation of assets.

4. Time limitation for the carrying forward of tax losses

Under the current legislation the deferral of tax losses realized in previous years is not limited in time such that tax losses might be carried forward indefinitely by the company that incurred them to off-set any future taxable profit.
The Bill will introduce a time limitation of 17 years to carry forward tax losses realized as from the 2017 fiscal year (after 31 December 2016). Luxembourg corporate taxpayers may continue to carry forward losses realized before that date indefinitely subject to the FIFO (first in/first out) concept (meaning that older tax losses have to be used first). The same temporal limitation applies for MBT purposes.

According to the explanatory statements to the Bill this 17 years' period is considered to be sufficiently long to allow a viable business to offset its incurred losses.

5. Increase of investment tax credit

To stimulate the investment policy of companies, the Bill provides for an increase of (i) the tax credit on additional investment from 12% to 13%, (ii) the tax credit for global investment from 7% to 8%, both for investment not exceeding EUR 150,000 and (iii) the tax credit on investments in assets eligible for a special depreciation from 8% to 9%, for assets that can depreciate in less than 3 years.

The tax credit for investments could also benefit assets that are physically used outside Luxembourg, notably in the territory of another State party to the Agreement on the European Economic Area (**EEA**).

6. Neutralization of foreign exchange capital gains

The new article 54bis of the Luxembourg Income Tax Law the (**"LITL**") provides for a neutralization of foreign exchange capital gains in case of a conversion in euro of assets denominated in foreign currencies that are deemed to represent the company's capital. Under the current legislation the benefit of the neutralization of exchange capital gains regime (pursuant to article 54bis of the LITL) is restricted to Luxembourg credit institutions, professional custodians of securities, insurance and reinsurance companies.
The Bill foresees the extension of this regime of neutralization of capital gains on assets denominated in foreign currencies to all Luxembourg corporate taxpayers, the share capital of which is denominated in foreign currency, and should apply retroactively as from the 2016 fiscal year.

Such currency exchange gains neutralization regime should be subject to a formal written request to be filed three months before the end of the first operating year from which the application of neutralization is requested. The request for the 2016 fiscal year should be filed by 30 June 2017 at the latest.

Meanwhile, in accordance with articles 55ter and 169bis LITL the foreign exchange gains neutralization should be made available to Luxembourg corporate taxpayers with share capital denominated in foreign currency, as to exchange gains realized upon liquidation or disposal.

7. Deferred depreciation of assets

The Bill foresees the introduction of an optional deferred annual depreciation of assets under which corporate taxpayers may be allowed to defer the annual depreciation amount of an asset. The unused depreciation amount could be carried forward until the end of the time used of said asset at the latest.

8. Transfer of family business

With a view of ensuring sustainability of family business, capital gains on immovable properties (land and/or buildings) transferred to family heirs or third parties (notably an employee of the company) who should use the assets in the exploitation of the business would benefit from a tax deferral until the effective realization of the assets.

9. E-filing

Electronic filing for CIT, MBT and NWT returns should be mandatory for 2016 tax returns (01/01/2017 for NWT).

10. VAT measures

Legal proceedings of directors, managers, agents, liquidators, beneficial owners and successors from their personal assets should be extended to VAT due by corporate taxpayers but not paid. This provision is designed to increase VAT recovery.

The Bill also plans to introduce new measures to combat VAT fraud and evasion by increasing penalties from EUR 5,000 to EUR 25,000 and, in the event of VAT evasion, from 10% to 50% of the evaded VAT.

11. Abolition of the registration duty of 0.24%

The Bill contemplates the abolishment of the registration duty of 0.24% on the registration of notarial deeds related to the transfer of claims.

III. TAX MEASURES FOR INDIVIDUAL TAXPAYERS

1. Abolition of budget balancing tax

The budget balancing tax of 0.5% levied on the earnings of individuals that was set up temporarily to rebalance the state budget should be abolished as from 1 January 2017.

2. Individual taxation as an option for couples

The main measure of the Bill designed to reinforce the financial autonomy of each spouse relates to the individual taxation of couples (married or under civil partnership). Starting from 1 January 2018 (*2018 fiscal year*) married couples or couples under a civil partnership could opt for being taxed collectively (Class 2) or individually (Class 1 or Class 1A). Spouses opting for individual taxation might choose between a pure individualization and individualization with revenue reallocation. Finally, the option for individual taxation should imply that spouses can no longer be held liable for the tax liability of his/her partner.

3. Introduction of new tax brackets

The Bill provides for an increase of taxation for those earning substantial income such that for 2017 fiscal year onwards annual taxable income over EUR 150,000 (or EUR 300,000 for joint taxed couples) a tax rate of 41% should apply (currently 40%), increased to 42% for annual taxable income exceeding EUR 200,004 (or EUR 400,008 for joint taxed couples).

The introduction of two new tax brackets in the individual income tax rates table to ease the tax burden on low-income individuals is also contemplated so that annual taxable income below EUR 11,265 (Class 1) or EUR 22.530 (Class 1A) should be subject to income tax.

Class 1		
From	**To**	Tax rate
0 €	11,265 €	0%
11,265 €	13,137 €	8%
13,137 €	15,009 €	9%
15,009 €	16,881 €	10%
16,881 €	18,753 €	11%
18,753 €	20,625 €	12%
20,625 €	22,569 €	14%
22,569 €	24,513 €	16%
24,513 €	26,457 €	18%
26,457 €	28,401 €	20%
28,401 €	30,345 €	22%
30,345 €	32,289 €	24%
32,289 €	34,233 €	26%
34,233 €	36,177 €	28%
36,177 €	38,121 €	30%
38,121 €	40,065 €	32%
40,065 €	42,009 €	34%
42,009 €	43,953 €	36%
43,953 €	45,897 €	38%
45,897 €	100,002 €	39%
100,002 €	150,000 €	40%
150,000 €	200,004 €	41%
200,004 €	9,999,99 €	42%

Class 1A		
From	**To**	Tax rate
0 €	22,530 €	0,00%
22,530 €	23,778 €	12,00%
23,778 €	25,026 €	13,50%
25,026 €	26,274 €	15,00%
26,274 €	27,522 €	16,50%
27,522 €	28,770 €	18,00%
28,770 €	30,066 €	21,00%
30,066 €	31,362 €	24,00%
31,362 €	32,658 €	27,00%
32,658 €	33,954 €	30,00%
33,954 €	35,250 €	33,00%
35,250 €	36,546 €	36,00%
36,546 €	100,002 €	39,00%
100,002 €	150,000 €	40,00%
150,000 €	200,004 €	41,00%
200,004 €	9,999,999 €	42,00%

4. Increase of Employee Tax Credit ("ETC"), Pensioner Tax Credit ("PTC") and Freelancer Tax Credit ("FTC")

The ETC, PTC and FTC should be (i) doubled for income between EUR 11,266 and EUR 40,000 and (ii) reduced to zero for income over EUR 80,000. To comply with the KOHLL decision delivered by the Court of Justice of the European Union on 26 May 2016, the ETC and the PTC will in the future also be granted to taxpayers who could avail of a tax card.

5. Alignment of the tax treatment for non-residents taxpayers

The tax regime applicable to non-residents taxpayers, married or under civil partnership, should be amended to be in line with that applicable to resident taxpayers in terms of tax classes, tax deductions/allowances and option for individual taxation.

6. Housing support

While the tax rate applicable to capital gains on real estate transactions occurring between 1 July and 31 December 2017 has been reduced to a quarter of the global rate (instead of half of the global rate applicable) by the law of 29 June 2016, the Bill provides for an additional income tax exemption of 50% of rental income for leasing managed through approved bodies exercising social rental management.

Furthermore, to encourage young families to access their first home, the current deduction limit for home saving schemes should be increased from EUR 672 to EUR 1,344 for taxpayers under the age of 40 years. Finally, the deductibility of mortgage interest related to the individual principal residence should also be increased (without age limits condition) and the rental value reference should be abolished.

7. Allowance for domesticity costs and childcare expenses

The lump sum allowance for extraordinary charges (like domesticity costs, healthcare in case of dependence, as well as the childcare expenses) should be increased from EUR 3,600 (currently) to EUR 5,400 per tax year.

8. Fixed deduction limit on premiums to pension policies

While the age of the underwriter of a complementary pension plan is currently the criterion determining the annual deductible amount, the Bill provides for a fixed deductible limit amounting to EUR 3,200 without an age condition. The measure aims at encouraging young individual taxpayers to subscribe to complementary pension plan as early as possible during their working life.

9. Increase of the final withholding tax on interest (Relibi Law)

The law of 23 December 2005, (the "**Relibi Law**"), adopted in line with the EU Savings Directive, has introduced a withholding tax of 10% on certain interest payments made to Luxembourg resident individuals by Luxembourg agent's. Such withholding tax is a final taxation.

The Bill foresees to increase this withholding tax on interest from 10% to 20% for the interest earnings exceeding an annual amount of EUR 250 per person and per credit institution.

10. Other tax measures concerning individual taxpayers

The Bill provides for the following additional tax measures:

- Increase of the single-parent tax credit and other benefits for single-parent taxpayers;
- Widows and widowers on a case by case basis may benefit from a decrease of the tax brackets, receive certain benefits in relation to the ETC, PTC, benefit from the single-parent tax credit and the standard allowance for costs of domesticity, or costs of assistance, health care and childcare expenses;
- Merger of the tax deduction for debit interest (consumer loan) and life insurance, with a maximum tax deduction of EUR 672;
- Increase of the value of meal vouchers from EUR 8.40 to EUR 10.80;
- Increase of tax deductions for children not being part of the taxpayer's household from EUR 3,480 to EUR 4,020;
- Replacement of annual withholding records by multi-year records;
- Deduction for "sustainable mobility" in case of acquisition of environmentally friendly vehicles;
- Replacement in case of car leasing of the 1.5% flat rate for benefits in kind by a rate linked to the CO2 emitted by the company vehicle (ranging from 0.5 to 1.5% for the most polluting cars); and
- Requirement for freelancers to keep regular accounts (double-entry accounting) in case of a turnover exceeding EUR 100,000.

IV. FIGHT AGAINST TAX FRAUD AND MONEY LAUNDERING

1. Tax fraud

Under the Bill it is proposed to amend the general tax law (*Abgabenordnung* or AO), the VAT Law of 12 February 1979, as further amended, and the Law of 28 January 1948 on the fair and accurate collection of records and inheritance duties for indirect taxes to sanction more intensively tax fraud.

The "**Tax Fraud**" concept will be divided into simple tax fraud, aggravated tax fraud and tax evasion. Simple tax fraud should be punishable by an administrative fine, while aggravated tax fraud (a new concept introduced by the Bill) and tax evasion should be considered as criminal offenses. The Bill provides for thresholds for the offense of aggravated tax fraud. The three types of Tax Fraud apply to direct and indirect tax matters.

In respect to the principle of non-retroactivity of more severe criminal sanctions, the new offenses (aggravated tax fraud and tax swindling) inserted into the Criminal Code only applies to acts committed after 1 January 2017.

2. Anti-money Laundering

To comply with the requirements resulting from the revised Financial Action Task Force (FATF or GAFI) standard of 2012/2013 and the European Directive 2015/849 on the prevention of the use of the financial system for money laundering or terrorist financing, money laundering infringement should be extended to tax fraud and tax evasion.

3. Tax penalties revised upwards

Tax penalties in cases of late tax return filing should be increased from EUR 1,239.47 to EUR 25,000 to strengthen the coercive power of the tax administration. The filing of voluntary incomplete or incorrect direct tax return and the non-filing of direct tax returns should be subject to a penalty in an amount between 5% and 25% of the eluded tax or tax wrongfully reimbursed.

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