New tax measures for corporations and individuals for 2017: Bill 7020 submitted to Luxembourg Parliament

2 August 2016

In brief

On 26 July 2016, the Luxembourg Government introduced a bill on the proposed 2017 tax measures for corporations and individuals. The proposed changes are in line with the announcements made during the State of the Nation address on 26 April 2016. These measures have already been discussed in our previous **Flash News** reports of **26 February 2016 and 3 May 2016.**

In detail

1. Corporations

1.1. Reduction in the corporate income tax rate

The proposal is to reduce the corporate income tax rate from 21% to 18% over the next two years. The proposals do not include any changes to the "solidarity surcharge" on the corporate income tax rate or to the rate of municipal business tax payable by companies.

The overall corporate income tax rate for companies with a net tax base of more than EUR 30,000 would be reduced to **19%** for **FY 2017** and **18%** for **FY 2018**, leading to an overall tax rate of **27.08%** for companies in Luxembourg City for **FY 2017** and **26.01%** for **FY 2018** (taking into account the 7% solidarity surcharge on the corporate income tax rate and including the 6.75% municipal business tax rate).

In addition, the bill introduces a reduced corporate income tax rate of 15% applicable as from financial FY 2017 for companies with a tax base of less than EUR 25,000. For companies with a tax base of between EUR 25,000 and EUR 30,001, the corporate income tax would be EUR 3,750 plus 39% of the tax base above EUR 25,000 (for FY 2017) or 33% of the tax base above EUR 25,000 (for FY 2018).

1.2. Increase in the minimum net wealth tax charge

A minimum Net Wealth Tax ("NWT") charge was introduced on 1 January 2016 for all corporate entities having their registered office or central administration in Luxembourg. The measures imposing this new charge are very similar to the previous provisions for a minimum corporate income tax charge, which were abolished with effect from the same date.

For holding and finance companies whose sum of fixed financial assets, transferable securities and cash at bank (as reported in their commercial accounts presented in the standard Luxembourg form) exceeds 90% of their total gross assets and EUR 350,000, the minimum NWT would increase from EUR 3,210 (including the solidarity surcharge) to EUR 4,815 (including the solidarity surcharge) as from FY 2017.

The minimum NWT applicable to all other corporations having their registered office or central administration in Luxembourg would remain unchanged.

1.3. Restrictions on the use of future losses

The use of losses generated as from FY 2017 will be limited. Losses generated during and after FY 2017 would only be able to be carried forward for a maximum period of 17 years.

Losses that arose before FY 2017 are not affected by this time limit.

Contrary to what the Government initially announced, the deduction would not be limited to 75% of the net taxable profit of each subsequent year.

1.4. Other new tax measures

The following measures that would benefit companies were also announced in the bill:

- The scope of Article 54bis LITL (deferred taxation for foreign-exchange gains on certain assets denominated in a foreign currency) would be extended to all companies as from FY 2016.

- As from FY 2017, the tax returns for companies liable to corporate income tax would no longer be allowed to be filed by post. The bill provides that it would be mandatory to file them electronically.

- Registration duties: the so-called "théorie de l'usage" would be limited to deeds which have to be mandatorily registered

- Deferred depreciations would also be introduced: taxpayers could opt to defer the deduction given by the depreciation. These new measures would increase the corporate income tax for a given year and may allow to reduce the net wealth tax due (under conditions).

- In order to make inter-generational transfers of family businesses easier, capital gains linked to real-estate assets (both land and buildings) would benefit from tax-neutral treatment.

- Farming businesses could deduct 30% of the amount of any new investment of up to a total of EUR 250,000 into the business. Investments above this amount would be eligible for a deduction of 20% of the difference between the investment amount and the EUR 250,000 limit.

- Research and development would be encouraged through the increase of investment tax credits. Complementary and overall investment tax credits would be increased from 12% to 13% and from 7% to 8% respectively (the tax credit for investments exceeding EUR 150,000 would remain at 2%). The investment tax credit for assets approved for the special depreciation regime would also be increased from 8% to 9% (the tax credit for investments exceeding EUR 150,000 would remain at 4%). In addition, the scope of eligible investments would be extended to include investments made with the European Economic Area.

1.5. VAT measures

- Introduction of new provisions pursuant to which managers, liquidators and administrators may be held jointly and/or severally liable in cases of breach of compliance obligations and/or non-payment of a VAT debt by the taxpayer they manage.

- General increase of penalties, for instance penalties applicable in cases of breach of VAT compliance or payment obligations should increase from the current amounts to between EUR 250 to EUR 10,000; daily penalties applicable in specific circumstances should increase to EUR 25,000 per day and penalties in cases of VAT avoidance or unduly recovered VAT should increase from the current rate to between 10% and 50% of the VAT avoided or unduly reclaimed.

- Introduction of specific measures and sanctions in cases of VAT fraud.

2. *Individuals*

The most important changes which should impact individual taxpayers are the following:

2.1. Introduction of an optional separate taxation regime for both married couples and civil partners

Resident and non-resident married taxpayers would be able to choose to have their income taxed separately.

Under this regime, married taxpayers opting for separate taxation would be classed in tax class 1 and would be able to apply for:

- **a full individualisation ("*individualisation pure*"),** where each item of remuneration is allocated individually to each spouse considering the applicable matrimonial regime, and where the deductions (e.g. for insurance premiums, interest payments, dependent children) and the potential increase in ceilings for married couples with dependent children are split equally between the spouses;

- **an individualisation with reallocation of income ("*individualisation avec réallocation des revenus*"),** where the total adjusted taxable income (determined based on the aggregated net income and applicable tax deductions) will by default be allocated equally between the spouses irrespective of the level of their respective income (except if the spouses opt for a different allocation).

In practice, the desired type of individualisation would have to be requested (jointly) by 31 December of the previous tax year (N-1) in order to be effective for the tax year concerned (N). An additional deadline up to 31 December of the year concerned (N) should be granted (i) for couples who get married during the year concerned and (ii) for married taxpayers who become Luxembourg tax residents during that year.

In addition, the bill contains a provision which extends this specific separate taxation method to civil partners. As full individualisation is applied by default to the partners who do not elect to file jointly, only the individualisation with reallocation of income is introduced for civil partners. The application for individualisation with reallocation of income would have to be made (jointly) by 31 March (N+1) of the tax year concerned (N).

2.2. Equality of treatment between resident and non-resident married couples

Amendments will be made to the way in which non-resident married taxpayers who elect to file jointly are taxed, particularly concerning applicable tax classes.

More specifically, upon issuance of the tax cards, non-resident married taxpayers would be able to opt for the application of a flat tax rate determined based on the household income and considering the income that should be tax exempt under the relevant double tax treaty provisions (where applicable).

2.3. Modifications to the income tax scale

Income tax brackets should be revised, with the introduction of several new tax scales. The overall consequence is expected to be a reduction in the average tax rate. However, new tax rates for individuals with higher income should be introduced (tax rates of 41% and 42% on income exceeding EUR 150,000 and EUR 200,004 respectively).

2.4. Access to real estate

- **Increase in deductible contributions to home saving schemes ("*contrat d'épargne-logement*"):** tax-deductible contributions should increase from EUR 672 to EUR 1,344 for individuals aged up to 40. Beyond the age of 40, the annual deduction should remain set at EUR 672.

- **Residence occupied by the owner (main residence):** the deemed rental income of a property occupied by the owner should be abolished.

- **Increase in deductible mortgage interest:** ceilings for mortgage interest deductions related to the main residence would increase as follows:
    - EUR 2,000 (from EUR 1,500) for the first year of occupation and the following five years;
    - EUR 1,500 (from EUR 1,125) for the following five years;
    - EUR 1,000 (from EUR 750) for the following years.
- **Encouraging rentals to approved social organisations:** income arising from the rental of housing to approved social organisations (e.g. *Agence Immobilière Sociale*) should benefit from a 50% exemption.

2.5. Strengthening of households' purchasing power

- Depending on the level of income derived, the tax credit for employees ("*crédit d'impôt pour salariés*"), for pensioners ("*crédit d'impôt pour pensionnés*") and for self-employed individuals ("*crédit d'impôt pour indépendants*") should increase up to EUR 600 (instead of EUR 300 per year currently). If the taxpayer's annual income exceeds EUR 80,000, the tax credits should be no longer be granted;

- Single parents would enjoy a tax credit ("*crédit d'impôt monoparental*") of maximum EUR 1,500 per year (instead of EUR 750 per year currently) where the annual taxable income does not exceed EUR 35,000, and of EUR 750 where the annual taxable income exceeds EUR 105,000. Currently, the tax credit is reduced by 50% of the allowances received for the child – e.g. child support payments, but excluding child allowances and orphans' pensions – insofar as they exceed EUR 1,920 per year. For annual taxable income ranging between EUR 35,000 and EUR 105,000, this amount should be increased to EUR 2,208 and the above-mentioned allowances will no longer be included in this threshold. Eligibility for the tax credit would be denied if the parents share a common residence.

- The tax deduction received by a taxpayer contributing to the education and maintenance costs of a child that is not part of his/her household will increase from EUR 3,480 to EUR 4,020 per year and per child. However, parents sharing a common residence would not be entitled to this deduction.

- The lump-sum allowance for domestic fees (cleaning and childcare expenses, and social assistance for dependent people) would increase from EUR 3,600 to EUR 5,400 per year.

- The face value of luncheon vouchers would increase from EUR 8.40 to EUR 10.80. The related taxable benefit would increase from EUR 2.80 to EUR 3.60.

2.6. Sustainable transport

- A new tax deduction to encourage sustainable transport should be introduced for vehicles and cycles registered or purchased after 31 December 2016.

- The tax deduction should be set as follows:
  - EUR 5,000 for zero-emission vehicles
  - EUR 2,000 for natural gas and specific hybrid vehicles
  - EUR 300 for cycles (including cycles with pedalling assistance)

In addition, the lump-sum valuation method for determining the taxable benefit in kind arising from the private use of a company car should be amended, in order to take account of the car's CO2 emission level and fuel type. While currently the monthly taxable benefit amounts to a flat 1.5% of the car's value (inclusive of VAT), it should range from 0.5% to 1.8% as from 1 January 2017. This new valuation method would only apply to company cars which are leased from 1 January 2017.

Cycles (including cycles with pedalling assistance) made available to employees should not generate any taxable benefit.

2.7. Other changes

- **Interest payments and insurance premiums:** Currently, individual taxpayers can claim a deduction for interest payments up to a maximum of EUR 336 per member of the household and another deduction for insurance premiums (for life, death, disability, accident, sickness, civil liability) up to a maximum of EUR 672 per member of the household. The above ceilings would be merged under the bill. Instead of an aggregate ceiling of EUR 1,008 per member of the household (EUR 336 + EUR 672) the deduction of both interest payments and insurance premiums would be limited to a maximum of EUR 672 per member of the household.

- **Private old-age pension plan**: the annual tax deduction for private old-age pension plans ("*contrat de prévoyance-vieillesse*") should be set at a maximum of EUR 3,200 for all taxpayers, irrespective of their age. Currently, the deduction ranges from EUR 1,500 to EUR 3,200, depending on the taxpayer's age.

- **Withholding tax on interest income**: under the "Relibi" Law, qualifying interest income derived by a Luxembourg resident is currently subject to a 10% flat and final withholding tax. This withholding tax rate would increase to 20%.

- **Abolition of the temporary budget-balancing tax**: the 0.5% temporary "budget-balancing" tax should be abolished.

3. *Strengthening of the measures designed to fight tax fraud and money laundering*

The Government is willing to strengthen the measures to fight tax fraud and money laundering by distinguishing between three types of fraud:

- Simple tax fraud ("*fraude simple*");

- Aggravated tax fraud ("*fraude aggravée*"); and

- Tax swindle ("*escroquerie fiscale*").

The "aggravated" tax fraud is a new criminal offence that would be introduced by the bill.

In addition, administrative penalties would also be increased, particularly if direct tax returns are filed late or not filed at all.

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Let's talk

Wim Piot	Managing Partner, Tax Leader	+352 49 48 48 3052	wim.piot@lu.pwc.com
Sami Douénias	Partner, Corporate Tax	+352 49 48 48 3060	sami.douenias@lu.pwc.com
Frédéric Wersand	Partner, VAT	+352 49 48 48 3111	frederic.wersand@lu.pwc.com
Eric Paques	Partner, Personal Tax	+352 49 48 48 3165	eric.paques@lu.pwc.com