Luxembourg Government announces 2017 tax changes

29 February 2016

In brief

On 29 February 2016, Finance Minister Pierre Gramegna announced changes to the Luxembourg corporate and personal tax systems planned for 2017. The changes are the outcome of extensive discussions over the last eighteen months regarding possible reforms of the Luxembourg tax system. The changes include, notably, a reduction of the corporate income tax rate from 21% to 18% (in two steps), and an increase of the personal tax rates for individuals earning more than EUR 150,000.

These measures, planned to take effect progressively from 1 January 2017, are now likely to be included in a Bill, to be voted by the Luxembourg Parliament later in 2016.

In detail

1. *Corporations*

1.1 Reduction of the corporate income tax rate

The corporate income tax rate is proposed to be reduced from 21% to 18% over the next two years. The announcements do not foresee any change to the "solidarity surtax" on the corporate income tax rate, nor any change in the rate of municipal business tax due by companies.

The corporate income tax rate would be reduced to 19% for 2017, leading to an overall tax rate for companies of **27.08%** in Luxembourg City for **FY 2017** (taking into account the solidarity surtax of 7% on the corporate income tax rate, and including the 6.75% municipal business tax rate applicable).

The corporate income tax rate would be further reduced to 18% for 2018, leading to an overall tax rate of **26.01%** in Luxembourg City for **FY 2018** (taking into account the solidarity surtax of 7% on the corporate income tax rate, and including the 6.75% municipal business tax rate applicable).

Also, the corporate income tax rate for small and start-up companies (i.e. companies having taxable income below EUR 25,000) would be reduced in a single step to 15% for 2017, leading to an overall tax rate of **22.08%** in Luxembourg City (taking into account the solidarity surtax of 7% on the corporate income tax rate, and including the 6.75% municipal business tax rate applicable).

1.2 Increase of the minimum net wealth tax

A minimum Net Wealth Tax (NWT) charge was introduced on 1 January 2016, for all corporate entities having their statutory seat or central administration in Luxembourg. (The measures imposing this new charge have very many similarities with the outgoing provisions for a minimum corporate income tax charge, which were abolished with effect from the same date).

For holding and finance companies ("SOPARFIs") - being those for which the sum of their 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 be increased from EUR 3,210 (including the solidarity surtax) to EUR 4,815 (including the solidarity surtax).

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

1.3 Restrictions on the use of future losses

It is proposed to limit the use of losses generated as from 1 January 2017. It is understood from the Finance Minister's press presentation that such losses would only be available to offset the taxable profits of subsequent periods up to a maximum of 80% of the taxable profits of each period. Also, losses generated after 1 January 2017 would only be able to be carried forward for a maximum period of 10 years.

Losses that arose before 1 January 2017 should not be affected in any way by either of these limitations.

1.4 Other new tax measures

Other measures noted in the announcement which would benefit companies were as follows:

- With the aim of helping inter-generational transfers of family businesses, capital gains linked to real estate assets (both land and buildings) would benefit from a tax-neutral treatment.
- Farming businesses could deduct 30% of the amount of any new investment of up to a total of EUR 250,000 made in the business. Investment above this amount would attract a deduction of 20% of the excess.

2. *Individuals*

A number of measures have been announced, most of them reducing the tax burden for the "middle class". Conversely, the marginal income tax rate would increase from 40 to 42% (before application of the "solidarity surcharge").

2.1 Abolition of the temporary budget balancing tax

The 0.5% temporary "budget balancing" tax is to be abolished.

2.2 Strengthening of households' purchasing power

Tax credits for salary/pensioners/single-parent families would be increased in a targeted way:

- Low income households would benefit from a higher tax credit (i.e. up to EUR 600 per year for salaried individuals/pensioners, instead of EUR 300 per year currently). The tax credit would decrease down to 0 EUR for taxpayers with income exceeding EUR 80,000 per year.
- Single parents would enjoy a tax credit of up to EUR 1,500 per year (instead of EUR 750 per year currently), where annual income does not exceed EUR 35,000. The tax credit would remain at EUR 750 where the annual income exceeds EUR 35,000.

2.3 Introduction of an optional separate taxation regime for married couples

Resident and non-resident married taxpayer would be entitled to opt for separate taxation of income. It is not yet clear what the consequences of this option will be.

2.4 Modifications to the income tax scale

Income tax brackets would be revised, with the introduction of several new tax scales. The overall consequence is anticipated to be a reduction of the average tax rate.

However, new tax rates for individuals with higher incomes would be introduced (tax rates of 41% and 42% on income exceeding respectively EUR 150,000 and EUR 200,004).

2.5 Private old-age pension plans

The annual tax deduction for private old-age pension plans would 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.

2.6 Real estate

Various provisions would be implemented to facilitate the acquisition of a main residence in Luxembourg.

- **Mortgage interest deductions**

  Ceilings for mortgage interest deductions related to the main residence would increase as follows:

  - First year of occupation and 5 following years: to EUR 2,000 per year (from EUR 1,500);
  - 5 following years: EUR 1,500 (from EUR 1,125);
  - Then: EUR 1,000 (from EUR 750).

- **Home savings plans**

  Tax-deductible contributions to home savings plans ("*épargne-logement*") will increase from EUR 672 to EUR 1,344 for individuals aged up to 40.

- **Rental value of the main property**

  The deemed rental income of a property occupied by the owner would be abolished.

- **Capital gain on the disposal of real estate**

  Capital gains arising from the disposal of real estate (other than the capital gain on the sale of a main residence, which is fully tax exempt) would be taxable at ¼ of the taxpayer's overall effective tax rate, if the sale occurs during the period from 1 July 2016 to 31 December 2017.

- **Rental of housing to approved social organisations**

  Income arising from the rental of housing to approved social organisations (e.g. Agence Immobilière Sociale) would benefit from a 50% exemption.

2.7 Sustainable transport

A new EUR 5,000 deduction for zero emission vehicles would be introduced.

The lump-sum valuation method for determining the taxable benefit in kind arising from the use of a company car would be amended, in order to take account of the CO_2 emission level of the car, and its fuel type. While currently the monthly taxable benefit amounts to a flat 1.5% of the value of the car (VAT included), it would range in the future from 0.5% to 1.8%.

2.8 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%.

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