

## Changes to the tax regime governing directors' fees

### Circular LIR no. 94/4 dated 24 June 2008

#### July 2008

In a recently-issued circular (Circular LIR 94/4, hereafter "The Circular), the Luxembourg tax authorities have introduced a scheme under which operational expenses connected with directors' fees may be deducted on a lump-sum basis. This scheme may only be used by taxpayers who declare their directors' fees through an income tax return.

#### Scope of the Circular

The Circular only applies to the income referred to in article 91(1)(2) of the Luxembourg Income Tax Law, i.e. directors' fees (and any other special payment or benefit granted in lieu of or in addition to directors' fees) paid to directors or other persons acting in a similar capacity at a company.

The income paid to directors for day-to-day management duties qualifies as a salary for tax purposes (and not as directors' fees) in the hands of beneficiaries and therefore falls outside the scope of the Circular. The same goes for the fees received by government or municipal employees who act as non-executive directors for companies by which they are not employed.

#### How directors' fees are taxed

Below is a brief reminder of how directors' fees are taxed. They may be taxed in one or two stages.

Directors' fees are first subject to a withholding tax levied by the company which pays those fees. The tax comes to 20% of the gross fee amount and no tax deduction is permitted (it comes to 25% if the tax is withheld from the net fee amount).

This withholding tax can be the final tax due (the tax is then in full discharge of income tax). In certain cases, recipients may but are not required to include the fees in their tax return. This applies to non-resident directors who receive less than €100,000 per tax year in directors' fees, as long as those fees are their only Luxembourg-source income.

If the recipient of the fees is a Luxembourg tax resident or a non-resident who receives more than €100,000 in gross directors' fees a year, he / she will have to file a tax return in Luxembourg. The gross amount of directors' fees received by those taxpayers will have to be shown in their personal income tax return and it will be subject to the graduated income tax scale (from 0 to 38.95%, with a minimum tax rate of 15.375% for non-residents). The 20% withholding tax will be deductible from this progressive tax.

The lump-sum deduction provided for in the Circular does not apply to cases where the withholding tax is the final tax due.

Taxpayers will only be able to claim operational expenses in connection with directors' fees if they declare that income in their tax return.

## Deduction of operational expenses connected with directors' fees when the tax is calculated by assessment

When the tax is calculated by assessment, taxpayers are taxed on gross directors' fees, after deduction of operational expenses and social security contributions. Operational expenses usually include travel expenses, housing expenses, out-of-pocket expenses, the amount of directors' fees which may have been transferred back to the employer, etc.

Up until now, taxpayers could only claim those expenses if they provided supporting documents which they had to enclose to their tax returns.

To simplify administrative procedures and reduce paperwork, starting tax year 2008, taxpayers can elect to have operational expenses connected with directors' fees assessed on a lump-sum basis. In that case, no supporting documents are required.

Operational expenses may be assessed on a lump-sum basis, as shown in the table below:

Yearly amount of gross directors' fees (in EURO)	Claimable expenses assessed on a lump-sum basis
From 0 to 2,000	30%
From 2,000 to 6,000	€600 + 25% (fee amount - €2,000)
From 6,000 to 15,000	€1,600 + 20% (fee amount - €6,000)
Amount exceeds 15,000	€3,400

The abovementioned amounts apply to the aggregate yearly amount of directors' fees received from one or several companies.

Let us take, say, a resident taxpayer who received directors' fees in the amount of €12,750 in 2008. Operational expenses assessed on a lump-sum basis come to €2,950 (i.e. €1,600 + 20% (€12,750 - €6,000) = €2,950).

That taxpayer will be able to claim operational expenses in the amount of €2,950 (lump-sum amount) or the actual expense amount incurred, whichever is higher.

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