

Real estate: a legal and tax reform (Bill n°5696) dated July 2008

The Luxembourg parliament has passed new measures to increase the housing offer and control the domestic real estate market. In addition to implementing public action measures (i.e. housing pact and applying the right of first refusal), the new law (i.e. hereafter the “Law”) considers:

- renewing the legislation governing building rights and long leases; and
- implementing new tax measures.

Building right (“droit de superficie”) and long lease (“emphytéose”)

Building rights and long leases are real rights (“jus in re”) giving the holder of these rights the full enjoyment of a property over a long period of time, with a reduced cost compared to an acquisition of the property ownership. Such real rights were provided for under Luxembourg laws dating back to 1824. They are based on Roman law, under which they were created to govern the running of large properties mainly to the benefit of landlords. Amazingly, they are enjoying renewed interest and may now benefit tenants in a period where housing is scarce and expensive. The Law repeals and updates the old legislation.

Building right

A building right is still defined as a real right (“jus in re”) to erect constructions on land owned by another person, in consideration for a financial contribution. The Law expressly states that this right provides temporary ownership over the erected constructions. It also gives full enjoyment of existing constructions although their value has not been paid to the landlord. The period for which the right may be granted has been extended from 50 years to 99 years. A renewal is still possible under the Law. Upon expiration of the building right, the landlord becomes the owner of the erected constructions, subject to the payment of a compensation.

The Law grants a new right to the beneficiary of the building right, i.e. a right of first refusal to purchase the property.

Long lease

A long lease is still defined as a real right to the full enjoyment of a property owned by another person, in consideration for a regular payment. It allows the exercise of all rights attaching to the ownership, subject to the condition that the property’s value is not thereby diminished. Long leases are entered into for a period of 27 to 99 years (unchanged by the Law). Upon expiration, the landlord is usually not liable to pay a compensation for the constructions that the tenant has erected.

The agreement may be renewed under the Law. In addition, the minimum period of the lease is increased to 50 years in the case of a housing property. Further, the Law grants the tenant a new right, i.e. a right of first refusal to purchase the property.

Registration duties

The Law provides that the registration duty tax credit granted to individuals upon acquisition of their principal place of residence (according the law of 30 July 2002, see below) is extended to the creation and disposal of building and long lease rights (provided these rights relate to the principal place of residence).

However, the Law does not further clarify the registration duty regime applicable to building and long lease rights, and even adds to the confusion in relation to:

- the creation of rights: based on the administrative practice applicable to date, the creation of building and long lease rights has followed the regime governing ordinary leases, i.e. registration duties of 0.6% and exemption from transcription tax (assuming the payment of a regular compensation for long leases as opposed to a one-shot payment). However, it is unclear whether this tax treatment remains applicable under the Law. In fact, the authors of the bill seem to move from treating these transactions as ordinary leases to treating them as real estate transfers. This shift raises two questions:
 - Is it the intention of the legislator to submit the creation and transfer of these rights to the real estate transfer tax (i.e. 7% duty including the transcription tax; potentially increased to 10% for some types of real estate located in Luxembourg city)?
 - Does the Luxembourg legislation provide for the adequate legal basis for levying such a real estate transfer tax?
- the end of the contract: the question of whether or not the transfer of erected constructions may give rise to the real estate transfer tax is not solved. In our opinion, such transfers are made by virtue of legal provisions and shall not be subject to registration duties. There is, however, no general agreement on this point, especially in respect of building rights. No further guidance has been given in the Law or in the explanatory notes to the bill.

Tax measures

Tax on vacant property

The Law introduces a tax on vacant property that will be levied at the discretion of municipalities. It targets two categories of real estate properties, i.e.:

- residential buildings, which have been vacant for 18 consecutive months;
- building lands that have qualified for a building permit for 3 years and for which construction has not started yet.

Details regarding the implementation of this tax should be provided through local level decrees.

Tax on land still vacant further to the issue of a “building order”

Municipalities may compel owners of land located in areas to be developed in accordance with their overall development plan, to begin construction in those areas. If no action is taken by the owner within 3 years of the “building order” being issued, the municipality may enforce expropriation provisions. As an alternative, municipalities may levy a tax on undeveloped land. Details regarding the implementation of this tax should be provided through local level decrees.

Real estate tax (“taxe foncière”)

The Law also provides for the identification of building lands for the purposes of the computation of the real estate tax, in order to increase the tax due for this category of asset and thereby sanction building lands that remain vacant.

Capital gains: end of tax incentives for sales by individuals

The Law does not extend the temporary tax incentives introduced by the law dated 30 July 2002 with respect to real estate capital gains made by individuals. The measures that no longer apply as of 31 December 2007 concern:

- personal income tax: (i) personal drawings of plots being part of a business based on accounting value and (ii) sale of real estate properties by individuals;
- personal income tax and corporate income tax: sale of building lands located in a housing area.

As a result, capital gains upon the sale of real estate properties that are part of private assets will be taxed more heavily, as illustrated below. On the other hand, individuals will now benefit from a tax exemption if they sell a real estate property to the government, to a city or to an association of cities (unless the sale occurs within the framework of a right of first refusal procedure).

Individual taxation	2002-2007	2008
	Temporary regime	Standard regime
Short term (≤ 2 years)	<ul style="list-style-type: none"> ▪ Deduction of EUR 50,000 (renewed every 10 years; doubled for spouses and partners filing jointly) ▪ Taxation at a rate equal to 25% of the ordinary tax rate 	<ul style="list-style-type: none"> ▪ Taxation pursuant to progressive income tax rates (max 38.95%)
	Specific exemptions	
Speculative profit	<ul style="list-style-type: none"> ▪ Sale of principal place of residence (specific conditions apply) 	<ul style="list-style-type: none"> ▪ Sale to the government, to a city or to an association of cities (allowing for exceptions) ▪ Sale of principal place of residence (specific conditions apply)
	Temporary regime	Standard regime
Long term (> 2 years)	<ul style="list-style-type: none"> ▪ Revaluation of the acquisition cost ▪ Deduction of EUR 50,000 (renewed every 10 years; doubled for spouses and partners filing jointly) ▪ Taxation at a rate equal to 25% of the ordinary tax rate 	<ul style="list-style-type: none"> ▪ Revaluation of the acquisition cost ▪ Deduction of EUR 50,000 (renewed every 10 years, doubled for spouses and partners filing jointly) ▪ Taxation at a rate equal to 50% of the ordinary tax rate (max 19.475%)
	Specific exemptions	
Sale profit	<ul style="list-style-type: none"> ▪ Sale of principal place of residence (specific conditions apply) 	<ul style="list-style-type: none"> ▪ Sale to the government, to a city or to an association of cities (allowing for exceptions) ▪ Sale of principal place of residence (specific conditions apply)

Registration duties in relation to the principal place of residence

Since the law of 30 July 2002 came into force, individuals have enjoyed reduced registration duties when buying their principal place of residence (in fee simple or in usufruct/bare ownership where the transaction puts an end to the subdivision of ownership rights). This reduction takes the form of a tax credit limited to EUR 20,000 per person.

Various requirements need to be met for this tax credit to be granted. Among other things, the buyer must commit to live in the building as his / her principal place of residence for at least 5 years. This condition is reduced by the Law from 5 to 2 years.

As mentioned above, the Law also extended the benefit of the tax credit to the creation and disposal of building and long lease rights by individuals (provided these rights relate to the principal place of residence).

These new provisions apply to deeds acknowledged before a notary as from 1st January 2008 (i.e. individuals who acquired their principal place of residence before 2008 would not benefit from the reduced occupancy period).

It is foreseen that the new measures will come into force on different dates (i.e. 1st January 2008, 1st January 2009 or on the first day of the month following the month in which the Law will be published in the Luxembourg gazette) subject to a second hearing and vote by the Luxembourg parliament. The text voted in the first hearing may still be amended.

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