Optional NWT reduction - §8a VStG - Circular I. Fort. N°47quarter of 17 May 2018

12 June 2018

On 17 May 2018, the Luxembourg tax authority issued Circular I. Fort. N°47quarter ("the Circular") clarifying the modalities of the Net Worth Tax (NWT) reduction from 1 January 2017, further to the Law of 23 December 2016 amending § 8a VStG.

As a reminder, Luxembourg entities can opt to reduce their actual NWT due if several conditions are met, including the following:

- An NWT special reserve of 5 times the amount of the NWT reduction for year N is booked in the financial statements of year N (no more administrative tolerance - see below) and kept for 5 years, i.e. N, N+1, N+2, N+3 and N+4. The reserve must be constituted by allocating the N-1 results / carried-forward results / available reserves
- 1st limit: the amount of the NWT reduction for year N is limited to the CIT due for year N-1, including the solidarity surtax before tax credits.
- 2nd limit: the NWT due after the optional reduction cannot be lower than the "reduced" minimum NWT.
- The creation and development of the NWT reserve for each year must be clearly identified in the accounting records. It is also recommended that a sub-account be created for each year of NWT reduction.

Deadline for booking the 5-year NWT reserve – no more administrative tolerance

The NWT reserve for year N must appear in the financial statements of year N (further to approval at the general meeting). The administrative tolerance of one additional year to book the special reserve no longer applies, with effect from the 2017 NWT.

Consequently, 2017 NWT reserve (unitary value as at 1 January 2017) must be booked in the 2017 annual accounts by allocating the 2016 results/carried-forward results/ available reserves to a special NWT reserve amounting to 5 times the amount of the NWT reduction.

Deferred depreciation

The Circular further confirms the impact of the possibility for the taxpayer to opt for deferred depreciation pursuant to Article 32(1) of the Luxembourg Income tax Law (LITL).

In such a case, from the 2018 tax year, the 1st limit for the NWT reduction for year N becomes the CIT due for year N-1, including the solidarity surtax **after** tax credits.

Non-compliance with the 5-year period

If the NWT reserve is not kept for 5 years, the related NWT reduction granted is lost and the NWT due for the following year (after release) is increased by a fifth of the NWT reserve breached. There is an exception to this rule in the event of liquidation, in which case the NWT for the year of release is increased.

However, in the event of restructuring pursuant to Articles 170 and 172 LITL (de/merger, change of legal form or outbound migration) at book value or fair-market value, the 5-year requirement is not considered breached, provided that the NWT reserve is taken over/continued by the beneficiary, irrespective of its tax residency.

Capitalisation of the NWT reserve is also not considered a breach of the 5-year requirement unless the capital increase is followed by a capital reduction within the 5-year period. In the event of capital reduction, the NWT reserve previously incorporated into capital will be deemed to be released first.

Tax unity

The NWT is still outside the scope of the tax unity regime. However, even if the integrating entity is the sole taxpayer, all the integrated entities are eligible for the optional NWT reduction for year N if they were part of the tax unity group in year N-1. The total NWT reduction for year N for the entities in the tax unity group is limited to the total CIT for year N-1 due by the group, including the solidarity surtax and **before** any tax credits.

An entity's NWT reserve for year N can be formed by any other entity in the tax unity group, provided that the beneficiary was part of the tax unity group in year N-1 and the allocation of the reserves is clearly documented in relation to the years of NWT reductions and the entities concerned.

Luxembourg permanent establishments of foreign companies

Luxembourg permanent establishments of foreign companies are eligible for the optional NWT reduction if their proper accounting records are kept separately from the head office. As they are not subject to the minimum NWT, the NWT reduction for year N is limited to the CIT for year N-1, and the second limit does not apply.

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