

## New Tax Measures in the Pipeline Bill No. 5801 dated 7 November 2007

Within a context of uncertain economic development and budgetary discipline, the Luxembourg government has announced a tax reform in favor of individuals only. Nevertheless, the bill No. 5801 submitted yesterday also includes measures for the benefit of business entities, namely a partial exemption of income and gains from intellectual property rights and an increase of the investment tax credit. Besides the tax cuts, some measures are less favorable. This is especially the case for provisions in relation with polluting vehicles.

### Individuals

#### Indexation of the brackets of taxable income

For the first time since 2002, the tax brackets will be indexed linearly by 6%. The various tax rates (from 0 to 38%) that apply progressively to the income brackets have not been modified. As a result of this provision, with comparison to the current regime, taxpayers should enjoy a yearly decrease of their tax burden of maximum EUR 473 for individuals in tax class 1 and of EUR 946 for the taxpayers in class 2.

#### Taxation of company cars

Official comments relating to the new measure on polluting vehicles mention in passing that the tax authorities will scale up the lump-sum fringe benefit deriving from the personal use of a company car. Such benefit would be fixed at 2% of the purchase price of the car (including VAT), instead of 1.5% currently.

#### Replacement of the tax credit for dependent children by a tax bonus

For most taxpayers, the yearly tax credit for dependent children (amounting to EUR 922.5 per child) will be cancelled and replaced by an equivalent yearly tax bonus payable by the "Caisse Nationale des Prestations Familiales". From a practical point of view, this provision will benefit the taxpayers whose tax liability was not sufficient to take advantage of this tax credit. For the other taxpayers, this amendment will be neutral.

#### Option for common-law spouses to be taxed collectively

Individuals covered by a Luxembourg or a foreign formal recognition of common law status for a full tax year (i.e. from 1 January to 31 December) may elect to be taxed collectively (with the benefit of the tax class 2). This collective taxation will be beneficial when only one partner derives income. This provision will apply to Luxembourg residents and under certain conditions to non-residents.

In addition, various tax provisions will be amended with the aim to assimilate common-law partners to married spouses from a tax perspective.

## Overtime

The tax regime currently exempting from tax the supplement of salary paid on overtime, night or weekend work, will be modified to be in line with the "statut unique" applying to private employees. One of the major changes is that the exemption on overtime will no longer be capped. A grand-ducal decree will be issued to establish how this amendment will be applied and under which conditions.

## Non-resident taxation

In line with the European Court of Justice case law, the optional assimilation tax regime provided for non-resident taxpayers will be modified. Non-resident taxpayers deriving more than 90% of their professional income in Luxembourg may elect to be taxed on Luxembourg source income as if they were residents. In such case, the applicable tax rate is currently determined taking into consideration their worldwide professional income. For the future, it is proposed to determine the tax rate of the concerned individuals based on their worldwide global income. This provision may notably be beneficial to foreign taxpayers having negative rental income (or mortgage interest on their main accommodation).

## Business entities

### 80% exemption for IP income and gains

The Luxembourg government wishes to position Luxembourg as a key centre for the management of intellectual property rights and the development of research and innovative activities.

To meet this goal, the government proposes an 80% exemption on the net positive income received as consideration for the use of, or the right to use, any copyright on software, any patent, trade mark, design or model. This partial exemption would lead to an effective tax rate of 5.9% on the net IP income.

It's worth noting that the 80% deduction would also apply to taxpayers that have created a patent and used it for their own business purposes. This notional deduction would be computed by reference to the arm's length net positive income that the taxpayer would have received had it licensed this patent to an unrelated party.

Last but not least, the 80% exemption would also apply to the capital gain realised on the disposal of the considered IP. A recapture system is, however, foreseen to avoid exempting a gain, where the concerned IP has generated negative net income.

This new measure would only apply to IP acquired or created after 31 December 2007.

Finally, some anti-abuse provisions are foreseen, mainly to avoid:

- The full deduction of related expenses;
- The cumulative use of tax incentives for the same IP.

### Increase of the investment tax credit

The tax credit for complementary investments would be increased up to 12% (instead of 10% currently).

## Polluting motor vehicles

Expenses in relation to motor vehicles, which generate CO2 emissions above 190g/km, would no longer be deductible while income resulting from the alienation of such vehicles would not be included in the commercial profit anymore. This measure would, however, not be applicable to:

- Vehicles registered prior to 1 January 2008, provided they have not been transferred to a new owner or holder as from this date;
- Vehicles used in defined activities (e.g. transportation, car leasing) or expressly excluded.

The CO2 emissions threshold would decrease to 180g/km as from 1 January 2010.

***Please be aware that this bill is not yet voted and may still be amended.***

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