

10% Taxation for interest income from private investments (amendments to the so-called “Relibi law”)

dated June 2008

The Luxembourg parliament passed a bill in a first reading* to amend the so-called “Relibi law” of 23 December 2005 on the taxation of interest income received by individuals resident in Luxembourg. The Relibi law brought significant changes to how savings income is taxed by implementing a 10% withholding tax on interest income paid to Luxembourg individual residents by paying agents located in Luxembourg. As this withholding tax is in full discharge of personal income tax, it is potentially favourable to taxpayers. Since the Relibi law excluded interest income paid by paying agents located in an EU Member State other than Luxembourg, the Relibi law was deemed to be in breach of the EU principles of free movement of capital and freedom to provide services. Following the Reasoned Opinion from the European Commission, the amending law aims at ending this discrimination for interest income accrued from 1 July 2005 and paid as from 1 January 2008.

*the Council of State should now provide that no second reading is required

Optional 10% flat tax

The amending law gives resident taxpayers receiving cross-border interest income the option to apply for a 10% flat tax. The 10% flat rate is limited to interest income (within the meaning of the Relibi law) that is paid to individual Luxembourg residents by a paying agent located:

- in another EU Member State, or
- in a country that is part of the European Economic Area (i.e. Iceland, Norway and Liechtenstein, although the latter is not referred to in the parliamentary documents), or
- in a country that has entered into an international agreement relating directly to the EU savings directive (2003/48/EC). According to the parliamentary documents, this reference solely covers dependent and associated territories of EU member states within the meaning of article 17, paragraph 2 of the EU savings directive.

Interest income that may benefit from the 10% flat tax basically corresponds to the income that would be subject to the 10% withholding tax if payment were made through a Luxembourg paying agent. Notwithstanding the above, interest income that qualifies as professional income (i.e. business income, agriculture and forestry income, income from independent services) is out of the scope of the 10% flat tax. It stands to reason that this income would be out of the scope of the flat tax, since it remains subject to filing requirements and progressive income tax rates, even when a 10% withholding tax has been levied by a Luxembourg paying agent.

The 10% flat tax must be declared and paid by the beneficial owner of the interest. These obligations have to be fulfilled at the latest on 31 March of the year following the year during which the interest is paid. If that is not the case, the taxpayers' rights to opt for this flat tax will lapse for that year. The relevant office in this respect is the tax office in charge of the withholding tax on interest. This tax office will liaise with the tax office in charge of the taxpayer's regular assessments, to ensure that the income is not taxed or exempt twice.

A not so level playing field?

In some respects, the 10% flat tax may prove to be more favourable than the 10% withholding tax, creating a competitive disadvantage for Luxembourg paying agents, as:

- The 10% flat tax is optional, whereas the 10% withholding tax is compulsory: Depending on the level of investment income and on the taxpayer's average tax rate, the tax burden resulting from the application of progressive income tax rates may be below 10%. In that case, it is in the taxpayers' interest not to opt for the 10% flat tax. It should be noted that an option for the 10% flat tax is global and covers all interest income received from foreign paying agents located in the relevant areas;
- The 10% flat tax provides a cash flow benefit, as it is paid once a year, i.e. before 31 March following the year during which the interest was paid, whereas the 10% withholding tax is immediately levied upon interest payment.

10% taxation for interest income derived from private financial investments

	10% withholding tax	10% flat tax
Beneficial owner	Individual resident in Luxembourg	
Paying agent	Located in Luxembourg	Located in another Member State of the EU or of the EEA or in a country that has entered into an international agreement relating directly to the EU savings directive
In scope income	<ul style="list-style-type: none"> - Interest paid or credited to an account, relating to debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits; - Interest accrued or capitalised at the sale, refund or redemption of the debt claims referred to above 	
Out of scope income	<ul style="list-style-type: none"> - Income from grand-fathered bonds and other negotiable debt securities (for a transitional period); - Income from derivatives and innovative financial instruments; - Income deriving from UCITS or entities deemed to be UCITS - Income on current accounts if not exceeding 0.75%; - Income paid or credited once a year on savings deposits not exceeding EUR 250 per year and per paying agent 	
In charge of declaring and paying the tax	Paying agent	Beneficial owner
Timing of the tax levy	Upon each interest payment	Once a year, at the latest on 31 March of the year following the year of the interest payment
Nature of the tax levy	<ul style="list-style-type: none"> - Compulsory - In full discharge of personal income tax 	<ul style="list-style-type: none"> - Optional - In full discharge of personal income tax
Foreign withholding tax	Possible reduction/refund in consideration of foreign withholding tax based on double tax treaty or domestic provisions implementing the EU savings directive and connected agreements	

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