

24 October 2005

Abolition of net wealth tax for individuals and introduction of a withholding tax in full discharge of income tax on certain interest payments derived from transferable securities

Objective

On October 19, 2005, Luxembourg Treasury and Budget Minister Luc Frieden introduced a bill which should become effective as of January 1, 2006. The main objective of the bill is to make the tax regime which applies to Luxembourg residents more attractive.

Net wealth tax to be abolished for individuals

The abolition of net wealth tax for resident and non-resident individuals has been in the pipeline for some time. This tax currently applies to individuals' net wealth at a rate of 0.5%. The bill's provisions should be effective as of January 1, 2006. Net wealth tax will continue to apply to corporations however.

Introduction of a withholding tax in full discharge of income tax on savings income in the form of interest payments

The bill also introduces a withholding tax in full discharge of income tax of 10% on interest derived from certain transferable securities and paid to Luxembourg resident individuals through a paying agent located in Luxembourg. These taxpayers will no longer need to declare these interest payments in their tax returns and these payments will no longer be subject to a tax calculated by assessment.

This taxation system builds on the law of June 21, 2005 which transposed Council Directive 2003/48/EC of June 3, 2003 on taxation of savings income in the form of interest payments into Luxembourg law.

Scope

The 10% withholding tax will apply to the interest paid by a paying agent¹ to a resident beneficial owner² to the extent that the products which bear this interest are part of the beneficial owner's private assets.

Broadly speaking, the bill refers to the interest paid or credited to an account, relating to debt claims of every kind and to interest accrued or capitalised at the sale, refund or redemption of debt claims of every kind.

Certain negotiable debt securities which fall within the scope of Directive 2003/48/EC have been specifically left out of this withholding tax system. They include income derived from interest payments distributed by UCITS and income realised upon the sale, refund or redemption of UCITS shares if these UCITS invest more than 40% of their assets in debt claims.

The bill provides for further exemptions from withholding tax, including for interest relating to savings deposits with a home savings bank (caisse d'épargne-logement) and for interest relating to debt claims which carry a right to participate in the debtor's profits.

These transferable securities, to which the withholding tax in full discharge of income tax does not apply, will continue to be subject to the current tax regime. For instance, capitalising SICAVs will continue to be taxed favourably in the hands of Luxembourg tax residents (i.e. the capital gain from the disposal will be exempt providing that the taxpayer has held the shares for a period exceeding 6 months and that his shareholding is below 10%).

The income from life-insurance products, which was outside the scope of Directive 2003/48/EC, is not covered by this new tax regime either.

Finally, the withholding tax in full discharge of income tax does not apply to dividends either. Tax on dividends in the hands of the Luxembourg residents will still be withheld at source (e.g. 20%) and/or calculated by assessment, as the case may be.

¹ Paying agent means any Luxembourg-based economic operator who pays interest to or secures the payment of interest for the immediate benefit of a resident beneficial owner.

² Beneficial owner means any individual:

- who receives an interest payment or for whom an interest payment is secured unless he provides evidence that it was not received or secured for his own benefit, and
- who is a resident of Luxembourg unless he provides the paying agent with a certificate evidencing that he is a resident of another country.

Exemption

Under the bill, interest deriving from savings deposits (demand or term deposits or deposits at notice) benefits from a EUR 1 500 exemption per year and per person.

In practice, this interest would be subject to the 10% withholding tax and taxpayers can later file a request with the withholding tax office for a tax refund corresponding to the exempt income.

Levying the tax

The imposition of withholding tax is the responsibility of the paying agent who will levy withholding tax whenever income is paid.

Preserving banking secrecy – outstanding assessments

The bill does not jeopardize banking secrecy vis-à-vis the tax authorities. The tax withheld by the paying agent will be paid to the tax authorities without disclosing the beneficial owner's identity. In addition, the bill expressly provides that the information relating to the income subject to the withholding tax in full discharge of income tax may not be used (under certain conditions) to prosecute taxpayers for tax fraud or to impose taxation on them in respect of income tax or net wealth tax originating before the entry into force of the law.

Contacts

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