

Luxembourg announces changes that would decrease corporate income tax rate and increase personal tax rate

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In brief

Luxembourg Finance Minister Pierre Gramegna on February 29, 2016, announced changes to Luxembourg's corporate and personal tax systems that are planned for 2017. The changes are the result of extensive discussions over the previous 18 months, and relate to possible reforms of the Luxembourg tax system. The changes include a reduction of the corporate income tax rate from 21% to 18% in two steps and an increase in the personal tax rates for individuals earning more than EUR 150,000.

These measures, which are planned to take effect progressively beginning on January 1, 2017, are likely to be included in a bill that could be voted on by the Luxembourg Parliament later this year.

In detail

Corporations

Reduction of the corporate income tax rate

The changes include a proposal to lower the corporate income tax rate from 21% to 18% over the next two years, beginning in 2017. The announcements are not expected to change either the 'solidarity surtax' on the corporate income tax rate or the rate of municipal business tax due by companies.

The corporate income tax rate would be reduced to 19% for 2017, resulting in an overall effective tax rate of 27.08% for companies in Luxembourg City for FY 2017. This estimate includes the solidarity surtax of

7% on the corporate income tax rate and the applicable 6.75% municipal business tax rate.

The corporate income tax rate would be reduced again to 18% for 2018, resulting in an overall tax rate of 26.01% in Luxembourg City for FY 2018. Similar to the estimate for FY 2017, this amount includes the solidarity surtax of 7% on the corporate income tax rate and the applicable 6.75% municipal business tax rate.

The corporate income tax rate for small and start-up companies — such as companies with taxable income of less than EUR 25,000 — would be reduced to 15% beginning in 2017. The rate reduction would result in an overall tax rate of

22.08% for Luxembourg City, including the solidarity surtax of 7% on the corporate income tax rate as well as the applicable 6.75% municipal business tax rate.

Increase in the minimum net wealth tax

Luxembourg introduced a minimum net wealth tax (NWT), effective January 1, 2016, for all corporate entities with a statutory seat or central administration in Luxembourg. The measures imposing the tax are very similar to the outgoing provisions for a minimum corporate income tax charge, which were abolished effective on the same date.

The minimum NWT applicable to holding and finance companies (SOPARFIs) with a sum of fixed financial assets, transferable securities, and cash in banks, as reported in their commercial accounts presented on the standard Luxembourg form, that exceeds the sum of 90% of total gross assets and EUR 350,000 would be increased from EUR 3,210 (including the solidarity surtax) to EUR 4,815 (including the solidarity surtax).

The minimum NWT applicable to all other corporations with their statutory seat or central administration in Luxembourg would remain unchanged.

Restriction on the use of future losses

The use of generated losses would be limited, effective on January 1, 2017. The Finance Minister's press presentation outlined that such losses would be available only to offset the taxable profits of subsequent periods, up to a maximum of 80% of the taxable profits of each period. Losses generated after January 1, 2017, could be carried forward only for up to 10 years.

Losses generated before January 1, 2017, should not be affected by these limitations.

Other new tax measures

Other measures that would benefit companies include:

- To assist inter-generational transfers of family businesses, capital gains linked to real estate assets (both land and buildings) would benefit from tax-neutral treatment.
- Farming businesses would be able to deduct 30% of the amount of any new investment in the business up to a total of EUR 250,000.

Investment above this amount would benefit from a deduction of 20% of the excess.

Individuals

A number of individual-based measures have been announced, most of which reduce the tax burden for the 'middle class.'

Conversely, the marginal income tax rate would increase from 40 to 42%, before application of the solidarity surcharge.

Abolition of the temporary budget tax

The 0.5% temporary 'budget balancing' tax would be abolished.

Strengthening of households' purchasing power

Tax credits for salaried individuals, pensioners, and single-parent families would be increased in a targeted way:

Low-income households would benefit from a higher tax credit up to EUR 600 per year for salaried individuals and pensioners, up from the current EUR 300 per year. The tax credit would decrease to EUR 0 (nil) for taxpayers with income exceeding EUR 80,000 per year.

Single parents would enjoy a tax credit of up to EUR 1,500 per year, up from the current EUR 750 per year if annual income does not exceed EUR 35,000. The tax credit would remain EUR 750 if the annual income exceeds EUR 35,000.

Optional separate taxation regime for married couples

The changes would enable resident and non-resident married taxpayers to elect separate taxation of income. The consequences of this election are still unclear.

Modification of the income tax brackets

The measures include a revision of income tax brackets and introduce several new tax rates. The overall consequence is anticipated to be a reduction of the average tax rate.

However, the measures would introduce new tax rates for individuals with higher incomes; specifically, rates of 41% and 42% on income exceeding EUR 150,000 and EUR 200,004, respectively.

Real estate

The changes would implement various provisions to facilitate the acquisition of a main residence in Luxembourg.

For example, the changes would increase the limits on mortgage interest deductions related to the taxpayer's main residence, for the first year of occupation and the five following years to EUR 2,000 per year from EUR 1,500; for the next five years, to EUR 1,500 from EUR 1,125; and for years after that, to EUR 1,000 from EUR 750.

Furthermore, tax-deductible contributions to home savings plans (*épargne-logement*) would increase from EUR 672 to EUR 1,344 for individuals below the age of 40.

Deemed rental income of a property occupied by the owner no longer would be imputed.

Capital gains arising from the disposal of real estate — other than the capital gain on the sale of a main residence, which is fully tax exempt — would be taxable at 25% of the taxpayer's overall effective tax rate, if the sale occurs between July 1, 2016, and December 31, 2017.

Withholding tax on interest income

Under the 'Relibi' Law, qualifying interest income derived by a

Luxembourg resident currently is subject to a 10% flat, final withholding tax. This rate would increase to 20%.

The takeaway

Companies or individuals with activities in Luxembourg should consider the impact these changes could have on their structures, tax positions, and operations.

Let's talk

For a deeper discussion of how this may affect your business, please contact:

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