QUARTERLY TAX NEWSLETTER

SUMMARY

1. NEW DRAFT LAW ON CODIFICATION OF TAX MEASURES

- **More guidance regarding the tax treatment of classes of shares**

On May 23, 2024, the Luxembourg Government presented a draft law to the Luxembourg Parliament, which intend to clarify the concept of “partial liquidation”, which is not subjected to withholding tax and occurs when an entire shareholding is redeemed, leading to a capital reduction.

The “partial liquidation” regime will explicitly include the redemption of a specific class of shares followed by their cancellation, provided the following conditions are met:

- The redemption must encompass the entire class of shares, followed by its cancellation reflecting a share capital reduction within 6 months of the redemption date.
- The classes of shares were established at the company incorporation or during a capital increase.
- Each class of shares has distinct economic rights outlined in the company’s bylaws, such as preferential dividends, exclusive profit rights for a specific period, or financial rights tracking assets performance or activities of the company.
- The redemption price will be set at the fair market value at the time of repurchase, and the method for calculating this price will be specified in the company’s bylaws.

If the redemption involves a class of shares owned by an individual with a substantial interest in the company, that company must include a special declaration in its company’s annual tax return. A substantial interest is defined as a direct or indirect ownership of more than 10% of the share capital, either individually or collectively with a spouse, partner, or minor children, at any time in the five years prior to the transfer.

Lastly, the draft law confirms that the general anti abuse provisions remain in effect.

As a reminder, in an administrative court decision, dated 27 January 2023, the Luxembourg Administrative Court ruled that income from the redemption/cancellation of classes of share should be treated as a capital gain, not subject to withholding tax.

- **Possibility to waive Luxembourg dividends and capital gains exemption**

Starting from the 2025 tax year, the draft legislation seeks to allow companies to opt out of two exemption regimes related to dividends, specifically:

- **Full exemption**: The Luxembourg participation exemption **outlined in article 166 of the Luxembourg Income Tax Law ("LITL")**, which applied to dividends received from qualifying participation where the holding represents at least 10% of the subsidiary share capital or has an acquisition cost of at least EUR 1.2 million (for dividends) or EUR 6 million (for capital gains). Due to restrictions imposed by the Parent-Subsidiary Directive, option out would only be allowed when the exemption is solely based on the EUR 1.2 million threshold, or six million and not the shareholding.

- **Partial exemption (50%)**: The partial exemption regime **established in article 115 15a of the LITL** concerning dividend.

In both scenarios, the option to opt out must be exercised annually and on an individual participation basis.

The introduction of such an option is inspired by similar regulation in other EU Member States. The aim is to provide greater flexibility for taxpayers who may wish to utilize their carried- forward tax losses, especially since losses incurred from January 1, 2017, can be carried forward for a maximum of 17 years.

- **Codification of a Constitutional Court's case law**

On November 10, 2023, the Constitutional court determined that the minimum net wealth tax regime for companies primarily holding financial assets violated the principle of equality. In response, the draft legislation proposes a revised and simplified framework, in which the minimum tax will solely depend on the taxpayers' total balance sheet. A minimum net wealth tax of **EUR 535** should apply when the total balance sheet is **less than or equal to EUR 350,000**. A minimum net wealth tax of **EUR 1,605** should apply when the total balance sheets **is greater than EUR 350,000 and less or equal to EUR 2,000,000**. A minimum net wealth tax of **EUR 4,815** should apply when the total balance sheets **is greater than EUR 2,000,000**.

- **E-filing of tax returns**

Beginning January 1, 2025, electronic filing will become mandatory to modernize tax compliance and assessment processes. This will replace paper filing for certain tax returns, including those of withholding tax on directors' fees ("tantièmes") and withholding tax on wages and pensions.

2. NEW ADMINISTRATIVE CIRCULAR ON THE RESIDENCE CERTIFICATED FOR LUXEMBOURG SPFS

On June 4, 2024, the Luxembourg tax authorities released a circular offering guidance on residence certificates to be issued to private wealth management companies ("SPFs").

SPFs are tailored for individuals managing their private wealth and can take various corporate forms. However, they are restricted to holding and managing financial assets and are prohibited from engaging in commercial activities. They enjoy a favorable tax regime, being exempt from income tax and net wealth tax, but they are subject to an annual subscription tax of 0.25% (on the net assets value of the company) and are not eligible for Luxembourg's double tax treaties.

According to the circular, SPFs qualify as Luxembourg residents if they fulfil the cumulative criteria outlined in Article 159 of the LIR, which (i) specifies certain corporate structures and (ii) requires **registered office or central administration** in Luxembourg. The Direct Tax Administration must issue a certificate.

To apply for a residence certificate, SPFs must submit relevant company information (the name and address of the SPF; the tax identification number of the SPF; the date of adoption of the SPF regime; the language in which the residence certificate has to be issued; by whom the request is introduced and the reason for the request including notably the accurate reference to the foreign legislation requiring the issuance of a certificate of residence), with the possibility of additional documentation being requested before issuance.

3. THE DOUBLE TAXATION TREATY BETWEEN LUXEMBOURG AND THE REPUBLIC OF RWANDA ENTERS INTO FORCE

In July 2024, the Double Taxation Treaty between Luxembourg and the Republic of Rwanda officially comes into effect. This treaty aims to eliminate the issue of double taxation on income earned by residents of either country, promoting cross-border investment and economic cooperation. By providing clarity on tax obligations, the agreement is expected to enhance bilateral relations and encourage businesses to operate more freely between Luxembourg and Rwanda.

4. LUXEMBOURG TAX INCENTIVES FOR CORPORATIONS AND INDIVIDUALS

On 17 July 2024, the Luxembourg government introduced a Draft Law to Parliament with various tax measures aimed at reducing the tax burden on households and enhancing the country's appeal for work and investment. This follows the general policy statement made by the government earlier this year. Key changes for corporate taxpayers include lower CIT rates, updates to the SPF Law, and a proposed subscription tax exemption for UCITS ETFs, with the new CIT rates set to take effect in the 2025 tax year.

- **Corporate income tax rate reduction**

The Draft Law proposes a 1% reduction in the CIT rate to better align with EU and OECD averages, following previous cuts since 2017. Currently, the CIT structure has a maximum rate of 17% for income over EUR 200,000 and a minimum of 15% for income up to EUR 175,000. The new proposal aims to lower these to 16% and 14%, respectively, starting in 2025, with an intermediate rate for incomes between EUR 175,000 and EUR 200,001.

Additionally, a 7% surcharge for the employment fund remains in place. For companies in Luxembourg City with taxable income over €200,000, the total tax rate—including the surcharge and municipal business tax—would decrease from 24.94% to 23.87% in 2025.

- **Modification of the SPF regime**

Introduced in 2007, the Société de Gestion de Patrimoine Familial (SPF) in Luxembourg manages private wealth without engaging in economic activities. SPFs are exempt from CIT, MBT, and net wealth tax but pay an annual subscription tax.

The Draft Law proposes several amendments:

- Identification requirements: Companies must include "société de gestion de patrimoine familial" or "SPF" in their names.
- Tax base guidelines: Clear rules for determining the subscription tax base, especially for non-calendar fiscal years.
- Increased minimum subscription tax: Rising from EUR 100 to EUR 1,000.
- Electronic filing: Annual certifications and tax returns must be submitted electronically.
- Administrative fines: Fines up to EUR 250,000 for serious noncompliance.

- Withdrawal process: A structured framework for revoking SPF status, allowing companies to rectify issues beforehand.

These measures will take effect at the start of the trimester following the law's publication, with fines and withdrawal provisions applying only to breaches after the law comes into force.

- **Subscription tax exemption for certain UCITS ETFs**

Based on the draft law, and from the first day of the trimester following the law's enactment, UCITS ETFs (and their compartments) meeting specific conditions should be exempt from subscription tax. The Bill suggests modifying Articles 175 and 176 of the UCI Law dated 17 December 2010.

To qualify, a UCITS ETF must be actively traded on a regulated market or multilateral trading facility, with at least one market maker ensuring the share price reflects the net asset value. The exemption applies only to share classes that meet the ETF (Exchange Traded Funds) criteria.

- **Tax measures for individuals**

- Reform of the Inpatriate Regime: The current regime for foreign workers in Luxembourg ("inpatriates") allows for a tax-exempt impatriation allowance of up to 30% of annual remuneration, along with employer-incurred hiring expenses also being tax-exempt for employees.
- Favourable regime for young professional: The employer can disclose a bonus, at his discretion and linked to salary, decreasing as income increases and ceasing above EUR 100,000. To qualify for the bonus, eligible workers under the age of thirty must have a first permanent contract in Luxembourg and remain with the same employer for a maximum period of five years.
- Profit-Sharing Bonus Regime: The profit-sharing bonus can now be up to 30% of annual gross salary and the total employer bonus can represent 7.5% of the previous year’s profit. It can benefit from a with 50% tax exemption if it does not exceed 5% of the employer's positive results or 25% of the employee's annual salary for that fiscal year.
- Tax Credit for Cross-Border Workers’ Overtime: Employees (excluding officials and trainees) residing in a country with a double taxation treaty with Luxembourg, who receive fully tax-exempt overtime pay for work in Luxembourg, may face taxation on that income in their home country. This can happen if their residence state applies a tax credit or if the treaty allows such taxation. To mitigate this income loss, a 2024 overtime tax credit is proposed to provide compensation, maintaining Luxembourg's attractiveness for employers.
- Adjustment of the Tax Scale for Inflation: The tax scale will be adjusted starting in fiscal year 2025, addressing “cold progression” with a 2.5 indexation.
- Targeted Measures for Lower-Income Taxpayers: Effective from fiscal year 2025, key measures include:

  - Increased tax-exempt threshold for Class 1a from EUR 24,876 to EUR 26,460.
  - Single-parent tax credit raised from EUR 2,505 to EUR 3,504.
  - Child allowance increased from EUR 4,422 to EUR 5,424.
  - Minimum social wage tax credit increased from EUR 70 to EUR 81 monthly.

5. NEW ADMINISTRATIVE CIRCULAR CONCERNING THE LUXEMBOURG LIQUIDATION PROCEDURE

On July 19, 2024, the ACD issued a new Circular ("Circulaire du directeur des contributions, L.I.R., n. 170/1. 170bis/1") regarding the tax treatment of dissolution without liquidation under Article 1865bis of the Luxembourg Civil Code ("Simplified Liquidation"). This allows a Luxembourg entity wholly owned by a sole shareholder to dissolve by transferring all assets and liabilities to that shareholder.

Key points from the Circular include:

Corporate Income Tax (CIT): the Circular emphasizes that the simplified liquidation under Article 1865bis of the Civil Code should have the same tax implications as a traditional liquidation. This means that the company will be taxed on the realization of all its assets and liabilities at their fair market value.

Additionally, the Circular clarifies that a dissolution without liquidation should be treated as a merger, allowing it to benefit from the same tax-neutral regime applicable to mergers. Once the necessary conditions outlined by article 170 of the Luxembourg Income Tax Law are fulfilled—specifically, (i) the transfer is executed through the cancellation of the absorbing entity's participation in the absorbed entity, and (ii) the transfer must ensure future taxation in Luxembourg of any hidden reserves that would have been taxable without the tax-neutral regime—the simplified liquidation can occur without triggering taxation at the level of the dissolved company.

Municipal Business Tax (MBT): The same rules apply as for CIT, permitting a tax-neutral merger.

Net Wealth Tax (NWT): The NWT reserve can be maintained without impact during a simplified liquidation if the receiving entity fulfils the five-year condition. If an NWT reduction is required, the reserve must be established in the prior tax year. For standard liquidations, the company remains liable for one-fifth of the NWT reserve at liquidation's end.

The Circular offers favourable updates regarding the tax implications of simplified liquidations in Luxembourg.