Luxembourg Tax Alert: 2021 Luxembourg Budget - Key Tax Measures

October 20, 2020

On October 14, 2020, the Luxembourg Minister of Finance tabled a draft bill for the 2021 Budget (the Budget Bill). Described as “an exceptional budget for exceptional times”, the minister highlighted the Budget Bill’s focus on tax justice, encouraging sustainability, as well as on the general need to increase the overall competitiveness and attractiveness of the Grand Duchy’s financial industry.

The most dramatic changes announced by the Budget Bill were already unveiled earlier in 2018 via the government’s coalition agreement. Many of these measures relate to anti-abuse measures that target inconsistencies and anomalies that are mostly peculiar to the Luxembourg real estate industry.

When looked at in conjunction with the other proposals in the Budget Bill, notably the introduction of tax-friendly participatory bonus and impatriate schemes, this package signifies an attempt at economic realignment, rather than a tax hike in the Grand Duchy.

You will find below a short summary of the key measures proposed under the Budget Bill.

Attracting talent

Employee participation scheme

To enhance the attractiveness of Luxembourg as a financial center, the 2021 Budget Bill unveiled a new employee participation scheme, whilst simultaneously announcing the abolition as of January 1, 2021, of the so-called “warrant regime”.

This employee participation scheme will allow corporate employers to grant employees a profit-sharing bonus with a 50% tax exemption. The overall available amount for such a bonus is, however, limited to 5% of the employer’s profits, is only available to employees that are affiliated with the Luxembourg social security scheme, and cannot total more than 25% of that employee’s annual income.

Impatriate bonus

The Budget Bill also proposes certain changes to Luxembourg’s impatriate regime, which will also undergo formal codification into the Luxembourg Income Tax Law. The impatriate regime will grant employers the option of providing impatriate employees with a bonus that will benefit from a 50% tax exemption, whilst also being fully deductible as a business expense at the level of the employer.

To qualify for the impatriate regime, an impatriate must be an employee who has not been fiscally domiciled in Luxembourg in the past, has not been subject to income tax in Luxembourg levied on their professional income for at least five years, and does not live within 150km of Luxembourg’s borders.

Sustainability

To aid in the development of sustainable financing, the budget for 2021 also proposes the progressive lowering of subscription taxes for UCIs (Undertakings for Collective Investments) investing in “environmentally sustainable economic activities” as per the European Union’s Taxonomy Regulation.

The subscription tax reduction will be proportional to the amount of sustainable assets held as a percentage of a fund’s total net assets. Whilst encouraging the growth of sustainable financing in the Grand Duchy, this progressive reduction also serves to realign Luxembourg’s financial sector with investment trends of the future.

Real estate levy for investment vehicles holding Luxembourg real estate

Investment funds

The Budget Bill also includes an anti-abuse measure in the form of an annual levy on investment vehicles holding and deriving income from Luxembourg real estate as of January 1, 2021. The proposed levy will be set at a rate of 20% without the possibility of deductions. Income from Luxembourg real estate includes capital gains, rental income, as well as income from the sale of shares/units in tax-transparent entities holding Luxembourg real estate (but only up to the portion of the gain corresponding to the value increase of the Luxembourg assets).

The investment vehicles within the scope of such a levy include undertakings for collective investment within the meaning of Part II of the law of 17 December 2010 (UCI), specialized investment funds (SIF) within the meaning of the law of 13 February 2007, and reserved alternative investment funds (RAIF) within the meaning of article 1 of the law of 23 July 2016.

The real estate levy would not apply when the vehicles exist under a tax-transparent form such as a Luxembourg SCS/SCSp (Luxembourg limited partnerships), or a contractual fund regime such as a Luxembourg fonds commun de placement (FCP). Fully taxable RAIFs only investing in risk capital and subject to the specific tax rules of article 48 of the RAIF law are also excluded.

SPF regime and indirect real estate holdings

For consistency purposes with the aforementioned measures, the Budget Bill also proposes an explicit prohibition for private wealth management companies (SPF) subject to the law of 11 May 2007 from holding real estate indirectly via tax transparent entities or funds.

Real estate registration duties and share deals

To further emphasize the notion of consistency regarding the real estate sector, the Budget Bill also proposes increasing the rates of ad valorem registration and transcription duties for cases where real estate is contributed to a company in exchange for shares in that company.

The Budget Bill proposes to increase the rate of registration duties for share-remunerated real estate contributions from 0.5% (+2/10) to 2% (+2/10) and to double the transcription duty from currently 0.5% to 1%. As such, the new overall registration duties will amount to 3.4% instead of 1.1%. For real estate located in Luxembourg-City, a 0.3% city surtax is to be added.

Tax consolidation regime

The Budget Bill also acknowledges the European Court of Justice's ruling of May 14, 2020 (C-749/18), wherein Luxembourg's tax consolidation regime applicable prior to 2015 was declared in contradiction of the fundamental freedom of establishment.

As such, the Budget Bill includes a proposal to allow, for FY2020, FY2021 and FY2022, the possibility to change from "vertical" to "horizontal" tax consolidation, without negative tax consequences for the members of the tax-consolidated group, provided certain conditions are met.

Your Key Contacts

Jean-Luc Fisch
Partner, Luxembourg
D +352 468 38 32 17
M +352 621 238 072
jeanluc.fisch@dentons.com