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BOOSTING LUXEMBOURG'S ATTRACTIVENESS – KEY TAX MEASURES RECENTLY ADOPTED BY THE GOVERNMENT

On 11 December 2024, the Luxembourg Parliament adopted, among others, two major bills containing much awaited measures and clarifications regarding the Luxembourg tax framework. These two bills (n°8414 and n°8388) contain a package of measures which clarify, modify and/or ratify existing practices or provisions.

A third bill (n°8186A) mainly amends the Luxembourg general tax law (*Abgabenordnung*) to simplify and harmonise certain tax matters.

The measures contained in these bills aim to boost the economy and promote growth by establishing a framework enabling the financial centre to strengthen and clarify the application of tax provisions to ensure legal certainty. Such measures are mainly related to corporate income tax, personal tax, the interest deduction limitation rule and the tax treatment of the redemption of classes of shares, most of which will apply from 1st January 2025 (except for the amendment with respect to the interest deduction limitation rule which applies retroactively from 1st January 2024).

BILL 8414 – EMPHASIS ON THE AMENDMENT OF THE INTEREST DEDUCTION LIMITATION RULE

Situation before Bill 8414

Amendment provided by Bill 8414 on the interest deduction limitation rule concerns all Luxembourg joint-stock companies but is particularly relevant in the context of securitisation transactions.

Securitisation transactions in Luxembourg are governed by the law of 22 March 2004 on securitisation, as amended (the "**Securitisation Law**"). According to the commentary of the Securitisation Law, securitisation transactions pursue an objective of tax neutrality which is essentially

Key issues

- Interest deduction limitation rule
- Corporate income tax rate
- Personal tax
- Subscription tax
- Redemption of classes of shares
- Minimum net wealth tax
- Participation exemption regime
- Tax filing obligations

guaranteed by the deductibility of all commitments assumed towards investors and creditors.

This objective has however been undermined by the entry into force of the law of 21 December 2018 implementing the Directive (EU) 2016/1165 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market and introducing interest limitation rules (the "**Interest Limitation Rule**") by the insertion of an article 168bis in the Luxembourg income tax law, as amended ("**LITL**"). According to the Interest Limitation Rule, exceeding borrowing costs (i.e. borrowing costs that are in excess of interest and economically equivalent income) are deductible in the tax period in which they are incurred only up to the higher of (i) 30% of the taxpayer's adjusted net revenues before interest, tax, depreciation and amortisation (EBITDA), or (ii) EUR 3 million.

Interest (and economically equivalent) expenses of a securitisation vehicle may constitute exceeding borrowing costs when the Luxembourg taxpayer recognises income/gains that are (economically equivalent to) interest income, which would in turn trigger the application of the Interest Limitation Rule and increase the taxable base of such taxpayer.

Nonetheless, the LITL sets out that taxpayers who qualify as autonomous entities or financial undertakings can be excluded from the scope of the Interest Limitation Rule.

The concept of "autonomous entity" refers to entities which are not part of a consolidated group for financial accounting purposes and have no associated enterprise (see definition below).

The concept of "financial undertakings" refers to a list of entities which are excluded from the application of the Interest Limitation Rule including securitisation special purpose entities ("**SSPEs**") within the meaning of the article 2, point 2 of Regulation (EU) 2017/2402 of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (the "**Regulation**"). Other securitisation companies (i.e. that are not governed by the Regulation) are not included in the list of excluded "financial undertakings", to the extent they do not qualify as alternative investment funds.

Impact of the amendment introduced by Bill 8414

On 11 December 2024, the Luxembourg Parliament approved the introduction in the LITL of the "single-company-group" concept (also called "group of one" or "single-entity-group" provision). This amendment creates a single-entity-group in Luxembourg that will in principle not be subject to the Interest Limitation Rule (effective retroactively, i.e. for financial years starting on or after 1st January 2024).

In order to be considered as a single-entity-group, the Luxembourg taxpayer must notably not be part of a consolidated group for financial accounting purposes (this includes also a voluntary consolidation).

A single-entity-group is then able to deduct the entirety of its borrowing costs (upon request), to the extent that such borrowing costs are not incurred towards an associated enterprise. For this purpose, an associated enterprise is defined as:

- any entity which is a part of the same consolidated group for financial accounting purposes (which would *de facto* not be relevant for a single-entity-group); or
- any entity in which the taxpayer has a significant influence in the management, or an entity that has a significant influence in the management of the taxpayer; or
- any entity in which the taxpayer holds directly or indirectly a participation in terms of voting rights or capital ownership of at least 25%, or is entitled to receive at least 25% of that entity's profit; or
- an individual, or any entity that holds directly or indirectly a participation in terms of voting rights or capital ownership in the taxpayer of at least 25%, or is entitled to receive at least 25% of the taxpayer's profit.

Accordingly, a Luxembourg securitisation company will be able to deduct the entirety of its borrowing costs (irrespective of (i) the nature of its income, or (ii) any SSPE status), as long as the noteholders cannot be considered as an associated enterprise and provided that it can demonstrate that the ratio of its equity over total assets amounts to or exceeds the equivalent ratio of the group formed by itself – which should always be the case (with a tolerance of 2%).

Other tax measures introduced by Bill 8414

Reduction of corporate income tax rate

Bill 8414 introduces a reduction of the corporate income tax rate as from 1st January 2025 under the following scales:

- from 17% to 16% for businesses with taxable income in excess of EUR 200,001, which will result in an aggregate corporate tax rate decreasing from 24.94% to 23.87% for companies located in Luxembourg City;
- from 15% to 14% for businesses with taxable income lower than EUR 175,000;
- for businesses with taxable income comprised between EUR 175,000 and EUR 200,001, the corporate income tax will be EUR 24,500 (instead of currently EUR 26,250) plus 30% (instead of currently 31%) of the tax base above EUR 175,000.

The reduction of the corporate income tax rate will reduce subsequently the tax base for the determination of the comparable tax for the purposes of the participation exemption regime and controlled foreign companies (CFCs) rules.

Inpatriate regime

Bill 8414 amends the inpatriate tax regime (*régime d'impatrié*) which enhances recruitment through the setting of a tax regime for highly qualified and specialised employees on the international market.

It sets out notably a lump-sum regime according to which 50% of the gross annual remuneration of the employee (excluding any benefits in kind or in cash) would be tax exempt provided that the amount of such a remuneration does not exceed EUR 400,000.

These measures will be applicable as of 1st January 2025.

Profit sharing bonus

Bill 8414 amends the profit sharing bonus (*prime participative*) which allows the employer to grant, under conditions, a bonus based on the employer's results to one or more of its employees.

It improves the profit sharing bonus regime, as of 2025, with the raise of the following thresholds (i) the limit of the partially tax-exempt profit sharing bonus is increased from 25% of gross annual remuneration, before incorporation of benefits in cash and in kind, to 30%, and (ii) the profit sharing bonus that a company can grant to employees has been increased from 5% to 7.5% of the positive result of the operating year.

Subscription tax

According to Bill 8414, Luxembourg listed undertakings for collective investment in transferable securities (i.e. actively managed UCITS ETFs) may be exempt from subscription tax under conditions.

BILL 8388 – EMPHASIS ON THE LEGAL CONFIRMATION OF THE MECANISM OF CLASSES OF SHARES

Situation before Bill 8388

According to article 101(2) LITL, the redemption of a shareholding followed by a share capital decrease should be treated as a liquidation of the company's assets. The resulting profit (i.e. liquidation proceeds) of such redemption does not constitute income from transferable securities (*revenus de capitaux mobiliers*) and is in principle not subject to Luxembourg withholding tax.

By assimilation, a redemption of a class of shares followed by the cancellation of such class was treated in practice as a partial liquidation (i.e. viewed as the allocation of the proceeds derived from the redemption of a participation, rather than a distribution of profit) and therefore not subject to Luxembourg withholding tax.

For several years though, the Luxembourg tax treatment of classes of shares was uncertain in the absence of any explicit provisions in the LITL and the lack of administrative guidance on this matter, despite recent Luxembourg case law.

Impact of the amendment introduced by Bill 8388

Bill 8388 modifies article 101 LITL, which now specifically states that the redemption or withdrawal of a class of shares, followed by a corresponding reduction of the share capital within six months of the redemption or the withdrawal, constitutes a partial liquidation.

It precises that the redemption or withdrawal of a class of shares is characterised when the following cumulative conditions are met:

- The redemption or withdrawal concerns the whole shares comprised in a class;
- The classes of shares are put in place at the time of the incorporation of the company or through a subsequent increase of its share capital;

- Each class of shares has different economic rights from each other pursuant to the articles of association of the company;
- The redemption or withdrawal price of a class of shares is determinable based on a specific mechanism provided by the articles of association of the company (or any documents referred to in these articles of association) and allowing to assess the fair value of the redeemed or withdrawn shares.

The commentary of Bill 8388 provides useful clarifications on the above conditions, in particular when it comes to the existence of different economic rights for each class of shares. In that sense, can be notably considered as having distinct economic rights, classes of shares (i) giving entitlement to preferential dividend, (ii) giving an exclusive right to profits for a specific or determinable period, or (iii) whose respective financial rights are linked to the performance of one or more direct or indirect assets or activities of the company.

It should be noted that according to Bill 8388, classes of shares can now be formally issued to individuals. In case of individuals having an important participation (according to article 100 LITL) in the issuing Luxembourg company, this will trigger notification obligation by the latter in its tax return of all information allowing the identification of such individual concerned by a redemption or withdrawal of a class of shares.

While this new provision is particularly welcomed by taxpayers and practitioners, the drafting and implementation of classes of shares will have to be monitored, as this mechanism remains subject to general anti-abuse provisions.

Other tax measures introduced by Bill 8388

Minimum net wealth tax

Following a decision of the Luxembourg Constitutional Court (case n°00185), Bill 8388 amends the minimum net wealth tax ("**NWT**") regime with (i) the withdrawal of the condition related to the composition of the balance sheet, which means that the minimum NWT should only rely on the criteria of the total balance sheet, and (ii) a decrease of the number of applicable tax brackets.

Under the new regime, as from 2025, there will only be a progressive minimum NWT comprised in a range between EUR 535 and EUR 4,815 depending on the company's total amount of balance sheet as follows:

- for companies having a total balance sheet ≤ EUR 350,000, the minimum NWT will be EUR 535;
- for companies having a total balance sheet > EUR 350,000 but ≤ EUR 2,000,000, the minimum NWT will be EUR 1,605;
- for companies having a total balance sheet > EUR 2,000,000, the minimum NWT will be EUR 4,815.

Participation exemption regime

With respect to participation exemption regime, Bill 8388 amends article 115 15a LITL (relating to the 50% exemption of dividends when certain conditions are met), introducing an optionality to benefit from the dividend exemption

provided by this article (i.e. the taxpayer can renounce to benefit from this exemption).

It also amends article 166 LITL (relating to the "full" participation exemption regime for dividends), introducing an optionality to benefit from the dividend exemption when the acquisition price of the participation is at least EUR 1,2 million (i.e. the taxpayer can renounce to benefit from this exemption).

This renunciation should be done individually by the taxpayer for each tax year and each participation.

Amendment of the general tax law

Bill 8388 amends the Luxembourg general tax law (*Abgabenordnung*) of 22 May 1931, as amended, with the introduction of an obligation to file (i) the declaration of the withholding tax on directors' fees, (ii) the declaration of withholding tax on wages and enhanced tax credit, and (iii) the declaration of flat rate withholding tax, via electronic format.

ENTRY INTO FORCE

There are still some legal steps to be completed in terms of legislative process before the entry into force of these bills (i.e. exemption from the second constitutional vote by the State Council – which should be granted, publication in the Official Gazette etc.), which we anticipate will occur before the end of the year.

HOW CAN WE HELP?

The tax lawyers at Clifford Chance Luxembourg are at your disposal to further advise on the potential impact of these measures on your current and/or contemplated operations.

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