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Budget 2021: various tax measures to address the impact of the COVID-19 pandemic and support a sustainable recovery

On 14 October 2020, the Luxembourg government filed budget bill 7666 with the Luxembourg parliament.

The budget bill introduces several tax measures in favour of social equity aiming to address the impact of the COVID-19 pandemic and support a sustainable recovery. It does not, however, increase the rates of existing taxes, nor does it introduce any new wealth tax or succession duties.
The budget bill sets out the following main tax measures:

Tax competitiveness measures – attracting and retaining talent

- A new "participating bonus" regime will be available to employees. The discretionary bonus will benefit from a 50% tax exemption, to the extent that it does not exceed 25% of the employee's ordinary annual compensation, without taking into account any bonuses and other advantages. In addition, the total amount of participating bonuses allocated by the employer on an annual basis should not exceed 5% of the employer's profit for the operating year immediately preceding that for which the bonuses are granted. This new regime replaces the current "stock option" regime, which will be abolished with effect from 1 January 2021.
- The scheme for highly skilled and qualified workers (impatriates) will be adapted, including the possibility for the employer to grant an "impatriation bonus" benefiting from up to 50% tax exemption (subject to conditions) for an amount not exceeding 30% of the annual remuneration of the impatriate. The cost of moving to Luxembourg borne by the employer, as well as repetitive charges (housing, tuition, etc.), up to a limit of EUR 50,000 (EUR 80,000 for a couple), will also be free from tax for up to 8 years.

Tax measures for sustainability

- A reduced subscription tax will apply for sustainable investment funds with a rate that decreases depending on the degree of investment in sustainability. In principle, the annual base rate of subscription tax is 0.05% of net assets under management of a fund. A fund investing at least 5% of its net assets over a long-term period benefits from a rate of 0.04% on its sustainable net assets. When sustainable investments exceed the threshold of 20%, 35% or 50%, the subscription tax rate on the sustainable investments is reduced to 0.03%, 0.02% or 0.01% respectively.

- A CO_2 tax of EUR 20 per tonne of CO_2 issued will be introduced. The impact of this measure will be attenuated by the implementation of compensatory measures.

Real estate – main measures

- A lump-sum 20% real estate levy will be introduced as of 1 January 2021 on gross income (rents and capital gains) derived by certain investment funds **(“Funds”)** from real estate located in Luxembourg. The Funds concerned are Specialised Investment Fund (SIF), Undertakings for Collective Investments (UCI) and Reserved Alternative Investment Funds (RAIF). Until now, income derived from Luxembourg real estate was not taxable in the hands of these Funds. However, contrary to certain media releases, **Funds which do not invest in Luxembourg-based real estate will not be affected by this change**.
- As of 1 July 2021, family asset management companies **("SPF")** will no longer be able to hold real estate through partnerships or other tax-transparent entities.
- The rate of the real estate transfer tax levied upon a contribution of Luxembourg real estate to the share capital of a Luxembourg civil or commercial company will be increased from a current aggregate of 1.1% to 3.4%.

Real estate – other main measures

- Reduction of the accelerated depreciation rate for new buildings acquired after 1 January 2021 and converted into rental accommodation from 6% to 4%, as well as reduction of the period of application of this rate from 6 to 5 years. A grand-fathering period applies under conditions to buildings acquired before 1 January 2021.
- Introduction of 6% depreciation rate for capital expenditure in renovation benefiting from "PRIMe House" financial aid granted by the Environment Administration and completed less than 9 years prior to January 1 of the fiscal year in question.
- Introduction of a tax deduction for landlords who have reduced companies’ rents within the framework of commercial leases for the calendar year 2020, corresponding to twice the amount of the rent reduction, up to EUR 15,000 per building or part building and per commercial lease contract.

Other main tax measures

- Modification of the tax consolidation regime to align the Luxembourg tax provisions with ECJ case 749/18. The new provisions ensure that a group benefiting from a "vertical consolidation" can form a new group integrated according to a "horizontal consolidation" without any negative tax consequences for the individual members of the tax consolidation group, to the extent that certain conditions are met, notably that the integrating company should remain the same. This possibility will be open up to the fiscal year 2022.
- Implementation of a secure IT platform allowing employers to access their employees' tax withholding cards (fiches de retenue d’impôt) online, such that as from 2022, employees will no longer need to submit their cards to the employer. In addition, the tax withholding cards issued through the new platform will be potentially valid beyond the tax year of their emission.
- Increase in the VAT exemption threshold for small businesses from EUR 30,000 to EUR 35,000.
- Repeal of the tax regime for venture capital investment certificates.
- Endowment of the civil scope of the exemption certificate issued by the AED in case of a succession exempt from inheritance tax to improve the access rights of heirs on movable assets forming part of an estate.

Concluding remarks

The proposed measures (in most cases to be implemented as from 1 January 2021) are driven primarily by the COVID-19 crisis and resulting budget constraints, as well as the will to ensure social fairness. Unlike certain expectations, the government deliberately chose not to increase or introduce new taxes that would hinder a swift recovery of the local economy. The main negative impact of the new measures is certainly the 20% real estate levy on Funds. The fact that Luxembourg residents may invest through Funds into Luxembourg real estate without any significant taxation had been criticised for several years as being unfair vis-à-vis direct investments. The amendments had been on the political agenda since 2017 and were expected to be implemented shortly.

The budget law will now follow the normal legislative process before the parliament.

How can we help?

The Tax Law partners and your usual contacts at Arendt & Medernach are at your disposal to further assess and advise on the impact of the new measures on your tax affairs.

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