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Tax – Luxembourg investment tax credit revised to encourage digital, environmental and energy transition

On 19 December 2023, the Luxembourg Parliament passed bill of law 8276 amending the investment tax credit (ITC) rules.

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On 19 December 2023, the Luxembourg Parliament passed **bill of law 8276_** (Bill) amending the investment tax credit (ITC) rules. The Bill's aim is to support the digital transformation of businesses, as well as their environmental and energy transition, thereby strengthening Luxembourg's competitiveness. The new provisions will apply as from the 2024 tax year.

Current ITC rules

Upon request, a taxpayer may be granted an ITC in respect of eligible investments which they make in their business. The investments must be in an establishment which is located in Luxembourg and intended to remain there permanently. Investments must also be physically implemented on Luxembourg territory or the territory of another State party to the Agreement on the European Economic Area (EEA) (except for investments in certain space equipment).

The current ITC regime can be briefly summarised as follows:

- An ITC of 13% of the additional investment made during the financial year in tangible depreciable assets other than buildings, farm livestock, and mineral and fossil deposits. The additional investment for a financial year is equal to the value assigned at the end of that financial year to the category of eligible assets, less the **reference value** assigned to the same category of assets. The additional investment so determined is increased by the depreciation applied to the eligible assets acquired or created during the financial year, other than certain excluded assets (e.g. assets depreciable over less than 3 years, assets acquired through a universal transfer, used assets and certain motor vehicles). The reference value, which cannot be less than 1,850 euros, is determined by the arithmetical average of the values of the eligible assets at the end of the 5 previous financial years. The amount of the additional investment is limited to the value of the investment made during that financial year in the eligible assets.

- An ITC for eligible global investments made during the financial year may also be granted. Eligible investments include investments in (i) tangible depreciable property other than buildings, livestock, and mineral and fossil deposits, (ii) certain sanitary and central heating installations incorporated into hotel buildings, (iii) certain buildings of a social nature, (iv) certain fixed assets eligible for special depreciation, and (v) software, provided it is not acquired from an affiliate. Certain assets are excluded, such as assets depreciable over less than 3 years, assets acquired through a universal transfer, used assets and certain motor vehicles. The ITC is calculated on the acquisition or cost price of the eligible investments made during the financial year. The ITC is 8% for the first tranche of investment not exceeding 150,000 euros and 2% for the tranche of investment exceeding 150,000 euros. This may be increased to 9% and 4% respectively in the case of certain environmentally friendly investments.

The ITC resulting from the addition of the above may be deducted from the corporate income tax (CIT) due for the tax year during which the financial year in which the investment is made ends. If there is insufficient CIT, the remaining ITC may be carried forward and deducted from the CIT for the 10 subsequent tax years.

Highlights of the new rules

- **ITC for global investments increased from 8% to 12%:** the increased rate applies regardless of the amount invested. Investments eligible for special depreciation, i.e. certain environmentally friendly investments, may benefit from an increased rate of 14%.

- **ITC for additional investment repealed:** this is replaced by an ITC for investment in the digital transformation or the ecological and energy transition of the business.

- **New ITC for investments in the digital transformation or the ecological and energy transition of a business:** this ITC may only be granted where the investment and expenses are confirmed in a certificate issued by the Minister of the Economy. The ITC is 18%, except for depreciable tangible assets, for which it is 6%.

Qualifying investments and expenditure

The new credit will apply to the following:

- Investments in depreciable tangible assets other than buildings, livestock, and mineral and fossil deposits.

- Investments in software and patents, except where acquired from an affiliate (such software or patents will no longer be eligible for the IP Box regime).

- Expenditure on the use of, or the right to use, patents or software, other than where granted by an affiliate.

- Expenditure on consultancy, diagnostic and technical support services provided by external service providers which do not relate to the enterprise’s normal operating expenditure, such as regular tax or legal consultancy services, or advertising.

- Expenditure on staff directly assigned to the enterprise's digital transformation or ecological and energy transition.

- Training costs for staff directly involved in digital transformation or ecological and energy transition.

The new ITC is calculated based on the acquisition price or production costs of the relevant investments made or expenditure incurred during the financial year.

Digital transformation and ecological and energy transition

The investments and expenditure must be inherent to the digital transformation or the ecological and energy transition of the enterprise, which is specifically defined in the Bill.

Investments or expenditure relating to digital transformation must fulfil at least one of the following objectives:

- Redefinition of an entire production process so as to substantially improve the enterprise's productivity, energy efficiency or raw materials efficiency.
- Implementation of an innovative business model within the enterprise, including the circular economy, so as to create new value for stakeholders.
- Significant redefinition of the overall service delivery in a way that creates new value for stakeholders.
- Significant transformation of the enterprise’s organisation so as to create new value for stakeholders.
- Significant redefinition of all the enterprise’s processes in order to substantially increase the identification and mitigation of the digital risks of the enterprise's activities.

Investments or expenditure relating to ecological and energy transition must fulfil at least one of the following objectives:

- Significant improvement in the energy efficiency of a production process, so as to save at least 20% of the energy used, calculated by reference to the average energy performance of that process over a reference period of 5 operating years preceding that in which the ecological and energy transition began.
- Significant decarbonisation of a production process, so as to reduce greenhouse gas emissions by at least 40%, calculated by reference to the average emissions produced by that process during a reference period of 5 operating years preceding that in which the ecological and energy transition began.
- Production or storage of energy from renewable non-fossil sources in order to meet the business’ energy needs through self-consumption. Energy produced from renewable non-fossil sources means wind energy, solar thermal and photovoltaic energy, geothermal energy, ambient energy, tidal, wave and other marine energy, hydroelectric energy, biomass, landfill gas, gas from wastewater treatment plants, biogas, and renewable hydrogen and its renewable derivatives.
- Reduction in air pollution from the production site beyond the emission limits for pollutants covered by existing Luxembourg regulations. The emission reduction potential of the business activity is determined by reference to the production site’s average emissions during a reference period of 5 operating years preceding that in which the ecological and energy transition began.
- Significant improvement in the raw materials efficiency of one of the enterprise’s production processes, so as to reduce the use of primary raw materials by at least 15% or replace primary raw materials by at least 20% with by-products or secondary raw materials. Improvement in raw materials efficiency is calculated by reference to the average consumption of primary raw materials by the process during a reference period of the last 5 financial years of operation preceding that in which the ecological and energy transition began.
- Implementation of a production process that extends the use of products by reusing them.

However, certain assets remain excluded. These are: assets depreciable over less than 3 years, motor vehicles, and investments and expenditure to comply with statutory environmental protection obligations.

Eligibility certificate

Grant of the ITC is subject to the issue of an eligibility certificate by the Minister of the Economy. A specific application must be submitted to the Minister of the Economy, containing detailed information on the relevant project.

How can we help?

The Tax Law Partners and your usual contacts at Arendt & Medernach are at your disposal to advise on the opportunities offered by the new ITC provisions_

your contacts

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