Executive summary

In December 2015, the Luxembourg Parliament approved several draft laws that amended the tax legislation for the year 2016 in important areas such as net wealth tax, the intellectual property regime and the participation exemption.

**2016 Budget law**¹ - On 14 October 2015, the Minister of Finance, Mr. Pierre Gramegna, presented the draft law on the Luxembourg budget for the year 2016 (the Budget law).

In his speech to the members of Parliament, Mr. Gramegna emphasized the need to adapt to a new tax environment where key considerations are transparency and exchange of information, as well as the alignment of taxation with economic substance and value creation. In this connection, the Budget law contains a measure of adaptation, being the abolition of the existing preferential tax regime for income derived from qualifying intellectual property (the IP regime) as of 1 July 2016. However a grandfather period of five years will be in place during which it is still possible to benefit from this regime, under specific conditions. The Minister of Finance had already confirmed in February 2015 in his response to a parliamentary question that a new regime in line with the nexus approach, as agreed at the level of the Organisation for Economic Co-operation and Development (OECD), will be conceived.

**Law of 18 December 2015 on net wealth tax**² (the Net Wealth Tax law) - Next to the long awaited step-up in the acquisition price of certain securities upon the migration of an individual’s tax residency to Luxembourg, the Net Wealth Tax...
law also abolishes the current minimum corporate income tax regime. Deemed non-compliant with European Union (EU) legislation according to the EU Commission, it will be replaced by a minimum net wealth tax regime.

The law provides for a reduction of the net wealth tax rate to 0.05% for taxable net wealth exceeding €500 million. The minimum net wealth tax regime is extended to securitization companies, venture capital companies (société d'investissement en capital à risque, or SICAR), corporate pension funds (société d' épargne-pension à capital variable, or SEPCAV) and pension savings associations (association d'épargne-pension, or ASSEP), which to date have been exempt from net worth tax.

**Law of 18 December on corporate income tax**

- The Corporate Income Tax law provides for an adaptation of the Luxembourg participation exemption in line with the amended Parent-Subsidiary Directive, the introduction of the so-called “horizontal tax consolidation” and the extension of the benefit of tax deferral for certain migrations (triggering exit taxation) from Luxembourg to any tax treaty country.

### Detailed discussion

#### Amendments affecting businesses

**Termination of the current IP regime**

In order to comply with the nexus approach, as agreed at the level of the OECD (Action 5 of the Base Erosion and Profit Shifting (BEPS) plan on Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance) and at the EU level, the Government has incorporated the announced termination of the current IP regime in the Budget law. As a reminder, under the current regime, codified in article 50bis of the Income Tax Law, a partial exemption of 80% applies to net income and capital gains deriving from software copyrights, patents, trademarks, designs, domain names and models acquired or created after 31 December 2007.

The Budget law abolishes article 50bis of the Income Tax Law as from 1 July 2016 and accordingly paragraph 60bis of the Valuation Law, which provides for an exemption, for net wealth tax purposes, of qualifying intellectual property as of 1 January 2017. However, it also provides for the internationally agreed five-year transitional period, as it was proposed by the UK and German Governments and endorsed by the OECD and the G20. The current IP regime will thus be maintained for income tax purposes for a transitional period starting on 1 July 2016 and expiring on 30 June 2021.

This means that the regime will continue to apply, until the aforementioned expiry date, to any qualifying IP that has been created or acquired before 1 July 2016, including improvements made to such IP, provided that the latter are completed before 1 July 2016. Similarly, for net wealth tax purposes the current regime will continue to apply to the above-mentioned IP until 1 January 2021 (inclusive) as a key date for the calculation of the unitary value.

The transitional period however comprises a safeguard measure (in line with the OECD recommendations on Action 5), which states that the transitional period will expire on 31 December 2016 if:

- The IP has been acquired after 31 December 2015 from a related party. For the definition of related party, the law refers to article 56 of the Income Tax Law.

- The IP has, at the time of its acquisition, not already qualified for the Luxembourg IP regime or for a foreign tax regime corresponding to the Luxembourg IP regime.

A further safeguard measure which has been adopted from the OECD Final Report on Action 5 is the automatic communication by the Luxembourg tax authorities, to the competent authority of another country, of the identity of any taxpayer who is considered to be a new adherent to the IP regime, i.e., any taxpayer that benefits from the IP regime for IP created or acquired after 6 February 2015, which corresponds to the date of release by the OECD of *Agreement on the Modified Nexus Approach for IP Regimes* document. The information will be communicated, regardless of whether a ruling is provided, no later than the earlier of (i) three months after the date on which the information becomes available to the Luxembourg tax authorities; or (ii) one year after the date of filing of the tax return by the taxpayer.

**Abolition of the minimum corporate income tax**

According to the Net Wealth Tax law, the minimum corporate tax regime, which was introduced as of tax year 2011 and further amended as of tax year 2013, is abolished as from 2016. This is due to an incompatibility with EU legislation, and more precisely with the Parent-Subsidiary Directive 2011/96/EU which provides, under certain conditions, for an exemption of dividends received from qualifying
EU subsidiaries. According to the European Commission, the levy of a minimum corporate income tax implies that the aforementioned tax exemption is in certain cases not completely granted. As a consequence, the Net Wealth Tax law abolishes the minimum corporate tax regime by abrogating the relevant legal provision, i.e., article 174(6) of the Income Tax Law.

Transposition of the latest amendments to the Parent-Subsidiary Directive (PSD)

In order to embed the anti-hybrid rule into Luxembourg legislation, the Corporate Income Tax law amends the Luxembourg participation exemption regime for dividends received from qualifying EU subsidiaries. Luxembourg law sets out the general conditions under which the income (dividends) derived from such a qualifying EU participation is tax exempt at the level of the Luxembourg recipient. Pursuant to the proposed amendments, the Luxembourg tax exemption for income derived from an otherwise qualifying EU subsidiary will not be applicable to the extent that this income is deductible by the EU subsidiary. The new anti-hybrid rule will only apply within the EU i.e., it is not applicable to hybrid arrangements between a Luxembourg entity and a non-EU parent or subsidiary.

Following the wording as adopted by the Council on 27 January 2015, the Corporate Income Tax law also introduces an anti-abuse clause. It provides that:
• The participation exemption for income from qualifying EU subsidiaries, and
• The exemption from Luxembourg dividend withholding tax to income (dividend) distributions to qualifying EU parent companies of a Luxembourg company,

are not applicable if the income is allocated in the context of “an arrangement or a series of arrangements which, having been put into place for the main purpose, or one of the main purposes, of obtaining a tax advantage that defeats the object or purpose of the PSD, are not genuine having regard to all relevant facts and circumstances.” In line with the Council’s resolution, the Corporate Income Tax law continues by stating that “an arrangement, which may comprise more than one step or part, or a series of arrangements, shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.”

It should be noted that the anti-abuse provision only applies to distributions falling within the scope of the PSD. As a consequence, distributions to/from a company resident in a treaty country and fully liable to a tax corresponding to the Luxembourg corporate income tax (including companies resident in the EU) are not affected by this provision. It is also understood that the anti-abuse provision does not apply to capital gains and net wealth tax exemption.

These provisions will become effective for income allocated after 31 December 2015.

Amendments to the tax consolidation regime

On 12 June 2014, the Court of Justice of the European Union (CJEU) issued its ruling on the compatibility of the Dutch fiscal unity regime in light of the so-called freedom of establishment. Luxembourg applies a similar restriction in its fiscal unity regime, currently providing only for “vertical tax consolidation,” i.e., a tax consolidation between two or more Luxembourg resident companies owned by the same Luxembourg resident parent-company or by the same Luxembourg permanent establishment of a nonresident company which is fully liable to a tax corresponding to the Luxembourg corporate income tax. The Corporate Income Tax law aligns the Luxembourg tax consolidation regime with this CJEU decision by introducing the possibility of a so-called “horizontal tax consolidation.” This is a consolidation between two or more Luxembourg-resident companies owned by the same nonresident parent, provided the parent company is resident in a State of the European Economic Area (EEA). Additionally, a new provision is introduced allowing Luxembourg permanent establishments of a nonresident company (irrespective of its fiscal residence, to be included in a tax consolidation, provided however that this company is fully liable to a tax corresponding to Luxembourg corporate income tax. So far, only Luxembourg-resident capital companies could be part of a tax consolidation group. This provision already applies to fiscal year 2015.

Extension of the benefit of exit taxation

In 2014, Luxembourg enacted legislation that allows companies transferring (migrating) out of Luxembourg to defer the exit taxes that would normally be applicable. It introduced the possibility to opt for an interest-free deferral of the tax normally due upon transfer of (i) the statutory seat and place of effective management of a resident company
and of (ii) a Luxembourg permanent establishment to another Member State of the EEA. Further to the Corporate Income Tax law the benefit of this tax deferral is extended to migration to any country which is not within the EEA provided that this third country has concluded a double taxation treaty with Luxembourg containing a clause allowing the exchange of information in line with OECD principles. In the absence of such clause, the existence of a bi- or multilateral agreement ensuring the exchange of information according to the OECD standards is required.

The new net wealth tax regime

The abolition of the minimum corporate income tax regime is compensated by the introduction of a differentiated rate of net wealth tax depending on the amount of taxable net wealth (i.e., the unitary value) and of a new minimum net wealth tax regime as of 1 January 2016.

According to the provisions of the Net Wealth Tax law, net wealth tax continues to be levied at a rate of 0.5% on an amount of unitary value up to and including €500 million. When the unitary value exceeds the aforementioned threshold, net wealth tax is calculated as follows:

- €2.5 million (which corresponds to a rate of 0.5% applied to the amount of €500 million); plus
- 0.05% calculated on the taxable amount exceeding €500 million

The Net Wealth Tax law also amends the existing legal provisions by replacing the current minimum taxable net wealth tax provision by a minimum annual net wealth tax payable for resident companies as follows:

- €3,210 if the sum of fixed financial assets, transferable securities, cash, and receivables owed by affiliated companies exceeds 90% of their balance-sheet total and €350,000; or
- If the aforementioned threshold is not met, the amount of minimum net wealth tax will depend on the balance-sheet total at the closing of the preceding financial year:

<table>
<thead>
<tr>
<th>Balance-sheet total in euros</th>
<th>Minimum net wealth tax in euros</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to and including 350,000</td>
<td>535</td>
</tr>
<tr>
<td>350,001 - 2,000,000</td>
<td>1,605</td>
</tr>
<tr>
<td>2,000,001 - 10,000,000</td>
<td>5,350</td>
</tr>
<tr>
<td>10,000,001 - 15,000,000</td>
<td>10,700</td>
</tr>
<tr>
<td>15,000,001 - 20,000,000</td>
<td>16,050</td>
</tr>
<tr>
<td>20,000,001 - 30,000,000</td>
<td>21,400</td>
</tr>
<tr>
<td>Above 30,000,000</td>
<td>32,100</td>
</tr>
</tbody>
</table>

A resident company must hence determine its unitary value based on the latest balance sheet by applying the provisions of the Valuation Law and the net wealth tax due based on such unitary value. In parallel, the company must also determine the minimum net wealth tax based on its balance sheet total. This is derived from the balance sheet established for income tax purposes; consequently immovable property and qualifying participations are to be maintained at their book value. As it was already the case for the minimum corporate tax regime, assets that generate income (or are likely to generate income) for which the taxation right belongs to another country based on a double tax treaty concluded with Luxembourg (for example immovable property or assets allocated to a permanent establishment) must be excluded from the balance-sheet total for the purpose of calculating the minimum net wealth tax. The net wealth tax finally be due will be the higher of the net wealth tax calculated on the unitary value and the minimum net wealth tax calculated on the balance sheet total.
In case the minimum net wealth tax is applicable, it is reduced by the amount of corporate income tax (including contribution to the employment fund but after deduction of possible tax credits) due by the company for the preceding year. Exceptionally, for the transitional year 2016, the amount of corporate income tax to be credited against the minimum net wealth tax 2016 is the positive difference between (i) the amount of corporate income tax (including contribution to the employment fund but after deduction of possible tax credits) due for the year 2015 and (ii) the minimum corporate income tax (including contribution to the employment fund) determined according to the provisions of the minimum corporate income tax regime. The minimum net wealth tax after deduction of the corporate income tax can however not be lower than the net wealth tax that would have been due based on the unitary value regime.

The minimum net wealth tax regime also applies to companies in a fiscal consolidation, but it is capped at an overall amount of €32,100. Corporate income tax due by the tax group is first credited against the minimum net wealth tax of the consolidated companies in descending order of their taxable net wealth. Any excess of corporate income tax will lastly reduce the minimum net wealth tax due by the company heading the fiscal consolidation, either the consolidating parent company or the consolidating subsidiary (“horizontal” tax consolidation based on the Corporate Income Tax law). The minimum net wealth tax regime will also apply to certain types of entity which currently fall within the scope of the minimum corporate income tax. While still benefitting from a net wealth tax exemption as such (meaning an exemption from paying net wealth tax based on the unitary value), securitization companies, venture capital companies (société d’investissement en capital à risque, or SICAR), corporate pension funds (société d’épargne-pension à capital variable, or SEPCAV), all incorporated under the form of a capital company, and pension savings associations (association d’épargne-pension, or ASSEP) will be liable to the minimum net wealth tax as of 1 January 2016.

Additionally, the net wealth tax reduction as foreseen by paragraph 8a of the law is amended such that net wealth tax for a given year can only be reduced up to the amount of minimum net wealth tax determined as described above. An anti-abuse provision is also inserted into paragraph 8a: under current legislation, the benefit of the net wealth tax reduction is not withdrawn if, before the five-year period has elapsed, a special net wealth tax reserve is incorporated into the share capital of the company. The new provision specifies that where there is a subsequent capital reimbursement, the special net wealth tax reserve that has been incorporated is deemed to have been reimbursed first. As a consequence, if the five year period has not elapsed at the date of the reimbursement, net wealth tax will be due for an amount of one fifth of the amount of the special reserve reimbursed.

Amendments affecting individuals

Adaptation of revaluation coefficients

Revaluation coefficients set forth by article 102(6) of the Income Tax Law are adapted for the year 2016. These coefficients are used in particular to reevaluate the acquisition price of specific assets (e.g., immovable property, substantial shareholdings) when determining the taxable gain of an individual transferring such assets.

Introduction of a tax amnesty

The Budget law incorporates a temporary tax regularization according to which any individual having owned assets and collected undeclared income therefrom can regularize his/her situation by automatically filing a corrective income tax return between 1 January 2016 and 31 December 2017 and paying the amount of tax due within one month following the receipt of the revised tax assessment. In this case, the taxpayer will not be prosecuted for tax fraud, but the amount of tax due will be increased by 10% for any corrective tax return filed between 1 January 2016 and 31 December 2016 (respectively 20% for corrective tax returns filed in 2017). The measure is not applicable towards taxpayers against whom an administrative or court proceedings has been initiated in relation with the tax evaded.

Step-up provision for substantial shareholdings

The Net Wealth Tax law introduces the principle of a step-up in the acquisition price of substantial shareholdings upon the migration of an individual’s tax residency to Luxembourg. According to this new provision, the acquisition price of the following investments would be revalued at their estimated market value as at the date of migration to Luxembourg:

- Stock, equity shares, beneficiary shares or, any other form of investment in collective undertakings, that qualify as a substantial shareholding (i.e., more than 10%)
- Convertible loans if the taxpayer has a substantial shareholding (i.e., more than 10%) in the entity that has issued the convertible loan
Such step-up would however not be applicable if, at the aforementioned date, the individual has been resident for more than 15 years and subsequently nonresident for less than 5 years. It should be noted that the step-up does not impact the holding period, i.e., the migration to Luxembourg does not trigger the beginning of a new holding period. This provision already applies to fiscal year 2015.

Option to be taxed as a resident for the entire tax year
Taxpayers who are only resident in Luxembourg for part of the year may now opt to be taxed as if they were resident in Luxembourg for the full year. In this case, they are entitled to claim the reimbursement of a possible excess of income tax withheld on salaries as compared to the final income tax determined according to the provisions applicable to resident taxpayers. This provision is already applicable to fiscal year 2015.

Endnotes
2. Loi du 18 décembre 2015 portant modification de la loi modifiée du 4 décembre 1967 concernant l’impôt sur le revenu; de la loi modifiée du 16 octobre 1934 concernant l’impôt sur la fortune; de la loi modifiée du 22 mars 2004 relative à la titrisation; de la loi modifiée du 15 juin 2004 relative à la Société d’investissement en capital à risque (SICAR); de la loi modifiée du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d’épargne-pension à capital variable (sepcav) et d’association d’épargne-pension (assep).
4. Article 56 ITL: “When an enterprise participates, directly or indirectly in the management, control or capital of another enterprise, or where the same individuals participate, directly or indirectly, in the management, control or capital of two enterprises (...).”
5. SCA Group Holding BV and others, Joined cases C-39/13, C-40/13 and C-41/13; see EY Global Tax Alert, EU Court of Justice holds Dutch fiscal unity regime contrary to EU law in SCA-Holding case, dated 12 June 2014.
6. Which currently triggers annual net wealth tax of €62.5 or €25, depending on the legal form of the company.
7. Nonresident companies are outside the scope of the minimum net wealth tax regime.
8. Net wealth tax reduction by booking and maintaining during five years a special net wealth tax reserve amounting to five times the amount of the net wealth tax reduced.
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