Executive summary

On 14 December 2017, the Luxembourg Parliament voted and approved the 2018 Budget Law (Budget Law).

The Budget Law comprises various provisions that are of interest for enterprises. As outlined below, there are also measures affecting the taxation of individuals.

This Tax Alert summarizes the main changes with regard to taxation.

Detailed discussion

Extension of the Investment Tax Credit to electric cars and acquired software

According to article 152bis of the Income Tax Law, a tax credit of 13% is granted for additional investments (bonification d’impôt pour investissement complémentaire) in qualifying assets made during a given tax year. Qualifying assets consist of depreciable tangible fixed assets, other than buildings, physically used in European Union (EU) Member States, Iceland, Liechtenstein and Norway (the European Economic Area or EEA). In addition, an 8% tax credit is granted for qualifying new investments (bonification d’impôt pour investissement global) up to €150,000, and a 2% tax credit for investments over that amount.
Under current legislation, both motor vehicles (with exceptions) and software are excluded from the list of qualifying investments. In order to facilitate the transition towards a zero-emissions mobility, the Budget Law includes, as from tax year 2018, passenger cars with zero emissions, functioning exclusively on electricity or on hydrogen fuel cells. The measure however only applies to those cars whose date of first registration is after 31 December 2017 and, for the application of the credit for qualifying new investments, up to the first tranche of €50,000 of the acquisition price per vehicle.

Furthermore, in order to encourage enterprises in digitalization, the Budget Law introduces a tax credit for investments in acquired software, subject to certain limits and conditions, as follows:

- Contrary to passenger cars with zero emissions, software will only be taken into account for the computation of the tax credit for qualifying new investments.
- Only acquired and not developed software is in principle eligible.
- Software acquisitions will only be eligible if the income generated (royalties, capital gains) by such software does not benefit from the Intellectual Property Tax regime that the Government is proposing to introduce as of tax year 2018. Granting access to both the Investment Tax Credit and the Intellectual Property Tax regimes would not be equitable from a tax perspective nor be acceptable at an international level. Consequently, if the taxpayer chooses to claim an investment tax credit for the acquisition of software, the income generated by it will not benefit from the Intellectual Property Tax regime.
- Only software acquired from third parties is eligible; software acquired from a related party as defined in article 56 of the Income Tax Law is thus excluded from the benefit of the Investment Tax Credit.
- The Investment Tax Credit on the acquisition of software amounts to 8% for investment amounts not exceeding €150,000 and to 2% for the investment exceeding that amount.
- The maximum amount of the tax credit for the acquisition of software cannot exceed 10% of the corporate income tax due for the tax year in which the financial year of the acquisition of the software ends. For example, the tax credit on software acquired in a financial year ending 31 March 2018 cannot exceed 10% of the corporate income tax due for the tax year 2018.

Language modifications and clarifications to the Income Tax Law

Various minor amendments to the Income Tax Law are introduced, mainly to correct language or material inconsistencies or to clarify existing provisions. Examples include:

- The simplified public limited company limited by shares (société par actions simplifiée; SAS) and the simplified limited company (société à responsabilité limitée simplifiée; S.à r.l.-S), introduced in 2016 into the Luxembourg Law on Commercial Companies, are added by the Budget Law to the list of collective undertakings subject to corporate income tax (article 159 of the Income Tax Law). Similar amendments are made to the Valuation Law, the Net Wealth Tax Law and the Municipal Business Tax Law.

Exchange of information upon request

The procedure for the exchange of information upon request is laid down in the law of 31 March 2010. This law was subsequently adapted, with the aim of accelerating the exchange procedure, by limiting the possibility to appeal the amount of an administrative fine imposed in case of refusal to provide information.

In 2015, in the framework of an appeal by a taxpayer against such a fine, the Luxembourg Administrative Court referred questions for a preliminary ruling to Court of Justice of the European Union (CJEU) on the interpretation of various provisions of the Directive 2011/16/EU. On 16 May 2017, the Grand Chamber of the CJEU released its decision (C-682/15) and ruled that the requested party has the right to appeal against the request for information as well as the penalties imposed by the Luxembourg tax authorities due to the failure to provide the information required.

While the draft Budget Law contained provisions to adapt the existing procedure in light of the aforementioned decision in order to bring Luxembourg law in line with EU law, those
provisions have finally been removed from the final version of the Budget Law. The required adaptations of the Luxembourg law will be dealt with in a separate law.3

VAT measures
With regard to Value Added Tax (VAT), the following amendments are introduced by the Budget Law:

- Extension of the VAT exemption for management services provided to collective internal life insurance funds whose investment risks are borne by policyholders and which are subject to the supervision of the Luxembourg Insurance Commission
- Increase of the VAT rate applicable to forestry products from 4% to 12%

Individual tax
Tax classes
The 2017 Tax Reform introduced changes to the Luxembourg tax classes, which depend on the taxpayers' personal situation and are used to determine the tax liability. These changes are due to enter into force in 2018.

The Budget Law brings some adjustments to the changes adopted last year:

- Resident taxpayers
As from 2018, married resident taxpayers will no longer necessarily be jointly taxable, but will be able to opt for individual taxation (either full individual taxation or individual taxation with reallocation of the household's income). Such choice was initially supposed to be made at the latest by 31 December of the preceding tax year, i.e. 31 December 2017 as far as tax class for 2018 is concerned. The Budget Law now foresees that taxpayers will be able to express their choice by 31 March of the subsequent tax year, i.e. 31 March 2019 as far as tax class for 2018 is concerned.

- Nonresident taxpayers
The conditions under which married nonresident taxpayers will be able to benefit from tax class 2 have changed substantially with the tax reform adopted in 2016. The Budget Law also introduced adjustments to those conditions.

Indeed, as from 2018, tax class 2 will be available to married nonresident taxpayers under the following circumstances:

- More than 90% of the taxpayer's overall income is taxable in Luxembourg. For the purpose of determining whether this condition is met, the first 50 days of professional travels will be considered as if they would have been spent in Luxembourg (without this portion of salary however being taxable in Luxembourg).

Or

- The taxpayer's foreign income does not exceed €13,000.

Choices related to nonresident tax classes will also have to be expressed by 31 March 2019.

Other measures

- Reduced tax rate on long term capital gains derived from the sale of real estate: Since 1 July 2016, long term capital gains derived from the sale of real estate are taxed at a quarter of the overall taxpayer’s tax rate. This measure was planned to last until 31 December 2017, but has now been extended until 31 December 2018.

- Tax incentive for purchase of hybrid cars: The 2017 Tax Reform introduced a tax allowance for the purchase of electric cars (€5,000) or bikes (€300). The Budget Law now also introduces a tax allowance (€2,500) for the purchase of a hybrid car.

Inheritance Tax
Under current law, inheritance tax is levied, after application of an abatement of €38,000, at a rate of 5% between spouses without common descendants, while spouses with common descendants benefit from a total exemption of inheritance taxes. This difference in treatment is removed by the Budget Law; going forward the existence of common descendants is no longer required to benefit from the inheritance tax exemption between spouses and between persons being in a registered partnership for at least three years.
Endnotes

1. Article 56 Income Tax Law: “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 (…).”

2. See EY Global Tax Alert, CJEU rules on rights of requested party with respect to exchange of information, dated 17 May 2017.


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