16 December 2024
BDO Luxembourg Newsletter

KEY TAX MEASURES PASSED BY THE PARLIAMENT ON 11 DECEMBER 2024 FOR MORE FLEXIBILITY AND TAX CERTAINTY

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KEY TAX MEASURES PASSED BY THE PARLIAMENT ON 11 DECEMBER 2024 FOR MORE FLEXIBILITY AND TAX CERTAINTY

INTRODUCTION

On 11 December 2024, the Luxembourg Parliament passed draft law 8388, which introduces targeted measures to adapt the Luxembourg tax system to recent developments and clarify some of its provisions in order to improve tax certainty for taxpayers.

We present the changes to be introduced, with a focus on the measures applicable to corporate taxpayers. These include a simplification of the minimum net wealth tax (“NWT”) regime, a clarification of the tax treatment of share class redemptions and withdrawals as well as a new possibility to opt-out from the participation exemption regime.

While we do not detail other tax changes either impacting individual taxpayers (such as the introduction of a new temporary tax credit, the crédit d’impôt barème), or impacting corporate taxpayers but related to individuals (e.g. new electronic filing obligation applicable to the withholding tax return for director’s fees), we remain at your disposal to discuss these changes further with you.

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MINIMUM NWT RULES AMENDED

With effect as from tax year 2025, the minimum NWT rules (Section 8-2 of the NWT law) will be amended in order to comply with a ruling of the Luxembourg Constitutional Court of 10 November 2023, which concluded that the minimum NWT rules in force so far resulted in a differential treatment between taxpayers in comparable situations and, as such, did not comply with the Luxembourg Constitution.

Based on the rules applicable prior to the amendment introduced, the minimum NWT due by Luxembourg resident companies

- either amounted to EUR 4,815 if the amount of financial assets, transferable securities, bank deposits and receivables against related parties exceeded both 90% of the total balance sheet and EUR 350,000; or
- varied between EUR 535 and EUR 32,100, depending on the size of the total balance sheet.

Based on the new rules introduced, the amount of minimum NWT will no longer depend on both the type of assets held and the size of the balance sheet of the company but only on the size of its total balance sheet. The minimum NWT will amount to:

- EUR 535 if the total balance sheet is lower than or equal to EUR 350,000;
- EUR 1,605 if the total balance sheet is greater than EUR 350,000 and lower than or equal to EUR 2,000,000; or
- EUR 4,815 if the total balance sheet exceeds EUR 2,000,000.

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MINIMUM NWT RULES AMENDED

This change can be considered as positive as it will simplify the way the minimum NWT will be computed and should at the same time provide more tax certainty to corporate taxpayers. This is because, so far, due to the 90% financial asset limit, the sale of one single asset could potentially have a major impact on the minimum NWT due (fixed amount of 4,815 vs. amount evolving progressively based on the size of the total balance sheet), no matter the size of the activity. Thus, a system according to which the amount of minimum NWT is only dependent on the size of the activity seems to be fairer.

The amendment will also mean a reduction of the minimum NWT burden of some of the companies with less than 90% of financial assets. This is because the maximum amount of minimum NWT due by these companies (i.e. companies with a total balance sheet exceeding EUR 2,000,000, which were subject to a minimum NWT varying between EUR 5.350 and EUR 32,100 under the former regime) has now been brought down to EUR 4,815 while it could have reached up to EUR 32,100 under the former regime.

Still, it is important to note that the provision of the NWT law dealing with companies belonging to a tax consolidation group, which caps to EUR 32,100 the total amount of minimum NWT of the group, has not been amended. It means that despite the maximum amount of minimum NWT at individual level having been brought down from EUR 32,100 to EUR 4,815, the maximum total minimum NWT liability within a tax consolidation group will remain EUR 32,100.

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TAX TREATMENT OF SHARE CLASS REDEMPTIONS & WITHDRAWALS CLARIFIED

With effect as from the entry into force of the 8388 law, Article 101 of the Luxembourg income tax law ("ITL") is amended in order to clarify the conditions under which a share class redemption or withdrawal is treated as a partial liquidation for Luxembourg tax purposes, and so, exempt from Luxembourg withholding tax. The clarifications added are mainly based on the case law of the Luxembourg Administrative Court.

According to the amended Article 101 of the ITL, the following conditions have to be met cumulatively for a share class redemption/withdrawal to be treated as a partial liquidation:

- The redemption or withdrawal has to relate to an entire class of shares.
- The classes of shares redeemed or withdrawn have been implemented upon incorporation or capital increase.
- Each class of shares has distinct economic rights. A distinct economic right is characterised by a specific right in relation to the rights of other classes of shares. As examples of distinct economic rights, the commentary to draft law 8388 refers to shares entitling their holders to preferential dividends, securities giving an exclusive right to profits for a specific time period, or securities whose respective financial rights are linked to the performance of one or more direct or indirect assets or activities.
- The redemption/withdrawal price can be determined based on criteria defined in the articles of association (or in any other document the articles of association refer to) allowing to reflect the fair market value of the shares at the time of the redemption or withdrawal.
- The related share capital decrease has to take place at the latest 6 months following the redemption/withdrawal. This last condition is based on the case law according to which, since the partial liquidation must affect part of the company's substance, the corresponding share capital reduction is a condition for the application of the partial liquidation regime. For this capital reduction to be considered as linked to the redemption/withdrawal, it has to occur within a sufficiently short period of time following the redemption/withdrawal.

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If the class of shares redeemed/withdrawn is held directly by an individual with a significant shareholding, the company will have to report information on the individual in its corporate income tax return.

Finally, the commentary to the draft law indicates, as a reminder, that the general anti-abuse rule will remain applicable in case of an abuse of law.

Before Article 101 of the ITL was amended, the ITL was silent on the Luxembourg tax treatment of share class redemptions and the treatment of the related proceeds as either a capital gain (exempt from withholding tax) or as a dividend (potentially subject to 15% withholding tax) was a matter of interpretation by the tax authorities and the Luxembourg courts. Since this interpretation has evolved over time in practice, it was high time to incorporate the lessons learned from the Luxembourg courts into the text of the ITL. Thus, the amendment of Article 101 of the ITL can be considered as positive and should bring more tax certainty to Luxembourg corporate taxpayers.

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OPT-OUT FROM THE PARTICIPATION EXEMPTION REGIME

OPT-OUT FROM THE FULL EXEMPTION REGIME

With effect as from tax year 2025, under certain circumstances, Luxembourg corporate taxpayers will have the possibility to opt-out from the full exemption of dividends, liquidations proceeds, and capital gains, as provided by the Luxembourg participation exemption regime (Article 166 of the ITL for dividends and liquidations proceeds and Grand-Ducal Regulation of 21 December 2001 for capital gains).

As a reminder, under the Luxembourg participation exemption regime, a full exemption applies automatically to dividends, liquidation proceeds, and capital gains received/realized by Luxembourg companies if certain conditions are met. These conditions include conditions linked to the level/size of the participation held by the Luxembourg company in its subsidiary. In this respect, Article 166 of the ITL requires either a minimum participation of 10% of the share capital of the subsidiary or an acquisition price of the participation of at least EUR 1.2 million. As far as the exemption of capital gains is concerned, the Grand-Ducal Regulation of 21 December 2001 requires either a minimum participation of 10% in the subsidiary or an acquisition price of the participation of at least EUR 6 million.

The newly introduced opt-out from the participation exemption regime will only be possible if the conditions of the participation exemption are met solely by virtue of the acquisition price of the shareholding (i.e. if the acquisition price of the shareholding is at least EUR 1.2 million for dividends and liquidation proceeds or EUR 6 million for capital gains). Thus, the opt-out will not be possible each time the conditions of the regime are met on the basis of a shareholding of at least 10%.

The reason for limiting the scope of the opt-out to this particular situation is that the provision exempting dividends based on a 10% minimum participation is a provision implementing the EU Parent-Subsidiary Directive and the Luxembourg Government wanted to make sure that the introduction of the opt-out would not jeopardise the correct implementation of that directive.

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OPT-OUT FROM THE PARTICIPATION EXEMPTION REGIME

The opt-out will have to be exercised for each tax year and in respect of each participation held by the Luxembourg company. This means that each tax year, for each of its participations, the corporate taxpayer will have the possibility to either benefit from the full exemption or opt-out from the exemption and have its income fully taxed.

One of the reasons of this newly introduced opt-out is to make sure that Luxembourg corporate taxpayers can use their carried forward losses before they elapse (given the 17-year limitation). The intention is also to align with the legislation of other jurisdictions which also provide such a possibility of opting out from their participation exemption regime.

Other reasons could also be to make sure that corporate taxpayers can increase their tax base in order to achieve a certain level of effective taxation. Achieving a certain level of effective taxation might be relevant in an international context (e.g. for taxpayers in the scope of the minimum taxation rules implemented for multinational groups and large-scale domestic groups (the so-called “Pillar 2” rules). It can also be relevant for ensuring the application of certain foreign participation exemption regimes (which may require a certain minimum level of effective taxation at the level of the Luxembourg parent company or subsidiary). As such, the amendment introduced is positive and will bring more flexibility to Luxembourg corporate taxpayers.

OPT-OUT FROM THE PARTIAL EXEMPTION REGIME

As from tax year 2025, Luxembourg corporate taxpayers will have the possibility to opt-out from the 50% dividend exemption regime applicable based on Article 115-15a of the ITL. It should be noted that the possibility of an opt-out is only available to corporate taxpayers (despite Article 115-15a of the ITL applying to both individual and corporate taxpayers).

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INTERESTED?

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