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Modifications to the Luxembourg Tax Law and Budget 2016

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The Minister of Finance presented a new draft law (draft law N°6891 hereafter referred to as the "**Draft Law**") on October 13th 2015 and the 2016 State Budget on October 14th 2015 (hereafter referred to as the "**Budget Law**"), to the Luxembourg Parliament. These draft laws, if approved in their current form, provide for the following main amendments to the Luxembourg direct tax law: (i) replacement of the minimum corporate income tax by a minimum net wealth tax, (ii) phase-out of the IP regime, (iii) step-up in basis of the shares held by non-resident individuals becoming Luxembourg tax resident and (iv) introduction of penalties for voluntary disclosures.

1. Replacement of the minimum corporate income tax by a minimum net wealth tax

Further to a notification from the European Commission and in order to avoid an imminent infringement procedure regarding the non-compatibility of the minimum corporate income tax (hereafter "**Min CIT**") with EU law and especially with the Parent-Subsidiary Directive (2011/96/EU), the legislator decided to replace the existing Min CIT by a minimum net wealth tax (hereafter "**Min NWT**"). The Min CIT will be abolished starting tax year 2016 and a Min NWT will be introduced as of January 1st 2016. Additionally, the NWT rate itself will be amended.

The Min NWT will be introduced with the same two-pronged approach as the Min CIT:

- For taxpayers whose financial fixed assets, receivables towards related parties, securities and cash (i.e. the accounts 23, 41, 50 and 51 of the *plan comptable normalisé*) amount to more than 90% of the total balance sheet and more than EUR 350,000, the Min NWT will amount to EUR 3,210.
- For taxpayers whose financial assets listed above represent less than 90% of the total balance (or more than 90% but less than EUR 350,000), a variable Min NWT ranging between EUR 535 and EUR 32,100 will be due depending on the total balance sheet.

It will however be possible to reduce the Min NWT by the amount of corporate income tax due for the prior year (exceptionally by the tax due in the same year for the year 2016) down to the NWT effectively due based on the taxable net asset value, leading to a lower Min NWT charge.

In case companies have entered into a fiscal unity for corporate income tax purposes, the aggregated Min NWT due by the members of the tax group will be limited to EUR 32,100. Additionally, the integrating entity as well as the integrated entities will be able to reduce their Min NWT with the corporate income tax charge down to the NWT effectively due based on their taxable net asset value, according to specific attribution rules.

Corporate securitisation vehicles and SICARs as well as ASSEPs and SEPCAVs which were exempt from NWT will now become liable to the Min NWT.

The NWT credit is maintained but such a credit can only reduce the NWT to the amount of the Min NWT. A clarification of the NWT reserve mechanism has also been included, specifying that in case a taxpayer incorporates the NWT reserve into the share capital, the reduction of the share capital within a 5-year period will be deemed an early cancellation of the NWT reserve.

The NWT rate is amended in order to introduce a two-scale rate. The rate will continue to amount to 0.5% for the taxable net asset value amounting up to EUR 500,000,000. The net asset value exceeding the threshold of EUR 500,000,000 will be subject to a reduced rate of 0.05%. For instance, the net wealth tax due for a taxable net asset value of EUR 750,000,000 is EUR 2,625,000 (EUR 500,000,000 *0.5% + (750,000,000-500,000,000)*0.05%).

In conclusion, the overall minimum tax charge of most taxpayers should not be negatively impacted by the above changes given that they were all already subject to the Min CIT.

2. Phase-out of the Luxembourg Intellectual Property regime (IP Box)

Further to the agreements at the OECD and EU levels regarding intellectual property regimes, the Luxembourg IP Box regime which provides for an 80% exemption of the income and capital gains derived from certain IP rights should be abolished as from July 1st 2016. A grand-fathering period is however foreseen until June 30th 2021 for those taxpayers that benefit from the IP Box regime on June 30th 2016.

Acquisition of IP rights within the frame of intra-group restructurings between January 1st 2016 and June 30th 2016 will have to comply with more stringent conditions in order to benefit from the Luxembourg IP Box regime (exclusion of tax-free restructurings, unless the rights already benefited from an equivalent IP Box regime in the hands of the former owner) after 31st December 2016.

Additionally, in order to increase tax transparency, the Luxembourg tax authorities will automatically communicate to the relevant competent authorities of the foreign countries the identity of taxpayers benefiting from the IP Box regime on IP rights developed or acquired after February 6th 2015, as foreseen in the international agreements.

Luxembourg has, for the time being, decided to abolish the IP Box Regime rather than modify it.

3. Introduction of a step-up in basis for individuals becoming Luxembourg tax residents

Initially foreseen in the draft law regarding the Luxembourg private foundation that has not been voted upon yet, non-resident individuals that become Luxembourg tax residents will now be granted a step-up in value of the tax basis of participations and convertible bonds they held prior to becoming tax resident in Luxembourg.

This step-up will only apply to participations that qualify as important participations (i.e. those through which the taxpayer holds more than 10% of the share capital either alone or together with his spouse and minor children) and convertible bonds issued by companies in which the holders also hold important participations. The step-up in basis will be refused to former Luxembourg residents (i.e. individuals that were Luxembourg tax residents for more than 15 years and became non-resident within the previous 5 years).

The initial acquisition date will not be impacted by the step-up in basis. The holding period will thus be computed by reference to the original acquisition (as opposed to the date on which the individual became a Luxembourg tax resident).

The limitation of the step-up to important participation is explained by the fact that under Luxembourg domestic law, capital gains realised upon disposal of shares that do not represent an important participation are only taxable if such disposal occurs within the 6-month period following the acquisition. The taxation of capital gains on shares is hence quite limited and considering that the holding period is not deemed to start again on the date of migration, the situation where a non-resident would sell shares after its migration and would become taxable on such disposal should be quite exceptional in practice.

4. Introduction of penalties for voluntary disclosures

The paragraph 410 of the *Abgabenordnung* (AO) will be abolished and replaced by a new temporary penalty system applicable to income taxes, registration duties and inheritance taxes.

While Luxembourg taxpayers wishing to regularise their tax situation through a voluntary disclosure (*Selbstanzeige* or *repentir actif*) will continue to be allowed to do so without sanctions until December 31st 2015 on the basis of par. 410 AO, penalties will apply starting January 1st 2016:

- For voluntary disclosures filed between January 1st and December 31st 2016 a tax penalty amounting to 10% of the eluded taxes will be due.
- For voluntary disclosures filed between January 1st and December 31st 2017 a tax penalty amounting to 20% of the eluded taxes will be due.

The new voluntary disclosure regime will continue to be granted only if no administrative or judicial proceeding was opened against the taxpayer on the date of filing of the voluntary disclosure and provided that the taxpayer pays the reassessed amounts of taxes within one month of the issuance of the rectified tax assessment.

As a result, we would strongly advise taxpayers considering a voluntary disclosure to do so before the end of the year, in order to avoid any penalty.

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