



Luxembourg newsflash

13 October 2017

Tax changes for 2018 disclosed in the new budget bill

On 11 October 2017, and for the last time before next year's parliamentary elections, the Luxembourg Finance Minister presented the budget bill for 2018 ("**Bill**") N° 7200 to Parliament (*Chambre des Députés*).

The main tax-related provisions of the Bill are laid out below in detail and include *inter alia*:

- changes to the tax treatment of capital gains in the case of business restructurings;
- improvements to the investment tax credit system;
- extension of the VAT exemption to the management of collective internal funds held by a life-insurance undertaking;
- introduction of 3 assessment options for resident spouses/partners;
- extension of the inheritance tax exemption for spouses/partners without common descendants; and
- amendment of the law on the exchange of information upon request in tax matters further to the decision of the Court of Justice of the European Union ("**CJEU**") in the Berlioz case (C-682/15).

In addition the Finance Minister reiterated that the Luxembourg government is working with the international community for a fair and appropriate taxation of internet-based innovative business models. In this respect Luxembourg pushes for an harmonised approach and a **global level playing field**.

In the same context, the Luxembourg government expressed again its opposition against the current EU proposal for a **financial transaction tax**.

The Bill does not include the expected substantial modification of the **investment tax credit system**, in particular as regards start-ups, research and investment intensive enterprises. Even though the Bill includes some improvements for investments in software and zero emission cars, a more substantial revision to the investment tax credit was expected to accompany the new IP Box regime presented earlier in August by the Bill of Law N° 7163 ("**IP Bill**"). For a more detailed analysis of the IP Bill, please refer to section (b) below.

Finally, the Finance Minister announced that the government will most likely amend the **taxation of warrants and stock options** and submit capital gains thereon to the half global rate (*i.e.* max. 21%).

a. Main tax-related provisions of the Bill

Business taxation

- Clarification on the tax treatment of capital gains realised by a resident company on the shares of a subsidiary that is absorbed within a merger: in case the conditions of the participation exemption are not met with respect to such shareholding, the capital gains realised by the absorbing company on the shares of the absorbed subsidiary are nevertheless exempt if the absorbing company owns at least 10% of the shares of the absorbed subsidiary. This regime applies to mergers, divisions and other types of restructurings.

<i>Current regime</i>	<i>Amended regime</i>
The exemption applies to shareholdings that could not be exempt under the participation exemption because either (i) the minimum 12 months holding period is not complied with; or (ii) the subsidiary is not an eligible entity for the participation exemption (e.g. a tax exempt entity).	The exemption only applies to subsidiaries eligible for the participation exemption when the minimum 12 months holding period is not complied with.

- Extension of the investment tax credit to (i) zero emission cars and (ii) software that has been acquired – as opposed to self-developed - by the enterprise. Under the Luxembourg investment tax credit regime, taxpayers may obtain a credit against income tax for (i) additional investments and (ii) global investments. The tax credit for additional investments amounts to 13% of the acquisition price of the qualifying investments. The tax credit for global investments amounts to (i) 8% for a first tranche of the total acquisition price for qualifying assets acquired during the current tax year not exceeding EUR 150,000 and (ii) 2% beyond this tranche.

<i>Current regime</i>	<i>Amended regime</i>
<ul style="list-style-type: none"> ▪ Motorised vehicles are generally excluded from both the additional and global investment tax credit. 	<ul style="list-style-type: none"> ▪ Qualifying investments for the additional investment tax credit include zero emission cars. Zero emission cars are also taken into account for an amount up to EUR 50,000 in the determination of the global investment tax credit.

<ul style="list-style-type: none"> ▪ Intangible investments are excluded for both the additional and global investment tax credit 	<ul style="list-style-type: none"> ▪ Software acquired by the taxpayer from an unrelated party qualifies for the global investment tax credit. The related investment tax credit may however not exceed 10% of the tax due for the fiscal year during which the software is purchased.
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It has to be noted that self-developed software should benefit in the future from the new IP Box regime presented early August (please refer to section (b) below).

- Extension of the VAT exemption for the management of investment funds provided under Article 44, 1, d) of the Luxembourg VAT law to the management of collective internal funds held by a life-insurance undertaking for which the customer bears the financial risk and which are subject to the supervision of the Luxembourg Insurance Authority ("*Commissariat aux assurances*"). This amendment of the Luxembourg VAT law radically changes the position taken until now and will therefore improve the VAT treatment of such insurance products.

Individual taxation

- Introduction of 3 assessment options for resident spouses/partners:

Current regime	Amended regime
Resident spouses/partners are assessed collectively.	Resident spouses/partners may be assessed at their option: <ul style="list-style-type: none"> ▪ collectively; ▪ individually; or ▪ individually at a rate taking into account the income of both spouses/partners.

- Extension of the inheritance tax exemption to spouses/partners without common descendants:

Current regime	Amended regime
A 5% inheritance tax is levied on successions between spouses/partners without common descendants, while an exemption applies to spouses/partners with common descendants.	No inheritance tax is levied on successions between spouses/partners with or without common descendants.

- Assimilation of non-resident taxpayers to resident taxpayers:

<i>Current regime</i>	<i>Amended regime</i>
Non-resident taxpayers who are taxable in Luxembourg on at least 90% of their worldwide income may opt to be assimilated to resident taxpayers.	Non-resident taxpayers may opt to be assimilated to resident taxpayers if either: <ul style="list-style-type: none"> ▪ they are taxable in Luxembourg on at least 90% of their worldwide income; or ▪ their net income not taxable in Luxembourg is less than EUR 13,000.

- Other amendments include the following:
 - Extension of the abatement for sustainable mobility to zero emission cars: a specific abatement of EUR 4,500 is available for zero emission cars;
 - Updated revaluation coefficients accounting for monetary inflation in the determination of capital gains on immovable and certain movables: the acquisition price used for the determination of capital gains has to be revaluated in order to take into account the monetary inflation through the application of revaluation coefficients. These coefficients are regularly updated;
 - Introduction of an electronic format for tax cards.

Exchange of information upon request in tax matters

The Bill also amends the current procedure on the exchange of information upon request in tax matters.

The current regime, provided for by the law dated 25 November 2014, had been introduced further to the criticism of the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes ("**Global Forum**") and accordingly limited any possible dispute to the exclusive point of the amount of the administrative fine applied in case of non-communication of the requested information by the holder. In particular, it is not possible for the information holder to challenge the validity of the information request.

In 2015, the Luxembourg administrative court filed a preliminary ruling before the CJEU, asking whether the information holder has a right to an effective remedy if it cannot, even exceptionally, have the validity of the information order underpinning the penalty imposed on him examined *a priori*. It asked, in particular to clarify the meaning of the 'foreseeable relevance' of the information requested and the scope of the review which the tax and judicial authorities of the requested State must carry out in that respect without undermining the purpose of that directive.

On 16 May 2017, the CJEU (C-682/15) ruled that article 47 of the Charter of Fundamental Rights of the European Union must be interpreted as meaning that the person on whom a fine has been imposed for failure to comply with the exchange of information request is entitled to challenge the legality of that decision. The 'foreseeable relevance' of the information requested is a condition which the information request must fulfil. It is thus a condition of the legality of the information request and of the administrative fine. The verification by the requested authority to which a request for information has been submitted must not be limited to the procedural regularity of that request but must enable the requested authority to ensure that the information sought is not devoid of any foreseeable relevance. In the context of an action brought by the

information holder against a fine for non-compliance with an information request, the national court not only has jurisdiction to adjust the penalty imposed but also has jurisdiction to review the legality of that information request. As regards the condition of legality of that information order, which relates to the foreseeable relevance of the requested information, the courts' review is limited to the verification of the manifest irrelevance of the information requested. In the context of a judicial review by a court of the requested Member State, that court must have access to the full request for information addressed to the requested Member State by the requesting Member State. The relevant person does not, however, have a right of access to that request in its entirety, as this document remains secret.

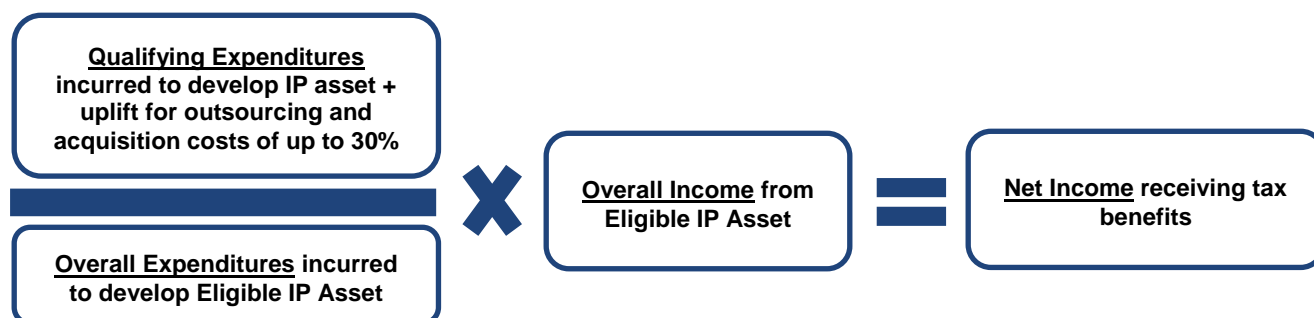
In order to comply with the above-mentioned case law, the Bill re-introduces the possibility for the information holder to challenge the legality of the information request addressed by the Luxembourg tax authorities. It is noteworthy to mention that such a recourse was actually foreseen by the former regime of the law dated 31 March 2010, but was subsequently cancelled given the criticism it received at the OECD's Global Forum. The various amendments illustrate once again the discrepancies between European Union Law and the OECD's position in tax matters.

b. The IP Bill

What is it?

Inspired from the various recent "BEPS compliant" IP legislations in Europe, the newly proposed article 50ter of the Income Tax Law allows a Luxembourg resident company or individual to benefit from a partial exemption of 80% on the adjusted and compensated net income ("**Net Income**") obtained after application of the nexus approach and derived from the eligible IP assets ("**Eligible IP Assets**") that have been created, developed or improved after 31 December 2007. The application of such tax incentive leads to an effective taxation rate of +/- 5.2%. The Eligible IP Assets also benefit from a total net wealth tax exemption.

The modified nexus approach



Eligible assets

The new IP regime covers net income derived from the use (*usage*), or the right to use (*concession d'un usage*) an Eligible IP Asset created, developed or improved within the framework of research and development ("**R&D**") activities. The list of eligible IP Assets is wider than under the previous regime and includes *inter alia* patents and software protected by copyrights but also various forms of medicinal product rights. However, the exemption is no

longer applicable to IP assets of a commercial nature, excluding intangible assets related to marketing activities, such as trademarks.

Qualifying Expenditures

The eligible expenses ("**Qualifying Expenditures**") are those borne by the taxpayer for the purposes of actual R&D activities and which are directly connected with the creation, the development or the improvement of an Eligible IP Asset (e.g. wages, direct costs or overhead costs). It also covers payments made by the taxpayer to an unrelated party for the purposes of its research and development activities and directly connected to the creation, development or improvement of an Eligible IP Asset. Acquisition costs, interest and financing costs, real estate costs and other expenses which are not directly linked to the Eligible IP Asset are excluded from the Qualifying Expenditures.

Qualifying Expenditures borne by the taxpayer during the current or preceding financial years may be increased up to 30%, provided that this increased amount of the Qualifying Expenditures does not exceed the overall expenses borne by the taxpayer during the current or preceding financial years.

The notion of Qualifying Expenditures plays a crucial role in the new IP regime as it serves as an indicator of "substantial activity". It is indeed the proportion of expenditures directly related to R&D activities (*i.e.* the Qualifying Expenditures) that demonstrate the real value added by the taxpayer.

Overall Expenditures

The total expenses ("**Overall Expenditures**") generally include i) Qualifying Expenditures, ii) acquisition costs of an Eligible IP Asset including recurrent expenses such as royalties and iii) expenses necessary for the R&D activities that are directly related to the creation, development or improvement of an Eligible IP Asset and which are paid to a related entity who is carrying-out R&D activities for the benefit of the taxpayer.

Overall Income

The overall income ("**Overall Income**") is based on i) the income derived from the license from Eligible IP Assets, ii) innovation income embedded in the sales price of the Eligible IP Assets, iii) capital gain upon the sale of Eligible IP Assets and iv) payments indemnifying a violation of the IP rights

Net income

The income deriving from the Eligible IP Assets is subject to certain adjustments and compensations. The purpose thereof is to ensure that the net income derived from an Eligible IP Asset during a financial year will only benefit from the partial exemption when the aggregate net income exceeds the total business expenses (*i.e.* direct and indirect expenses) with regard to the said Eligible IP Asset. Specific rules are provided for in case a taxpayer holds more than one Eligible IP Asset.

The proportion of the income qualifying for the partial exemption regime is equal to the same proportion as that between Qualifying Expenditures and Overall Expenses. A taxpayer will thereby only be able to benefit from the partial exemption on a significant portion of net income from an Eligible IP Asset, where the taxpayer has actually himself/herself undertaken a significant part of the directly related R&D activities.

Example 1

Income	Amount	Expenses	Amount
Income deriving from Eligible IP Asset	1000	Qualifying Expenditures	100
		Acquisition costs	10
		R&D expenses paid to a related party	40
Total	1000	Total	150


A 30% uplift would apply to the Qualifying Expenditures of 100, which leads to a total of 130 (100+(100*30%)) whereas the Overall Expenditures incurred amount to 150. In order to determine the proportion of IP income in relation to the Qualifying Expenditures, the nexus approach formula should apply as follows:

$$\frac{\text{Qualifying Expenditures (130)}}{\text{Overall Expenditures (150)}} \times \text{Overall income (1000)} = \text{Net income (866.6)}$$

Example 2

In 2018, a taxpayer develops Eligible IP Assets. The taxpayer has incurred overhead costs in relation to these Eligible IP Assets (*i.e.* Qualifying Expenditures) for an amount of EUR 80,000.

As from 2019, the Eligible IP Asset generates an overall income of 55,000 per year.

Eligible IP Asset accounted as a charge					
Tax year	2018	2019	2020	2021	TOTAL
Overall Income	-	55000	55000	55000	165000
- Qualifying Expenditures	80000	-	-	-	80000
= Net Income	-80000	55000	55000	55000	110000
Tax year	2018	2019	2020	2021	TOTAL
Net income	-80000	55000	55000	55000	
+ Amount of net negative income to compensate with positive income		- 80000	- 25000		
= Adjusted Net Income	- 80000	-25000	30000	55000	
Adjusted positive Net Income	-	-	30000	55000	85000

Comparative table

Country	Eligible entity	Eligible IP Assets	Overall income	Rate	Application in time
Italy Law of 21 October 2015	Resident/non-resident companies Resident/non-resident PE (under certain conditions)	Patents, models, and inventions; Business, commercial, industrial and scientific information and know-how; Formulas and processes, Design models, Software protected by copyright; Trademarks.	Royalties and capital gains	Up to 50%	As of 1 January 2015
Ireland Law of 22 October 2015	Resident companies	Computer programs; Qualifying patent ; Supplementary protections; Plant breeders' rights.	Royalties and capital gains	50%	As of 1 January 2016
Belgium Law of 2 February 2017	Resident companies Resident PE	Patents; Extended patent certificates; Breeders' rights on orphan drugs and plants Copyrights on software.	Royalties and capital gains	85%	As of 1 July 2016
UK Law of 24 March 2016	Resident companies	Patents; Supplementary Protection certificate; Regulatory data protection; Plant variety rights.	Royalties and capital gains	50%	As of 1 July 2016
Spain Law of 29 October 2015	Resident companies Resident PE	Patents; Drawings or models; Plans; Secret formulas or process; Rights to information concerning industrial, commercial or scientific experience.	Royalties and capital gains	60%	As of 1 July 2016
Portugal Law of 22 August 2016	Resident companies Resident PE	Patents; Models; Industrial designs.	Royalties and capital gains	50%	As of 1 July 2016
Netherlands Decree of 15 December 2016	Resident companies	Any recognized protectable asset for "small taxpayers" Only for "large taxpayers": Patents; Plant breeders' rights; Software programs; Supplementary protection certificates for human/veterinary medicinal products; Intangible assets related to the above intangible assets; Exclusive license to use the above listed intangible assets.	Royalties and capital gains	80%	As of 1 January 2017
Luxembourg Bill of Law of 4 August 2017	Resident/non-resident companies Resident/non-resident PE (under certain conditions)	Patent; Utility model; Supplementary protection certificate granted for a patent on a medicinal product or a plant protection product; Extension of a supplementary protection certificate for a medicinal product of pediatric use; Plant variety certificate; Designation as an orphan medicinal product; Software protected by copyright under national or international provisions in force.	Royalties and capital gains	80%	As of 1 January 2018



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