

Luxembourg Draft Budget Law 2021: Tax measures affecting individuals

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Executive summary

On 14 October 2020, Luxembourg's Minister of Finance submitted the draft budget law for the year 2021 (Draft Budget Law) to the Parliament.

No general increase or decrease of personal taxes is envisaged. The Government also announced that the broader tax reform aimed at introducing one single tax class and one single tax scale (i.e., no longer factoring personal circumstances of taxpayers) will be postponed.

The Draft Budget Law nevertheless comprises a number of measures that affect individuals. In line with the Government Program of 2018, the lump-sum valuation existing for stock options and warrants will be abolished as from 1 January 2021. With the objective of contributing to employee retention as announced in the coalition agreement, the Draft Budget Law introduces a profit-sharing regime allowing employees to participate in the profits of their employer. Furthermore, the tax regime for expatriates will be adapted and anchored in the Law.

The Draft Budget Law also includes measures affecting companies. These measures are detailed in EY Global Tax Alert, [Luxembourg Draft Budget Law 2021 - A look at the tax measures affecting companies](#), dated 16 October 2020.

Detailed discussion

Employment income

Stock options plans

The Recitals to the Draft Budget Law mention, in accordance with the government coalition agreement, that the lump-sum valuation that is in place for certain stock-options will be abolished at the end of 2020.

The existing rules distinguish freely transferable options from non-transferable options.

Transferable options are considered to be taxable at the date of grant, and the taxable basis – for non-listed options – can either be determined using a financial method (e.g., Black & Scholes) or a lump-sum basis, such lump-sum basis being 30% of the value of the underlying assets. This lump-sum valuation basis has, among other situations, been used for the so-called warrants regime.

Non-transferable stock options are expected to remain taxable under the same regime as the one currently in place, i.e., the taxable event being the date of exercise and the taxable basis being the difference between the Fair Market Value on the date of exercise (possibly discounted in case of subsequent sale restriction) and the exercise price.

Employees profit sharing regime

The Draft Budget Law proposes to introduce a new employee profit-sharing regime.

According to the proposed employee profit-sharing regime, employers will be allowed to allocate profit-sharing bonuses to (freely) selected employees. These profit-sharing bonuses will benefit from a 50% exemption (i.e., only 50% of the gross amount will be taxable, subject to regular tax rates). The conditions for this preferential tax treatment to apply are:

- ▶ The employer needs to realize business profits, agricultural or forestry profits or self-employment income.
- ▶ The employer keeps regular accounting records for the year of payment of the profit-sharing bonus as well as the preceding year.
- ▶ The total amount that can be paid to beneficiaries is limited to 5% of the annual profit of the employer for the financial year preceding the year of payment (the employer being the Luxembourg entity employing the beneficiary).
- ▶ The beneficiary is duly registered as an employee with the Luxembourg (or a recognized foreign) social security scheme.

- ▶ A maximum of 25% of the beneficiary's annual salary (excluding benefits) of the year of payment can benefit from this 50% exemption.

If this profit-sharing regime is implemented, the employer will have specific reporting obligations towards the tax authorities (wage tax office).

Amounts paid under the profit-participating regime will be deductible for the employer for corporate tax purposes.

Expatriate tax regime

Luxembourg first introduced an expatriate tax regime as from 2011, through a Tax Circular that has been amended since it was originally issued. It is now proposed to anchor this regime in law and to make some amendments to the rules currently in place.

The below describes the main features of the regime as it is proposed to apply as from next year. It also outlines the main changes compared to the existing regime.

A certain number of conditions need to be fulfilled both at the employee and employer level for this regime to be applicable. The key conditions are:

- ▶ The employee can either be seconded to Luxembourg from abroad or locally hired in Luxembourg from a foreign country.
- ▶ The employee should become a Luxembourg tax resident.
- ▶ The employee was not a Luxembourg tax resident, was not residing less than 150 kilometers from the Luxembourg border and was not receiving professional income taxable in Luxembourg in the five preceding years.
- ▶ The employee's annual base salary is at least €100,000 (so far, the minimum salary level was €50,000).
- ▶ The employee should not replace an employee previously in that role but not qualifying for such regime.
- ▶ The employee should have a certain experience in the company or sector (in the case of a seconded employee) or gained an in-depth expertise in the related sector (in the case of a local hire).
- ▶ Not more than 30% of the full-time employees (FTEs) of the company should benefit from this regime (except if the company has been established in Luxembourg for less than 10 years).

The condition under which the Luxembourg employer should have (or plans to have mid-term) at least 20 FTEs would no longer apply.

If those conditions are met, some components of the employee's salary package would be considered as tax exempt. Those components include:

- Moving costs
- Relocation costs
- Certain travel costs
- School fees

Such costs being borne by the employer would be considered as fully tax exempt (without a limit) in the hands of the beneficiary.

Other qualifying salary components can also be considered as tax exempt, subject to certain limits. These include:

- Housing costs (with some nuance depending on whether or not the employee maintains housing in the home country)
- Annual return trip
- Tax equalization

These costs would be considered tax exempt up to the lower of €50,000 per year (€80,000 in cases where the employee uses the housing jointly with his/her spouse/partner) or 30% of the employee's annual base salary.

Finally, the existing exemption for Cost of Living Allowance (COLA) is proposed to be replaced by a lump-sum "impatriation premium" that would benefit from a 50% tax exemption. Such premium cannot exceed 30% of the employee's annual base salary.

So far, the expatriate tax regime was applicable for five years. Going forward it should be extended to eight years (as long as the conditions are still satisfied).

Employers whose employees enjoy such regime will still have to report by 31 January of the subsequent year related information to the tax office in charge of wage tax.

Tax cards

Tax cards are used by employers to determine the withholding tax to be levied on their employees' salary. Tax cards are issued annually in paper format by the tax authorities to the employees who have to remit them to their employers. Absent such tax card, the employer must withhold taxes using the highest of either 33% or the tax scale applicable to tax class 1 (single people) taxpayers.

As from 2021, the Draft Budget Law proposes changes to: (i) the way tax cards are delivered; and (ii) employers' obligations in this respect.

Under the Draft Budget Law, tax cards will start being issued electronically to employers during the course of 2021. 2021 is expected to be a transitional year, and the electronic process will be fully operational as from 2022. As from that year, tax cards will exclusively be made available electronically to both employer and employee. Tax cards will then be valid for several years and no longer only for one specific tax year. As from 2022, employers will be requested to check on a monthly basis on whether a new tax card was issued. Penalties (up to €10,000) are foreseen for not performing such check monthly.

Professional income tax credits

Professional income tax credits existing in relation to self-employment income, employment income and pension income are proposed to be increased (from a maximum of €600 to a maximum of €696 per year).

Rental income

Accelerated depreciation

Under current legislation, buildings or parts of buildings used for rental housing can benefit from an accelerated depreciation rate of 6%, when the completion of said building or part of the building was less than six years before the beginning of the tax year. The Draft Budget Law will decrease the aforementioned rate to 4% and the maximum age of the building or part of building at the beginning of the tax year to five years. As is already the case now, this accelerated depreciation may also apply to investment expenses for the renovation of old dwellings, provided that these expenses exceed 20% of the acquisition or cost price of the building.

Buildings used for rental housing that have been acquired or constituted before 1 January 2021, as well as renovations terminated before the same date, will continue to benefit from the depreciation rate of 6% if the completion date of said building or part of the building was less than six years as of the beginning of the tax year.

The 6% depreciation rate also continues to apply where a building or part of the building used for rental housing has undergone a sustainable energy renovation whose completion, as at 1 January of a given tax year, occurred less than nine years ago.

Special real estate deduction

Taxpayers benefiting from the aforementioned accelerated depreciation rate of 4% are also entitled to a special real estate rebate to be deducted from their taxable income.

Buildings or parts of buildings acquired or constituted before 1 January 2021 consequently do not qualify for this deduction.

The deduction amounts to 1% of the total acquisition price of the qualifying buildings or parts of buildings (excluding the cost of land), with a cap of €10,000.

The deduction would be doubled in the case of joint taxation.

COVID-19 related measures

Deduction for rent reductions granted

Owners of buildings rented to merchants or self-employed people that definitively waived (part of) the rent during the year 2020 will be entitled to a specific rebate that will reduce the taxpayer's net income, provided that the following conditions are met:

- ▶ The taxpayer, who can be a resident individual, a resident corporate entity or a nonresident corporate entity liable to Luxembourg corporate income tax with respect to Luxembourg-source income, must be the owner, co-owner or partner in a tax transparent entity that is the owner of the real estate.
- ▶ The real estate must be located in Luxembourg.
- ▶ The real estate must be rented under a commercial lease agreement, i.e., the building must be intended for the exercise of a commercial, industrial or craft activity.
- ▶ (Part of) the rent for calendar year 2020 must have been effectively waived before 31 December 2020.
- ▶ The waiver is motivated by the precarious situation of the tenant, caused by the economic situation in the context of the COVID-19 crisis.

The deduction is granted per building or part of building leased and per commercial lease agreement and amounts to double the amount of the rent that is waived, with a maximum amount of €15,000 per building or part of building.

Exemption of certain emergency compensations paid during the state of crisis

The Draft Budget Law 2021 foresees a tax exemption for the cash compensations that have been granted to certain micro-enterprises and self-employed persons in the context of the COVID-19 pandemic.

Other measures

Value-Added Tax (VAT) exemption regime

Taxable persons whose annual turnover during a given calendar year has not exceeded €30,000 will benefit from a VAT exemption. With a view to extending the benefits of the administrative simplification represented by this VAT exemption regime to a greater number of taxable persons, the Draft Budget Law proposes to increase the threshold to €35,000.

Abolition of the allowance for acquisition of an eco-transportation

Since 2017, taxpayers acquiring eco-transportation means are entitled to a tax allowance whose amount is varying as follows:

- ▶ Electric or hydrogen car: €5,000
- ▶ Hybrid car: €2,500
- ▶ Electric bike: €300

In 2019, a direct financial subsidy mechanism was introduced for the acquisition of the same type of eco-transportation means. The above-mentioned allowances cannot be cumulated with financial subsidies that are of a higher value (direct subsidies ranging from €300 to €5,000). Given that the latter are more generous than the former and that they cannot be cumulated, the allowance is proposed to be abolished.

Social security

It is proposed to increase the average contribution rate to the Mutuality (a branch of the social security system) from 1.85% to 1.90% (this contribution being due only by the employer), with this rate varying ultimately based on the absenteeism level within each entity.

Entry into force

If adopted as drafted, the provisions of the Draft Budget Law will apply as of 1 January 2021 (except if stated otherwise in this Alert).

Next steps

The next steps in the legislative process will be the analysis of the text by a dedicated parliamentary commission, the collection of opinions from different advisory bodies (and most importantly the Council of State), discussion and vote of the text in a parliamentary session and finally its publication in the *Official Gazette* (Memorial). The entire process should be completed in the course of December.

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