

## Luxembourg Draft Budget Law 2021 - A look at the tax measures affecting companies

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### Executive Summary

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

No general tax increase is envisaged. The Draft Budget Law 2021 was presented as a budget of "solidarity and sustainable recovery." It foresees targeted tax measures that aim to close some loopholes that are perceived to lead to tax avoidance in the context of specific transactions in the Luxembourg real estate market. The envisaged measures to address such situations include the introduction of a 20% withholding tax on income from Luxembourg real estate realized by certain investment vehicles, the prohibition for private wealth management companies to hold real estate properties through partnerships and mutual investment funds, and the redesign of indirect taxes levied upon contribution of a Luxembourg real estate to a civil law or commercial company.

The Draft Budget Law 2021 also makes certain adjustments to the fiscal unity regime, to address the outcome of a judgment by the Court of Justice of the European Union.

Among other measures to address sustainability, the Draft Budget Law 2021 contains a number of measures in light of the global pandemic and provides for a decrease of the subscription tax for sustainable investment funds

and the introduction of a carbon tax, whose amount will progressively increase over the next three years, thus triggering an increase in fuel prices.

The Draft Budget Law also comprises a number of measures that affect individuals. In line with the Government Program of 2018, the special regime 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 2021 introduces a profit-sharing regime allowing employees to participate, within determined limits, in the profits of the enterprises for whom they work. Furthermore, the tax regime for highly skilled expatriate employees will be adapted and anchored in the law and will provide for an expatriation bonus that employers can grant to the concerned employees for a maximum period of eight years. These measures will be reported in a separate EY Tax Alert.

## Detailed discussion

### Measures related to Luxembourg real estate

#### Levy on income derived from real estate located in Luxembourg

The Draft Budget Law 2021 introduces, as from 1 January 2021, a real estate levy (*prélèvement immobilier*) of 20% due by certain exhaustively listed investment vehicles receiving or realizing income from real estate located in Luxembourg (i.e., immovable assets in the sense of Luxembourg civil law).

The levy will only apply to income derived from immovable property located in Luxembourg; investment vehicles owning real estate located abroad are thus not affected by this measure.

The real estate levy only applies to specific real estate income realized by targeted investment vehicles with a legal personality distinct from that of their partners, being: (i) Specialized Investment Funds (SIFs) governed by the amended law of 13 February 2007, (ii) Undertakings for Collective Investment (UCIs) governed by Part II of the amended law of 17 December 2010, and (iii) Reserved Alternative Investment Funds (RAIFs) governed by article 1 of the amended law of 23 July 2016 (investment vehicles). SIFs, UCIs or RAIFs incorporated under the legal form of a limited partnership as well as mutual investment funds are, however, excluded from the measure.

Three types of income derived from Luxembourg real estate would be subject to the new real estate levy:

- (i) Rental income derived from property located in Luxembourg, i.e., gross rent, excluding value added tax (VAT), derived from the renting and leasing of real estate located in Luxembourg and received by an investment vehicle as defined above.
  - (ii) Capital gains derived from the transfer of property located in Luxembourg: "Capital gain" is defined as the positive difference between the price of the real estate that appears in the notarial deed drawn up at the time of the transfer of the real estate and the price paid or value used at the time of the acquisition, contribution or constitution of the real estate that is transferred. The concept of "transfer" is to be understood in a very broad sense, i.e., any operation such as a sale, exchange, contribution, merger, demerger liquidation or dissolution.
  - (iii) Income derived from the transfer of interests or units: the transfer of interests or units held by an investment vehicle in a tax transparent entity or mutual investment fund owning, either directly or indirectly (i.e., through one or more other tax transparent entities or mutual investment funds) real estate located in Luxembourg will be assimilated to the transfer of the underlying real estate in proportion of the value of the real estate in the said tax transparent entity or mutual investment fund and the investment vehicle will be liable to withholding tax in proportion to its holding in the first tax transparent entity or mutual investment fund. The income derived from the transfer of interests or units corresponds to the positive difference between the transfer price of the interests or units corresponding to the proportion of the value of the real estate located in Luxembourg at the time of their transfer and the acquisition price of these interests or units corresponding to the proportion of the value of the property located in Luxembourg at the time of their acquisition.
- In case of acquisition or constitution of the property by, or in case of contribution of the property to the tax transparent entity or mutual investment fund subsequent to the acquisition of the interests or units, the transfer price will be determined with respect to the proportion of the value of the real estate at the time of its acquisition, contribution or constitution by the tax transparent entity or mutual investment fund.

The draft provision contains detailed transparency rules according to which the types of income described above received or realized by a tax transparent entity or by a mutual investment fund held, directly or indirectly (through one or more tax transparent entities or mutual investment funds) by an investment vehicle, is deemed to have been received or realized by the investment vehicle. The allocation to the investment vehicle and, hence, the amount subject to the real estate levy will be determined on the basis of the proportion of interest or units held directly or indirectly (through one or more tax transparent entities or mutual investment funds) by the investment vehicle.

In case of indirect holding, the proportion of income is calculated by multiplying the holding percentage successively at the different levels. While for rental income the situation during the calendar year is relevant, for capital gains and the transfer of interests or units the situation at the moment when the capital gain/income from the transfer of interests or units is realized needs to be considered.

Investment vehicles concerned will have to declare the levy on all income and capital gains derived or received during a given calendar year to the Direct Tax Administration by 31 May of the next calendar year (e.g., 31 May 2022 for calendar year 2021). The actual payment of the levy must be made no later than 10 June.

The return to be filed will have to detail the income from real estate that is subject to the real estate levy, a breakdown by property and the amount of the real estate levy. The correct determination of the income derived from real estate property according to the provisions of the Draft Budget Law 2021 and the detail of the calculations have to be certified by an independent auditor in a report to be filed with the return. Upon request, the concerned investment vehicle, as well as any tax transparent entity or mutual investment funds in which the investment vehicle holds interests or units, must provide any relevant evidence to support the amount of real estate income declared and levy made.

In case of non-declaration, late declaration or incomplete or incorrect declaration by the investment vehicle, the tax authorities determine the amount of the deficiency by means of a tax assessment. The non-payment of the real estate levy within the required timeframe triggers late payment interest at a rate of 0.6% per month.

The real estate levy is not deductible from taxable income and is neither creditable nor deductible by any taxpayer.

In order for the tax authorities to collect the information required to verify and assess the implementation of this new provision, all investment vehicles, whether or not they have or have not received or realized any income covered by the new real estate levy, have to inform the Direct Tax Administration whether they have held any real estate located in Luxembourg, either directly or indirectly, at any time during the calendar years 2020 and 2021. Investment vehicles that transform into a partnership or into a mutual investment fund during the calendar years 2020 or 2021 and that have held, at that moment, either directly or indirectly real estate located in Luxembourg, will have to inform the Direct Tax Administration about this by 31 May 2022.

Failure to comply with this obligation to transmit information may trigger a fixed penalty of 10,000 euros. The filing of a real estate levy return by an investment vehicle by 31 May 2022 is equivalent to fulfilling the aforementioned information obligations.

#### **Amendments to the SPF law**

Introduced in Luxembourg legislation in 2007, the purpose of a private asset management company (*société de gestion de patrimoine familial*, SPF) is the management of private wealth of individuals without carrying out an economic activity. SPFs are not authorized to grant loans or to acquire directly real estate. SPFs are exempt from corporate income tax, municipal business tax and net wealth tax, but are subject to subscription tax levied at a rate of 0.25% with a minimum amount of EUR 100 and a maximum amount of EUR 125,000.

To close possible loopholes, the SPF law will be amended so as to clarify that the holding of real estate properties through one or more tax transparent entities or mutual investment funds is prohibited as well.

The Draft Budget Law 2021 also introduces the mandatory electronic filing for SPFs of their subscription tax returns.

#### **Adaptation of registration duties applicable to contributions of Luxembourg real estate**

Under current legislation, a contribution of a Luxembourg real estate property in exchange for shares or interests is subject to registration duties of 0.6% and transfer duty of 0.5%. The Draft Budget Law 2021 proposes to increase these rates to 3.4% in aggregate (2.4% registration duties and 1% transfer duty) to be levied upon contribution of real estate located in Luxembourg to a Luxembourg or foreign

civil law or commercial company. For certain types of properties located in Luxembourg-City, the aforementioned rate is increased by a municipal surtax, thus bringing the aggregate rate to 4.6%.

The existing legislation also provides for an anti-abuse provision, according to which any contribution of real estate by one shareholder that is allocated to another shareholder in the framework of a dissolution, liquidation or capital reduction of a civil or commercial company triggers the same registration and transfer duties that would apply to a sale of said real estate, if such transfer takes place within a period of five years following the contribution. This five-year period is increased to ten years by the Draft Budget Law 2021.

### 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 building was less than six years before the beginning of the tax year. The Draft Budget Law 2021 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 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 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 in addition 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 EUR 10,000.

### Adaptation of the fiscal unity regime

On 14 May 2020, the Court of Justice of the European Union (CJEU) concluded that certain features of Luxembourg's fiscal unity regime in both its pre-2015 and post-2014 versions do not comply with the European Union's (EU) freedom of establishment. The CJEU in particular concluded that the tax consequences attached to the requirement to first dissolve an existing vertical fiscal unity before being able to form a horizontal fiscal unity, are not in line with EU law.<sup>1</sup>

In response to those conclusions the Draft Budget Law 2021 foresees a specific rule: Where a group of companies in a vertical fiscal unity requests to form a horizontal fiscal unity, this may exceptionally occur without triggering any adverse tax consequences for the individual members of the vertical fiscal unity that is dissolved. As a result, where the switch occurs within the minimum five-year period of existence of a fiscal unity there will be no rectifying tax assessments on a stand-alone basis for the members of the dissolved fiscal unity. This is however subject to the fulfillment of the following conditions:

- ▶ The head of the dissolved vertical fiscal unity becomes the head of the new horizontal fiscal unity.
- ▶ The switch is operated at the latest for the tax year 2022.
- ▶ The switch enlarges the perimeter of the former vertical fiscal unity.
- ▶ The members of the new horizontal fiscal unity bind themselves for a period of at least five accounting years. The years spent in the former vertical fiscal unity are taken into account for the computation of the minimum period of five accounting years under the new horizontal fiscal unity.

Although not embedded in the text of the law as such, the parliamentary documents to the Draft Budget Law 2021 specify that the various tax attributes that arose prior to or during the vertical fiscal unity (tax losses or tax credits carried forward) can continue to be carried forward insofar as this would have been admissible for the individual entities concerned if there had been no switch. The switch will furthermore not impact any choice made with respect to the application of the interest limitation rules, in the sense that these rules will continue to apply to each member individually if this option had been taken under the vertical fiscal unity. Based on the general rules applying to fiscal

unities, a written request to form a new horizontal fiscal unity must be sent to the relevant taxation office before the end of the accounting period for which the application of the new fiscal unity regime is requested.

## Sustainability-related measures

### Reduced subscription tax for sustainable investment funds

The Draft Budget Law 2021 provides for reduced subscription tax rates for collective investment funds or individual compartments of such funds that invest a specific portion of their net asset value in determined sustainable economic activities, as defined by the EU Taxonomy Regulation.<sup>2</sup> The following scale is foreseen:

Percentage of the net asset value invested in qualifying economic activities	Subscription tax rate
At least 5%	0.04%
At least 20%	0.03%
At least 35%	0.02%
At least 50%	0.01%

In order to benefit from the aforementioned reduced rates, the portion of net asset value invested in qualifying economic activities must be verified by an independent auditor and disclosed together with the percentage corresponding to this share in the total net assets. An attestation certified by the independent auditor must furthermore be transmitted by the collective investment fund to the tax administration in charge of collecting the subscription tax (*Administration de l'enregistrement, des domaines et de la TVA*).

### Introduction of a carbon tax

The Draft Budget Law 2021 introduces a carbon tax to be levied on determined energy products such as fuel or natural gas. The carbon tax will progressively increase over the next three years (20 euros, 25 euros and 30 euros, respectively, per ton of CO<sub>2</sub> emitted), thus also triggering an increase of diesel and petrol prices.

## 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 twice the amount of the rent that is waived, with a maximum amount of 15,000 euros 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

### VAT franchise regime

Taxable persons whose annual turnover during a given calendar year has not exceeded 30,000 euros benefit from a VAT franchise. With a view to extending the benefits of the administrative simplification represented by this VAT franchise regime to a greater number of taxable persons, the Draft Budget Law 2021 proposes to increase the threshold to 35,000 euros.

### Mandatory electronic filing of tax returns

In addition to the subscription tax returns for SPFs, the Draft Budget Law 2021 further extends the already existing mandatory filing of tax returns through electronic means. It thus introduces the mandatory electronic filing of tax returns for the tax in the interest of rescue services, the tax on insurance premiums and the tax in the interest of the fire department. For those two last taxes, some amendments with respect to the timing of the filing of the tax returns and of the payment of the respective tax are foreseen.

### Abolition of tax credit for venture capital investments

Under current legislation, eligible projects may qualify for a corporate income tax credit of 30% of the nominal amount of so-called venture capital certificates, limited to a maximum credit of 30% of taxable income. Because of the little use that has been made of this regime in practice, the Draft Budget law 2021 proposes to abolish the tax credit for venture capital investments as from 1 January 2021.

### Entry into force

If adopted as drafted, the provisions of the Draft Budget Law 2021 will apply:

- ▶ As of tax year 2020 as regards the COVID-19 related measures and the adaptation of the fiscal unity regime

- ▶ As of tax year 2021 as regards the accelerated depreciation
- ▶ As of 1 July 2021 as regards the amendments to the SPF law
- ▶ As of 1 January 2021 as regards to all other measures

### Next steps

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 2020.

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## Endnotes

1. See EY Global Tax Alert, [CJEU rules Luxembourg's fiscal unity regime infringes EU law](#), dated 26 May 2020.
2. Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

For additional information with respect to this Alert, please contact the following:

**Ernst & Young Tax Advisory Services Sàrl, Luxembourg City**

- |  |                                 |
|--|---------------------------------|
| ▶ Bart Van Droogenbroek, <i>Tax Leader</i>                               | bart.van.droogenbroek@lu.ey.com |
| ▶ Marc Schmitz, <i>Tax Policy &amp; Controversy Leader</i>               | marc.schmitz@lu.ey.com          |
| ▶ Olivier Bertrand, <i>Private Equity Tax Leader</i>                     | olivier.bertrand@lu.ey.com      |
| ▶ Dietmar Klos, <i>Real Estate Tax Leader</i>                            | dietmar.klos@lu.ey.com          |
| ▶ Fernando Longares, <i>TMT &amp; Life Science Tax Leader</i>            | fernando.longares@lu.ey.com     |
| ▶ Christian Schlessner, <i>Commercial &amp; Public Sector Tax Leader</i> | christian.schlessner@lu.ey.com  |
| ▶ Jacques Linon, <i>Banking &amp; Insurance Tax Leader</i>               | jacques.linon@lu.ey.com         |
| ▶ Vincent Rémy, <i>Wealth &amp; Asset Management Tax Leader</i>          | vincent.remy@lu.ey.com          |
| ▶ Nicolas Gillet, <i>Transfer Pricing Leader</i>                         | nicolas.gillet@lu.ey.com        |
| ▶ Elmar Schwickerath, <i>Global Compliance &amp; Reporting Leader</i>    | elmar.schwickerath@lu.ey.com    |

**Ernst & Young LLP (United States), Luxembourg Tax Desk, New York**

- |                |                     |
|----------------|---------------------|
| ▶ Xavier Picha | xavier.picha@ey.com |
|----------------|---------------------|

**Ernst & Young LLP (United States), Luxembourg Tax Desk, Chicago**

- |                         |                           |
|-------------------------|---------------------------|
| ▶ Alexandre J. Pouchard | alexandre.pouchard@ey.com |
|-------------------------|---------------------------|

**Ernst & Young LLP (United States), Luxembourg Tax Desk, San Jose**

- |                         |                             |
|-------------------------|-----------------------------|
| ▶ Andres Ramirez-Gaston | andres.ramirezgaston@ey.com |
|-------------------------|-----------------------------|

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