

Luxembourg Tax Alert

Luxembourg tax authorities issue circular regarding the prime participative

16 February 2021

The Luxembourg tax authorities issued guidance regarding the new remuneration model, the *prime participative* (or profit-sharing bonus) on 11 February 2021 in a circular ([circular L.I.R. n°115/12 dated 11 February 2021](#)). The model had been introduced in Luxembourg's 2021 budget law adopted by the Chamber of Deputies on 19 December 2020 and published in the Official Journal on 23 December 2020.

The budget law entered into force on 1 January 2021 and specific individual tax measures, including the *prime participative*, apply as from that date.

The circular is complemented by a [Q&A](#), which aims to provide further clarifications regarding the new remuneration model.

Legal provisions: What is the new remuneration model?

Article 3 of the 2021 budget law introduced the *prime participative*, adding the new regime to article 115 al. 13(a) of the Luxembourg Income Tax Law (LITL), modifying article 95 al. 5 LITL to treat the *prime participative* as employment income, and modifying article 46 al. 15 LITL to treat it as an operating expense.

As discussed in our [Tax Alert dated 28 December 2020 "Luxembourg 2021 budget law,"](#) the *prime participative* allows employees to participate in corporate profits under certain conditions. The measure allows employers to grant a profit-sharing bonus to some (or all) of their employees, based on the employer's financial results (i.e., profits). The granting of the bonus is subject to certain conditions at both the employer and employee levels.

The employer-level conditions are as follows:

- The employer must make a profit (from commercial, agricultural, or forestry operations, or from the practice of a liberal profession) in the relevant tax year;
- The employer must keep regular accounts during the tax year the bonus is granted (i.e., 2021 at the earliest), as well as during the year immediately preceding the tax year the bonus is granted (i.e., 2020 for a bonus granted in 2021); and
- The total amount of bonus (i.e., the bonus pool) that may be granted to employees is limited to 5% of the employer's profits for the fiscal year immediately preceding the fiscal year in which the bonuses are granted (i.e., 2020 profits in case of a bonus granted in 2021, as imputed in the standardized chart of accounts, 142 – Results for the financial year).

The employee-level conditions are as follows:

- The bonus cannot exceed 25% of the employee's gross ordinary annual remuneration (i.e., excluding any cash, and/or in-kind benefits, bonuses, premiums, etc.) for any given tax year; and
- The employee must be affiliated either with the Luxembourg social security system or a foreign social security scheme covered by a bi- or multilateral social security agreement.

The discretionary bonus (i) is considered a corporate tax deductible operating expense at the level of the employer, (ii) qualifies as employment income at the employee level, and (iii) benefits from a 50% individual income tax exemption (applicable on the amount subject to the 25% limit).

Clarifications provided by the circular

Reporting

The circular specifies the procedure necessary to meet the LITL's reporting requirements: employers wishing to use the *prime participative* must send a detailed communication to the appropriate wage tax office (i.e., RTS) responsible for verifying payroll tax deductions at the time the bonus is granted to the chosen employees. Communications must be made in the [form prescribed](#) by the tax authorities on their website (in French only).

Failing to timely and properly send this detailed communication will result in the retroactive cancellation of the 50% individual income tax exemption. It also will result in necessary adjustments, to be made in line with the RTS and accounting audit provided for in article [16 of the Grand-Ducal regulation of 27 December 1974 regarding the procedure for withholding tax on salaries and pensions \(in French only\)](#). Paragraph 4 of article 136 LITL will apply accordingly (i.e., relating to personal liability of an employer to withhold tax). Therefore, the employer's obligation to communicate with the RTS is very important.

25% limit

The 25% limit is calculated based on the annual gross remuneration that the employee has already received and/or will receive during the calendar year when the bonus will be paid. In a situation where an employee leaves the employer during the year because the employee retires, changes employer, or stops working, the employer should recalculate the wage tax withholding, if necessary, taking into account the annual salary finally paid and taken into account for the 25% limit.

The tax authorities' [Q&A](#) (in French only) clarifies the 25% limit further:

- **Elements of salary to be included or excluded when calculating the 25% limit:** The elements of salary to be included are the regular salary as well as any possible component constituting this regular salary, such as overtime pay, etc. The elements to be excluded are benefits in kind, or cash benefits such as bonuses, 13th month payments, interest subsidies, travel expenses, reimbursed expenses, etc.
- **Estimated foreseeable annual salary:** The estimate must be based on all the data previously available or likely to have an impact during the year on the amount of the beneficiary's remuneration. Any possible salary adjustment made during the year and after payment of the *prime participative* that has an impact on the 25% limit such that the exemption granted would be too high will trigger a regularization of the withholding tax to be made by the employer.
- **Retirement, departure during the year, and change in the employee's degree of occupation:** The Q&A refers the reader back to information provided in the circular (as discussed above).
- **Exempt salaries:** When an employee works a certain number of days abroad and these working days are not taxable in Luxembourg by virtue of a tax treaty, the employee's worldwide annual salary is to be taken into account to calculate the 25% limit. Employers

need to determine the part of the bonus that is taxable in Luxembourg versus the part that is taxable abroad (i.e., individual tax exempt in Luxembourg). For this purpose, employers must source the bonus according to the number of days worked in Luxembourg and the number of days worked and taxed abroad during the year of payment.

Deloitte Luxembourg example:

| Assumption | |
|--|----------|
| All conditions for the <i>prime participative</i> are met | Yes |
| Annual salary | EUR 200 |
| Proportion taxable in Luxembourg | 50% |
| Sourcing principles | |
| Maximum <i>prime participative</i> | EUR 50 |
| <i>Prime participative</i> attributable to Luxembourg | EUR 25 |
| <i>Prime participative</i> exempted in Luxembourg but sourced abroad | EUR 25 |
| <i>Prime participative</i> exempted for Luxembourg income tax purposes | EUR 12.5 |

- **The *prime participative* exceeds 25%:** The portion exceeding the limit of 25% of annual gross salary, before adding benefits in cash and in kind, cannot benefit from the 50% individual tax exemption and is to be taxed as non-periodic income.

Non-deductibility of social security

The circular explains how to calculate non-deductible social contributions. For instance, social contributions related to exempted salary income, such as a *prime participative*, are not deductible for wage tax calculation purposes.

All remuneration received by a person from or through the same employer is to be considered a single remuneration. Therefore, to allow employers to determine the social security amount that is not deductible, the Luxembourg tax authorities allow the use of the “rule of three” and provide the following illustrative example (note that the social security annual employment income threshold as at 1 January 2021 is EUR 132,115.80):

| | |
|---|---------------|
| Gross remuneration (excluding benefit in kind and in cash) | EUR 10,000.00 |
|---|---------------|

| | |
|---------------------|--------------|
| Prime participative | EUR 2,000.00 |
|---------------------|--------------|

| | |
|---------------------------|----------------------|
| Total gross amount | EUR 12,000.00 |
|---------------------------|----------------------|

| | |
|-------------------------------|--------------|
| Social security contributions | EUR 1,183.45 |
|-------------------------------|--------------|

| | |
|--------------------------------------|--------------|
| Exempted part of prime participative | EUR 1,000.00 |
|--------------------------------------|--------------|

| | |
|---|-----------|
| Non-deductible social security contributions (1) | EUR 98.62 |
|---|-----------|

| | |
|--|---------------------|
| Salary subject to withholding tax | EUR 9,915.17 |
|--|---------------------|

(1) $(1,000.00 / 12,000.00) \times 1,183.45$

Finally, the circular provides information on a *prime participative* that is allocated to executive directors/managers and shareholders of limited liability companies who earn income derived from a salaried occupation.

The profit-sharing bonus received by an executive director/manager and shareholder, who may also be the sole beneficiary of the bonus is to be considered income derived from a salaried occupation, which is subject to both the employer-level and employee-level conditions discussed above.

Additional clarifications provided by the Q&A

The tax authorities provide additional clarifications in their [Q&A \(in French only\)](#):

- **Operating year to be taken into account for the determination of the employer's profits and the 25% limit:** The result to take into account is the result of the last operating year that closed before 1 January (i.e., as at 31 December or earlier) of the year during which the company wishes to allocate the bonus.
- **Definition of "positive result":** "Positive result" is defined as business profits after tax deductions (for a limited liability company) and the employer's net profits (for other employers), as imputed in the standardized chart of accounts, 142 – Results for the financial year).
- **Group level:** The employer to be considered is the one who is registered as such in the files of the tax authorities for the given employee (i.e., the one whose national identification number appears in the "Employment" section of the employee's tax deduction form (i.e. "tax card")). Consequently, any "group" context consideration is excluded.
- **Communication:** The Q&A refers the reader to information provided in the circular (as discussed above).
- **Exemption information on the certificate of salary, tax withholding, and enhanced tax credits (model 160):** The exempt portion of the bonus has to be disclosed in section C of model 160 with clear and precise wording.
- **Type and number of potential beneficiaries:** There is no limit on the number of employees who may benefit from the income tax exemption for profit-sharing bonuses or the job functions/qualifications that they may have (employee, managing partner, or other).

Comments on the circular and Q&A provided by the Luxembourg tax authorities

The clarifications provided by the circular and its underlying Q&A are very welcome and should allow companies to apply and implement the new *prime participative* remuneration model with more ease.

In addition, the new remuneration model allows the sharing of profits among a wider population than former remuneration schemes, which may help companies attract and retain talent.

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