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International Tax

Luxembourg Tax Alert

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2016 draft budget includes measure to repeal IP regime

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The Luxembourg finance minister presented the country's 2016 state budget draft law to parliament on 14 October 2015, which includes a number of proposals affecting companies and individuals. There are proposals to abolish the minimum corporate income tax, revise the net worth tax (NWT), repeal the intellectual property (IP) box regime, provide a step up in basis for certain assets and introduce a tax amnesty.

The parliament now must review, discuss and, if necessary, modify the draft law for it to be approved by the end of 2015.

Measures affecting companies

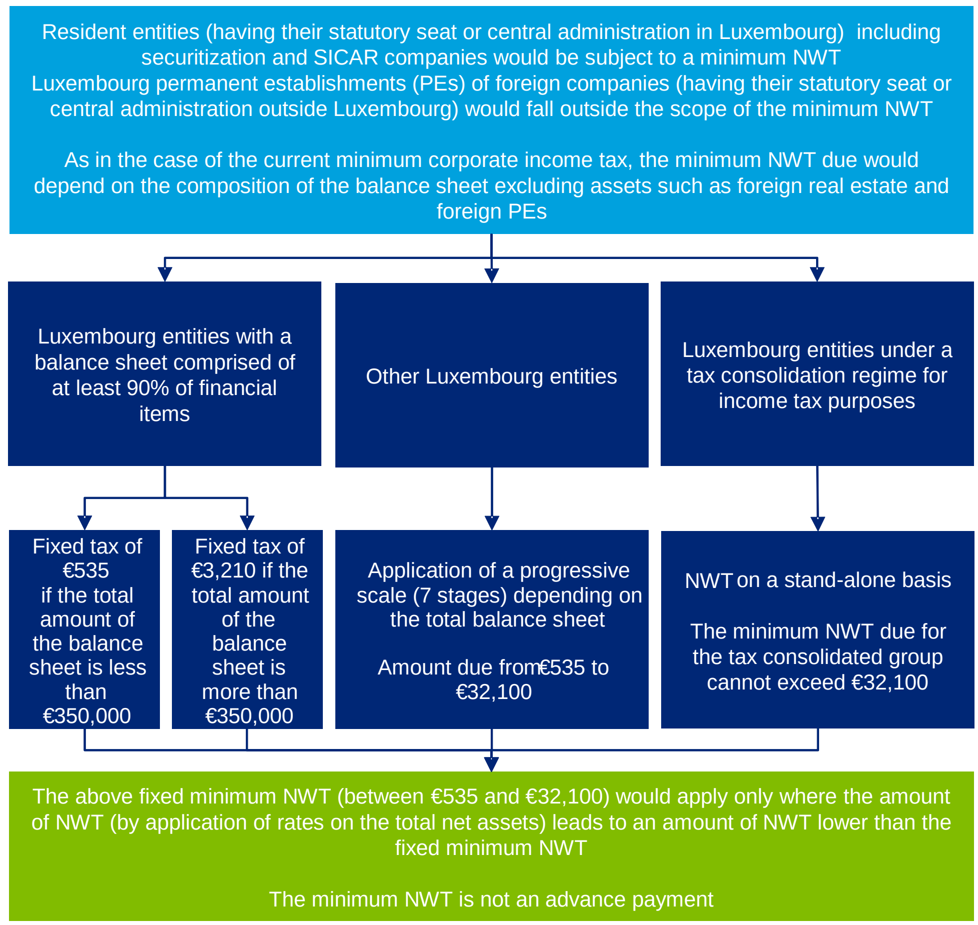
Abolition of minimum corporate income tax and revision of NWT: A NWT of 0.5% is levied annually on the total taxable net assets of Luxembourg companies. The draft law proposes the revision of the NWT in two ways: the rate would be reduced for certain taxpayers and a minimum NWT would be introduced to replace the minimum corporate income tax.

Under the proposed bill, the NWT rate as from 1 January 2016 would depend on a company's total net assets:

- The rate would be 0.5% on total net assets up to EUR 500 million (unchanged from the current rule); and
- The rate would be 0.05% on total net assets of EUR 500 million or more.

The minimum corporate income tax, which was introduced in 2011 and has since been revised, is proposed to be abolished to bring Luxembourg in line with EU law (based on a letter from the European Commission in which the commission stated that it considered the minimum corporate income tax not to be fully in line with EU law). It would be replaced by a minimum NWT as from fiscal year 2016.

The following diagram summarizes the proposed minimum NWT regime.



The NWT charge may be reduced, in whole or in part, if the relevant entity creates and maintains a specific reserve for five years. Currently, the minimum corporate income tax is not taken into account for this NWT reduction. The same measure would apply for the minimum NWT.

Repeal of IP box: Pursuant to the discussions and the agreement reached at both the OECD and the EU levels, the provisions in Luxembourg law relating to the domestic IP regime would be repealed, although some “grandfathering” rules would apply, subject to the fulfillment of certain conditions.

The proposed repeal echoes the political agreement reached for patent box regimes, under which IP regimes must comply with the new “modified nexus approach” provided in the OECD’s final report under base erosion and profit shifting (BEPS) action 5, “Agreement on Modified Nexus Approach for IP Regimes” (for prior coverage, see the tax alert dated 8 October 2015). The nexus approach is based on a substantial activity requirement, i.e. there must be a direct nexus between the income receiving benefits and the activity contributing to that income.

The repeal of Luxembourg’s IP regime would be applicable as from 1 July 2016, and as from 1 January 2017 for NWT purposes. A new replacement IP regime is expected to be presented in the near future. However, under BEPS action 5, existing IP regimes may be maintained during a transition period beginning on 1

July 2016 and ending on 30 June 2021. As a result, taxpayers benefiting from the current Luxembourg IP regime that create, acquire or definitively improve qualifying IP rights before 1 July 2016 would be able to continue to benefit from this regime until 30 June 2021. New entrants also could be admitted to the existing regime until 30 June 2016.

The transitional period, however, would be subject to two "safeguard" conditions:

- The benefit of the transitional period would not apply after 31 December 2016 for IP rights that are acquired directly or indirectly from related parties after 31 December 2015, unless the IP rights were eligible at the time of their acquisition for the Luxembourg IP regime or a foreign IP regime corresponding to the Luxembourg regime. The term "related parties" would be broadly defined by reference to Luxembourg's Income Tax Law as an undertaking participating directly or indirectly in the management, control or capital of another undertaking, or a situation in which the same persons participate directly or indirectly in the management, control or capital of two undertakings.
- For taxpayers benefiting from the current Luxembourg IP regime in connection with IP rights acquired or created after 6 February 2015, there would be a spontaneous exchange of information three months after the Luxembourg tax authorities have been informed, or no later than one year after the filing of the tax return by the taxpayer.

For the purpose of the transitional period, IP rights transferred through a tax-neutral corporate reorganization (e.g. a merger, division or contribution) would be deemed to be acquired on the date of the reorganization.

Measures affecting individuals

Step up: A "step-up" mechanism for individuals would be introduced (this mechanism already may be applied in the case of corporations). Under the step-up, latent unrealized gains accrued in foreign jurisdictions on (i) shares (and equivalent participations) and (ii) convertible loans if the individual owns a "significant participation" in the company would not be taken into account in Luxembourg when computing the taxable basis for the disposal.

To calculate the taxable basis, the original acquisition cost of the asset would be replaced by its fair market value at the time of migration to Luxembourg, under tax-neutrality conditions; however, the acquisition date for the asset would remain the initial acquisition date (rather than the date of migration) when calculating holding periods. In contrast, revaluation coefficients (used to compute taxable capital gains) would refer to the date of migration and not the acquisition date.

Taxation of part-year residents: The government would modify the provision of the Income Tax Law dealing with the taxation of employees and retired individuals who have been resident in Luxembourg for only a part of the year. These individuals may claim a refund of withholding taxes by declaring their worldwide income and claiming full-year tax deductions.

According to the draft legislation, the application of this article would be extended to all taxpayers that are only part-year residents. Currently, a part-year Luxembourg tax resident who does not receive any Luxembourg or foreign-source income during the period of nonresidence is entitled to only a pro rata portion of the available tax deductions, reliefs and credits, based on the number of months he or she is taxable in Luxembourg. To align Luxembourg law with EU legislation, these individuals would be entitled to the full amount of the available tax deductions. This modifications would have a very limited impact (employees and retired individuals would not be affected).

Other measures

The draft budget law would provide for a tax amnesty for direct taxes, registration fees and inheritance tax in connection with wealth or income previously not declared by Luxembourg tax residents. However, to benefit from the amnesty, the taxpayer would have to spontaneously file an amended tax return and pay the entire tax due, plus a surcharge. For amended tax returns filed between 1 January 2016 and 31 December 2016, the surcharge would be 10%, and it would be 20% for amended tax returns filed during calendar year 2017.

Only Luxembourg residents would be permitted to participate in the tax amnesty and it could not be used by a person involved in an administrative or judicial proceeding in connection with avoided taxes.