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GMS Flash Alert

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Luxembourg - 2017 Tax Reform Legislation Submitted to Parliament

Following the announcement of the tax reform in February and further clarifications presented in April,[1] the Luxembourg government submitted its tax reform draft law[2] to parliament. The reform is comprehensive and is designed to create social fairness, increase competitiveness, and strengthen employment. It entails the introduction of a significant number of new tax measures concerning both corporate and individual taxpayers in the fields of direct and indirect taxation. We have highlighted below some of the important measures affecting individual taxpayers.

Once voted in by a majority in parliament, most of the measures are expected to enter into force from 1 January 2017 (with some exceptions).

WHY THIS MATTERS

The tax reform will affect individuals living or working in Luxembourg, including local employees, cross-border workers and international assignees. Certain nonresident taxpayer couples will be taxed as single taxpayers under a different tax class. Therefore, special attention needs to be paid to the company's current approach to the taxation of its nonresident married employees in Luxembourg and make sure they establish proper compliance.

In addition, the new marginal tax rates – slightly above current top marginal tax rates – may increase the tax burden on assignees and slightly augment employers' tax-related costs for assignments to Luxembourg and for Luxembourg outbound assignees still subject to Luxembourg taxation. However, the abolition of the temporary tax for the budget balance and the increases to various taxpayer credits and deductions could help offset the aforementioned tax increase – the impact of these changes on taxpayers should be determined in light of their particular facts and circumstances.

International assignment cost projections and budgeting for assignments to Luxembourg and for assignees outside Luxembourg still subject to Luxembourg taxation should take into account the changes proposed to the extent they become legislated. Luxembourg-based employers should take note of the changes described in this newsletter and address their payroll requirements and update, where appropriate, hypothetical tax calculations for tax equalized assignees.

Principal Measures Affecting Individual Taxpayers

The following measures are included in the draft law in order to support households' purchasing power of the middle class.

Taxation of Nonresidents

The taxation of married nonresident taxpayers would be substantially amended: nonresident couples would be taxed as single taxpayers in tax class 1 (i.e., single taxpayer without dependent children) during the full calendar year, unless at least one of the spouses is taxable in Luxembourg on at least 90 percent of his or her yearly worldwide income from Luxembourg sources, in which case, they can opt to be jointly taxed (in tax class 2) at the tax rate applicable on their household's worldwide income. This measure may have a cash-flow impact for the couples.

Abolishing the Temporary Tax to Balance the Budget

The 0.5-percent temporary tax for the budget balance (*l'impôt d'équilibrage budgétaire* temporaire) will be abolished.

Tax Rates

The global tax schedule will be revised, and additional income brackets and tax rates will be introduced. The government is adding new marginal tax rates of:

- 41 percent on annual income which equals or is in excess of €150,000; and
- 42-percent rate, which will apply for single taxpayers on their annual income which equals or is in excess of €200,004 (for taxpayers in tax class 1).

Option for Individual Taxation of Couples and Registered Partners

Married couples and registered partners would be permitted to opt to be taxed individually in a given year. In order to be so taxed, married couples must file a joint non-revocable application by 31 December of the tax year preceding the tax year concerned, unless they are getting married during that tax year or become resident taxpayers during the tax year concerned; in the latter case, the joint taxation application should be filed by 31 December of the tax year concerned.

The above applies also to registered partners who file a joint non-revocable application by 31 March of the tax year following the tax year concerned.

Family-Related Tax Measures

The tax credit granted to **single parents** will increase to EUR 1,500 if their yearly adjusted taxable income is below €35,000; however, it will remain at €750 if their yearly income exceeds EUR 105,000.

The deductible amount of **education allowance** for children not part of the household will increase from €3,480 to €4,020. This allowance is not granted when both parents are living with their child in the same household.

There will be an increase in the maximum amount that is tax deductible for **combined child-care costs, housekeeping costs, and home assistance for the disabled:** from EUR 3,600 to EUR 5,400 per year.

Changes to Certain Tax Credits/Deductions

<u>Pension Schemes</u>: Premiums for voluntary pension schemes (3rd pillar) would be deductible now for all taxpayers up to €3,200 per year.

Tax Credit: The tax credit for salaried individuals, pensioners, and independent workers will vary between EUR 300 and €600 depending on the level of income of the taxpayer. For taxpayers with an annual income exceeding EUR 80,000, the tax credit will be abolished.

Deduction for Debt-Related Interest: The ceiling for the tax deduction in relation to the payment of debit interest (i.e. consumer loans, credit cards, etc.) is merged with the ceiling for the tax deduction on insurance premiums. Therefore the combined annual ceiling applicable is EUR 672 per member of the household.

Other Measures

Final Withholding Tax on Interest: The final withholding tax on interest paid out to Luxembourg-resident individuals (RELIBI) would be increased from 10 percent to 20 percent. The tax is only due if the annual amount of interest exceeds €250 per individual and per paying agent.

Promoting House Purchases:

- *Home Savings Plans*: The maximum tax amount deductible for contributions qualifying for home savings plans would be increased from EUR 672 to EUR 1,344 for individuals aged between 18 to 40 years. In the other cases, the initial ceiling of EUR 672 would remain applicable per member of the household.

- *Mortgage Interest Deduction*: In addition, the amount of mortgage interest deduction related to the main residence will be increased as follows:

  - EUR 2,000 for the first year of occupation and following five years;

  - EUR 1,500 for the next five years; and

  - EUR 1,000 thereafter.

Car Taxation: To support sustainable individual transportation, zero-emission vehicles purchased by private individuals will benefit from a tax allowance varying from EUR 300 to EUR 5,000. This tax allowance is not applicable to company cars/cycles.

The monthly valuation of the salaried benefit-in-kind for a company car would be amended by Grand-Duchy Regulation and may vary from 0.5 percent to 1.8 percent (of the price of the vehicle purchased as new) depending on the ecological impact of the vehicle. The above is applicable to new vehicles, while the 1.5-percent lump-sum rate would remain applicable to vehicles covered by a contract ongoing on 1 January 2017.

Lunch Vouchers: The face value of lunch vouchers provided by employers would be increased from EUR 8.40 to EUR 10.80.

Tax Amnesty: Taxpayers still can benefit from a tax amnesty by filing a corrective income tax return until 31 December 2017, and by paying the amount of tax due (including an increase of the tax due of 10 percent, for a regularization in 2016, or 20 percent in 2017) within one month following the receipt of the revised tax assessment.

Measures Regarding Money Laundering and Improper Compliance

Several measures are to be introduced in direct and indirect tax law in order to better fight tax fraud and money laundering. The purpose of the reform is to distinguish between three types of tax fraud: “simple” tax fraud, “aggravated” tax fraud, and tax evasion (“escroquerie fiscale”). Thus, the draft law introduces a new concept of “aggravated” tax fraud for direct and indirect tax purposes which would be considered a criminal offence.

Furthermore, the money laundering infraction would be extended to cases of "aggravated" tax fraud and tax evasion.

In addition, the filing of a deliberately incomplete or incorrect direct tax return and the non-filing of direct tax returns will be subject to an administrative fine. The fine depends on the amount of the under-stated tax (or unduly reimbursed tax) and should range between 5 percent and 25 percent of that amount.

The draft law further provides that penalties imposed in cases of late filing of direct tax returns will be increased to a maximum amount of EUR 25,000.

KPMG NOTE

The new measures represent important changes to Luxembourg's individual tax system. For example, married couples and registered partners will have the option to file tax returns separately as opposed to filing joint tax returns, giving taxpayers more flexibility to manage their tax affairs. Employers providing tax return support to international assignees or other employees should be aware of the changes and where necessary, review their internal policies with regards to tax return authorization in respect of assignees' spouses.

The increase of tax credits and tax deductions should help increase the net incomes of many individuals, which is welcome news. However, for nonresident taxpayers – especially for the approximately 160,000 cross-border nonresident workers – their tax calculation and Luxembourg tax return filing requirements have been substantially changed, and this could have a cash-flow impact. Employers should pay particular attention regarding correct implementation – when the time comes – to the relevant changes, for example, in their payroll area (e.g., in light of changes to the calculation of company car benefits, collection of valid tax cards). It will also be worth considering providing additional support to international assignees and other employees in light of the tax law changes (especially with the new option allowing the spouses to file separately with a potential reallocation of their income).

In addition, a stricter penalty regime will be in place from 2017 for taxpayers who are non-compliant, with additional sanctions in cases of tax fraud or tax evasion. International assignees and their employers should take note of this, and act to foster proper compliance with Luxembourg tax laws.

FOOTNOTES:

1 See our previous issues of GMS *Flash Alert* 2016-058 (6 May 2016) and 2016-059 (26 July 2016).

2 The full text of the draft law (in French) can be found at:

http://www.chd.lu/wps/portal/public/RoleEtendu?action=doDocpaDetails&backto=/wps/portal/public/accueil/actualite/!ut/p/b1/04_SjzQ2tzS2NDazNNaP0I_KSyzLTE8syczPS8wB8aPM4I2MXMKCPE2MDPxdg80MjIwDjB2Dgo0MDAxMgAoigQoMcABHA0L6_Tzyc1P1c6NyLACMJKEd/dl4/d5/L2dBISEvZ0FBIS9nQSEh/&id=7020# .

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