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Luxembourg's 2019 Finance Bill: key tax considerations

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Following the smooth passage of a new Budget bill, Luxembourg has cut the rate of corporate income tax with immediate effect to attract more international investors.

The decrease in the corporate income tax (CIT) rate was promised in the Government's coalition agreement for the period 2018-2023 following the 2018 general elections.

Previously CIT was levied at a rate of:

- 15% where net profit did not exceed EUR 25,000
- EUR 3,750 plus 33% of net profit exceeding EUR 25,000 where net profit ranged from EUR 25,000 to EUR 30,000
- 18% where net profit exceeded EUR 30,000

On top of CIT, Luxembourg companies are liable for (i) a solidarity surcharge equal to 7% of the CIT contribution and (ii) the municipal business tax, whose taxable basis is similar to the CIT's and whose rates depend on the municipality where the company is established (for example, in Luxembourg city the rate is 6.75%).

Altogether Luxembourg companies were therefore in principle liable for tax on their worldwide income at an aggregate rate of 26.01%.

Under the Bill, the bracket for minimum tax has increased from EUR 25,000 to EUR 175,000. Additionally, the intermediary rate is now EUR 26,250 plus 31% of net profit exceeding EUR 175,000 where net profit ranges from EUR 175,000 to EUR 200,000. Where net profit exceeds EUR 200,000, the rate is 17%.

The new rates apply with immediate effect for fiscal year 2019. No change to the solidarity

surcharge or municipal business tax is anticipated at this stage.

For a Luxembourg company with profits exceeding EUR 200,000, the aggregate tax rate has decreased to 24.94% from 26.01%.

Along with the above CIT and additional charges, a Luxembourg company will still be subject to net wealth tax (NWT) annually at the rate of 0.5%, assessed on its unitary value (assets minus liabilities). Assets qualifying for the participation exemption regime are exempt from the NWT basis (deduction of connected liabilities is then disallowed). Such companies will be liable for at least the minimum NWT (when the amount of NWT is lower than the minimum NWT), whose amount varies depending on the asset structure or the company, as follows:

- minimum NWT of EUR 4,815 for holding companies
- minimum NWT varying from EUR 535 to EUR 32,100 for other companies

Put into perspective with other European countries, the 2019 rate would be higher than the average 21.86% observed in the EU for 2018 and 21.68% for 2019 (including the new Luxembourg rate), both including the UK. In the EU rates vary from 9% to 35%, with a median value of 20.5%.

Internationally, the average rate in 2018 was 21.4% across the 94 countries covered by the OCED Corporate Tax Statistics[1].

However it should be remembered that the statutory rate does not give the full picture of the corporate tax liability of a company.

One should pay special attention to the effective tax rate (ETR). This concept has different definitions; a rudimentary one being the rate at which a company's pre-tax accounting profits are taxed. These tax contributions can be measured by reference to the EBITDA (earnings before interest, tax, depreciation or amortisation) or simply by reference to the EBT (earnings before tax), both determined according to accounting rules. ETR then takes into account exemptions and additional deductions granted by tax rules in force, i.e. any reduction of the taxable basis in deviation of the accounting profit. For instance in Luxembourg:

- pure holding companies, whose activity consists of managing a portfolio of subsidiaries and whose unique sources of revenue are dividends thereof and capital gains therefrom, could, under certain conditions, be subject to an effective rate of 0% (or thereabouts) should the investments qualify for the relevant participation exemption
- finance companies' tax base may be limited, under certain conditions, to an adjusted return on their equity put at risk for the purpose of intra-group lending activities. This taxable basis would be a combination of the expected loss and expected return based on the capital asset pricing method, adjusted to take into account the Luxembourg tax liability and operational

expenses

- companies holding and licensing the use of software and/or patents may benefit from a 80% exemption on the adjusted income from some eligible assets

Another more sophisticated method for the computation of the ETR concerns the effective marginal tax rate and the effective average tax rate (see notably the work of Michael P. Devereux and Rachel Griffith, or Mervyn A. King and Don Fullerton). The effective marginal tax rate on capital income is " the expected pre-tax rate of return minus the expected after-tax rate of return on a new marginal investment, divided by the pre-tax rate of return"[2]. It measures the effects of taxation on the pre-tax rate of return required by investors to break even. According to the OCED Corporate Tax Statistics, this marginal tax rate was 6.8% in Luxembourg in 2017, compared to 9.7% in the Netherlands, 14% in France or 17.4% in the UK.

When questioning the ETR, the tax cost of profit or income repatriation should also be monitored. Under Luxembourg law, no withholding tax applies on the payment of interest to non-resident creditors or on the payment of royalties. Withholding tax on dividends can be reduced from 15% (statutory rate) to 0% by application of the domestic participation exemption or by the provisions of certain double tax treaties signed by Luxembourg as the case may be.

Taking all of the above into consideration, Luxembourg is clearly a top choice for multinational companies wishing to establish a pan-European and international investment platform.

[1] https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-database-first-edition.pdf

[2] Don Fullerton

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