Luxembourg: Withholding tax on its way out and other attractive new tax measures

Last May, the Luxembourg Prime Minister, Jean-Claude Juncker, announced several tax measures aimed at increasing the country's competitiveness. In line with the Prime Minister's announcement, a finance bill (the "Finance Bill") intended to implement most of these measures was introduced on October 1, 2008. One of the measures announced by the Prime Minister, i.e. the abolition of capital duty, was already the subject of a bill introduced on September 9, 2008 (the "Capital Duty Bill"). Most of the measures apply to companies but the Finance Bill includes a number of measures directed at individuals as well.

The measures contained in the Finance Bill and the Capital Duty Bill are as follows:

Abolition of withholding tax on dividends paid to treaty – Country companies

Most of Luxembourg's double tax treaties currently provide for a minimum withholding tax rate of five percent on dividends. Under the Finance Bill, dividends paid to a parent company ("*organisme à caractère collectif*") resident in a country with which Luxembourg has concluded a double tax treaty will be exempt from withholding tax. This exemption is subject to the condition that the parent company is liable in its country of residence to an income tax comparable to the Luxembourg corporate income tax. This means that the foreign income tax must be levied at a nominal rate of at least half of Luxembourg national corporate tax rate (i.e. at least 11 percent, or 10.5 percent if the Finance Bill is enacted, see below) and on a similar tax base. Moreover, at the time of the distribution, the parent company must have held (or have committed to continue to hold) for an uninterrupted period of at least 12 months: (i) a participation of at least 10 percent in the capital of the subsidiary, or (ii) a participation with an acquisition cost of at least EUR1.2 million in the subsidiary.

Reduction of corporate income tax rate

Companies established in Luxembourg City are currently subject to corporate tax at an aggregate rate of 29.63 percent, which represents a combination of: (i) the national corporate income tax (22 percent) increased by a solidarity surcharge (four percent), and (ii) the municipal business tax (6.75 percent for Luxembourg City). The Finance Bill will reduce the national corporate income tax to 21 percent. As a result, the aggregate corporate income tax rate for companies established in Luxembourg City will be reduced from 29.63 percent to 28.59 percent. It is expected that the corporate income tax rate will gradually be reduced further in the future.

Net wealth tax exemption for IP

Luxembourg tax law provides certain exemptions from net wealth tax, such as the exemption for the value of a substantial shareholding. The Finance Bill will add an exemption for intellectual property rights. The measure will complement a law of December 21, 2007 which introduced an 80 percent exemption from corporate income tax for income derived from intellectual property and capital gains realised on the disposal of such property. The Finance Bill also expressly provides that domain names are covered by the favourable IP regime (with effect from January 1, 2008 with respect to the corporate income tax exemption).

Fiscal neutrality for companies applying IFRS

The Finance Bill will ensure fiscal neutrality for companies opting to apply the IFRS.

Abolition of capital duty

Luxembourg currently levies a fixed capital duty of EUR1,250 on securitisation vehicles, undertakings for collective investment ("OPCs"), specialised investments funds ("FISs") and companies investing in risk capital ("SICARs"), as well as an *ad valorem* capital duty on civil and commercial companies. Effective January 1, 2008, the *ad valorem* rate was reduced from percent to 0.5 percent. The Capital Duty Bill will abolish capital duty (fixed and *ad valorem*) from January 1, 2009.

The Capital Duty Bill will also introduce a fixed registration duty of EUR100 for European Companies (*Societas Europaeas* or "Ses"), public limited companies ("Sas"), partnerships limited by shares ("SCAs"), and cooperative companies in the form of public limited companies and EUR50 for limited liability companies ("Sàrls") and other civil and commercial companies. The duty will be due upon the incorporation of the relevant entity, the amendment of its articles of association and the transfer of its registered office or place of effective management to Luxembourg.

Under current Luxembourg law, an exemption from capital duty is available for certain restructurings, such as share-for-share exchanges. These are exempt under certain conditions, including the observance of a five-year holding period for the new shares received following the exchange. According to the explanatory notes to the Capital Duty Bill, once the bill comes into effect taxpayers that have already invoked the exemption but have not yet held the shares for five years will no longer be required to do so which means that the exemption is final.

The Capital Duty Bill provides that a contribution made to a Luxembourg company in the context of a reorganisation (contribution of shares, all assets and liabilities or branches of activities) will be exempt from fixed registration duty; provided it is remunerated by a majority of shares.

Under the Capital Duty Bill, a contribution of real estate located in Luxembourg to a Luxembourg or foreign company will trigger a 1.2 percent registration duty and 0.5 percent transcription tax, provided that such contribution is remunerated by shares (*droits sociaux*). If such contribution is not remunerated by shares (*droits sociaux*), it will be subject to a six percent registration duty and a one percent transcription tax. A contribution of Luxembourg real estate made in the context of a reorganisation will be exempt from registration duty.

Tax cut for individuals

Effective January 1, 2008, tax brackets for individuals were increased by six percent each to compensate for inflation. The Finance Bill will increase the brackets by another nine percent.

If enacted, the Finance Bill and the Capital Duty Bill will enter into force on January 1, 2009. These measures will make Luxembourg an even more attractive jurisdiction for certain types of investors and investments. In particular, non-EU investors such as US and Asian corporate entities will become entitled to a zero withholding tax on dividends received from their Luxembourg subsidiaries.

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