

LUXEMBOURG 2019 BUDGET LAW

On 25 April 2019, the Luxembourg Parliament approved the 2019 budget law which entered into force on 1 May 2019. Amongst others, the new law will lead to a reduction in the corporate income tax rate and implement the interest limitation rule applicable to the tax unity regime.

CORPORATE INCOME TAX RATE REDUCTION

A significant highlight of the Budget Law is the reduction of the Luxembourg corporate income tax (**CIT**) rate by one percentage point, from 18% to 17%, leading to an aggregate CIT rate of 24.94% (previously 26.01%) for taxpayers resident in Luxembourg City. Moreover, the threshold under which a company can benefit from the reduced CIT rate of 15% is raised from EUR 25,000 to EUR 175,000.

These changes will apply as from the tax year 2019 and may impact investment activities in the Luxembourg market. For instance, German investors may be affected, as the reduced overall tax rate of less than 25% could lead to the application of German CFC rules (*Hinzurechnungsbesteuerung*). This could (subject to further requirements) result in the allocation of certain passive income items from Luxembourg capital companies to German investors and consequently lead to additional taxation at the investor level. Relocation of holdings to other municipalities in Luxembourg with a higher communal tax rate, resulting in an overall rate greater than 25%, may become a subject for discussion. It is worth noting that, at least under the current statutory rules, German CFC rules do not apply to Luxembourg corporations that qualify as alternative investment funds (e.g. S.A. SICAV-SIF). It is expected that the German CFC rules will be reformed (presumably with effect from 1 January 2020).

INTEREST LIMITATION FOR FISCAL UNITIES

For tax years starting on or after 1 January 2019, a new version of article 164*bis* of the Luxembourg income tax law (**LITL**) will impact the Luxembourg fiscal unity regime. Besides clarifying the rules applicable to fiscal unities as such, the new provision will also implement the EU Anti Tax Avoidance Directive (**ATAD 1**), allowing group entities under the fiscal unity regime to apply the interest limitation rule at the level of the fiscal unity itself, and thus determining the exceeding borrowing costs and fiscal EBITDA on an aggregated basis.

This computation is, however, optional and the application of the interest limitation rule on an entity-by-entity basis will remain.

Key issues

- Budget law 2019 entered into force on 1 May 2019
- Corporate income tax reduction from 26.01% to 24.94% as from tax year 2019
- Interest limitation provisions applicable on fiscal unity level

The practical application of the computation and further clarification (e.g. concerning Luxembourg securitisation vehicles) remains uncertain.

MINIMUM SOCIAL SALARY TAX CREDIT

A minimum social salary tax credit (*crédit d'impôt salaire social minimum*) effective as of 1 January 2019 is created in order to increase the minimum social salary by EUR 100 net per month.

VALUE ADDED TAX MEASURES

Applicable as from 1 May 2019, the law foresees the extension of the super-reduced Value Added Tax (**VAT**) rate of 3% to certain new items including electronic books, online publications and essential hygiene-related items. In addition, a reduced VAT rate of 8% will now apply to specific plant protection products used for organic agriculture.

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B.P. 1147, L-1011 Luxembourg, Grand-Duché
de Luxembourg

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