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GMS Flash Alert

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Luxembourg – Update on 2018 Tax Reform Legislation

On 21 December 2017, the Luxembourg State Council approved the budget law, which had already been passed by Parliament on 14 December 2017[1]. The 2018 budget law provides a significant change for married nonresident taxpayers in Luxembourg. Resident taxpayers are also affected by some of the changes in this budget law.

This GMS *Flash Alert* describes some of the important aspects of the 2018 budget law.

- Tax card 2018
- Taxation of married nonresidents
- Favourable tax rate for certain real estate capital gains
- Process concerning the exchange of information
- Taxation of stock option plans
- Inheritance tax exemption for couples without children.

WHY THIS MATTERS

For employers of globally mobile employees there is always a great deal of interest in the budget measures as they can have a direct impact on the cost of assignments. Luxembourg has a large population of frontier workers from Belgium, France, and Germany who are impacted by the new rules. Some measures may increase the cost of assignments to Luxembourg.

Tax Card 2018

Since 3 October 2017, the Luxembourg tax authorities have been sending letters to all married nonresident taxpayers who receive employment income or pensions in Luxembourg. The purpose of these letters is to notify the taxpayer about:

- applying for one of the three options of taxation; and
- a personalised tax rate that could be included in their 2018 tax cards, based on the information at the disposal of the tax authorities.

The three options are as follows:

- **Joint taxation**: The household's total income is subject to the favourable tax rate of tax class 2.[2]
- **Fully individual taxation**: Income of the household is allocated to each spouse individually and deductions are equally split between both spouses.
- **Individual taxation with reallocation of income**: The household's total income is, by default, allocated equally between spouses without taking into account the level of their individual incomes. A different allocation can be requested by the taxpayers.

Example of Impact of Options

Scenario

- Taxpayer A and spouse (Taxpayer B) residing in France
- Taxpayer A's income: €50,000 (taxable in Luxembourg)
- Taxpayer B's income: €25,000 (taxable in Luxembourg)
- "Extra-professional" abatement: €4,500
- Total taxable income: €70,500
- Exempted income from Taxpayer B: €15,000
- Worldwide income of the household: €85,500

Assumptions	Tax class	Taxpayer A	Spouse	Total tax
Joint taxation	2	€5,220.53	€5,220.53	**€10,441.05**
Individual taxation without reallocation	1	€8,805.00	€2,814.18	€11,691.18
Individual taxation with reallocation (50/50)	1	€5,220.53	€5,220.53	**€10,441.05**
Individual taxation with reallocation (75/25)	1	€12,039.64	€854.81	€12,894.45

Source: KPMG, Luxembourg

KPMG NOTE

If no tax rate is provided, or the personalised tax rate is incorrect, an application should be submitted to the tax office. Such applications can be submitted online or in writing. The advantage of submitting online is that it will be processed faster. Ultimately, the application should be submitted before 31 March 2019. However, to have the correct tax class stated on the tax card and thus implemented through the payroll, the application should have been submitted before 31 October 2017.

Taxation of Nonresidents of Luxembourg

By default, nonresident taxpayers will be taxed as single taxpayers in tax class 1 during the tax year (i.e., no more under the more favourable tax classes 1A or 2). However, nonresident taxpayers can still qualify for tax class 2 if the part of their worldwide household income that is taxable in Luxembourg meets certain thresholds.

- **90-percent threshold**: If one spouse is taxable in Luxembourg on at least 90 percent of his/her annual worldwide income, both spouses can still benefit from tax class 2.

Example A

- Taxpayer A's taxable income in Luxembourg: €50,000
- Spouse's taxable income outside Luxembourg: €25,000
- Worldwide household taxable income: €75,000
- Luxembourg taxable income of Taxpayer A is 100 percent of worldwide income. Taxpayer A and spouse qualify for tax class 2.

For this 90-percent threshold, the first 50 days worked outside Luxembourg are deemed to be taxable in Luxembourg. For the calculation of the non-Luxembourg work-days, those first 50 days are exempted in Luxembourg.

Example B

- Taxpayer A's total gross salaried income: €50,000. He/she worked 60 days outside Luxembourg, out of 200 total work-days. As a result, the Luxembourg taxable income for the 90-percent threshold valuation is €47,500 for Taxpayer A.
- Taxpayer A's final taxable income in Luxembourg: €35,000
- Spouse does not generate income.
- Worldwide household taxable income: €50,000
- Luxembourg taxable income is thus 95 percent of worldwide income.

The 90-percent threshold is met. This is due to the fact that Taxpayer A can include the 50 first work-days outside Luxembourg in the computation as taxable income from Luxembourg. For the 90-percent threshold, both spouses still qualify for tax class 2 since the 10 days remaining performed outside Luxembourg are lower than 10 percent of their worldwide income. Thus the 90-percent threshold is still be applicable in the case at hand.

Alternative threshold for Belgian residents: taxpayers may be granted tax class 2 to the extent that more than 50 percent of their household's professional income is taxable in Luxembourg.

- **€13,000 threshold**: if none of the thresholds above are met, tax class 2 would still be available if the annual taxable income not subject to Luxembourg taxation is less than €13,000.

Example

- Taxpayer A's taxable income is €25,000. He/she worked 75 days outside Luxembourg out of 200 total work-days. As a result, his/her Luxembourg taxable income for the 90-percent threshold valuation is €21,875.
- The spouse's taxable income in France: €50,000
- Worldwide household taxable income: €75,000
- Luxembourg taxable income is thus 87.50 percent of Taxpayer A's worldwide income.

The 90-percent threshold is not met and the 50 days threshold is not met. However, because the taxable income that is not subject to Luxembourg taxation (€9,375) – since 75 out of 200 work-days are not taxable in Luxembourg – is less than €13,000, both spouses still qualify for tax class 2.

If the taxpayer is eligible for tax class 2 based on the above, and this is to be included in his/her 2018 tax card, an application should have been submitted to the tax office before 31 October 2017. If no application was submitted, the taxpayer can still benefit from tax class 2 through the filing of a Luxembourg tax return. The ultimate filing deadline for the 2018 tax return is 31 March 2019.

KPMG NOTE

The additional threshold of "50 days outside Luxembourg" is good news, as it will likely allow more cross-border workers to maintain the benefit of tax class 2. However, applying for tax class 2 also means that the household's worldwide income will need to be declared in Luxembourg and will be taken into account to calculate the effective tax rate applicable to the Luxembourg taxable income, i.e., possibly increases the household's total tax liability.

Special attention should be paid to the strict deadlines with respect to the taxation of the 2018 income:

- 31 October 2017: for the right tax class in the 2018 tax card;
- 31 March 2019: to claim a modification of the tax class/taxation option through the 2018 tax return.

The tax authorities have recently clarified that the 2018 wage tax may be temporarily operated based on the 2017 tax card for employees and pension-earners who are likely to receive their 2018 wage tax cards within the first two months of 2018.

Upon receipt of a valid 2018 tax card, the employers/pension authorities will be able to operate the withholding tax according to the new tax card, and make any necessary retrospective adjustments.

Favourable Tax Rate for Certain Real Estate Capital Gains

To further increase the supply of building land and housing, the favourable tax regime for certain real estate capital gains has been be extended by one year. Capital gains arising from the disposal of real estate will be taxable at one-quarter (¼) of the taxpayer's overall effective tax rate, if the sale occurs (or occurred) between 1 July 2016 and 31 December 2018. This favourable regime applies to capital gains on sales of real estate (i) tied to a secondary home or property (i.e., not the taxpayer's main residence) and (ii) held by the taxpayer for more than two years.

Process Concerning Exchange of Information

The proposed amendment of the Luxembourg law regarding the process for the exchange of information upon request was removed from the budget bill and will be dealt with in a new, separate draft law. The State Council argued that the budget bill went beyond the requirements set by the Court of Justice of the European Union in its judgement in the Berlioz case. We will endeavor to keep GMS *Flash Alert* readers informed once this new draft law is available.[3]

Taxation of Stock Option Plans

Additionally, as communicated in our GMS *Flash Alert* 2017-186 (18 December 2017), the taxation of stock option plans was modified by a new circular from the tax authorities issued on 29 November 2017.

Inheritance Tax – Exemption Also for Couples without Children

The (full) exemption from inheritance tax – previously applicable only for transfers upon death between spouses or partners with at least one child – shall be extended as well to spouses or partners without children in common or other descendants.

FOOTNOTES:

1 For the Budget law (in French), click here. For the "Newsletter du 21 décembre 2017" with links to the legislation, regulations, and related publications and documents, click here.

2 For more information about Luxembourg's tax classes, see the KPMG publication "Taxation of International Executives: Luxembourg".

3 To learn more about this matter, see "Tax Alert 2017-07," (18 May 2017) published by the KPMG International member firm in Luxembourg.

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