

CHANGES TO LUXEMBOURG'S INCOME TAX LAW TO BENEFIT NON-RESIDENTS

AMENDMENTS TO PROVISIONS APPLY AS FROM TAX YEAR 2010

Certain amendments to Luxembourg's income tax law have been given the go ahead in Luxembourg in a move to amend existing discriminatory provisions surrounding the taxation of non-residents. These amendments, recently adopted by the Luxembourg parliament will be favorable for non-residents and will apply as from tax year 2010.

These amendments follow a formal letter of notice issued on 14 April 2009 where the European Commission requested that Luxembourg amend certain discriminatory provisions of its non-resident tax legislation based on the Gerritse case (C-234/01 of 12 June 2003) of the European Court of Justice. Such provisions were seen as an infringement of Article 63 of the Treaty on the functioning of the European Union (ex-Article 56 of the EC Treaty regarding the free movement of capital). Accordingly, on 26 July 2010, the Law amending Articles 157, 157 bis and 157 ter of the Luxembourg Income Tax Law (the "Law") has been adopted by the Luxembourg Parliament.

1. EU ALLEGATIONS- BACKGROUND

The European Commission argued that certain types of income derived by non-residents were subject to higher progressive tax rates than if such income would have been increased with the maximum amount of the tax-free bracket. In addition, non-resident taxpayers sourcing the major part of their worldwide income in Luxembourg could not benefit from the tax-free bracket, if the Luxembourg source income consisted of non-professional income.

2. AMENDED PROVISIONS

- **Minimum Tax Rate on Non-Professional Income Not Subject to Withholding Tax**

Article 157 (5) of the Luxembourg income Tax law ("LIR") provides that non-professional income, which is not subject to withholding tax and derived by a non-resident taxpayer, should be taxed according to tax class 1 at the minimum rate of 15%. Luxembourg income tax liability is based on the individual's personal situation, e.g., family status. For the latter purpose, a tax class is granted to the taxpayer, with tax class 1 being the least advantageous.

The law introduces a new paragraph (5a) stating that the tax rate should be computed on the basis of a hypothetical income. This consists of the genuinely derived taxable income increased with the maximum allowable amount of tax-free income. If the hypothetical rate appears to be lower than 15%, such lower rate will apply. In the opposite case, the rate computed on the basis of Article 157 (5) LIR will be withheld.

- **Global Income Tax Rate on Professional Income Other Than Salaries and Pensions**

Article 157 bis (6) LIR states that the global income tax rate applicable to professional income, other than salaries and pensions, should be a minimum of 15%. In the light of the amendment catered by Article 157 (5a), the Law introduces a new paragraph (6a).

Henceforth, to compute the global income tax rate, the Luxembourg professional source income should be increased with the maximum tax-free income amount. If the global income tax rate appears to be less than 15%, the lower rate will apply. In the opposite case, the rate as computed according to paragraph (6) will be utilised.

- **Assimilation of Resident and Non-Resident Taxpayers**

Finally, the Law amended Article 157 ter (1) and (2) LIR so that non-resident taxpayers will no longer be required to derive 90% of their worldwide professional income in Luxembourg, but from now on, non-resident taxpayers will be deemed resident taxpayers if 90% of their total worldwide income is derived from Luxembourg.

Nonetheless, the amended provision could have adverse consequences for non-resident taxpayers who were previously assimilated to resident taxpayers due to the fact that more than 90% of their professional worldwide income was derived in Luxembourg. In the event that such taxpayer sources other income from abroad which constitutes more than 10% of its worldwide income, whilst more than 90% of the professional worldwide income may still be derived in Luxembourg, the non-resident will no longer be considered as a resident taxpayer.



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