ATOZ ALERT

Welcome modifications of the minimum NWT and the participation exemption for dividends and clarifications on the partial liquidation in case of the redemption of classes of shares

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Introduction

Today, the Luxembourg parliament published a draft law, approved by the government on Wednesday, which amends the minimum net wealth tax ("**NWT**") rules as well as the participation exemption and the Luxembourg rules on partial liquidations (the "**Draft Law**").

This Draft Law notably provides welcome flexibility in introducing an optionality for some tax exemptions, as well as welcome legal clarifications following the recent Luxembourg case law on the constitutionality of the minimum NWT and on the redemption of classes of shares.

We describe hereafter the main tax measures of this Draft Law:

Net Wealth Tax

The Draft Law proposes amendments to the minimum NWT in order to comply with ruling no. 185/23 of the Constitutional Court, which recently ruled that the current minimum NWT regime for companies holding predominantly financial assets is unconstitutional. For more information about this ruling, please read our article Unconstitutionality of the minimum net wealth tax regime for companies holding predominantly financial assets: consequences.

Currently, the minimum NWT provides that Luxembourg resident companies are, in principle, subject to a minimum NWT which is generally determined according to the nature and the size of their balance sheet. For purposes of determining the amount of minimum NWT due, the Luxembourg NWT law makes a distinction between, on the one hand, companies whose accounts 23, 41, 50 and 51 of the Luxembourg standard chart of accounts (i.e. financial assets, amounts owed by affiliated companies, transferable securities and cash at bank; hereafter referred to as the "qualifying assets") exceed both (i) 90% of their total balance sheet and (ii) a threshold of EUR 350,000 ("**SOPARFIs**"), and, on the other hand, the other companies ("**Non-SOPARFIs**").

It has now been proposed, in the Draft Law, to reorganise the structure of the minimum NWT by withdrawing the distinction between SOPARFIs and Non-SOPARFIs and by basing the various tax brackets on the sole criterion of the taxpayer's total balance sheet, without taking into account the proportion of financial assets held by the taxpayer in relation to its total balance sheet. The abolition of the balance sheet composition criterion should generally simplify the minimum net wealth tax system.

As a result of the proposed modification, the following minimum NWT amounts will be due:

a) a minimum of 535 euros where the total balance sheet is less than or equal to EUR 350,000;
b) a minimum of 1,605 euros where the total balance sheet is greater than EUR 350,000 and less than or equal to EUR 2,000,000.
c) A minimum of EUR 4,815 where the balance sheet total is greater than EUR 2,000,000".

For taxpayers whose financial assets exceed 90 per cent of their total balance sheet, the proposed changes imply an unchanged tax burden in terms of minimum wealth tax compared to the situation already resulting from the conclusions of the Constitutional Court. On the other hand, for taxpayers whose proportion of financial assets is below the 90 per cent threshold, the reform means a reduction in their minimum wealth tax burden.

The partial liquidation regime and the redemption of classes of shares

In order to provide a framework for situations in which a company's net assets are divided up in practice, the Draft Law intends to provide clarifications, based on the recent case law, on the partial liquidation regime, including in the case of classes of shares or corporate units that meet certain cumulative conditions.

As a result of the clarifications proposed in the Draft Law, when a shareholding in a corporate entity, including classes of shares or corporate units, is repurchased or withdrawn, and there is a corresponding capital reduction within a short period of time not exceeding six months from the date of the repurchase or withdrawal, the net assets of that entity are deemed to be divided up for the fraction corresponding to the said shareholding or class of shares or corporate units.

For the purposes of the application of partial liquidation regime to share classes, according to the Draft Law, the repurchase or withdrawal of a class of shares or corporate units must simultaneously meet the following conditions:

1. the redemption or withdrawal relates to an entire class of shares or corporate units;
2. the classes of shares or corporate units are set up at the time of the incorporation or capital increase of the undertaking;
3. each class of shares or corporate units has economic rights, defined in the undertaking's articles of association, distinct from those of the other classes of shares or corporate units;
    - A distinct economic right is characterised, based on the commentary to the Draft Law, by a specific right in relation to the rights of other classes of shares or corporate units, in particular, shares giving entitlement to reference dividends, securities giving an exclusive right to the profits of a specific or determinable period, or securities whose respective financial rights are linked to the performance of one or more direct or indirect assets or activities of the entity.
4. the redemption or withdrawal price of a class of shares or corporate units may be determined on the basis of criteria laid down in the undertaking's articles of association, or in any other document referred

to in those in these articles of association, and making it possible to reflect the estimated market value of the said class of shares or shares at the time of redemption or withdrawal.

Therefore, the redemption of classes of shares, meeting the above conditions, will be considered as partial liquidations and the redemption price should be considered as a capital gain and therefore not subject to Luxembourg withholding tax.

The commentary to the Draft Law finally recalls, however, in accordance with the recent case law, that §6 of the Adaptation Law remains applicable in case of abuse of law.

Where the redemption or withdrawal concerns a class of shares or corporate units held directly by an individual with a significant shareholding in the resident corporate entity in question, the latter will have to provide, as part of its annual income tax return, the information enabling such an individual to be identified."

The Luxembourg participation exemption: introduction of a waiver

The Luxembourg tax law provides, in Article 166 of the LITL, for a participation exemption regime for income received from qualifying shareholdings held by Luxembourg resident companies and Luxembourg qualifying permanent establishments of non-resident companies. To qualify for this regime, shareholdings must be of at least 10% of the share capital of the subsidiary or must have a minimum acquisition price of EUR 1.2 million. Taxpayers automatically benefit from the participation exemption.

The Draft Law aims to introduce the possibility for a taxpayer of waiving the benefit of the Luxembourg participation exemption referred to in Article 166 of the LITL. However, this option will only be available to the taxpayer where the conditions for the participation exemption are met solely by virtue of the threshold of the acquisition price of the shareholding, i.e. if is at least equal to an amount of EUR 1.2 million. In other words, when the conditions for the exemption are met on the basis of a shareholding of at least 10%, it will not be possible to exercise this waiver. The limitation of the waiver to these cases is due to the constraints arising from the Parent-Subsidiary Directive.

According to the Draft Law, the waiver will have to be exercised individually for each tax year and for each shareholding. If the waiver is not exercised, the participation exemption will continue to apply as it currently stands.

According to the commentaries to the Draft Law, the option to waive the benefit of the participation exemption aims to align with the participation exemption regime existing in a number of other EU Member States. Moreover, the proposed amendment allows greater flexibility for certain entities, which may have an interest in making use of their losses carry forward, the deductibility of which is now limited in time pursuant to Article 114, paragraph 2 of the LITL, rather than automatically benefiting from the participation exemption solely by virtue of the shareholding acquisition price of at least EUR 1.2 million.

For the same reasons, the Draft Law also proposes amendment to Article 115, number 15a, of the LITL to give corporate entities the option of waiving the 50% exemption on shareholding income, as referred to in number 15a. Like for the proposed amendment of Article 166 of the LITL, this option will have to be exercised individually for each tax year and for each shareholding.

Do you have further questions?

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