



NEWS FLASH

New Circular on Investment Tax Credit

On 31 March 2011 the Luxembourg direct taxation authorities (*Administration des Contributions Directes*) issued Circular 152bis/3 (the Circular), which explains that the geographical scope of the investment tax credit has been expanded to include investments “put to use” throughout the European Economic Area. This may open up new tax-planning opportunities, particularly for leasing and transport companies.

The investment tax credit is laid down in article 152bis of the Luxembourg income tax law (LITL). There are two types of credit: a credit for additional or “incremental investments”, and a credit for “global investment”. The credit for additional investments is calculated by comparing the net book value of qualifying assets for the current fiscal year (depreciation of current year additions being excluded) with their average book value over the last five years (the lump sum minimum is EUR 1,850). If the resulting amount is positive, it is then compared with the actual capital investment for the period. The tax credit equals 13% of the lower of these two amounts. The credit for global investment is based on the total value of qualifying additions during the period. The credit granted equals 7% up to EUR 150,000 in a given year and 3% on any amount exceeding EUR 150,000. Both types of investment tax credit may be offset against amounts of income tax due and they may be carried forward for 10 years.

Certain assets are excluded from the benefit of the investment tax credit: (i) buildings and mineral deposits, (ii) assets written off over a period of less than three years, (iii) motor vehicles (with significant exceptions) and (iv) second-hand assets (in most circumstances). To enable the taxpayer to benefit from the tax credit, the assets must be “put to use” in Luxembourg territory (except for vessels exploited in international traffic by licensed Luxembourg shipping companies).

This last exclusion was the object of a dispute between the tax authorities and a Luxembourg maritime company, Tankreederei I S.A., which led to litigation before the European Court of Justice (ECJ). Tankreederei exploited two vessels destined for river traffic in the ports of Antwerp and Amsterdam. The two vessels were booked as assets in the company’s balance sheet and were used in the context of an activity which was fully taxable in Luxembourg. The company requested application of the investment tax

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credit for the years 2000 to 2003. The tax authorities refused the claim on the basis of the wording of article 152bis LITL, which requires the investment to be made by a Luxembourg establishment. It also requires the assets to remain in this establishment on a permanent basis and be “put to use” only in Luxembourg territory.

The company brought the case before the Luxembourg Administrative Court, arguing that denying the benefit of the investment tax credit would cause it to receive less favourable tax treatment than that granted to companies carrying out the same activity in Luxembourg territory. The Court asked the ECJ for a preliminary ruling. In its decision of 22 December 2010 in Case C-287/10 *Tankreederei*, the ECJ concluded that the restriction set out in article 152bis LITL, pursuant to which the benefit of a tax credit for investments had been denied on the sole ground that the respective capital assets were physically used in the territory of another Member State, was incompatible with the freedom to provide services set out in article 56 of the Treaty on the Functioning of the EU (TFEU).

It was this judgment which has led the tax authorities to issue the Circular, in which they confirm that the investment tax credit applies to assets “put to use” not only in Luxembourg, but in any Member State of the European Economic Area (EEA), i.e. the 27 EU Member States and Iceland, Norway and Liechtenstein. The Circular also announces impending changes to the Luxembourg legislation to bring it in line with article 56 TFEU and the EEA Agreement. At this stage it has not been indicated how the legislation will be amended. Meanwhile, the tax authorities will follow the Circular in all cases where a tax assessment has not yet been issued. The Circular also emphasises that the investment must still be made by an establishment situated in Luxembourg.

The changes to the investment tax credit introduced by the Circular may make Luxembourg a very interesting location, particularly for transport and leasing companies. The forthcoming legislative amendments should be watched closely, but if they follow the spirit of the Circular, Luxembourg will have a real possibility in the future of becoming a hub for these types of industry.

INVESTMENT TAX CREDIT - EXAMPLE

Assumptions:		
A Luxembourg company (LuxCo) purchases a cargo ship in 2011:	EUR	50,000,000.00
LuxCo's annual income in 2011-2014 is estimated at:	EUR	10,000,000.00
Annual income tax at 21%* would be:	EUR	2,100,000.00
Tax credit for additional investment calculation:		
LuxCo's average investment over the last 5 years	EUR	0.00
Reference value (lump sum minimum)	EUR	1,850.00
Increase in investment	EUR	49,998,150.00
Tax credit for additional investment at 13%	EUR	6,499,759.50
Tax credit for global investment:		
Global investment in 2011	EUR	50,000,000.00
Tax credit up to EUR 150,000	EUR	10,500.00
Amount exceeding EUR 150,000	EUR	49,850,000.00
Tax credit for amount exceeding EUR 150,000	EUR	1,495,500.00
Total tax credit for global investment	EUR	1,506,000.00
TOTAL TAX CREDIT (both for additional and global investment):	EUR	8,005,759.50

Year	Income tax due (EUR)	Investment tax credit in a year (EUR)	Investment tax credit to carry forward (EUR)	Final income tax liability (EUR)	Municipal business tax liability at 6.75%** (EUR)	Contribution to the unemployment fund (5% on CIT due)
2011	2 100 000,00	2 100 000,00	5 905 759,50	0,00	675 000,00	105 000,00
2012	2 100 000,00	2 100 000,00	3 805 759,50	0,00	675 000,00	105 000,00
2013	2 100 000,00	2 100 000,00	1 705 759,50	0,00	675 000,00	105 000,00
2014	2 100 000,00	1 705 759,50	0,00	394 240,50	675 000,00	105 000,00
Subtotal:				394 240,50	2 700 000,00	420 000,00
Total tax liability for years 2011-2014:						3 514 240,50
Average Effective Tax Rate (ETR)						8,79%

* Assuming the income tax rate stays at 21% for 2011 - 2014

** Municipal business tax rate for Luxembourg City; assuming the rate stays at 6.75% for 2011-2014

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