

GRAND DUCHY OF LUXEMBOURG

TAX ADMINISTRATION

Unofficial summary of direct taxes levied

Situation on 1st January 2005

DIRECT TAXES LEVIED BY THE TAX ADMINISTRATION OF THE GRAND DUCHY OF LUXEMBOURG

Unofficial summary

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PERSONAL INCOME TAX

1. Persons liable to tax

The following persons are liable to income tax:

- 1) resident taxpayers, i.e. those physical persons who have their domicile or normal place of residence in Luxembourg. Luxembourg residents are taxable on their worldwide income.
- 2) non resident taxpayers, i.e. those physical persons who have no domicile or normal place of residence in Luxembourg. Non residents are taxable on income arising from Luxembourg sources only.

2. Joint taxation

2.1 Taxation of married taxpayers

Married couples are taxed jointly, provided that:

- a) they are residents from the beginning of the year and are not living in a state of de facto separation by virtue of a legal dispensation or a judgement;
- b) they are residents and get married in the course of the year;
- c) they become residents in the course of the year and are not living in a state of de facto separation by virtue of a legal dispensation or a judgement.
- d) after applying jointly, one is a resident and the other a non resident and they are not living in a state of de facto separation if the resident taxpayer obtains minimum 90% of the professional income in Luxembourg of their household during the fiscal year.

2.2 Taxation of the taxpayer and his minor children

The taxpayer and those of his minor children who are taken into consideration for the determination of his tax class and who are still living in his household are taxed jointly. Joint taxation applies only to resident taxpayers. In addition, these conditions must be fulfilled simultaneously at the beginning of the tax year.

Income earned by children from paid employment is not subject to joint taxation even if the child is employed in the taxpayers business or company.

3. Taxable income

3.1 «Taxable income» and «total net income»

Income earned by the taxpayer during the tax year, which coincides with the calendar year, is subject to tax.

Taxable income consists in the total net income less special expenses.

Total net income is made up of eight sources of net income. Net income in each category of income is computed, losses arising in one category being set against net income in other categories, if not otherwise determined.

3.2 Categories of net income

Only the following categories of income are taken into account for the determination of total net income:

- 1) trade and business income,
- 2) agriculture and forestry income,
- 3) income from independent professional services,
- 4) net income from employment,
- 5) net income from pensions and annuities,
- 6) net income from capital and investments,
- 7) net income from rentals and leases,
- 8) sundry net income.

3.2.1 Trade and business income

3.2.1.1 Definition of the trade and business income

The following are regarded as trade and business income:

- a) net income arising from a commercial, industrial, mining or craft undertaking;
- b) the share of profits of a partner in a partnership or a limited partnership, or of a co-trader in a collective commercial undertaking, (for example: general partnership = société en nom collectif, limited partnership = société en commandite simple, joint companies = société civile, société de fait, association momentanée) as well as the remunerations or indemnities paid to a partner or co-trader for
 - their activity in the partnership or collective undertaking,
 - loans granted or
 - assets made available to the partnership or collective undertaking;

- c) the share of profits of an active partner in a partnership limited by shares, as far as this share of profit does not arise as a result of his shareholding in the firm, as well as
- remunerations or indemnities paid to an active partner for his activity in the firm, or
 - for loans granted or
 - assets made available by him to the firm.
- d) apart from a) the net income arising from a profit seeking activity exercised limited partnership, a general partnership, joint companies, GIE, GIEE in which the majority is held by one or more corporations. A civil company which undertakes commercial activities under a) and which holds parts in another civil company, is considered as a corporation for qualification of income realised

Trade and business income also includes the profits arising from:

- the block sale of a business or of an autonomous part of it;
- the termination of a business or of an autonomous part of it;
- the sale of a fraction of such a business;
- the sale of a partner's or co-trader's share or part of his share in a business described under b) above;
- the sale of an active partner's assets or part of his assets in a business described under c) above, but only as far as it does not concern his holding in the limited partnership.

Any operation that leads to the realization of all the undiscovered capital gains of a business, or an autonomous part or of a fraction of such a business is assimilated to the block sale.

3.2.1.2 The computation of trade and business income

Annual profit generally consists in the difference between the net assets invested at the end of the accounting year and the net assets invested at the beginning, plus personal drawings and less injections of new capital carried out during the year.

Under certain conditions and within certain limits, the law allows a simplified method of profit calculation by comparing business receipts and business expenses.

3.2.1.3 Financial year

The profit realized during the financial year is taxable in the year in which ends the financial year. The financial year normally corresponds with the calendar year.

3.2.1.4 Various non-deductible business expenses

The following business expenses in particular are non-deductible:

- 1) the interest awarded to the working capital;
- 2) rent, lease or compensations paid to the contractor or the part of his family taxed jointly with him for goods used in the business;
- 3) wages paid to the contractor or his wife taxed subject to joint taxation;
- 4) contributions for life assurances contracted to the favour of the contractor, his successors in interest or his people;
- 5) reserves for self-assurance;
- 6) general provisions for business expenses;
- 7) contributions, allowances and premiums paid to additional pension schemes introduced by the law of 8 June 1999 on complementary pensions, if the person entitled to receive the performances is the owner of an undertaking, co-trader in a collective undertaking, partner in a joint company (société civile) or member of the board of directors or commissioner in a company liable to corporate income tax.

However, under certain conditions, these contributions are allowable for deduction.
- 8) retirement pensions, disability pensions and survivors' pensions paid after 1st January 2000 beyond the scope of the law of 8 June 1999 on complementary pensions.

Nevertheless, the part of the capital and the pension, which relates to the period preceding 1st January 2000, stays allowable for deduction.
- 9) retirement pensions, disability pensions and survivors pensions as far as the expenditure is due to an insufficiency of the provisions in the balance sheet of the company. However, this disposal only applies if the insufficiency of the provisions is due to the fact that part of the endowments carried out by the undertaking was not allowable for deduction.

- 10) payments made to finance the household of the taxpayer and the subsistence of his family;
- 11) gifts, donations and assistances;
- 12) personal income tax, net worth tax, estate duty, value-added tax on goods taken from the net assets or used for private purposes;
- 13) fines, confiscations, arrangements in criminal cases and any other penalties to the debit of the taxpayer.

3.2.1.5 Net assets invested in a business

The net assets invested in a business include assets (liabilities) deemed to be part of the business by their nature and under certain conditions, assets that are not deemed to be part of the business by their nature, but which could be used in the business (assets being part of the business by option).

The net assets include:

- the fixed assets, i.e. those assets that the undertaking intends to use in a permanent way,
- the current and liquid assets and
- the liabilities.

3.2.1.6 Evaluation principles

Evaluation must be carried out according to the following principles:

- 1) the situation at the moment when the accounts are closed is the decisive factor for evaluation at the end of the accounting year; the taxpayer may take into account facts and circumstances existing at that date, but whose existence was revealed only subsequently, but before the balance sheet was drawn up (e.g. the insolvency of a customer for the evaluation of a credit);
- 2) each asset that is a part of the net invested assets at the end of the accounting year must be evaluated separately; nevertheless, assets that are similar in nature and value may be evaluated jointly;
- 3) depreciation required by law may not be recovered subsequently, if the trader knowingly omitted to allow for it;
- 4) values of assets set out in the balance sheet at the end of the financial year must be carried over with the same values in the balance sheet of the beginning of the new financial year;

- 5) unrealised profits may not be added to the result, whereas unrealised losses are likely to affect the result;
- 6) values set out in the fiscal balance sheet must be the same as the values in the trading balance sheet, as far as these values agree with the requirements of the tax law;
- 7) the taxpayer must use a constant method of evaluation, unless economic considerations call for modification.

Evaluations are principally made on the basis of the cost or purchase price. In clearly defined cases the operating value may be used instead.

3.2.1.7 The purchase price

The purchase price of an asset consists of the total amount spent by the taxpayer for the asset at the moment of evaluation. For individual assets, which were acquired by the taxpayer free of charge, the initial purchase price is represented by their operating value at the moment they were acquired. In the event an asset is modified or extended during its useful life, then the purchase price must be increased by the expense undertaken in order to modify or extend the said asset.

Generally input value-added tax is not a part of the purchase or production cost.

3.2.1.8 The production cost

The production cost of an asset includes all the expenditure incurred by the taxpayer in order to manufacture the asset. The production cost should include the purchase or production cost of the materials or supplies used in the manufacture of the asset, wage costs, special manufacturing costs and the appropriate proportion of the manufacturing overheads, including depreciation of assets used in the process of manufacture.

Sales expenses and expenditure, which may not be considered to be operating expenditure, may not be included in the production cost. Generally input value-added tax is not a part of the purchase or production cost.

3.2.1.9 The operating value

The operating value of an asset is the price, which someone who purchases the entire undertaking as a going concern would attribute to each asset as part of the whole purchase price.

In the case of commodities, the operating value equals the replacement costs, including relating expenses.

The operating value of claims towards debtors must be computed by taking into consideration any capital or interest losses.

3.2.1.10 Evaluation of the depreciable fixed assets

Fixed assets subject to depreciation include all assets, which depreciate through wear and tear as well as assets, which depreciate by being used up (i.e. a decrease in substance).

Depreciable fixed assets are evaluated at the purchase price or production cost, less depreciation. The operating value may be used on condition that it is lower than the purchase price or production cost less the necessary depreciations. An intermediary value may also be used. Items that have already been included in the fixed assets may not be re-evaluated at a higher value than the value shown in the last balance sheet.

Assets, whose manufacture or purchase has been subsidized by public funds, must be shown in the accounts at the price that the taxpayer actually paid. This value is also used to calculate the depreciation.

3.2.1.11 Evaluation of non-depreciable fixed assets

Land and participations in other companies are non-depreciable fixed assets.

In principle, assets that are not subject to depreciation should be evaluated at their purchase or production cost. The operating value of the assets may however be used if it is lower than the purchase price or production cost.

Those non-depreciable assets, which were already part of the taxpayer's net assets at the end of the previous accounting year, may be evaluated at their operating value, even if it is higher than the value shown in the previous balance sheet. Nevertheless, the value may in all cases not exceed the purchase price or the production cost of the asset.

3.2.1.12 Evaluation of current and liquid assets

Stocks, bank deposits and receivables are part of the current and liquid assets.

Evaluation rules for current and liquid assets are equal to those applicable to fixed assets not subject to depreciation. In principle, these assets should be evaluated at their production cost. The operating value may however be shown in the balance sheet, if it is lower than the production cost. An intermediate value between

production cost and operating value may also be used in such a case.

Claims on customers must be valued in accordance with the situation existing at the end of the accounting year. Claims towards insolvent debtors that are deemed to be completely unrealisable as a result of the total insolvency of the debtor must be written down in full. Doubtful debts must be shown in the balance sheet at their estimated recovery value.

3.2.1.13 Evaluation of the liabilities

The law provides that debts towards third parties should be entered in the balance sheet at their purchase price. The purchase price of a debt corresponds to the sums advanced to the debtor. The operating value of a debt may be shown in the accounts on condition that it is higher than the purchase price.

Debts, which were part of the liabilities at the end of the previous accounting year may be shown in the balance sheet at their operating value even if it is lower than the value shown in the last balance sheet. In all cases the value shown in the balance sheet may not be lower than the purchase price. Debts in foreign currencies must be shown in the balance sheet at their equivalent value in the national currency received. The taxpayer may not reduce the value of the debt to a lower figure, even in if the exchange rate of the foreign currency should fall. In the case of a rise in the exchange rate, the debt may be shown in the balance sheet at the higher exchange rate.

3.2.1.14 Depreciation

The depreciation for the normal wear and tear of an asset in a particular financial year is computed as the difference between the current carrying value of the asset and, if necessary, an estimated residual value, to be spread in equal instalments over the remaining expected life of the asset (straight line depreciation).

As regards tangible fixed assets other than buildings subject to depreciation, the law provides, under certain conditions and within certain limits, for depreciation by decreasing annual instalments (declining-balance method).

An undertaking may change from the declining-balance method to the straight-line method, but not vice versa.

In specific cases an extraordinary depreciation is allowed for technical or economic obsolescence. The amount written off must be deducted from the operating results of the concerned accounting year.

Depreciation due to the loss of substance takes into account the decrease in substance arising from normal exploitation. It is calculated by applying the production cost per unit deposit to the quantity extracted during the year.

Depreciable assets with a useful life of one year or less, as well as those with a value not exceeding € 870 and which are used by the owner, may be deducted in full from business income in the year of acquisition.

Within certain limits and under certain conditions, the law provides for a special depreciation for investments favouring the protection of the environment, the realization of energy savings and the creation of employment for handicapped workers.

Buildings or part of buildings, used on a rental basis are amortized at a rate of 6%, under the condition that the buildings were completed no later than 6 years before.

3.2.1.15 Carry over of capital gains during normal business activity

If a fixed asset such as a building or non-depreciable asset has been held for at least five years, and is sold in the course of the business, then any capital gain arising may be rolled over to replacement fixed assets, acquired or produced by using the funds of the sale, as long as the replacement assets are located in the Grand Duchy. Exceptionally and under certain circumstances, a reinvestment based on a previous exercise, and not on the exercise when capital gains were realized, is possible.

If an assets invested in an business disappears for reasons beyond human control, or is seized through Government intervention, is sold or in order to avoid such intervention, and the entitlement to compensation is greater than the net book value at the time of its disappearance or disposal, the businessman may, under certain conditions, roll-over the realised capital gain to a replacement asset.

3.2.1.16 Tax deduction for trade and business income

Trade and business income realized by an individual will be reduced by 5% for profits up to €75.000 and by 2% for the amount of profit exceeding € 75.000. This deduction is not applicable to profits realized upon the sale of a business or to profits realised on the discontinuance of a business, nor to tax-exempt profits on account of a tax treaty or of a legal provision.

3.2.1.17 Income tax credit for new investments

Investments in commercial, industrial and mining enterprises located in the Grand Duchy of Luxembourg may generate, upon request a tax credit. The tax credit is composed of two parts.

- 1) The first allowance amounts to 10% on the increase in investment in tangible depreciable assets, other than buildings, livestock and mineral and fossil seams, made during the concerned year. The increase in investment of a year is computed as the difference between the current value of all qualifying assets as described above and the reference value allocated to the same type of assets.

However the following new investments realized during the financial year must be excluded:

- assets depreciable over a period of less than 3 years,
- assets acquired through the whole-sale integration of an undertaking,
- all second-hand assets,
- all individual assets acquired free of charge and
- certain motorised vehicles.

The investment determined that way has to be increased by the depreciation operated on the qualifying assets acquired in the year.

The reference value must be at least €1.850 and is computed as the arithmetical mean of the carrying values of all qualifying assets at the closing of the five preceeding financial years.

Nevertheless, the amount thus computed may in all cases not exceed the actual investment in qualifying assets for the current year.

- 2) The second allowance is granted for new investments realized during the financial year. It consists in:
 - a) a 6% tax credit on the first €150.000 of qualifying new investments, and a 2% tax credit on the amount of new investments exceeding € 150.000 in tangible depreciable assets other than buildings, livestock, mineral and fossil seams, as well as investments in sanitary and central heating installation in hotel

buildings and investments in buildings used for social activities.

- b) a 8% tax credit on the first €150.000 and a 4% tax credit on the amount exceeding € 150.000 of investments eligible for special depreciation (i.e. investments favouring the protection of the environment, the realization of energy savings and the creation of employment for handicapped workers).

However the following investments must be excluded:

- assets depreciable over a period of less than 3 years,
- assets acquired through the whole-sale integration of an undertaking
- second-hand assets,
- certain motorised vehicles

The tax credit is deductible from the income tax of the financial year during which the investments occurred. The tax credit is not deductible from non-refundable withholding tax. If the income tax of the current year is not sufficient, the remaining tax credit may be carried forward for ten years.

3.2.1.18 *Income tax credit for engaging unemployed persons*

Taxpayers can qualify, on request and by producing a certificate issued by the Labour Administration, for a tax credit for the hiring of an unemployed person.

This tax credit is available for taxpayers hiring unemployed persons within the scope of their industrial, agricultural or under certain conditions, their professional activities. The tax credit is not available for temporary-employment agencies.

The monthly tax credit amounts to 10% of the monthly deductible gross wage paid for each unemployed person concerned, during 36 months and this from the month of employment on and conditional upon full employment during the said period.

The tax credit is deductible from income tax due for the financial year during which the wage was paid. The tax credit is not deductible from non-refundable withholding tax. If the income tax of a given year is not sufficient, the remaining tax credit may be brought forward for the ten following years.

3.2.1.19 *Income tax credit for expenses related to further professional education*

On request and under the condition that the taxpayer has not opted in favour of direct state assistance, the taxpayer can get a tax credit for expenses related to further professional education as foreseen in the law of 22 June 1999 relating to further professional education. To this effect the taxpayer must produce a certificate issued by the competent minister.

The income tax credit amounts to 10% of the expenses invested in further professional education.

The tax credit is deductible from the income tax of the financial year during which the expenses occurred. The tax credit is not deductible from non-refundable withholding tax. If the income tax of the current year is not sufficient, the remaining tax credit may be carried forward for ten years.

3.2.1.20 *Tax exemption for investments*

A taxpayer who has established a new business or introduced a new manufacturing process, recognized as being particularly suited for contributing to the structural development and improvement of the national economy, to the regional economic development, or to a better geographical spread of economic activities, may apply for an exemption from income and municipal business tax for up to a maximum duration of ten years, on one quarter of the profits arising from the new business or manufacturing process. The total tax relief resulting from this partial exemption of profits may not exceed a fixed percentage of the investment carried out in land, buildings, plant, facilities and intangible assets, or a fixed percentage of the costs of wages relating to the creation of permanent working places.

3.2.1.21 *Immunization of the monetary capital gain realized on real estate*

If the profit arising from the sale of a business or from the termination of a business activity includes a capital gain on real estate, the monetary capital gain may be exempted from tax on request. The amount to be exempt is equal to the difference between the adjusted book value and the book value. The adjusted book value corresponds to the purchase or production cost less all previous amortizations and depreciations, to which coefficients are applied. The coefficients to be used depend upon the year-end of the financial periods during which the building was acquired or

constructed, and during which the amortizations and depre-ciations were booked.

3.2.1.22 Tax allowance for profits realized by the sale or termination of an industrial enterprise

A tax allowance of €10.000 or a proportion of this amount is granted on the profit realized by the sale or termination of an industrial enterprise, depending on whether the sale or termination of activity relates to the business as a whole, or to an autonomous part or fraction of it. If the profit from sale or termination of an activity includes a capital gain on real estate, the tax allowance is increased up to €25.000. The additional allowance may however not exceed the capital gains realised.

3.2.2 Agriculture and forestry income

3.2.2.1 Definition of the agriculture and forestry income

Profits from agriculture and forestry cover:

- profits realized by tilling the soil, like agriculture, sylviculture, viticulture, horticulture, the culture of vegetables and fruits, tree-nurseries and greenhouses. The possession of woodland alone represents a forestry undertaking;
- profits realized by breeding or fattening animals;
- profits realized by bee-keeping, or non-industrial exploitation of fishponds;
- profits realized by hunting or fishery, as far as these activities are undertaken in relation with agricultural or forestry enterprise.

Profit from agriculture and forestry also includes profit arising from:

- the sale of the whole business, an autonomous part, or a fraction of it, or
- the termination of all or an autonomous part of the enterprise.

3.2.2.2 The computation of agriculture and forestry income

In principle, agriculture and forestry income is determined by generally accepted accounting principles. However a decree has introduced a simplified method to compute the agriculture and forestry income.

3.2.2.3 The financial year

The financial year corresponds to the calendar year. Conversely the financial year for farming

and forestry covers the period from the 01.10.N to the 30.09.N+1.

3.2.2.4 Net assets of the exploitation

Only the assets deemed to be part of the enterprise by their nature belong to the net assets of the undertaking.

The fluctuations of value of land belonging to the fixed assets of the undertaking as well as, of fertilizers and seed already disseminated and of the produce not yet harvested are disregarded when computing the income from agriculture and forestry.

3.2.2.5 Evaluation principles

The evaluation principles applicable to trade and business income are also applicable to agriculture and forestry income with the following exceptions:

- breeding livestock can be valued at the higher operating value;
- real estate is brought into or withdrawn from the undertaking at the original purchase price;
- harvested agricultural or forestry products are valued at the year end at their operating value.

3.2.2.6 Agricultural and forestry allowance

Agriculture and forestry income is reduced by an allowance of € 2.250. This amount is doubled for married taxpayers taxed jointly, but only as far as the taxpayers do not benefit from the extra-professional allowance.

The deduction of the allowance must not lead to a loss.

3.2.2.7 Income deduction for new investments

In order to promote the modernization of agriculture, farmers, except for those engaged in forestry, may deduct from their profits part of the purchase or production cost of tools and productive equipment, and of the cost of equipping farm premises, under the condition that such investment are made in undertakings located within the Grand Duchy and intended to permanently remain there. This tax deduction doesn't concern assets whose purchase price or production cost is less than €867, 63.

The deduction is determined as follows:

- 30% for the first € 148.736,11 of investments and
- 20% for the investment exceeding € 148.736,11.

3.2.2.8 *Income tax credit for unemployed persons*

Taxpayers can get, upon request and by producing a certificate produced the Labour Administration, a tax credit for hiring unemployed persons.

This tax credit is available for taxpayers hiring unemployed persons in their agricultural or forestry undertaking.

The monthly tax credit amounts to 10% of the monthly deductible gross wage paid for each unemployed person concerned, during 36 months and this from the month of employment on and conditional upon full employment during the said period.

The tax credit is deductible from income tax due for the financial year, during which the wage was paid. The tax credit is not deductible from non-refundable withholding tax. If the income tax of a given year is not sufficient, the remaining tax credit may be brought forward for the ten following years.

3.2.2.9 *Income tax credit for expenses related to further professional education*

On request and under the condition that the taxpayer has not opted in favour of direct state assistance, the taxpayer can get a tax credit for expenses related to further professional education as foreseen in the law of 22 June 1999 relating to further professional education. To this effect the taxpayer must produce a certificate issued by the competent minister.

The income tax credit amounts to 10% of the expenses invested in further professional education.

The tax credit is deductible from the income tax of the financial year during which the expenses occurred. The tax credit is not deductible from non-refundable withholding tax. If the income tax of the current year is not sufficient, the remaining tax credit may be carried forward for ten years.

3.2.2.10 *Immunization of the monetary capital gain realized on real estate*

The immunization of the monetary capital gains is allowed under the same conditions as those applicable to trade and business income.

3.2.2.11 *Tax allowance for profits realized by the sale or termination of an agricultural enterprise.*

The computation of the allowance is done the same way as for trade and business income.

3.2.3 *Income from independent professional services*

3.2.3.1 *Definition of income from independent professional services*

Net income from the following activities is regarded as income from independent professional services, provided that the profession is exercised independently:

- 1) scientific, artistic, literary, teaching or educational activities;
- 2) the professional activities of
 - doctors, dentists, veterinaries, midwives, physiotherapists, masseurs, barristers, lawyers, bailiffs, executors of a will, attorneys, managers of assets, accounting and tax experts;
 - engineers, architects, chemists, inventors, consultants, journalists, press photo-graphers, interpreters and translators as well as similar professions;
- 3) the activity of administrators, commissioners and persons with similar functions in a joint-stock company, a limited liability company, a co-operative company or another corporation within the meaning of the law governing tax on profits of corporations. However, the remuneration of administrators is regarded as employment income as far as it is paid with respect to the day-to-day management of the company or corporation.

Income from independent professional services also includes profit resulting from the sale of the net assets necessary to practice the profession, or resulting from the termination of activity.

3.2.3.2 *Computation of income from independent professional services and evaluation principles*

The regulations used for the computation of income of business and trade are, as far as compatible, also applied to the computation of income from independent professional services.

3.2.3.3 *Assets deemed to have been invested in the undertaking*

Only assets, that by their very nature are meant to be used in the exercise of an independent professional service, are deemed to be part of the net assets of such an undertaking.

3.2.3.4 *Income tax credit for hiring unemployed persons*

The taxpayers can qualify, upon request and by producing a certificate issued by the Labour Administration, for a tax credit for the hiring of an unemployed person.

This tax credit is available for taxpayers hiring unemployed persons within the scope of their independent professional activities as defined above under point 1) and 2) (Definition of income from independent professional services).

The monthly tax credit amounts to 10% of the monthly deductible gross wage paid to each unemployed person, during the first 36 months beginning from the month of employment and conditional upon full employment during the whole period.

The tax credit is deductible from income tax due for the financial year, during which the wage was paid. The tax credit is not deductible from non-refundable withholding tax. If the income tax of a given year is not sufficient, the remaining tax credit may be brought forward for the ten following years.

3.2.3.5 *Income tax credit for expenses related to further professional education*

On request and under the condition that the taxpayer has not opted in favour of direct state assistance, the taxpayer can get a tax credit for expenses related to further professional education as foreseen in the law of 22 June 1999 relating to further professional education. To this effect the taxpayer must produce a certificate issued by the competent minister.

The income tax credit amounts to 10% of the expenses invested in further professional education.

The tax credit is deductible from the income tax of the financial year during which the expenses occurred. The tax credit is not deductible from non-refundable withholding tax. If the income tax of the current year is not sufficient, the remaining tax credit may be carried forward for ten years.

3.2.3.6 *Immunitization of the monetary capital gain realized on real estate*

A tax exemption of monetary capital gain is allowed under the same conditions as those applicable for trade and business income.

3.2.3.7 *Tax allowance for profits realized by the sale or termination of activities*

The computation of the allowance is undertaken in the same manner as for trade and business income.

3.2.4 *Net income from employment*

3.2.4.1 *Definition of the net income from employment*

The following is regarded as income from employment:

- 1) emoluments and benefits received by virtue of an employment and pensions granted by the employer before the end of employment;
- 2) arrears of salaries and wages or severance pay received after termination of employment, although severance pay may be partly or wholly exempt from tax under certain conditions;
- 3) unemployment pay, sickness benefits, and maternity benefits paid instead of wages;
- 4) allowances, contributions and insurance premiums paid to additional pension schemes introduced by the law of 8 June 1999 on complementary pensions, endowments made by the employer to an internal scheme referred to by the law of 8 June 1999 on complementary pensions, as well as, in cases where the employee or his beneficiaries received a lump-sum from such a scheme, the positive difference between the lump-sum paid and the corresponding provision in the balance sheet of the financial year preceding the financial year in which the payment occurred.

These advantages are subject to a withholding tax at the expense of the employer. The withholding tax rate amounts to 20%.

During the annual assessment or regularization of payroll taxes withheld, allowances or premiums taxed on a lump sum basis are not taken into account in order to compute the net income or special expenses and the lump sum tax is not taken into account to when determining the amount of taxes creditable or already withheld.

3.2.4.2 *Computation of net income from employment*

Net income from employment is computed as the difference between receipts and relating expenses. Professional expenses are those expenses made directly to acquire, to safeguard and to conserve the receipts.

A minimum deduction of €936 is granted from the annual taxable income as a personal allowance. The amount of € 936 includes a lump sum of € 396 for travelling expenses between the taxpayer's domicile and his working place and a lump sum of € 540 for expenses other than travelling expenses.

The allowance is in principle doubled for spouses taxed jointly, who both receive income from employment.

The annual taxable income is reduced by a lump sum of €480 for special expenses. This lump sum is in principle doubled for spouses taxed jointly and who both receive income from employment.

Legal social security contributions (health insurance and pensions) paid by wage earners to establishments located in the Grand Duchy of Luxembourg or abroad are deductible as special expenses.

3.2.5 Net income from pensions or annuities

3.2.5.1 Definition of the net income from pensions or annuities

Net income from pensions or annuities does not only include any payment received by virtue of a previous employment, or paid by an independent retirement fund, that is financed wholly or partly by insurance contributions, but also any other annuity or occasional payment to which the taxpayer is entitled or which are paid voluntarily.

3.2.5.2 Computation of the net income from pensions or annuities

Under certain conditions, only 50% of the net amount received, as a pension for life, that was acquired through a lump-sum or as a compensation, is subject to tax.

Net income from pensions or annuities is computed as the difference between the receipts and the relating expenses. Relating expenses are those expenses that are made directly to acquire, to safeguard and to conserve the receipts.

A minimum, annual deduction of € 300 is granted from the taxable income as a personal allowance. The allowance is in principle doubled for spouse, that are taxed jointly and who both receive income from pensions or annuities.

3.2.6 Net income from financial investments

3.2.6.1 Definition of net income from financial investments

The following income is regarded as income from financial investments:

- a) dividends, shares of profit and other returns on shares, stocks and other holdings in public limited companies, partnerships limited by shares, limited liability companies and co-operative companies; under certain conditions, half of this income is however exempted from income tax and, as the case may be, from municipal business tax;
- b) the portion of profits in a commercial, industrial, mining or craft undertaking, paid to a lender whose investment is remunerated in accordance with the profits realised;
- c) back-interests and interests on debentures and similar securities, including shares of profit and redemption premiums;
- d) interests of any kind not listed under b) or c), namely of mortgages, loans, credits, depo-sits, savings and current accounts;
- e) discounts on negotiable papers;
- f) special allowances or benefits granted in addition to or instead of those listed from a) to e) above;
- g) proceeds from the disposal before maturity of dividends or interest coupons or similar instruments if the share or bond itself is not simultaneously disposed of;
- h) the compensation received when selling fixed-interest securities, for the interest, which has accrued but not matured, if such compensation is accounted for separately.

If the income described under a) to h) is included in the income of a trade and business, or in the income from agriculture and forestry, or in the income of independent professional services, it is taxable in the pertaining category of net income.

The following does not constitute income from financial investments:

- a) stocks or shares distributed either wholly or partly free of charge by companies with a share capital, as well as rights of assignment and rights of subscription relating to them, as far as the issue of the stocks or shares leads to a corresponding dilution of the issued capital represented by the shareholder's original holding;

- b) sums allocated as capital distributions by a joint stock company or a co-operative company, subject to the rules applicable to the sale of shares (see under sundry income);
- c) allocations which constitute the counterpart of a reduction of capital as well as of the reserves and which are granted on the occasion of a redemption of shares by an open-end pension savings company within the meaning of the law creating pension funds in the form of open-end pension savings companies (société d'épargne-pension à capital variable; sepcav) and pension savings associations (association d'épargne-pension; assep).

3.2.6.2 Computation of net income from capital and investments

The first € 1.500 of net income from financial investments is tax-exempt. This tax exemption is doubled for spouses taxed jointly.

Net income from financial investments is computed as the difference between the receipts and any relating expenses. Relating expenses are those expenses made directly to acquire, to safe-guard and to conserve the receipts.

A minimum annual allowance of € 25 is deducted from the income from financial investments. This amount is also doubled for spouses taxed jointly.

3.2.7 Net income from rentals and leases

3.2.7.1 Definition of net income from rentals and leases

The following is regarded as income from rentals and leases:

- a) income arising from the letting and leasing of movable property or real estate, if this income has not to be classified under b) or c) below;
- b) income arising from the granting of exploitation or extraction rights of mineral or fossil deposits existing under the ground or on the surface. The disposal of such substances is assimilated to the granting of exploitation or extraction rights, unless it is relating to a limited deposit, is not temporary and the selling price or part of it is not fixed according to the intensity of extraction;
- c) income arising from the payment of royalties for the use, or the right to use, the owner's rights in a literary, artistic or scientific work including cinematographic

films, a patent, registered trade-mark or brand name, drawing or design, plan, secret formula or process, or any analogous right, and for the use or right to use industrial, commercial or scientific plant, or for information relating to experience acquired in the field of industry, commerce or science;

- d) the proceeds of the disposal of credits relating to letting or leasing, even if the claim relating to a time prior to the disposal of a real estate is included in the selling-price;
- e) the rental value of the residence and its dependences occupied by the owner. This value is determined by a standard procedure.

If the income described under a) to e) above belongs to the net income of business and trade, agriculture and forestry or independent professional services, it is taxed in the pertaining category of net income.

3.2.7.2 Computation of the net income from rentals or leases

Net income from rentals or leases is determined by comparing the receipts and the expenses. Professional expenses are those expenses made directly to acquire, to safeguard and to conserve the receipts.

3.2.8 Sundry net income

3.2.8.1 Definition and computation of the sundry net income

Sundry net income includes:

- a) profits resulting from the speculative operations specified below, as far as they are not taxable in any of the other 7 categories of net income:
 - 1) the sale of assets recently acquired for a valuable consideration. Assets are deemed recently acquired when the interval between acquisition or establishment and realization does not exceed two years for real estate and six months for other assets;
 - 2) disposal of assets when disposal precedes acquisition.

The profits of speculation are not taxable if the total annual profit is less than €500.

- b) the income arising from the sale, more than two years after purchase or establishment, of real estate, which does not form part of the assets of a business or of the assets used

within the scope of independent professional activities. Real estate forming part of an agricultural and forestry undertaking is also excluded, except land.

Income under a) and b) is determined by the difference existing between the selling-price and the purchase or production cost plus the acquisition charges. The purchase or production cost of assets indicated under b) is, if the occasion should arise, re-valored by the multiplication of a coefficient stipulated by law to take into account the devaluation of money.

The directions under a) and b) are not applicable as far as the sale concerns the taxpayer's principal place of residence.

- c) the income arising from the sale, more than six months after acquisition, of a substantial shareholding in a company limited by shares or a co-operative company. Net income is equal to the selling-price, less sale expenses, less the re-evaluated purchase price.

When all or part of the assets of a stock corporation or a co-operative company are distributed, any proceeds given over to an important shareholder are taxable as far as their value exceeds the re-evaluated purchase price.

A shareholding is deemed to be a substantial shareholding if a taxpayer, alone or together with his spouse and minor children, has held directly or indirectly, at any time during the five years preceding the sale, more than 10% of the company's share capital.

The threshold for participations acquired before 1st January 2002 is fixed at 25% until the fiscal year of 2007 included.

An exchange of shares, under certain conditions, does not automatically lead to the realisation of capital gains.

The income arising from a substantial shareholding, forming part of net income of business and trade, agriculture and forestry or independent professional services is taxed in the pertaining category of net income.

Total income related to under b) and c) is reduced by a tax allowance of € 50.000, provided that this does not result in an overall loss. The allowance is increased to € 100.000 for spouses taxed jointly. A taxpayer may use the standard exemption allowance only once during a 10-year period. This allowance is reduced by the previous allowances granted during the last 10 years, in accordance with the previous sentence.

The income arising from the sale of real estate acquired by way of direct succession and previously used by the parents as principal residence is reduced under certain conditions by additional tax allowances.

Moreover, the net income realized by the sale of real estate may be under certain conditions rolled over to real estate acquired in its place.

- d) the income arising from services that are not taxable in any other category of income, e.g. income arising from casual labour. However, this income is not taxable if its annual amount is less than €500.
- e) reimbursement of the capital sum and accumulated savings to the beneficiary, in execution of certain retirement insurance contracts.
- f) anticipatory reimbursement of the capital sum and accumulated savings paid in accordance with a life annuity contract.

3.3 *Special expenses*

The following disbursements and expenses, called special expenses, may be deducted from the total net income, as far as these charges and expenses do not represent business expenses or professional expenses:

- 1) payments of annuities and permanent expenses due by virtue of a special obligation, as far as these annuities are not economically linked to exempt income. However, payments made to persons who, in case of need, would be entitled under civil law to claim alimony from the taxpayer, do not constitute special expenses, unless they are
- stipulated at the time of the transfer of property and are not excessive in relation to the value of the property transferred, or
 - fixed by court and paid to one of the spouses in the course of a divorce pronounced after the 31.12.1997.

These alimonies, as well as payments of annuities and long-term expenses paid by mutual agreement to divorced spouses, are only deductible up to an annual amount of € 20.400 as special expenses.

Payments, which are not deductible from taxable income of the payer, are not taxable in the hands of the payee.

Only 50% of life annuity payments due in exchange for a lump sum performance are allowable as special expenses.

2) debt interest, up to a certain limit depending upon the family situation of the taxpayer, in so far as they are not economically linked to exempt income. However, this limitation is not applicable to interests related to debt contracted in order to finance the buying-out of co-heirs of a trade or a business.

3) certain contributions and insurance premiums, namely:

a) mandatory social security contributions imposed on salary and wages and paid to social security institutions in Luxembourg as well as mandatory employee contributions paid into public social security institutions abroad, in accordance with a bi- or multilateral social-security agreement;

b) compulsory contributions paid by self-employed persons for membership in a social security plan in Luxembourg or abroad;

c) the deductions from wages or salaries on account of an additional pension scheme introduced by the law of 8 June 1999 on complementary pension schemes, up to an annual amount of €1.200;

d) personal non-mandatory insurance contributions to a social security institution in the Grand Duchy or abroad;

e) premiums paid to companies chartered in the Grand Duchy or in the other states member of the European Union for voluntary life, death, accident, invalidity, sickness or civil liability insurance as well as payments made to chartered mutual complementary sick funds, whose aim it is to aid associates or members of their families in case of sickness, accident, incapacity to work, infirmity, unemployment, old age or death. Premiums and contributions, which are economically linked to the granting of a loan, are only deductible under certain conditions. Premiums and contributions paid for life insurances are only deductible, if the contract is signed for an effective period of at least ten years. Premiums and contributions are only deductible up to certain fixed limits depending primarily on the taxpayer's family situation;

f) Contributions paid to recognized building societies, located in Luxembourg or in a member state of the European Union and which are financially linked with the construction, acquisition or transformation of a flat or dwelling destined to be occupied by the owner. Premiums and contributions are only deductible up to certain fixed limits depending on the taxpayers' family situation;

g) annual premiums, up to a certain limit, paid in relation with a retirement-insurance contract which guarantees to the taxpayer, purchaser and insurant, a life-pension payable on a monthly basis, but not before a minimum period of 10 years and starting no sooner than from the age of 60 and no later than from the age of 75. The benefit of the contract can specify either a life annuity with monthly payments or a lump sum equal to up to 50% of accumulated principal, plus a life annuity based on the remaining amount. The annual deduction-limit depends on the age bracket of the policy holder.

A minimum annual lump-sum of €480 may be deducted in place of the special expenses described under 1) to 3) (e-g). above. In the case of married taxpayers who are taxed jointly and who both receive income from employment, the minimum deduction corresponds to the sum of deductions applicable if the couple was not taxed jointly;

4) certain donations, as far as they do not exceed either 10% of total net income or € 500.000;

5) losses incurred over the preceding tax years in the income categories business and trade income, agriculture and forestry income or income from independent professional services, as far as these losses could neither be set off against other net income during the tax year in which they occurred nor be deducted as special expenses during any subsequent tax year.

4. Adjusted taxable income

Taxable income computed as the sum of all the different categories of net income less special expenses, is still liable to be adjusted by the following abatements:

1) an allowance for unavoidable extraordinary expenses, which reduce the taxpayer's financial capabilities in a considerable way;

- 2) an allowance for children, who are not living in the taxpayer's household, but are principally at his expense;
- 3) lump-sum allowance for a spouse; the allowance amounts to a maximum of € 9.780 per year. This amount is increased by €1.020 per year per child of the spouse who is max. 21 years old;
- 4) compensatory allowance for wage earners; the allowance amounts to €600 per year and is doubled for taxpayers taxed jointly;
- 5) extraprofessional allowance for married taxpayers taxed jointly, the allowance amounts to a maximum of €4.500 per year;
- 6) retirement allowance; upon request an amount of € 600 is due on retirement income, the allowance doubled in case of taxpayer taxed jointly, should both of them receive retirement income;
- 7) mono parental allowance for taxpayers belonging to tax class 1a.

5. Assessment and levy of tax

5.1 Assessment

In general, taxable income is assessed annually on the basis of a tax return.

The taxpayer, whose taxable income is composed wholly or partly of income subject to withholding tax, is taxed by assessment, if

- his annual taxable income exceeds €58.000, or
- includes income not subject to withholding tax exceeding €600, or
- includes net income from capital and investments subject to a withholding tax exceeding €1.500.
- in case of joint taxation, one taxpayer is resident and the other taxpayer is a non-resident,
- the taxable income includes income from directors' fees which exceeds €1.500

In cases of several sources of remunerations subject to withholding tax on salaries and pensions, the amount of taxable income which renders a tax return necessary is reduced to € 31.000 for taxpayers belonging to the tax classes 1 and 2 and to € 25.000 for the taxpayers of class 1a.

The tax year matches the calendar year and covers all the profit or income arising during a given year. Industrial taxpayers with regular

bookkeeping may choose financial years, which do not end on 31 December; in such a case the tax year takes into account the industrial income realized during the financial year or years that end in the given tax year or years.

5.2 Withholding tax

Taxpayers must make quarterly payments calculated on the basis of their presumed income. Furthermore the following kinds of income are subject to tax withheld at source (withholding tax):

- income from employment;
- income from pensions and annuities received by virtue of previous employment or from an independent retirement fund financed wholly or partly by insurance contributions;
- income arising from the following investments:
 - a) dividends and other income from shares or stocks in joint stock companies, companies limited by shares, limited liability companies and co-operative companies;
 - b) the investor's share of the profit in a commercial, industrial, mining or craft undertaking, paid proportionally to the profits realised and by virtue of his capital outlay;
 - c) interest and payments on bonds, where, over and above the fixed rate of interest, a right to a supplementary interest, which varies according to the distributed profits, is granted.

This tax on income from securities amounts to 20%. The tax is withheld on the gross amount payable, free from any deductions.

The income mentioned under a) to c) is considered to be Luxembourg sourced income, if the debtor is the Grand Duchy of Luxembourg, a municipality, a public Luxembourg institute, a private corporation that has its statutory seat or principal place of management in Luxembourg or a physical person resident in Luxembourg for tax purposes.

- the withholding tax on directors' fees amounts to 20%. The tax is withheld on the gross amount paid, free from any deductions.

For a non resident, the withholding tax on directors' fees is considered to be a definitive

tax only if the fees amount to less than € 100.000.

5.3 *Compensating advance payments and withholding taxes*

Taxes withheld at source as well as quarterly advance prepayments are credited on the amount of tax finally assessed.

Any excess amounts paid or withheld are remitted to the taxpayer.

6. Tax computation

6.1 *Tax classes*

Taxpayers are classified into three classes:

- class 1 applicable to all persons belonging neither to class 1a, nor to class 2;
- class 1a applicable to the following persons as far as they do not belong to class 2:
 - a) widowed persons;
 - b) persons who receive a tax allowance for a child living in their household whose age at the beginning of the tax year is
 - less than 21 years, or
 - more than 21 years, and the child is continuing its studies, or
 - more than 21 years, and the child is physically or mentally handicapped;
 - c) persons having completed the age of 64 at the beginning of the tax year;
- class 2 for:
 - a) married persons taxed jointly;
 - b) widowed persons, whose marriage was dissolved by through the spouse's death in the course of the three years preceding the tax year;
 - c) divorced persons and de facto separated persons by virtue of a legal dispensation or a court judgement, who became divorced or separated in the course of the three years preceding the tax year.

6.2 *Unemployment fund*

A 2,5% surcharge is levied on final income tax due to finance an unemployment fund.

6.3 *Tax-free minimum revenue*

The tax-free minimum revenue amounts to € 9.750 for tax class 1 and € 19.500 for tax classes 1a and 2.

6.4 *Tax rates*

As a rule the rates of taxation are the same for all income, whatever its nature and whatever the method of collection.

The rates of withholding tax on wages and salaries and on pensions and annuities are based on the rates applicable to the final income tax. However these rates take into account the nature of the withholding system as well as the categories of income concerned and include the surcharge of 2,5% for the unemployment fund.

Furthermore wages and benefits paid by an employer within the scope of his private life, to an employee hired to do either housework, to look after a child or to provide the employer with the necessary help and care required by his disabilities, are on principle taxed at a flat rate of 6% of the net amount paid. The base rate is charged to the employer. The base rate is levied by the social security (Centre commun de la sécurité sociale) for the account of the tax administration.

At the end of the tax year, the wage earner may demand a tax assessment and refund, if applicable of the taxes withheld.

6.5 *Extraordinary income*

6.5.1 *Definition of extraordinary income*

If the taxable income includes extraordinary income, this income is not taxed at the normal rate, but at special, more favourable rates.

The following income is deemed to be extraordinary:

- 1) income from independent professional services, which constitutes the remuneration of an activity clearly distinct from the usual activities, and which extends over several years, or which constitutes the entire remuneration of an ordinary professional activity carried out over several years to the exclusion of any other activity within the scope of the independent professional service, if all the income becomes taxable in a single year;
- 2) extraordinary income arising from a salaried occupation, economically linked to a period of more than one year and which becomes taxable, for reasons beyond the control of the payer and the payee, in a single tax year;
- 3) periodical remuneration for a salaried occupation relative to a pay-period lying before or after the tax year, and which becomes taxable, for reasons beyond the

control of the payer and the payee, in a single tax year;

- 4) indemnities paid for losses incurred or for income forfeited by giving up or not exercising an activity or by waiving a share in profits or the expectation of such a share in profits, as far as such indemnities replace income relating to a period other than the tax year;

- 5) profits arising from the disposal or termination of a commercial undertaking, an agricultural and forestry undertaking, or of assets used in the provision of independent services;
- 6) income from the sale of real estate, excepted income from speculative transactions;
- 7) income from the sale of a substantial shareholdings;
- 8) income from exceptional felling of trees;
- 9) indemnities as described under 4), which are granted for physical damage;
- 10) Reimbursement in the form of capital of a retirement insurance contract and the restitution of accumulated savings of such contracts due to illness or disablement;
- 11) income from exceptional felling of trees in a forestry exploitation resulting from a case of overpowering circumstances.

6.5.2 Tax computation on extraordinary income

6.5.2.1 Taxation at a fourth of the global rate

The tax on income described under 1) to 4) above is equal to four times the extra tax due at normal rates on the sum of all ordinary income plus one quarter of the fore-mentioned extraordinary income, as compared to the tax at normal rates due on all ordinary income. The tax rate on extraordinary income cannot be higher than 22,8%.

6.5.2.2 Taxation at half of the global rate

The tax rate on income described under 5) to 10) above is equal to half the global rate chargeable on adjusted taxable income.

6.5.2.3 Taxation at a quarter of the global rate

The tax rate on income described under 11) is equal to a quarter of the global rate chargeable on adjusted taxable income.

6.6 Tax computation on income from agriculture and forestry

That portion of profit arising from agriculture that exceeds the average amount of the profits of the current year and the three preceding years is subject to tax at the global tax rate applicable to the ordinary income, without exceeding the rate of 27% and without provoking a tax reduction higher than €5.000.

6.7 Tax computation on income of performance activity

That portion of the profit arising from a performance activity that exceeds the average amount of the profits of the taxable trading year and the three preceding years is charged based on a special flat rate taxation with a maximum of 22,8%.

6.8 Foreign-source income and foreign taxes

6.8.1 Foreign-source income from treaty country

If a resident taxpayer receives income, which is exempt by an international convention to avoid double taxation, the said income is nevertheless included in his taxable income, but the tax due is reduced up to the fraction corresponding to the exempt income.

Extraordinary income is ignored for the calculation of the global tax rate.

6.8.2 Foreign-source income from a non-treaty country

If a resident taxpayer receives income arising in a country, with which the Grand Duchy has not concluded a convention to avoid double taxation, and the income is liable in that country to a tax which corresponds to Luxembourg income tax, the fraction of Luxembourg income tax relating to the income will be reduced by an amount equal to the tax assessed and paid in that country. The above provisions are applicable separately for each state in which income arises. In the case of foreign-source income from capital and investments, the above-mentioned disposition may, under certain conditions and within certain limits, be applied globally. In case foreign tax paid exceeds Luxembourg tax charged on the considered foreign income, the exceeding part of foreign tax is deductible from that income. The method used to determine the amount of foreign tax chargeable and the amount of foreign tax deductible is settled in the administrative regulation of 26th May 1979.

7. Taxation of non resident taxpayers

7.1 Delimitation of domestic taxable income

The inland income of non-residents consists of:

- 1) income from business and trade realized:
 - a) directly or indirectly by a permanent establishment or by a permanent representative in the Grand Duchy, unless the permanent representative is an

- independent wholesaler, commission agent or trade representative;
- b) by a non resident taxpayer whose activity is regulated by the law on hawkers, peddlers and itinerant trades and requires a special licence;
- c) by professional actors or entertainers or professional sportsmen within the Grand Duchy;
- 2) income from agriculture and forestry arising from enterprises situated in Luxembourg;
- 3) income from independent professional services, if the profession is carried out or the earnings are realized in Luxembourg;
- 4) income from employment:
- a) if the employment is or has been executed in Luxembourg;
- b) if the employment is or has been realized in the Grand Duchy, unless however the employee is engaged by a trader, an industrial undertaking or a transport firm and can prove that his earnings in the Grand Duchy are subject to a foreign tax equivalent to Luxembourg income tax;
- c) if the income is paid by a public native treasury or by the Société des Chemins de Fer Luxembourgeois;
- 5) income from pensions and annuities:
- a) paid by virtue of a previous employment, performed or made valuable in the Grand Duchy;
- b) paid by a public native treasury fund within the Grand Duchy;
- c) paid by the Société Nationale des Chemins de Fer Luxembourgeois;
- d) paid by an independent native retirement fund in Luxembourg, financed wholly or partly by insurance contributions;
- e) paid by pension funds incorporated in the form of a pension savings association (assep), provided that the contributions that generated the income were deducted from taxable income in Luxembourg;
- 6) the following income from capital and investments, if the debtor is the Grand Duchy of Luxembourg, a municipality, a public Luxembourg institute, a private corporation whose statutory seat or principal place of management is in Luxembourg, or a physical person whose fiscal domicile is in the Grand Duchy:
- dividends, shares of profit and other returns on shares in public limited companies, partnerships limited by shares, limited liability companies and co-operative companies;
 - shares in profits received by an investor by virtue of his capital outlay in a commercial, industrial, mining or craft undertaking paid proportionally to the profits;
 - interest and payments on debentures participating in profits;
- Revenues which are not subject to a withholding tax are exempt.
- 7) income from rentals and leases of property, if the property and rights are situated in Luxembourg;
- 8) the following sundry income:
- a) income arising from the sale of a substantial shareholding in a corporation whose statutory seat or principal management place is in the Grand Duchy, if the shareholder had been a resident taxpayer for more than 15 years and became non-resident less than five years before the realization of the income and the sale occurred more than six month after the acquisition;
- b) income arising from the sale of real estate situated in the Grand Duchy and income arising from the sale of a substantial shareholding in a corporation whose statutory seat or principal place of management is in Luxembourg, disposed of less than six months after acquisition.
- Income arising from the sale of shareholdings in the SICAR, a private equity vehicle, is excluded.

7.2 Special regulations for the computation of domestic income

Non resident taxpayers are entitled to deduct business expenses or professional expenses only as far as these costs are economically in direct relation with domestic income.

In principle, the deduction of special expenses is limited in the case of non resident taxpayers. Compulsory contributions to a social security institution are deductible. The minimum annual amount of € 480 is granted to taxpayers receiving professional income. Losses of former

financial years are deductible, if they are economically in direct relation with domestic income.

The usual provisions relating to the deduction for extraordinary expenses are not applicable to non-residents.

In general, the rules governing the tax assessment and tax collection are similar to those applicable to residents with the restriction that they are only applicable to domestic income.

7.3 Withholding tax

In addition to the cases, where income tax is withheld at source for resident taxpayers (salaries, pensions and certain income from capital and investments) withholding tax is also applied to the following domestic income in the case of non-residents:

- 1) income from independent literary or artistic activities realized in Luxembourg;
- 2) income from a professional sports activity which is exercised in Luxembourg.

The tax withheld for 1) and 2) is 10% of the gross income, without any deductions.

Even in cases where the income of non resident taxpayers is in principle not subject to withholding tax, the tax administration may nevertheless withhold, if this seems necessary to ensure payment of the tax liability. The amount withheld, which represents an advance payment, is determined by the tax administration.

7.4 Flat-rate taxation of non resident sailors

Income realized by sailors employed by a certified shipping company active in international maritime transport is taxed at a flat rate.

This flat rate amounts to 10% of 90% of the gross monthly earnings after a monthly deduction of €875.

7.5 Assessment

Non resident taxpayers, hired on a continuous basis as wage-earners in the Grand Duchy during at least nine months of the year, as well as those realizing more than 50% of their professional income of their household in Luxembourg, are subject to tax assessment under the same conditions and dispositions as residents.

7.6 Tax classes

Generally, non resident taxpayers, who realize a taxable income in the Grand Duchy that is not

subject to withholding tax, are classified into tax class 1 but the tax rate cannot be inferior to 15%.

Non resident married taxpayers however, who do not live separately and whose spouses realize a professional income in Luxembourg, as well as widowed persons, persons receiving a tax relief for a child and persons who have completed their 64th year at the beginning of the tax year, are classified into class 1a.

However non resident married taxpayers, who do not live separately, are classified into class 2, if more than 50% of the professional income of their household is realized and taxable in Luxembourg. However, if both spouses realize professional income taxable in the Grand Duchy, taxation in tax class 2 means joint taxation of the couple.

Non resident taxpayers, whose marriage has been dissolved by death in the course of the three years preceding the tax year, as well as non resident taxpayers divorced or de facto separated by virtue of a legal dispensation or a judgement in the course of the three years preceding the tax year, are taxable in tax class 2.

7.7 Equal fiscal treatment of resident and non resident taxpayers

Non resident taxpayers taxable in the Grand Duchy on at least 90% of their total professional income are, upon request, taxable on their income realized in the Grand Duchy at the tax rate applicable, as if they were taxable as residents on their domestic and foreign professional income.

Non resident taxpayers, who do not live separately, are taxed jointly on their inland income. In that case, the professional foreign income of both spouses is taken into account to fix the tax rate.

For married taxpayers taxed jointly, this decree also applies, if only one of the spouses realizes at least 90% of his total professional income in the Grand Duchy.

As a result, non resident taxpayers, who fulfil the above conditions, are allowed to deduct all special expenses provided for by law, the deduction for extraordinary charges which is in principle only applicable to residents. For tax computation, these non resident taxpayers are classified into the appropriate tax class, as if they were resident taxpayers.

8. Explanation concerning the care insurance

As of 1st January 1999, Luxembourg has introduced the care insurance. In this context, the tax administration has been given the responsibility to determine and to collect for the account of the institute managing the care insurance, the care contributions which are due by resident taxpayers subject to personal income tax, on income from property and on income from certain pensions. Income from property comprises net income from capital and investments, net income from rentals and leases and sundry income.

The rate of the care contribution is 1%.

The care contribution is no income tax and it does not represent a business expense, or a professional expense or a special expense.

CORPORATE INCOME TAX

9. Taxable corporations

The legal form of a body corporate is not the decisive factor for taxation. In general, any economic entity realizing income that is not directly taxable in the hands of the partners or members is subject to corporation tax.

The law specially enumerates the following collective entities:

- 1) stock corporations (public limited companies, private limited companies, partnerships limited by shares);
- 2) commercial co-operative companies, co-operative companies in the form of a limited company and agricultural co-operative companies;
- 3) religious congregations and associations, recognized or not by government, without regard to their legal form;
- 4) mutual insurance associations, pension savings associations (association d'épargne-pension; assep) and pension funds within the meaning of the modified law of 6th December 1991 concerning the insurance sector;
- 5) institutes promoting the public good and other foundations;
- 6) associations without profit-making purpose;
- 7) other private corporations, whose income is not directly taxable in the hands of other taxpayers;
- 8) specially assigned assets, and intestacies;
- 9) commercial, industrial or mining undertakings owned by the state, by local authorities or syndicates of local authorities, public establishments and other legal entities with statutory rights.

10. Tax-exempt corporations

Under certain conditions, the entities described under 2) and under 4) to 9) are tax-exempt. Indeed, the entities described under 4) to 9) are exempt from income tax, if, by the terms of their statutes or contract of association, they limit themselves solely and directly to cultural or charitable activities, or activities in the general interest. If they are involved in an industrial or commercial activity, they are subject to tax on this activity.

By decision of the government in council, taken on the advice of the Minister of Finances, certain activities of associations without profit-making purpose are not considered to be commercial or industrial, if the association's object is deemed to be of particular public interest and the association is not aiming to provide a material advantage to its members.

General partnerships, limited partnerships and companies of civil law are in general not liable to corporate income tax, because these kinds of associations are not considered to be distinct from that of their partners for tax purposes. The partners of these associations are liable to income tax on their share of the total income realized by their association.

11. Statutory seat or principal place of management

For tax purposes a distinction is made between:

- corporations whose statutory seat or principal place of management is situated in Luxembourg and
- corporations whose statutory seat or principal place of management is not situated in Luxembourg.

The former are taxable on their worldwide income, the latter are only taxable on income arising in Luxembourg.

12. Taxable income

The taxable income of corporations is equal to the taxable income of physical persons subject to certain particularities resulting from the nature of a corporation.

The taxable income consists of both distributed and retained earnings. It also includes any payments made to members of the board of directors or to commissioners, as far as these fees do not represent remuneration for the daily management.

12.1 Substantial holding privilege

The income derived by:

- a resident fully taxable stock corporation,
- the state, the municipalities, the municipal syndicates, the public institutions and the other corporations governed by public law,
- an inland permanent establishment of a stock corporation resident of a member state of the European Union,
- an inland permanent establishment of a stock corporation resident of a state, with

which the Grand Duchy has concluded a double tax treaty,

from a direct shareholding in:

- a resident fully taxable stock corporation,
- a non-resident stock corporation subject to a foreign tax similar to Luxembourg corporation income tax,
- a stock corporation resident of a member state of the European Union,

is tax-exempt, if the beneficiary has held or commits himself to hold during an uninterrupted period of at least 12 months, a direct or indirect shareholding in the registered capital of at least 10% or of a purchase price of at least € 1.200.000.

In the present case, the distributing subsidiary is, under certain conditions, not required to withhold the tax of 20% of the distributed dividends.

If:

- a resident fully taxable stock corporation,
- the state, the municipalities, the municipal syndicates, the public institutions and the other corporations governed by public law,
- an inland permanent establishment of a stock corporation being resident of a state of the European Union,
- an inland permanent establishment of a stock corporation being resident of a state, with which the Grand Duchy has concluded a convention for the avoidance of double taxation,

sells shares in:

- a resident fully taxable stock corporation,
- a non-resident stock corporation subject to a foreign income tax similar to Luxembourg corporation income tax,
- a stock corporation resident of a member state of the European Union,

then the capital gains realised on the sale of the share are tax-exempt, provided that the seller has held or commits himself to hold during a period of at least 12 months a shareholding representing at least 10% of the registered capital of the subsidiary company, or that was purchased for at least € 6.000.000. Moreover the subsidiary company has to be a resident fully taxable taxpayer or a non resident company fully liable to a tax equivalent to Luxembourg corporation income tax.

12.2 Fiscal unity

On request, corporations may be allowed to enter into a fiscal unity with its subsidiaries. This system leads to the taxation of the consolidated income of a group of companies and can be applied under the following conditions:

- 1) the parent and subsidiary companies must be resident and fully taxable stock corporations;
- 2) the subsidiaries must be financially integrated in the leading company. Financial integration exists, if at least 95% of the capital of the subsidiary is held directly or indirectly by the parent company. The above-mentioned conditions must be fulfilled at the beginning of the first financial year for which fiscal unity is applied for. Fiscal unity may exceptionally be granted even if the financial integration is less than 95%;
- 3) written requests must be submitted jointly by the parent company and the subsidiaries, which wish to be assimilated to permanent establishments;
- 4) fiscal unity is only granted for a period covering at least 5 financial years.

12.3 Non deductible items

The following items are not deductible:

- expenses related to statutory commitments;
- corporate income tax, net worth tax and municipal business tax;
- remunerations paid to directors in respect of supervisory and non managerial duties.

12.4 Income tax credit for new investments

See 3.2.1.17.

12.5 Income tax credit for engaging unemployed persons

See 3.2.1.18.

12.6 Income tax credit for expenses related to further professional education

See 3.2.19.

12.7 Tax exemption for investments

See 3.2.1.20.

12.8 Immunization of the monetary capital gain realized on real estate

See 3.2.1.21.

12.9 Abatement for audiovisual investments

Joint stock companies that hold a certificate for investments in the audiovisual field are granted upon request an deduction from their taxable income.

12.10 Abatement for investments in venture capital

Taxpayers who hold a venture capital certificate, may upon request, benefit from a deduction from their taxable income.

13. Assessment and levy of corporate income tax

In general, corporate income tax is assessed and collected in the same way as personal income tax. Income from financial investments of corporations is also subject to withholding tax.

All corporations are subject to an annual, individual assessment without regard to the amount or nature of their income.

14. Tax computation

14.1 Tax rates for resident and non resident corporations

Corporate income tax is determined as follows:

- 20%, if the taxable income does not exceed €10.000;
- €2.000 plus 26% of the income exceeding €10.000, if the income is comprised between €10.000 and €15.001;
- 22%, if the income exceeds €15.000.

The tax is reduced to one half for religious congregations and associations, and to a third for credit and agricultural co-operative companies, whose activities consist in raising funds and lending to members.

Non resident corporations are not assessed annually and individually on income subject to a withholding tax in Luxembourg, if this income is not part of the profits realised through a domestic, commercial, industrial, agricultural or forestry undertaking.

14.2 Unemployment fund

A surcharge of 4% is levied on final corporate tax due in order to finance the unemployment fund.

NET WORTH TAX

15. Taxable persons

The persons liable to net worth tax are in general the same as those liable to personal or corporate income tax.

As for income tax purposes, the law distinguishes between physical persons and corporations.

Physical persons who have their domicile or normal place of residence in Luxembourg and corporations, whose statutory seat or principal place of business is in Luxembourg, are taxable on their worldwide net wealth. Non resident physical persons and corporations are taxable only on their net wealth situated in Luxembourg.

General partnerships, limited partnerships and other forms of business entities under civil law are not liable to net worth tax on a stand-alone basis; as for income tax purposes each partner is taxed separately according to his share in the partnership's net wealth.

16. Definition of the taxable net wealth

Taxable net wealth includes:

- 1) agricultural and forestry property;
- 2) developed or undeveloped real estate which does not form part of an undertaking mentioned under 1) above or 3) below;
- 3) the net assets of a commercial, industrial, mining or skilled craft undertaking as well as the net assets used within the scope of an independent professional activity;
- 4) any movable property, which does not belong to the numbers 1) to 3) above, and which is not tax exempt by a special provision.

Only 50% of the operating value of the elements of net worth mentioned above under 1) and 3) are taken into account, when computing the total net wealth of a physical person. This regulation is also applicable to the domestic net worth of non resident physical persons.

Real estate is valued at its deemed value (valeur unitaire), which is determined in accordance with the provisions of the law on the valuation of property and assets (Bewertungsgesetz), at the prices prevailing on 1st January 1941. Thus, these values represent only a fraction of the present day values.

In particular, the following items are exempt: the taxpayer's household goods, the author's rights to literary or artistic work, provided that these rights are the property of the author or his descendants and that their use has not been ceded to a third party for a fee, as well as the capital value of retirement pensions and old age and invalidity annuities paid by virtue of a legal provision.

As far as they do not form part of the wealth described under 1) to 3), bank deposits and other means of payment, as well as shares in stock corporations and co-operative companies securities quoted benefit from a lump-sum exemption of € 75.000. This allowance is doubled for married taxpayers who are taxed jointly.

A lump-sum exemption of €75.000 applies to the capital value of certain rights. This amount is doubled for married taxpayers who are jointly taxed. Rights from certain insurance contracts, that are not yet due, are exempt up to an amount of €75.000. This amount is doubled for married taxpayers who are jointly taxed.

Debts are deducted from total gross wealth, provided that they have not already been deducted in determining the capital invested in accordance with 3) above.

17. Taxable net worth of non resident taxpayers

Physical persons whose domicile or normal place of residence is not in Luxembourg, as well as corporations whose statutory seat or principal place of management is not in Luxembourg are taxable on the wealth described under 1) to 3) above, if the real estate or the enterprises are situated in Luxembourg. They are also taxable on claims described under 4), if these claims are guaranteed by a preferential right or mortgage on a property situated in Luxembourg.

18. Net worth tax allowances

Physical persons who have their domicile or normal place of residence in Luxembourg are granted a net worth tax allowance. This tax allowance amounts to €2.500 for the taxpayer and € 2.500 for the taxpayer's spouse, if the married partners do not live in a state of de facto separation by virtue of a legal dispensation or judgement.

A supplementary allowance of € 2.500 is granted for each child aged less than 21 years belonging to the household, as well as on request, for each child aged less than 21 years which does not belong to the taxpayer's

household, but who is supported and educated principally at the taxpayer's expense. On request, the allowance is also granted for children of at least 21 years who belong to the household and who continue their professional education, as well as for children of at least 21 years who continue their professional education but do not belong to the taxpayers household as long as these expenses are principally borne by the taxpayer. The allowance is also granted for children of at least 21 years, who benefit from the continuous family allowance for handicapped or infirm children, if they are maintained principally at the taxpayer's expense.

19. Assessment and levy of net worth tax

Net worth tax is determined by assessment every three years. If the wealth of a taxpayer rises or falls beyond certain limits during this period, a new assessment is made before the term of three years.

Net worth tax is levied directly from the taxpayer.

20. Tax rate

The annual tax rate is 0,5% of taxable wealth.

21. Minimum taxation

For resident fully liable stock corporations, the minimum taxable net worth is:

- € 12.500 for public limited companies and partnerships limited by shares;
- € 5.000 for private limited companies.

22. Net worth tax credit on corporate income tax

Taxpayers liable to corporate income tax, may on request, deduct partly or wholly, the net worth tax from the corporate income tax of the same year, if they commit themselves to create, before the end of the following financial year, a reserve corresponding to five times the net worth tax deducted and to maintain this reserve for the five tax years following the year of deduction.

If the company distributes whole or part of the reserve before the end of the five-year period, the corporate income tax of the concerned tax year is increased by 1/5 of the distributed reserve.

These rules are also applicable to domestic permanent establishments of non-resident companies that maintain separate accounts.

MUNICIPAL BUSINESS TAX

23. Persons liable to tax

Municipal business tax is only levied on income from commercial, industrial, mining and skilled craft undertakings.

Municipal business tax is levied by the state on behalf of the municipalities.

24. Real character of municipal business tax

The municipal business tax may be characterised as objective as merely the commercial activity is taxed without taking into account the status of the taxpayer. Furthermore, in the case of taxpayers that are not subject to corporate income tax, the municipal business tax is deductible as an expense for income tax purposes.

The following are always considered to be a commercial undertaking:

- 1) the activities of general partnerships, limited partnerships, economic interest groupings, European economic interest groupings, as well as all other common undertakings, as long as the partners are considered to be co-owners;
- 2) the activities of stock corporations (public limited companies, private limited companies, partnerships limited by shares), co-operative companies and mutual insurance associations;
- 3) any profit seeking activities of either a limited partnership with at least one general partner who is a stock corporation or of a general partnership, an economic interest grouping, an European economic interest groupings or a civil law company, which are majority held by one or more stock corporations. A partnership which undertakes a commercial activity and holds shares in another partnership, is deemed to be a stock corporation when determining the nature of the latter's activity.

25. Computation of municipal business tax

Municipal business tax is based on commercial income.

25.1 Municipal business tax on income

Municipal business tax on income is based on taxable income as computed for corporate income or personal income tax purposes and is subject to certain adjustments due to its objective character.

25.1.1 Additions

Are added back the profits distributed as well as the payments made to the general partner of a partnership limited by shares for services rendered to the partnership, as well as, should the case may be, the losses realised in a collective commercial undertaking.

25.1.2 Deductions

The income is shortened by:

- the profits realised by a collective commercial undertaking,
- the dividend income distributed by resident fully taxable stock corporation or a non resident stock corporation subject to an corporate income similar to the one in Luxembourg, provided a participation of at least 10% was held since the beginning of the financial year. A participation held through a general partnership, a limited partnership, an economic interest grouping, or a European economic interest grouping, is considered to be a direct holding in proportion to the share held in such an undertaking.
- the profits allocated to a foreign permanent establishment,

if this income is included in the income of the enterprise.

Income, which for corporate income tax purposes qualifies for the substantial holding exemption is already excluded from the municipal business tax basis, thus no special deduction is needed.

The taxable income is also reduced by the compulsory personal contributions paid by the individual contractor and the partners of a partnership, to a Luxembourg social security institution and by the losses incurred from 1991 onwards, provided that the losses have been determined through generally accepted accounting principles.

25.1.3 Basic tax rate on income

The applicable base rate is fixed at 3% of the adjusted income of business and trade, previously reduced by an allowance of €17.500 for taxpayers liable to corporate income tax and €40.000 for taxpayers liable to personal income tax.

26. Global tax basis

The global tax basis is arrived at by multiplying the taxable income with the basic tax rate on

business profits. The global tax basis is then multiplied by the municipal tax rate in order to determine the amount of business tax due. The municipal business tax rates are set by the municipalities according to their financial requirements, and vary between 200% and 350%.

27. Assessment and levy of municipal business tax

The assessment and levy of municipal business tax is carried out by the tax administration, which then distributes the transferred receipts to the respective municipal treasuries.
