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Preferential loans and interest subsidies

It is current practice for employers to grant preferential loans or interest subsidies to their employees.

The interest savings realized by the employees constitute a benefit in kind and must, therefore, be subject to wage withholding tax. However, the Luxembourg law provides some exemptions which make such benefit particularly attractive for both employees and employers.

I. Preferential loans vs. interest subsidies

Two mechanisms exist in order to optimize employee's remuneration: preferential loans and interest subsidies.

An employer may grant preferential loan to an employee, i.e. an interest-free loan or a loan at a below-market rate. In this case, a lump sum valuation, based on a reference interest rate, is required by law to determine the benefit resulting from such loans. It should be noted that the loan does not have to be concluded with the employer; it can also be concluded with a third party financial institution with which the employer has a specific agreement for the granting of loans on preferential terms to its staff.

The employer may also refund all or part of the interest related to a loan contracted by one of its employees. In such case, we are talking about the interest subsidy mechanism. The latter is usually proposed as an alternative to the payment of a variable remuneration.

II. What are the loans covered

A. Loans in relation with the main residence of the taxpayer

Are considered as loans in relation with the main residence, all loans having an economical link with either the personal residence of the employee, or the acquisition of a first plot of land to be built, or a building under construction or renovation, building that the employee has the intention to use for his personal needs. In this context, loans for the purchase of a second residence are not taken into account.

B. Personal loans

All loans that are not related to the main residence of the employee qualify as personal loans. This may be, for example, consumer loans, loans for studies or loans to finance a second residence.

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III. How the benefit is evaluated

In presence of a preferential loan, the law provides a lump sum valuation of the benefit in kind based on a reference interest rate. This rate is generally reviewed every two years to take into account the evolution of the market rates.

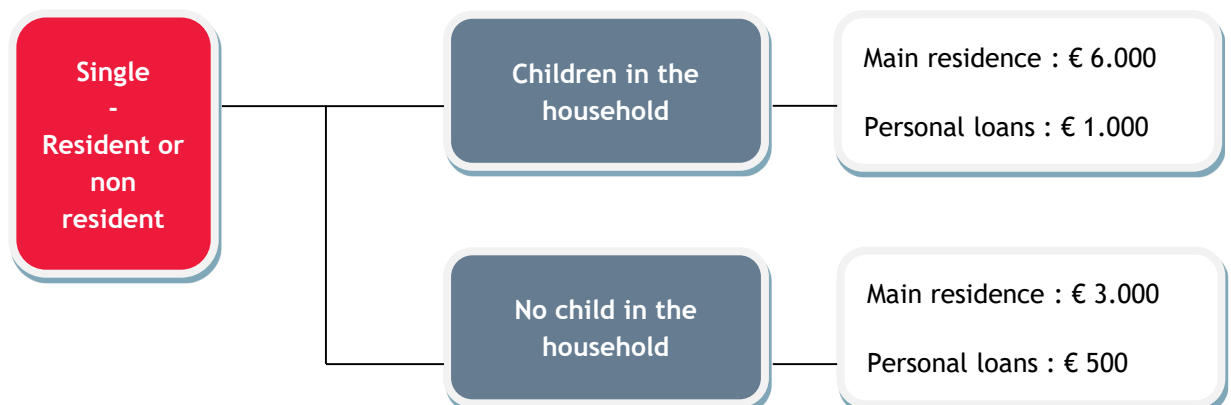
As from tax year 2015, the applicable reference rate is 1.5%.

In case of interest-free loan, the taxable benefit is therefore equivalent to 1.5% of the loan amount for the tax year 2015. In the case of a below-market rate loan, the benefit is determined by the difference between the interest rate of the loan and the reference rate of 1.5%.

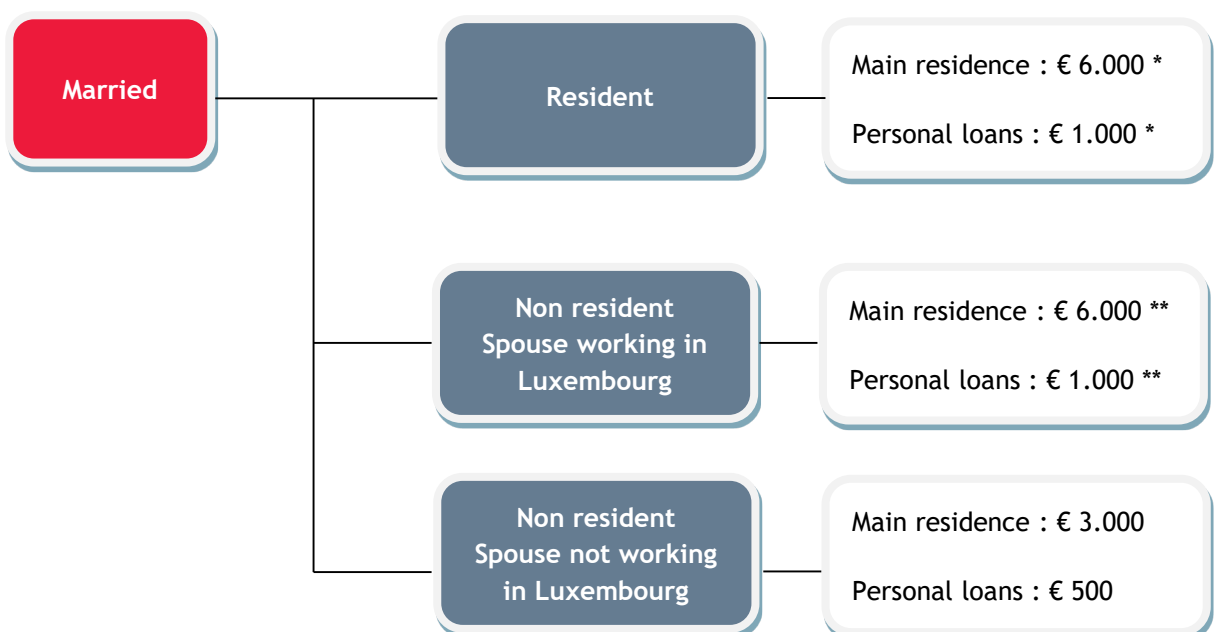
In case of interest subsidy, i.e. reimbursement by the employer of all or part of the interest from a loan contracted by the employee, the taxable benefit corresponds to the amount of interest refunded.

IV. What are the applicable exemptions

Preferential loans and interest subsidies benefit from a specific tax exemptions regime. The exempt amounts depend on the purpose of the loan (main residence or other) as well as on the family situation of the employee.



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* The exemption of 6.000€ is not applicable in case of separate taxation.

** The exemption that can be considered in payroll is limited to € 3.000 / € 500. The additional exemption can be claimed by the employee in his tax return.

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V. What is the social security treatment

Benefits resulting from preferential loans or interest subsidies granted to employees by their employers are fully exempted from social security contributions (employer and employee's part).

VI. Practical questions

A. Moment of taxation

Regarding preferential loans, taxation occurs at the time of the account statement, i.e. when the interest is debited from the bank account of the employee, or at the latest at the end of the calendar year.

The taxation in case of interest subsidy occurs when the subsidy is paid by the employer, i.e. when the employer reimburses the interest to the employee.

B. Supporting documents to be provided by the employee

The employer being responsible for the tax calculation and therefore for the application of any exemption, and in order to avoid any issue in case of wage tax audit by the tax authorities, it is recommended that he keeps a copy of the various supporting documents in the files of the staff concerned.

This should not be a problem in the cases where the employer himself grants the loan to the employee, since, in this case, the employer should be in possession of all the information regarding the loan agreement.

However, if the employer does not grant the loan himself, he will have to get from the employee the documents concerning the existence and purpose of the loan (e.g. copy of the loan agreement) as well as the amount of interest covered by the interest subsidy.

For the latter, a bank certificate or any other document justifying the interest actually paid by the employee will be required.

In addition, for loans related to the main residence, the employer must have the confirmation of the purpose of the loan. The proof may be provided by a copy of the loan agreement, a confirmation issued by the financial institution that granted the loan, or any other document establishing a clear relationship between the loan and the main residence.

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Since the exemptions are granted only once per year and per household, the employer shall also check if the spouse of the employee benefits from a similar benefit or not. For this purpose, the employee must provide a written statement from the employer's spouse either certifying that he / she does not benefit from a preferential loan or interest subsidy, or stating the amount of benefits and exemptions granted.

It can be useful that the employer sets up written rules (interest subsidy scheme) informing employees about the regime, processes to be followed and documents required, particularly when the number of employees concerned is high. This allows an efficient and consistent management of the benefit and better guarantees the responsibility of the employer.

C. Departure or arrival of the employee during the year

When the employee leaves or joins the company during the year, there is no need to prorate the amounts of tax exemptions according to the employee's period of activity. Indeed, the employer can apply the full tax exemption up to the amount of the benefit.

When an employee is hired during the year, it should however be checked whether or not he received a similar benefit from his former employer. For this purpose, the employee must provide his new employer with a certificate from the former employer certifying the amount of the benefit and exemption previously granted, or that the employee did not benefit from such advantage.

D. Employee in sick leave or maternity leave

In such cases, the savings or the interest subsidies remains a professional income. This income is consequently taxable based on an additional tax card of the employee.

MEMENTO



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