BALANCING COMPETITIVENESS AND COHESION

With Budget 2026, Luxembourg is reshaping its tax framework, boosting the appeal of its financial centre while undertaking a far-reaching reform of household taxation amid intensifying fiscal and competitive pressures.

ETFS: REMOVING A STRUCTURAL DISADVANTAGE

A cornerstone of Budget 2026 is the permanent exemption of exchange-traded funds from the subscription tax. This levy, specific to Luxembourg, amounted to 0.05% per year (five basis points) on the net assets of investment funds. Initially introduced in 2025 and limited to passive ETFs, the exemption has now been extended to actively managed ETFs and formally embedded in the budget. As Luis Muñoz, tax lawyer at DLA Piper Luxembourg, explains, the reform centres on "*the full exemption from the subscription tax, a Luxembourg-specific levy of five basis points on net assets. This exemption, initially limited to passive ETFs, has now been extended to actively managed ETFs and made permanent under Budget 2026.*"

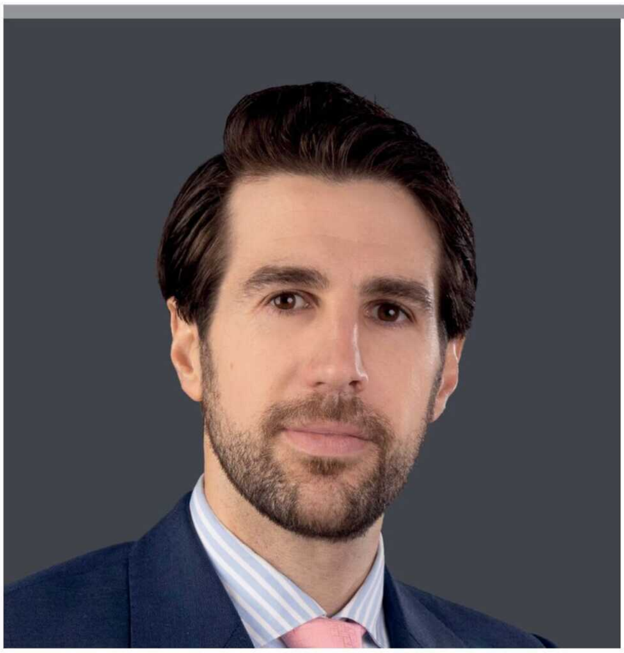
FORWARD-LOOKING FRAMEWORK

From an institutional perspective, these measures are not intended as isolated tax incentives. Tom Théobald, CEO of Luxembourg for Finance, underlines that Luxembourg's recent budget measures "*should be seen as part of a broader, long-term approach to supporting the development of the financial centre and ensuring a competitive business environment, rather than as isolated tax initiatives.*" According to him, the authorities have consistently focused on creating a stable and forward-looking framework enabling asset managers and financial institutions to develop new products efficiently, while building on Luxembourg's existing strengths.

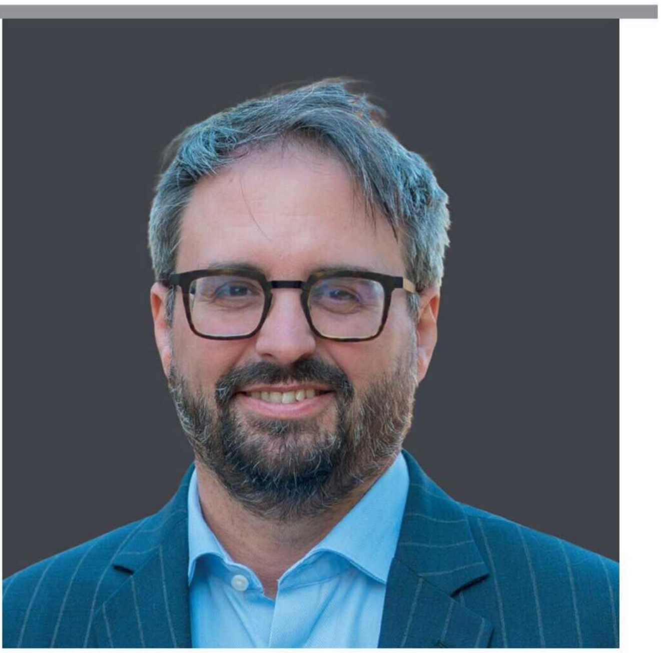
Market data lends weight to this strategy. Over the past 18 months, ETF assets domiciled in Luxembourg have grown strongly and by the end of 2025 exceeded €500 billion, confirming the country's role as a major European hub for ETF innovation and distribution. This growth has been accompanied by the launch of more specialised products from Luxembourg, including active ETFs, CLO ETFs and thematic ETFs linked to areas such as European defence and strategic autonomy.

NARROWING THE GAP WITH IRELAND

From a competitive standpoint, Muñoz notes that "*with the elimination of the subscription tax, Luxembourg is now on an equal footing with Ireland as regards taxation at the level of the ETF vehicle itself.*" He adds, however, that Ireland retains an advantage through its tax treaty with the United States, particularly in relation to withholding tax on dividends. In practice, while Luxembourg has



Luis Muñoz, pictured, is a tax lawyer at law firm DLA Piper Luxembourg.



Tom Théobald is CEO of Luxembourg for Finance, an official agency promoting Luxembourg as a financial hub.

eliminated a structural disadvantage at vehicle level, treaty-driven differences continue to influence the location of ETFs with significant physical exposure to US equities. This relative positioning is also visible in market shares. As Serge Weyland, CEO of the Association of the Luxembourg Fund Industry (ALFI) notes, *"while Ireland remains the dominant ETF domicile in Europe, Luxembourg is still the second largest ETF hub with a 20% market share."*

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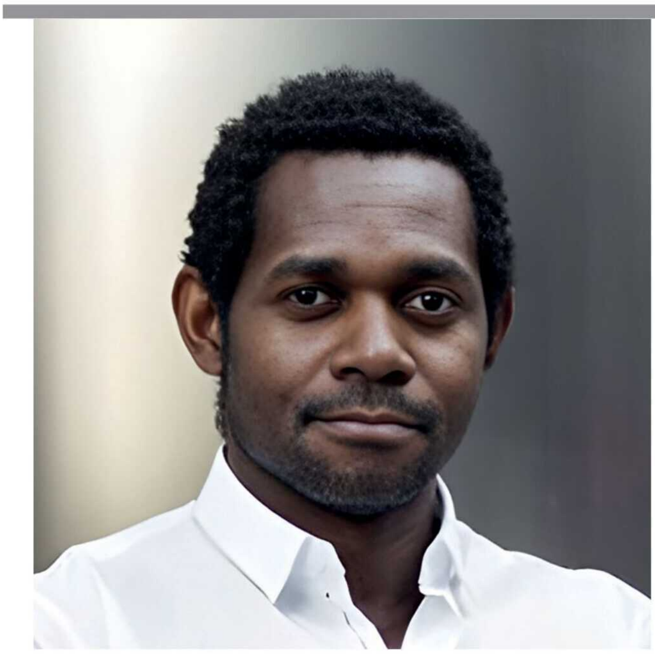
CORPORATE TAX: ALIGNMENT RATHER THAN OVERHAUL

Budget 2026 also includes a reduction in corporate income tax, continuing a trend initiated in previous budgets. From tax year 2025, Luxembourg's headline corporate income tax rate was reduced from 17% to 16% for companies with taxable income above €200,000. When combined with the 7% solidarity surcharge and the municipal business tax of 6.75% in Luxembourg City, the combined statutory corporate tax rate now stands at approximately 23.87%. This compares with an EU average combined statutory rate of around 21.6%. Luxembourg therefore remains slightly above the EU mean, but the gap has narrowed.

The impact of the reduction is uneven across the corporate landscape. According to Muñoz, it *"primarily benefits companies with genuine operational activities in Luxembourg."* By contrast, pure holding companies and private equity or international real estate structures *"will feel little direct impact."* For many such entities, income is already exempt at Luxembourg level or taxed where underlying operations take place. The reform is therefore less about transforming the tax position of all corporate structures than about signalling predictability and alignment. Within the constraints imposed by EU law and OECD frameworks, Luxembourg is positioning itself as responsive and stable, rather than engaging in aggressive tax competition.

THE END OF CLASS 2: A STRUCTURAL SHIFT FOR HOUSEHOLDS

If the measures aimed at the financial centre have been broadly welcomed, the abolition of Class 2 represents one of the most far-reaching social tax reforms in recent decades. The reform replaces joint taxation of married couples with an individualised system based on a unified tax scale broadly aligned with the former Class 1A. For many households, particularly dual-income couples, the



Michel-Edouard Ruben, economist at IDEA, a Luxembourg think tank.

Serge Weyland is CEO of ALFI.

reform is fiscally favourable. Muñoz observes that for "*the vast majority of dual-income couples, the end of Class 2 should translate into a lower tax burden,*" while also reflecting a broader trend towards individualisation and financial independence between partners, in line with evolving family models.

The reform nevertheless redistributes the tax burden for certain profiles. Michel-Edouard Ruben, economist at IDEA, a Luxembourg think tank, stresses that it "*profoundly alters the balance for certain households, particularly those where a single income dominates.*" He adds that it is "*somewhat surprising that no allowance for a dependent spouse is provided for future single-income couples,*" suggesting that this omission could still be addressed through an amendment to the draft legislation. To mitigate the impact, the reform includes a transition period of up to 25 years, primarily designed to protect existing married couples. While this cushioning mechanism softens the immediate effect, it does not eliminate the long-term redistribution inherent in the shift towards individual taxation.

A SIGNIFICANT COST FOR PUBLIC FINANCES

But the reform carries a substantial budgetary cost. Ruben estimates that the move to a single tax class represents "*a cost of around €950 million per year.*" This figure comes on top of other recent tax cuts, as well as the extensive public support deployed during the Covid crisis and the subsequent inflationary shock. "*Taken together,*" he notes, "*this is starting to add up.*" The end of Class 2 is among the most expensive fiscal measures of the current legislative cycle. Combined with corporate tax reductions and other tax initiatives, it reduces fiscal headroom at a time when economic growth is less certain and demographic pressures are increasing. While Luxembourg retains its AAA credit rating and has so far avoided negative market reactions, the cumulative effect of these measures raises legitimate questions about medium-term fiscal sustainability. In that sense, Budget 2026 is less an endpoint than a test: whether Luxembourg can continue to reconcile competitiveness with cohesion in an increasingly constrained fiscal environment. ■

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