

Tax implications of talent mobility – cross-border movement of employees – Luxembourg

Luxembourg offers a highly competitive tax environment for internationally mobile employees, combining a newly introduced impatriate regime with targeted incentives for performance-based remuneration and carried interest. This article provides a practical overview of the Luxembourg tax rules most relevant to cross-border talent mobility, with a focus on recent legislative developments and planning considerations for employers and employees alike.

1. Overview of the Luxembourg tax system

Luxembourg levies a progressive individual income tax on eight categories of aggregated income, ranging from employment and business profits to investment and miscellaneous income.

The system distinguishes between residents and non-residents. Resident individuals are subject to tax on their worldwide income (unlimited tax liability). Non-residents are taxed only on Luxembourg-source income (limited tax liability), subject to any applicable double taxation treaty.

An individual is treated as a Luxembourg tax resident if their domicile or usual place of abode is located in the Grand Duchy. Where an individual is physically present in Luxembourg for an uninterrupted period exceeding six months, even if that period spans two calendar years, a habitual abode is deemed to exist, with temporary departures disregarded. In practice and, notably, in an international tax context, the determination of residence turns on the overall factual circumstances, with particular attention paid to the location of the individual's centre of vital interests (eg, the location of the individual's family).

Taxation is determined at the individual level, but the applicable rate depends on the taxpayer's tax class, which reflects their marital status and family situation (class 1, 1a or 2). Luxembourg is considering a reform to its personal income tax system, aimed at simplifying the available tax classes and moving towards greater individualisation of taxation.

Individuals may also be subject to a municipal business tax on business income, compulsory social security contributions, a surcharge on behalf of the employment fund and a dependency contribution levied on positive income attributed to each category.

Luxembourg's extensive treaty network, comprising over 80 double taxation agreements, is a critical feature of the system for cross-border workers and expatriates. The treaties generally follow the Organisation for Economic Co-operation and Development (OECD) model and allocate taxing rights over employment income to the state where the employment is exercised, subject to the usual 183-day and employer-related exceptions.

2. Taxation of employment income

2.1 Scope of taxable income

Luxembourg tax resident or Luxembourg non-tax resident employees working in Luxembourg are subject to tax on a broad definition of employment income. It encompasses all forms of remuneration connected to an employment relationship, whether monetary or non-monetary, recurring or one-off, and regardless of whether such remuneration is received from the employer.

Bonuses

Bonuses are fully taxable as employment income. Since 2021, employers may additionally grant a profit-sharing premium (prime participative) that benefits from a 50 per cent income tax exemption, subject to certain conditions. The premium is granted at the employer's discretion and requires that the employee is subject to Luxembourg social security contributions or an equivalent foreign scheme.

The regime applies where the employer derives income from business or independent activities and maintains proper accounts for the relevant and preceding financial years. The total bonus pool is capped at 7.5 per cent of the employer's prior year profits, while the amount allocated to each employee may not exceed 30 per cent of their annual gross remuneration (excluding benefits). The implementation of the scheme must be formally notified to the Luxembourg withholding tax authorities.

Bonuses for young employees

Luxembourg has introduced a targeted incentive for younger employees and talent retention. A 75 per cent tax exemption applies to bonuses granted to employees under 30 years old who begin their first instance of permanent employment in Luxembourg. This regime applies for up to five years with the same employer and is subject to specific conditions and caps.

The exempt bonus is subject to salary-based caps, with a maximum annual eligible amount of €5,000 for employees earning up to €50,000, decreasing progressively to €2,500 for salaries up to €100,000. No exemption applies where the annual gross salary exceeds €100,000.

Director remuneration

The tax treatment of directors' remuneration in Luxembourg depends on the nature of their functions. Remuneration of executive directors that are in charge of day-to-day management is generally treated as employment income, whereas fees received by non-executive directors are typically classified as income from independent activities and subject to a 20 per cent withholding tax. In such cases, the company paying the fees must apply a withholding tax of 20 per cent on the gross amount of the directors' fees. This withholding tax constitutes an advance payment of income tax for Luxembourg resident directors and may be a final tax for non-resident directors, subject to the provisions of an applicable double tax treaty.

Equity compensation

Following the abolition of specific stock option plan rules in 2021, equity-based remuneration is largely channelled through the profit-sharing premium scheme described above. Before 2021, transferable stock options were taxed at the time they were granted (based on the Black-Scholes method or a deemed value of 30 per cent of the underlying share), whereas non-transferable options were taxed at exercise on the spread between the market value and the exercise price. A new stock option regime targeting startups was announced by the finance minister in June 2025, with draft legislation expected during 2026.

Allowances

Reimbursements by employers of duly supported professional expenses are generally tax exempt, up to authorised rates for government officials. Lump sum payments for non-itemised expenses remain taxable.

Allowances granted by the employer (eg, housing, relocation, school fees) and benefits in kind (eg, company cars) are taxable as part of the individual's employment income. The value of all fringe benefits is included in the individual's taxable income. Specific valuation rules govern company cars (based on the engine type and CO₂ emissions), free housing (based on the unitary value or square metre rates) and interest-free or low-interest loans.

Carried interest

The latest amendment to the tax regime for carried interest aims to clarify and modernise the regime as follows: (1) contractual carried interest (not linked to a fund participation) would be taxed as extraordinary income at one-quarter of the taxpayer's global rate, yielding an effective rate of approximately 12 per cent; and (2) carried interest linked to direct or indirect participation in an alternative investment fund would be exempt if held for more than six months and the individual does not hold a substantial (more than ten per cent) shareholding in the vehicle. The scope of eligible beneficiaries would be broadened to benefit Luxembourg tax resident individuals providing management services to alternative investment funds, also encompassing independent board members.

2.2 Income source rules

Employment income of a non-resident is treated as Luxembourg-source income when the activity is physically exercised in Luxembourg. Even where the activity is performed abroad, income may be treated as Luxembourg sourced if its economic effects directly benefit the domestic economy, a concept referred to in Luxembourg tax practice as the *mise en valeur* principle. This concept applies only in the absence of an applicable tax treaty.

Under Luxembourg's double taxation treaties, largely modelled on the OECD framework, employment income is generally taxable in the state where the activity is exercised. The standard 183-day exemption applies: short-term assignments remain taxable solely in the employee's state of residence provided their presence does not exceed 183 days, the remuneration is not paid by a local employer and no local permanent establishment (PE) bears the cost.

Cross-border worker provisions in the treaties concluded with Belgium, France and Germany permit a limited number of working days outside the habitual state of activity (currently 34 days under each of these treaties), while retaining taxation in Luxembourg.

2.3 Tax rates

Luxembourg applies progressive income tax rates that reach up to a maximum marginal rate of 42 per cent.

Income bracket (€)	Tax rate
Up to 13,230	0 per cent
13,230 – 15,435	8 per cent
15,435 – 17,640	9 per cent
17,640 – 19,845	10 per cent
19,845 – 22,050	11 per cent
22,050 – 24,255	12 per cent
24,255 – 26,550	14 per cent
26,550 – 28,845	16 per cent
28,845 – 31,140	18 per cent

31,140 – 33,435	20 per cent
33,435 – 35,730	22 per cent
35,730 – 38,025	24 per cent
38,025 – 40,320	26 per cent
40,320 – 42,615	28 per cent
42,615 – 44,910	30 per cent
44,910 – 47,205	32 per cent
47,205 – 49,500	34 per cent
49,500 – 51,795	36 per cent
51,795 – 54,090	38 per cent
54,090 – 117,450	39 per cent
117,450 – 176,160	40 per cent
176,160 – 234,870	41 per cent
Above 234,870	42 per cent

This is supplemented by a seven per cent employment fund surcharge (increasing to nine per cent for taxable income exceeding €150,000 in tax classes 1 and 1a, or €300,000 in tax class 2), bringing the effective maximum marginal rate up to approximately 45.78 per cent.

A 1.4 per cent dependency contribution is also levied on positive income from each income category.

Luxembourg does not operate a flat expatriate tax rate in the traditional sense. However, the impatriate regime (discussed below) provides substantial relief that has a broadly comparable economic effect for qualifying individuals.

Impatriate regime

Luxembourg has replaced its former expatriate regime with a new impatriate regime, which is among the most competitive in Europe. Qualifying impatriates benefit from a 50 per cent income tax exemption on their annual remuneration, up to a maximum gross annual remuneration of €400,000 and for a duration of up to eight years.

The regime is available to two categories of employees: (1) those seconded from a foreign group company to a Luxembourg group entity; and (2) those directly hired from abroad by a Luxembourg company or by a company located in the European Economic Area, with the company being of a certain size. A minimum annual gross salary of €75,000 is required, with bonuses and benefits in kind excluded from this threshold. The impatriate must exercise the qualifying activity for at least 75 per cent of their working time. The individual must not have been a Luxembourg tax resident nor resident within 150 km of the border, nor subject to Luxembourg income tax on their professional income, during the five years preceding the start of their Luxembourg activity. The impatriate must not replace one or more employees who do not themselves qualify as impatriates under this regime. In the case of group secondments, the impatriate must have five years' seniority within the international group or five years' specialised professional experience in the relevant sector, and a continuing work relationship with the foreign entity and a right to return must exist. For direct recruitment, the impatriate must have acquired in-depth specialisation in the relevant sector.

The number of qualifying impatriates may not exceed 30 per cent of the employer's total full-time headcount, although this cap does not apply to companies established in Luxembourg for ten years or less. Employers must apply in advance and demonstrate that the conditions are met.

2.4 Miscellaneous issues

Employer's withholding obligations: Luxembourg employers are required to withhold tax at source on employment income paid to both resident and non-resident employees. The withholding is computed on a monthly basis, using official tax tables. Employers must file monthly payroll tax returns and are liable for any shortfall in withholding. A foreign employer without a PE or permanent representative in Luxembourg is not required to withhold such taxes, but may opt to do so. In the absence of withholding, the employee is taxable by way of a tax return and assessment.

Social security contributions: employees and employers are each subject to social security contributions of approximately 12 to 13 per cent of the gross salary, covering pension, health and dependency insurance. Contributions are capped in reference to a ceiling (five times the minimum social wage), except for the dependency contribution.

Under the EU's Social Security Regulation 883/2004, employees temporarily seconded to Luxembourg may remain affiliated to their home-state social security for up to two years. The Framework Agreement on habitual cross-border telework, effective since 1 July 2023, permits employees who telework less than 50 per cent of their total working time from their country of residence to remain covered by the employer's home-state social security system.

Exemptions

Noteworthy exemptions include the impatriate regime described above, the tax treatment of bonus schemes, overtime compensation for private-sector employees and legal severance payments under labour law or collective bargaining agreements.

3. PE risks

Under Luxembourg domestic law, non-resident business profits are taxable when realised through a PE or by a dependent representative in Luxembourg.

3.1 Dependent agent PEs

Luxembourg's treaty network follows the OECD model, meaning that an employee who habitually exercises authority to conclude contracts on behalf of a non-resident enterprise can create a dependent agent PE (not applicable to commissioned agents or self-employed agents). This risk is particularly acute for sales personnel and senior executives who are empowered to make decisions that bind the foreign employer in Luxembourg.

3.2 Fixed-place PEs

A fixed place of business through which the enterprise carries on its activity, including offices, branches and long-term project sites, constitutes a PE under both domestic law and treaty provisions.

The growing prevalence of remote working that has occurred since the pandemic has heightened home-office PE risks. Employers should monitor the extent to which employees working from home in Luxembourg could create a fixed-place PE at the employer's disposal, particularly where the arrangement is long term and regular.

3.3 Service PE

Luxembourg's domestic law does not contain a specific service PE provision.

4. Exit tax/departure rules

Luxembourg does not impose a general exit tax on individuals that cease to be tax residents. However, the following rules are relevant upon departure.

Capital gains on substantial participations

Where a departing individual held a substantial participation (more than ten per cent) in a Luxembourg company and was resident for more than 15 years, capital gains on the disposal of that participation remain taxable in Luxembourg if the disposal occurs within five years of their departure. This provision is, however, subject to treaty protection.

Reporting requirements

Upon termination of Luxembourg residence, the departing taxpayer must submit an income tax return declaring the income received during the tax year up to the date of departure. This date corresponds to the date on which the individual notifies the relevant commune of their departure and completes the formal deregistration process, as evidenced by the certificate issued by the commune.

5. Recent developments and case law

Luxembourg has undertaken a series of legislative reforms aimed at reinforcing its attractiveness as a destination for international talent.

These include the modernised carried interest regime for the investment fund sector, a reshaped impatriate regime, replacing the former expatriate framework with a simplified and more competitive system, enhancements to the participative bonus regime and a new 75 per cent tax exemption for bonuses granted to young employees.

Luxembourg is also undertaking a reform to its personal income tax system, centred on the introduction of a single tax class, expected to apply from 1 January 2028, moving towards the application of full individualised taxation.

6. Key takeaways

- Employers should carefully monitor PE risks arising from employee mobility, in particular in the context of remote working arrangements and senior employees with contractual authority.
- Compliance with withholding tax and reporting obligations for employers is critical, especially in cross-border situations involving multiple jurisdictions.
- The Luxembourg framework offers significant opportunities to structure tax-efficient remuneration, notably through the impatriate regime, participative bonus regime and carried interest rules.
- Employees should pay close attention to their tax residence status and the allocation of taxing rights under applicable double tax treaties.
- Accurate tracking of an employee's workdays and physical presence in a location is essential to ensuring proper income allocation and the avoidance of double taxation.