

The French Luxembourg double tax treaty

The Luxembourg and French governments signed a new tax treaty (the **Treaty**) that amends the current treaty that was concluded on 1 April 1958 as amended from time to time. The Treaty reflects some of the points that were included in the 2017 version of the OECD Model Tax Convention. The Treaty is the result of the discussions carried out on the OECD



Please find below the most salient features of

the Treaty:
1. Residency – Article 4 of the Treaty – A resident of a Contracting State is any person that by virtue of the legislation of that State, is “liable to tax” in that State. The Treaty expressly entitles treaty benefits to French partnerships (*sociétés de personnes*) or French groups (*groupement de personnes*) or similar persons provided that (i) they have their place of effective management in France, (ii) they are subject to tax in France, and (iii) whose partners are fully taxable in France. The Treaty also excludes a trustee or a fiduciary who is not the beneficial owner of the income. Undertaking in collective investments (**UCI**) will benefit from the application of article 10 (*dividends*) and 11 (*interest*) of the Treaty provided that (i) this UCI can be assimilated as a UCI of the Other Contracting State and (ii) the beneficiaries of the UCI are residents of France or Luxembourg or of a State that has concluded a mutual assistance treaty on the fight against tax evasion and avoidance with the Source State.
2. Permanent Establishment – Article 5 of the Treaty – The definition of a permanent establishment (the **PE**) is in line with article 5 of the OECD Model. Profits of an enterprise located in a Contracting State are only taxable in that State except where the enterprise carries out its business in the other Contracting State through a PE situated in that State. A building site or construction site or installation project constitutes a PE if it lasts more than 12 months. In order to compute the twelve months period for an enterprise that carries out its business in the other Contracting State in a place that constitutes a building site, separate periods of 30 days which don’t exceed 12 months are considered and any related activities performed on the same building site during separate periods of more than 30 days each by one or several enterprises that are closely related are also added.

A PE is also constituted where a person in a Contracting State, habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are then routinely entered into without modification by the Company. These contracts are usually concluded (i) in the name of the enterprise, (ii) for the transfer of ownership or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or (iii) for the provision of services by that enterprise.
3. Dividends – Article 10 of the Treaty – The dividend article has the most significant impact and is amended as follows:

- Dividends paid by a company resident in a Contracting State (the **Subsidiary**) to a resident of another Contracting State (the **Parent**) are only taxable in the Parent State where the Parent, being the beneficial owner of the dividends of the paying Subsidiary, holds at least 5% of the share capital

of the Subsidiary for a period of 365 days including the day of payment of dividends (any change in the ownership of the shareholders resulting from a company restructuring such as a merger, demerger of either the parent or the paying subsidiary are disregarded).

- Dividends (originating from income or gains from immovable property) of an investment vehicle (the **Investment Vehicle**) situated in a Contracting State that (i) distributes most of its income annually and (ii) the income or capital gains derived from the immovable properties it holds are tax exempt, are taxable in the State of the Parent of the Investment Vehicle.
 - In that case, a 15% withholding tax applies under the Treaty in the state of the source on the gross amount of dividends paid where the beneficial owner is a resident that holds less than 10% of the Investment Vehicle.
 - The state of the source of the dividends is free to apply its withholding tax at the rate provided under its domestic tax law where the beneficial owner is a resident that holds more than 10% of the Investment Vehicle. France currently applies a 30% withholding tax that will be reduced to 25 % as from 1 January 2022. As a result of that rule, for example a French *SPPICAV* or *SIIC* owned by a fully taxable Luxembourg company will be subject to the 30% withholding tax and will not benefit from the exemption from taxes in Luxembourg on the basis of the Treaty nor from the domestic Luxembourg participation exemption, with potential credit for the French withholding tax. Under the old treaty, the French *SPPICAV* or *SIIC* controlled by a fully taxable Luxembourg company was subject to a 5% withholding tax and an exemption from taxes in Luxembourg on the basis of the old treaty.
- A 15 % withholding tax applies in all other cases.

4. Capital Gains – Article 13 of the Treaty –The capital gains article mainly follows the OECD Model.

- Capital gains derived from the sale of immovable property are taxable in the State where the immovable property is located.
- Capital gains derived from movable property allocated to a PE in the other Contracting State (including capital gains derived from the sale of the PE) are taxable in the State of the PE.
- Capital gains derived from the sale of shares or comparable interest in a real estate rich company – deriving directly or indirectly – at any time over the 365 days preceding the sale more than 50% of its value from immovable property situated in a Contracting State shall be taxable in the situs state.
- Capital gains derived by an individual resident in a Contracting State from the sale of a substantial participation in the share capital of a company resident in the Other Contracting state shall be taxable in the state where the company is located. In that regard, a participation is deemed to be substantial where the seller, acting alone or with affiliated persons, sells directly or indirectly the shares, units or other rights entitling to more than 25% of the profits of the company being sold. This provision applies to capital gains of a resident of a Contracting State who was a resident of the other Contracting State for at least five years prior to the sale.

5. Interest – Article 11 of the Treaty –Interest arising in a Contracting State and paid to a resident of another Contracting State are only taxable in the State of the recipient. No withholding tax applies to interest payment under the Treaty.

6. Royalties – Article 12 of the Treaty –Royalties arising in a Contracting State and paid to a resident of another Contracting State are taxable in the State of the recipient. A 5% withholding tax applies to royalties payments in the State of the source under the Treaty.

7. Wealth – Article 21 of the Treaty –Wealth constituted by immovable properties is taxable in the Situs State. Wealth connected to movable properties held by a PE in a Contracting State are taxable in the state of establishment of the PE. All other elements of wealth held are only taxable in the Residence State.

8. Elimination of Double Taxation – Article 23 of the Treaty –The Treaty switches from the exemption method to eliminate double taxation to the credit method for French residents. Under the method, the State of Residence can tax all sources of income but it will provide a tax credit for the tax burden already incurred in the State of source. For Luxembourg residents the exemption with progression method remains applicable.

9. Anti-Abuse – Article 28 of the Treaty –The Treaty introduces a principal purpose test. Treaty benefits will be denied if it is reasonable to conclude, having regard to all facts and circumstances, that obtaining the benefit was one of the principal purposes of any arrangement or transaction having resulted directly or indirectly in the grant of the benefit except where the grant of the benefit is in accordance with the object and purpose of the provisions of the Treaty. In addition, the Treaty does not prevent France from applying its domestic anti-abuse rules such as rules on Controlled Foreign Companies or interest limitations.

Concluding comments The Treaty reflects the willingness of the Luxembourg and French governments to comply with the latest developments at the OECD level and in the

European Union. The Treaty has a significant impact on the institutional real estate industry, since it closes a loophole related to French properties held by a French Investment Fund such as an SPPICAV or SIIC which is itself held by a fully taxable Luxembourg company. In that regard, the Treaty affects the competitiveness of Luxembourg and will require further analysis. The Treaty strengthens the power of the French tax authorities to challenge some Luxembourg structures and some provisions such as the principle purpose test remain to be tested. It will be of utmost importance for the Luxembourg companies to meet appropriate substance requirements. The Treaty provides some beneficial solution to multinational enterprises with the elimination of the withholding tax when the beneficiary is a legal entity that has held a minimum of 5% interest in the capital of the company paying the dividends over a period of 365 days. Please do not hesitate to contact us should you have any queries.

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