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Luxembourg Tax Alert

Double Tax Treaty Update

Luxembourg and Uruguay signed their first Income Tax Treaty on 10 March 2015. This Treaty will enter into force after the exchange of ratification instruments.

This treaty is a further significant landmark on the double tax treaty network Luxembourg offers and represents an outstanding opportunity to strengthen even more Luxembourg's position as a gateway for investments into Latin America.

Luxembourg and Uruguay sign an income tax treaty

In March 2015, Luxembourg and Uruguay signed their first Income Tax Treaty (the "Treaty").

We consider below what we believe to be the most relevant items of this treaty:

- Residence

In addition to adopting Article 4 of the OECD model, the Treaty opens the door to Investment Funds as entities which may rely on Treaty benefits provided these are considered as resident in Luxembourg or Uruguay according to the (respective) domestic law.

- Dividends, Interest and Royalties

- The Treaty foresees a top preferential rate of 5 percent on **dividend** payments between a Luxembourg and Uruguay company (and vice-versa) where the beneficial owner directly holds at least 10 percent of the capital of the payer company. In all other cases, dividends are taxable at a maximum rate of 15 percent;

- **Interest** payments made to residents of the other territory generally will be subject to a maximum 10% withholding tax which represents a decrease of 2% when compared to the highest Uruguay domestic interest rates (under Uruguay domestic regulations, withholding tax on interest paid to a nonresident is 3%, 5% or 12% depending on the period and currency of the loan, deposit or investment). Loans granted by banks to finance foreign investments or interest paid to a political subdivision, local authority, central bank, or public institutions are not subject to withholding tax at source.

- **Royalties** paid for the use or right to use industrial, commercial or scientific equipment may be taxed at a 5 percent rate; and at a 10 percent rate for all other cases.

- Capital gains

As a general rule, gains derived by a resident in Luxembourg or Uruguay from the sale of shares of a Company from the other contracting state deriving more than 50% of their value directly or indirectly from immovable property situated in the other territory, may be taxed in that other territory.

However, this provision does not apply to:

- gains derived from the sale of shares of a company listed in a recognized stock exchange; or
- gains derived from the sale of shares in the framework of a merger or spinoff; or
- gains derived from the sale of shares which main value is based on an asset (such as a mine or a hotel) where the business activity of the company is carried out.

Elimination of double taxation

Income received by a Luxembourg resident from a Uruguayan source will be tax exempt in Luxembourg. However, Luxembourg will apply the credit method to dividend income, interest income, royalty income, capital gains derived from the sale of shares in a land-rich company and income obtained by artists and sportsmen from a Uruguayan source.

Luxembourg source income, taxed in Luxembourg and received by a Uruguayan resident will, under specific circumstances, be exempt in Uruguay based on Uruguay domestic law (even though a credit method is foreseen in the Treaty).

Exchange of information

The agreement reflects the OECD standards related to the exchange of information, and the agreement's protocol details what kind of information should be included in the information request to demonstrate the relevance of the information to be requested (e.g. identity of the person, tax purpose, etc.).

Conclusion

Aside from key clarification points such as (i) the specific treatment of Investment Funds, (ii) clarifications on the application of Article 13, it is clear this Treaty makes Luxembourg well placed for enhanced relations with Latin America. This is indeed useful from an income tax perspective to assist in eliminating conflicting domestic legislations and double taxation on same income, but it is sure to also open the door for other types of relations to be established between both countries, notably to other trade markets such as the South American Common Market (MERCOSUR), aimed at promoting free trade and the fluid movement of goods, people, and currency amongst its Member States.

In term of process, the Treaty will be submitted to the Luxembourg parliament in the next months and should go through the Parliamentary approval process. The agreement will enter into force after the exchange of ratification instruments between both States.

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