Luxembourg
Tax Department

Luxembourg Tax Alert.

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The Tax department is a dedicated team of highly skilled tax professionals providing comprehensive consultancy and compliance services.

Our solid knowledge of local and international regulations, combined with our wide experience, allow us to serve our clients in a tailored, responsive and value-added manner.

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Luxembourg will connect soon the Croatian Riviera

The tax treaty with the Republic of Croatia on income and capital was signed on 20 June 2014. It is the first treaty for the avoidance of double taxation between these two countries.

The new tax treaty should boost economic and bilateral ties, stimulate the flow of capital, trade and technologies from Luxembourg to Croatia (and vice versa) and increase the competitiveness of both jurisdictions.

The main features of the tax treaty are as follows:

Residence

The protocol to the tax treaty provides that a collective investment vehicle will be considered a resident for treaty purposes and the beneficial owner of the income it receives if it is treated as a body corporate for tax purposes in its territory of residence. Where the collective investment vehicle is not treated as body corporate for tax purposes, it will be nevertheless considered as an individual resident in the country in which it is established and as the beneficial owner of the income it receives.

Such provision should be beneficial for the Luxembourg investment fund industry, in particular, for FCP/SICAVs/SICAFs that would be allowed to benefit from the tax treaty.

Permanent establishment

The permanent establishment articles follows the OECD Model and the protocol to the tax treaty specifies that a dredging project will be also considered as a permanent establishment if it last more than 12 months.

Dividend, interest and royalties

From a practical perspective, there should be few circumstances under which Article 10 (which provides for 15% or potentially for 5% withholding tax) will be relied on taking into account the Croatian (12%) and Luxembourg (15%) domestic withholding tax rate on dividends. Indeed, to the extent the dividend withholding tax rate is set at 0% based on the parent subsidiary directive (under specific conditions), one should not see frequent requests of application of the Article 10 (2) a) of the DTT which may provide for 5% withholding tax rate on dividend distributions paid to a corporation.

The Interest provision (Article 11) is however really interesting for the Luxembourg fund industry and especially debt funds. Indeed, even if payments made to residents of the other territory generally will be subject to a 10% withholding tax, an exemption from withholding tax will apply in certain cases described by the tax treaty, such as interest paid to financial institutions or to collective investment vehicles such as FCP/SICAVs/SICAFs. The provision will not affect the treatment of interest payments made by a Luxembourg resident, since Luxembourg generally does not levy withholding tax on interest paid to a non-resident under its domestic law. Moreover, the EU interest and royalties directive also provides exemption for interest payment between both countries.

For royalties, a 5% withholding tax rate will apply to payments to a resident of the other territory under the tax treaty. The definition of royalties follows the OECD model, and includes payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematographic films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience. The provision will not change the effect of Luxembourg domestic law, since Luxembourg does not levy withholding tax on royalties paid to a non-resident. Moreover, the EU interest and royalties directive also provides exemption for royalty payment between both countries.

Capital gains

Capital gains derived from real estate-rich companies remain taxable in the jurisdiction where the immovable property is located. However, this rule does not apply to gains derived from the alienation of shares of companies listed on an approved stock exchange of one of the States, to gains derived from the alienation of shares in the course of a corporate reorganisation or where the immovable property from which the shares derive their value is immovable property (such as a mine or a hotel) in which a business is carried on.

Exchange of information

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

Entry into force

Once the agreement ratified by both countries, it will enter into force, and it will become effective in the year following the exchange of ratification instruments between the two countries.

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