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Tax Department

Luxembourg Tax Alert.

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Luxembourg approves the tax agreement with Taiwan

The Luxembourg Chamber of Representatives approved the 2011 income and capital tax agreement with Taiwan on 9 June 2014. This is the first agreement for the avoidance of double taxation between the two jurisdictions. Luxembourg currently has 69 treaties in force and 24 agreements in process (awaiting approval of the Luxembourg parliament or the foreign country, or under negotiation).

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

The main features of the tax agreement are as follows:

Residence

The protocol to the tax agreement 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. This provision should be beneficial for the Luxembourg investment fund industry, in particular, for SICAVs/SICAFs that would be allowed to benefit from the tax agreement.

Permanent establishment

The permanent establishment article includes features from the OECD and United Nations models.

Deviations from the OECD model mainly relate to the time condition for creating a permanent establishment. The agreement expressly provides that a building site, construction or a dredging project will constitute a permanent establishment if such site, project or activities lasts for more than six months.

The furnishing of services, including consultancy services, will create a permanent establishment if such activities continue (for the same or a

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connected project) in the other territory for a period or periods aggregating more than six months within any 12-month period.

Shipping and air transport

Under the tax agreement, profits of an enterprise of one of the territories from the operation of ships or aircraft in international traffic will be taxable only in the territory in which the enterprise is resident, and there is a more precise definition of “profits from the operation of ships or aircraft in international traffic” than in the OECD model.

Dividend, interest and royalties

- The dividends provision will grant lower withholding tax rates than the general rates under Taiwanese and Luxembourg domestic law. Dividends paid by Taiwanese corporations to foreign investors are subject to a 20% withholding tax under Taiwan’s domestic law. The rate on dividends paid to foreign investors generally is 15% under Luxembourg’s domestic law, although the rate may be reduced to 0% for a company located in a treaty country partner under certain conditions similar to those in the Luxembourg participation exemption regime. The tax agreement generally provides for a maximum withholding tax rate of 10% on dividend distributions paid to a resident of the other territory (including individuals and corporations). With respect to investment funds, the agreement provides for a 15% withholding tax rate if the beneficial owner is an investment fund with a corporate form (e.g. SICAF/SICAV).

- Interest payments made to residents of the other territory generally will be subject to a 10% withholding tax. However, an exemption from withholding tax will apply in certain cases described by the tax agreement, such as interest paid on loans made between banks or interest paid to a political subdivision, local authority, central bank, etc. The interest provision also includes a specific 15% rate that will apply in cases where the beneficial owner is a collective investment vehicle treated as a body corporate for tax purposes in its jurisdiction of residence. 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.

- For royalties, a 10% withholding tax rate will apply to payments to a resident of the other territory under the tax agreement. The definition of royalties is broader than in the OECD model, and also includes cinematograph films and films for television. In contrast with Taiwanese domestic law, under which a 20% withholding tax rate generally applies at the time of the royalty payment, the royalties provision in the agreement should be very attractive for Luxembourg investors. 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.

Capital gains

The capital gain article reflects the OECD model. However, it does not contain any specific disposition rules for real-estate rich companies. As a rule, gain derived from the sale of shares will be taxed in the jurisdiction where the seller is resident.

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 the request (e.g. identity of the person, tax purpose, etc.).

Limitation on benefits

The agreement also includes a provision stating that treaty benefits will not be granted if it is established that the main purpose, or one of the main purposes, of a resident's conduct of operations was to obtain the benefits of the agreement. However, this general anti-abuse rule may not be applied without prior consultation between the competent authorities of both territories.

Entry into force

Once the agreement also is ratified by Taiwanese authorities, it will enter into force, and it will become effective in the year following the exchange of ratification instruments between the two jurisdictions.

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