

Luxembourg Tax Alert

New double taxation convention signed by Luxembourg and the United Kingdom

12 July 2022

On 7 June 2022, the governments of Luxembourg and the United Kingdom (UK) signed a new double taxation treaty ("new DTT"), available [here](#) in [English](#) and [French](#), which will replace the current agreement between both countries. The new DTT reflects the latest Organisation for Economic Co-operation and Development (OECD) standards and its wording is further aligned with the Multilateral Convention to Implement Tax Treaty Related Measures (the MLI).

As the new DTT and its Protocol will only enter into force when both countries have completed the required parliamentary procedures, it is not expected to take effect until at least 1 January 2023. Some of the taxes covered by the new DTT have later start dates, for example, 1 April 2023 for UK corporation tax on chargeable gains and 6 April 2023 for UK capital gains tax, if it is ratified by 31 December 2022.

Several of the new DTT's provisions could significantly affect regulated and unregulated real estate investment structures, such as the new provisions of the Residence, Dividends and Capital Gains articles.

This table is an overview of the main changes and consequences compared with the previous DDT:

		Before		After	
Residence	Luxembourg	Art. 4(1) through 4(3) if tiebreaker is needed	Standard residence clause with tiebreaker clause in favor of place of effective management.	Art. 4(1) through 4(4) Protocol	<p>Standard residence clause with tiebreaker clause based on the Mutual Agreement Procedure of Art. 24.</p> <p>Furthermore, under the Protocol, collective investment vehicles (CIVs) can be considered as Luxembourg resident and beneficial owners of the income arising from the UK, provided that:</p> <ul style="list-style-type: none"> a) They are part II undertakings for collective investment (UCIs), specialized investment funds (SIFs) and reserved alternative investment funds (RAIFs), and their interest is owned by at least 75% of equivalent beneficiaries (EB); or b) They are undertakings for collective investment in transferable securities (UCITS) within the meaning of EU Directive 2009/65. <p>The list of concerned CIVs could be increased in the future pursuant to agreements between HM Revenue and Customs (HMRC) and the Luxembourgish tax authority (LTA).</p>
Dividends paid by a	UK	Art. 10 §1-2	Taxable:	Art. 10 §1-2(a)	No WHT if the beneficial owner of the dividends is a Luxembourg resident.

UK resident company (non-REIT)			<ul style="list-style-type: none"> 5% if the beneficial owner controls at least 25% of the paying company; and 15% withholding tax (WHT) for all other cases. <p>No WHT under UK domestic tax rules.</p>	and Art. 22(4)(b) and (c)	
	Luxembourg		Tax credit under DTT and exempt in Luxembourg under the participation exemption (subject to a comparability analysis).		Tax credit under DTT and exempt in Luxembourg under the participation exemption (subject to a comparability analysis)
Dividends paid by a UK real estate investment trust (REIT)	UK	Art. 10 §1-2	<p>Taxable:</p> <ul style="list-style-type: none"> 5% if the beneficial owner controls at least 25% of the paying company; and 15% WHT for all other cases. 	Art. 10 §1-2(b)	<p>Taxable:</p> <ul style="list-style-type: none"> Subject to up to 15% WHT on distributions (DTT relief also available to a body corporate SIF/UCI part II/ RAIF, subject to EB conditions being met). No WHT applies if the beneficial owner is a recognized pension fund (entities listed in the Protocol include pension funds subject to supervision and regulation by the Commissariat aux Assurances).
	Luxembourg		Tax credit under DTT.		Tax credit under DTT.
Dividends paid by a LuxCo to a UK company ¹	UK	Art. 10 §1-2	Tax credit or exemption.	Art. 10 §1-2(a)	Tax credit or exemption.
	Luxembourg		<p>Taxable:</p> <ul style="list-style-type: none"> 5% if the beneficial owner controls at least 25% of the paying company; and 15% WHT for all other cases. <p>No WHT under the Luxembourg participation exemption subject to</p>		No WHT if the beneficial owner of the dividends is a UK resident.

¹ Not applicable to REITs, whose beneficial owner should be subject to a case-by-case study.

			a comparability analysis.		
Capital gains realized on income derived from immovable property located in UK	UK	Art. 13(1) and (3)	Taxable.	Art. 13(1), (2) and (6)	Taxable.
	Luxembourg		Gains derived directly from real estate (RE) are taxable in the UK. Gains derived from the sale of participations may only be taxed in Luxembourg.		Gains derived directly from RE are taxable in the UK. Article 13 (Capital Gains) now includes paragraph 13(2), which allows gains from the sale of shares in a property-rich company (or comparable interests, e.g., partnership or trust interests) to be taxed in the UK. “Property-rich” is defined as an entity deriving more than 50% of its value directly or indirectly from immovable property.
Interest paid by a UK resident company to a LuxCo	UK	Art. 11	No WHT.	Art. 11	No WHT.
	Luxembourg		Taxable only in Luxembourg if the beneficial owner is a Luxembourg resident.		Taxable only in Luxembourg if the beneficial owner is a Luxembourg resident.
Principal purpose test (PPT)		Art. 10 (3)(d), which was replaced by Art. 7(1) and (4) of the MLI	Access to the DTT is limited if it is possible to conclude that the main purpose of the arrangement/transaction is to obtain a tax benefit, unless it is established that granting this benefit in these circumstances would be in accordance with the DTT.	Art. 28	PPT provision is the same as in the previous version of the convention with MLI.

Below is a summary of the new DTT’s most significant changes—please note that this is not an exhaustive list.

Capital gains property-rich clause

Article 13 (Capital Gains) now includes Article 13(2), which allows gains from the sale of shares in a property-rich company (or comparable interests, e.g., partnership or trust interests) to be taxed in the jurisdiction where the immovable property is situated. “Property-rich” is defined as an entity deriving more than 50% of its value directly or indirectly from immovable property.

Dividend taxation (WHT)

Under Article 10 of the new DTT (Dividends), most residents that are beneficial owners of the income can claim a 0% WHT on dividends. In comparison, the current treaty provides for a 15% WHT on dividends in general, which is reduced to a 5% WHT limit if the recipient holds at least 25% voting power in the company paying the dividend. However, it is worth noting that for dividends paid by a Luxembourg company, the domestic participation exemption may reduce the WHT to 0% regardless.

Article 10.2.b) allows for dividends paid by REITs or similar entities to be subject to a WHT that does not exceed 15%, in line with most other UK DTTs, unless the REIT dividends' beneficial owner is a recognized pension fund, in which case the 0% rate applies.

This provision should also apply if Luxembourg introduces a REIT regime in the future. Also, Article 22 regarding the elimination of double taxation in respect of dividends (among other items) has been slightly reworded but not materially modified.

Company residence tiebreaker

The main change regarding residency provision is in the new DTT's Article 4.4, which includes a competent authority/mutual agreement dual-residency tiebreaker instead of the current "place of effective management" tiebreaker—this is in line with the 2017 OECD Model Tax Convention and the MLI.

Article 3 of the new DTT's Protocol sets out additional factors for competent authorities to consider. It also includes an exemption clause for dual residents whose status "was determined in accordance with paragraph 3 of Article 4 of the prior Convention [...] so long as all the material facts remain the same".

Treaty access for Luxembourg CIVs

Article 2 of the new DTT's Protocol includes new rules specifically for Luxembourg-incorporated CIVs (which are treated as a body corporate for tax purposes) that receive income arising in the UK. These rules—depending on the CIVs' ownership and to the extent a Luxembourg resident in the same situation would be considered as the beneficial owner—can allow the vehicles to be treated for DTT purposes as a Luxembourg-resident individual, as well as the beneficial owner of the income it receives.

Subject to these conditions, treaty access is granted to the following CIVs:

- Part II UCIs, SIFs and RAIFs, if at least 75% of the beneficial interests in the CIVs are owned by equivalent beneficiaries. According to the new DTT's Protocol, an equivalent beneficiary is a taxpayer resident of Luxembourg or any other jurisdiction with which the UK has arrangements that provide for effective information exchange, and who would be entitled to a rate of tax regarding that income item that is at least as low as the rate claimed under this DTT; or
- An UCITS within the meaning of EU Directive 2009/65.

The Protocol only references these Luxembourg vehicles and does not explicitly reference any UK entity types. It also states that the list of applicable CIVs could be increased based on negotiations between both countries' competent authorities.

Permanent establishment (PE) update:

The new DTT introduces specific activity exemptions in Article 4 (Permanent Establishment). For example, Articles 4.5 and 4.6 introduce base erosion and profit shifting (BEPS)-style anti-fragmentation rules. There are changes to Article 5.4.e), which relates to activities of a preparatory or auxiliary character. And, Article 4.4.f) has been added, which relates to a combination of activities with an overall preparatory or auxiliary character.

Article 4.3 has also been revised, replacing the previous treaty's reference to a "building site or construction or assembly project which exists for more than six months" with "a building site, a construction, installation or dredging project constitutes a permanent establishment only if it lasts more than twelve months".

Business profits

Article 7 of the new DTT (Business Profits) has been fully revised to further align it with the OECD Model Tax Convention article. In particular, the PE attribution rules concern broader transfer pricing principles, instead of the more prescriptive wording used previously.

Arbitration procedures

As expected, Article 24 (Mutual Agreement Procedure) still includes a mandatory binding arbitration provision, established in Article 24.5. This single paragraph is much shorter than the current synthesized treaty text, which was based on Part VI of the

BEPS MLI. The new article requires that competent authorities settle the mode of application of the arbitration paragraph by mutual agreement.

New assistance in the collection of taxes provision

The new DTT incorporates Article 26 regarding the Assistance in the Collection of Taxes, aligned with more recent versions of the OECD Model Tax Convention and not included in the current DTT. The article generally follows the OECD's article of the same name, apart from the addition of Article 26.8.e), which clarifies that a contracting state is not obliged to provide assistance if it considers these taxes are imposed contrary to generally accepted taxation principles.

Entitlement to benefits

The new DTT includes Article 28 (Entitlement to Benefits), which introduces a PPT for accessing treaty benefits. While the PPT is already in force under the MLI, this provision has been expressly included in the new DTT.

In accordance with Article 29 of the 2017 OECD Model Tax Convention, this provision seeks to stop DTT misuse or practices like treaty shopping. It limits access to the new DTT's benefits if it is possible to conclude that the main purpose of the arrangement/transaction is to obtain a tax benefit, unless granting this benefit in these circumstances would be in accordance with the DTT.

Entry into force

As mentioned above, the new DTT and its Protocol will only enter into force when both, the UK and Luxembourg governments, have completed the required parliamentary procedures. If this process is completed in 2022, the following dates will apply:

- UK:
 - 1 January 2023: WHT
 - 6 April 2023: Income tax and capital gains tax
 - 1 April 2023: Corporation tax

- Luxembourg: 1 January 2023 for all taxes covered.

If you have any questions or want to discuss these changes, please get in touch with your Deloitte professional or one of our team members:

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