

Luxembourg – India double tax treaty voted on by Luxembourg Parliament

dated 6 May 2009

After several years of negotiation, the Luxembourg Government signed a Double Tax Treaty (DTT) with India on 2 June 2008. The DTT was voted on by Luxembourg Parliament on 6 May 2009¹ and should enter into force once the notification process is completed in both States. Then, the DTT's provisions will be effective as from (i) tax years beginning on or after 1 April of the year following the entry into force of the DTT with respect to Indian taxes and (ii) tax years beginning on or after 1 January of the year following the entry into force of the DTT with respect to Luxembourg taxes.

The DTT's provisions are based on the OECD Model, with some exceptions. In line with the Indian tax authorities' usual DTT policy, some of the provisions of this DTT give an extensive right to tax to the source country (as opposed to what is generally provided for under DTTs which follow the OECD Model to the letter). For example, dividends, interest and royalties are subject to a 10 percent tax in the source country.

The main provisions of the DTT are briefly outlined below.

Dividends

For cross-border dividends (i.e. dividends arising in one Contracting State and paid to a beneficial owner resident of the other Contracting State), taxation by the source country may not exceed 10% of the gross dividend amount. This rule applies irrespective of the level of shareholding in the distributing company.

Interest

By the same token, cross-border interest payments may be subject to a 10 percent tax at source, on the gross amount of interest paid. However, this taxation at source does not apply to certain limited cases listed in the DTT (e.g. payments to one of the Contracting States).

Royalties or fees for technical services

For royalties paid by a resident of a Contracting State to a beneficial owner resident of the other Contracting State, the source country may also apply a 10% tax on the gross royalty amount.

In line with the old OECD Model convention of 1977 (and at the request of the Indian tax authorities), fees paid for technical services (e.g. managerial, technical or consultancy services) follow the same tax treatment as royalties and may thus be subject to a 10 percent tax at source.

¹ subject to confirmation by the Council of State that no second hearing is required

Capital gains

As a general rule, capital gains shall be taxed only by the Contracting State where the alienator is resident. However, there are a number of exceptions to this rule and capital gains may be taxed in the other Contracting State in the following cases:

- Immovable property: taxation in the Contracting State where the property is located;
- Movable property allocated to a permanent establishment: taxation in the Contracting State where the permanent establishment is located;
- Gains from the alienation of shares in a “real estate” company (i.e. a company whose main assets consist, directly or indirectly, of immovable property located in one Contracting State): taxation in the state where the real estate assets are located; or
- Gains from the alienation of shares in a company (other than a “real estate” company): taxation in the Contracting State where the company whose shares are alienated is located. This provision, inserted at the Indian tax authorities’ request, deviates from the OECD Model.
- Gains from the alienation of any other property not listed above shall be taxable only in the Contracting State where the alienator is resident.

Permanent Establishment

The DTT’s definition of permanent establishment is broader than the OECD model convention’s and it includes the following:

- The furnishing of services, including consultancy services, if they are performed in the other Contracting State by a person hired by a company for a total period or periods of more than 183 days within any twelve-month period;
- Construction or installation projects if they last for a period of at least 9 months;
- Activities performed by insurance companies in the other contracting state, if certain requirements are met.

Exchange of information

The DTT contains a provision relating to the exchange of information between both Contracting States. The protocol contains a “most favoured” clause which shall grant India the same rights with respect to exchange of information as Luxembourg may grant to other EU Member States in the future. Based on the parliamentary comments, this clause of the DTT would therefore not need to be amended in order to comply with OECD exchange of information guidelines, as agreed by the Luxembourg tax authorities in March 2009 (when banking secrecy was being discussed at international level).

Limitation of benefits

At India's request, the DTT contains a limitation of benefits clause, according to which each Contracting State remains entitled to apply its domestic anti-abuse legislation. The clause also provides that the DTT's provisions will not apply to companies which were set up mainly in order to benefit from advantages based on the DTT (e.g. entities which do not have bona fide operations), which would otherwise not have been available.

Whilst the purpose of this clause seems in itself justified, one may regret that the clause is drafted in broad terms, which do not necessarily enable taxpayers to assess in which cases they would or would not fall within the scope of this clause.

The DTT, as briefly outlined above, should therefore create a favourable and competitive environment for Luxembourg companies investing in India and should enable both countries to develop their economic and financial relationships.

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