

Luxembourg – Hong Kong double tax treaty: ratification process in progress in Luxembourg

dated 10 December 2008

The Luxembourg government launched the ratification process of the Double Tax Treaty (DTT) signed with Hong Kong on 2 November 2007, by submitting the bill to the approval of the Luxembourg Parliament on 4 April 2008. The Luxembourg Parliament just passed the bill into law on 10 December 2008¹.

The tax treaty will enter into force once the ratification process is completed by both parties. Then, the treaty's provisions will be effective as follows:

- 1 January 2008 with respect to Luxembourg withholding taxes, and with respect to corporate taxes and net wealth tax, tax years starting on or after 1 January 2008;
- Year of assessment beginning on or after 1 April 2008 with respect to Hong Kong taxes.

This is the fourth comprehensive DTT entered into by Hong Kong.

Dividends (article 10 of the DTT)

Cross-border dividends payments (i.e. dividends arising in one Contracting Party and paid to a resident of the other Contracting Party) may be subject to a 0% withholding tax under certain conditions which are described below.

For cross-border dividends paid to a beneficial owner resident in the territory of the other Contracting Party, the taxation by the source Party may not exceed:

- 0% if the beneficial owner is a company (other than a partnership) that directly holds at least 10% of the capital of the company paying the dividends, or a participation with an acquisition cost of at least €1.2 million; or
- 10% of the gross amount of the dividends in all other cases.

The conditions to benefit from the 0% withholding tax under the tax treaty are broadly similar to the requirements set forth by the Luxembourg domestic law (i.e. so called Luxembourg participation exemption regime), save for the holding period requirement (i.e. 12 months under Luxembourg domestic law) which has not been introduced here.

Interest (article 11 of the DTT)

Cross-border interest payments should be taxable only in the Contracting Party where the beneficial owner is a resident.

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

Royalties (article 12 of the DTT)

Cross-border royalty payments may be taxed in the Contracting Party where the recipient is a resident. Such royalties may also be taxed in the source Party. However, the taxation shall not exceed 3% of the gross amount of the royalties paid to a beneficial owner resident of the other Contracting Party.

It should be noted that under Luxembourg domestic tax law, there is generally no withholding tax on royalty payments (except for limited exceptions).

Capital gains (article 13 of the DTT)

As a general rule, capital gains shall be taxed only by the Contracting Party where the alienator is a resident. Some exceptions, however, allow the taxation of the capital gains in the other Contracting Party (where the asset is located), for:

- immovable property situated in this other Contracting Party;
- movable property allocated to a permanent establishment in this other Contracting Party; or
- shares of a “real estate” company, i.e. a company deriving more than 50% of its assets value from immovable property situated in the other Contracting Party. Exceptions are provided for quoted shares, for disposals made within the framework of reorganisation, or for companies using the immovable property to carry on their business activities.

Business profits / Permanent Establishment (articles 5 and 7 of the DTT)

Profits of a company located in one Contracting Party shall be taxable only in that Contracting Party, except when the company carries out business activities in the other Contracting Party through a permanent establishment situated therein. The definition of a permanent establishment under the DTT is broader than the OECD model definition (e.g., it notably also includes the furnishing of services, including consultancy services, if they are performed in the other Contracting Party for a total period or periods of more than 180 days within any twelve months period).

The DTT, briefly outlined above, should therefore create a favourable tax framework for structuring investments between Luxembourg and Hong Kong.

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