Deloitte.

Luxembourg Tax Alert

Impact of revised tax treaty signed by France and Luxembourg on real estate investment structures

18 April 2018

Quick overview of changes

		Before		After	
Dividends paid by a French resident company (non-OPCI/SIIC)	France	Art. 8	5/15% WHT	Art.10 §1-2	0/15% WHT
	Luxembourg		Exemption under DTT and Luxembourg participation exemption		Tax credit system under DTT / Tax exempt under Luxembourg participation exemption
Dividends paid by a French OPCI/SIIC	France	Art. 8	5%/15% WHT	Art. 10 §6	• In case of a shareholding <10%, 15% WHT • In case of a shareholding ≥ 10%, domestic rate of 30% for FY 2018
	Luxembourg		Exemption under DTT		Tax credit system under DTT
Capital gains realized on income derived from immovable property	France	Art. 6	Taxation	Art. 13	Taxation
	Luxembourg		No right to tax		No right to tax

Deloitte

located in France					
Liquidation proceeds received by a Luxembourg company	France	Art. 18	No WHT	Art. 20	Now assimilated to deemed dividends - no WHT provided the beneficiary has been holding at least 5% of the shares of the liquidated entity for at least 365 days[1].
	Luxembourg		Taxable, but domestic exemption applicable under Luxembourg participation exemption		Taxable, but domestic exemption applicable under Luxembourg participation exemption
Interest paid by French resident company[2]	France	Art. 9	10%	Art. 11	No WH
	Luxembourg		Taxable		Taxable

1 Not applicable to real estate investment vehicles (OPCI/SIIC) for which specific provisions are provided by Art. 10 §6.

2 Based on domestic French rules, interest payments are exempt from WHT provided they are paid on a bank account opened in a cooperative state (which includes EU countries, e.g. Luxembourg)

On 20 March 2018, the governments of Luxembourg and France signed a new double tax treaty and its additional protocol (hereinafter together referred to as “the new DTT”) to replace the current agreement between the two countries. The new DTT aims to include provisions that reflect the latest OECD standards and its wording gets closer to the wording of the Multilateral Convention to Implement Tax Treaty Related Measures (the MLI).

Several provisions of the new DTT will significantly affect regulated and unregulated real estate investment structures. The most significant provisions of the new DTT for the real estate industry consist in the reviewed tax treatment of the dividends paid by French real estate investment funds to investors based in Luxembourg. Outstanding practical questions remain, in particular relating to the benefit of the provisions of the new DTT on dividends and interest for Luxembourg investment funds.

Deloitte

Tax payers undertaking Luxembourg-France transactions may assess their tax position in view of the entry into force of the new DTT, which may become applicable at the earliest on 1 January 2019 (depending on the time required for its ratification by both countries), otherwise on 1 January 2020.

An overview of the main provisions of the new treaty affecting the real estate industry is provided below.

Tax residency and access to treaty

In line with the OECD model, the new DTT defines the resident as a person subject to tax in its country of residence (article 4).

Also in line with the OECD model, article 1.2 states that the income received by a tax transparent entity is considered as an income of a resident of a contracting state but only if this income is considered as an income of a resident by the state of residence, for tax purposes. As per the OECD commentaries, this provision aims to ensure that the benefits of the convention are not granted in a situation where both contracting states do not consider this income as the income of a resident.

The question of the tax residency of the French SCIs is clarified. Under article 4.4, French SCIs, which are considered as subject to tax in France but where only investors are legally liable to taxes, are clearly considered French tax residents, and therefore have access to the DTT.

The formalism required to benefit from the articles covering dividend, interest, and royalties (article 10, 11, and 12) in case the person concerned would benefit from the new DTT as resident of a contracting state is set out in the article 29. This article mentions that "in particular," the benefit of the advantages granted by those articles is conditioned by the presentation of a certificate of residency granted by the tax authority of the state of residency indicating the nature and the amount or the value of the income concerned.

The benefit of the provisions in connection with dividends and interest for the investment funds is caught under a dedicated provision of the additional protocol, granting them access to some provisions of the treaty without dealing with the residency question, as detailed hereinafter.

Withholding tax on dividends paid by a French resident company (non-OPCI)

The provision on dividend income of the new DTT has been fully reshaped.

As expected, the general provision allocating the taxing right to the country of residence of the recipient of the dividend income has been maintained.

However, in line with the OECD standards, a full exemption from any withholding tax in the source contracting state is now provided to the extent that the beneficial owner is a legal entity resident of the other contracting state that holds at least five percent of the share capital of the

paying legal entity during 365 days (including the day of the payment of the dividends).

In this case, a Luxembourg resident company receiving dividends from a French company (other than French OPCIs) would be fully taxable in Luxembourg but may seek the benefit of a domestic exemption such as the Luxembourg participation exemption (under conditions).

The source contracting state, however, has the possibility to tax the dividends up to 15 percent maximum of its gross amount where these conditions are not met.

Withholding tax on dividends paid by a French OPCI

The main amendment concerning the real estate industry affects payments of dividends by French "Organismes de Placement Collectif Immobilier" (OPCI) and French "Sociétés d'Investissement Immobilier Cotée" (SIIC) (French REIT).

If article 10 does not expressly mention the French OPCI and the SIIC, it clearly targets them. Indeed, a specific provision states that the dividends paid from income and gains in relation to real estate assets by an investment vehicle established in a contracting state (i) that annually distributes most of its income, and (ii) which income and gains derived from real estate assets are exempt from tax, to a resident of the other contracting state, are taxable in this last contracting state. Therefore, dividends received by a Luxembourg tax resident company will be fully subject to tax in Luxembourg. Any WHT should however be creditable in Luxembourg based on the elimination of double taxation provisions of the new DTT (please see section From a tax exemption system to a tax credit system).

In addition, the source state may also tax the gross amount of the dividends paid up to a maximum of 15 percent if the beneficial owner is a resident of the other contracting state and directly or indirectly holds a shareholding representing less than 10 percent of the share capital of this investment vehicle.

In case the beneficial owner is a resident of the other contracting state and directly or indirectly holds a shareholding representing 10 percent or more of the share capital of this investment vehicle, the domestic tax rate of the source country applies. This means in the case of a French OPCI/SIIC held by a Luxembourg resident for more than 10 percent that dividends should be taxed at a current domestic rate of 30 percent in France.

It has to be noted that this domestic rate of withholding tax on dividends paid out of France is reduced under French domestic law to 15 percent where the dividend is paid by a French investment vehicle, including OPCIs, to certain types of Luxembourg qualifying investment funds such as (but not limited to) AIFs.

Deloitte

From a tax exemption system to a tax credit system

For dividend income, the new DTT changes the way double taxation is eliminated, by moving from an exemption method to a tax credit method.

With the new DTT provisions, withholding taxes levied in France on dividend payments should give right to a tax credit in Luxembourg. It has to be noted that the tax credit which may be requested by a Luxembourg resident company should only be creditable against the Luxembourg corporate income tax, up to the amount of the tax due on the related foreign income.

The impact of this change should affect dividends distributed by French resident OPCIs to Luxembourg entities but should be limited for dividends distributions by French Companies other than OPCI to Luxembourg entities given the availability of the domestic Luxembourg participation exemption regime under certain conditions.

Dividend and interest income received by Luxembourg UCIs

The paragraph 2 of the Protocol foresees a differentiated access to the new DTT for the collective investment fund. A collective investment fund of one of the contracting states assimilated to funds of the other contracting state will be able to benefit from the dividends and interest articles of the new treaty with respect to the income corresponding to the rights held by residents of one of the contracting states or by residents of a third country that has concluded an administrative assistance agreement with the country in which the income is derived.

The paragraph 2 of the Protocol provides for a “look through” approach for UCIs residing in a contracting state and receiving dividends and interest from the other contracting state. UCIs having qualifying investors (i.e., meaning resident in a country with which the source country has signed an agreement on mutual administrative assistance against tax evasion) should benefit from the article 10 (dividends) and 11 (interest) for the part of the income corresponding to the rights held by the qualifying investors.

Guidance and clarifications will need to be released by both countries to clarify the practical conditions to benefit from this provision of the DTT, including, for example, how to determine the condition of assimilation to investment fund of the other country.

Impact on capital gains relating to land rich companies

As expected, French and Luxembourg authorities overhauled the capital gains provisions applicable to real estate investments to include the 2014 amendment of the current DTT as well as the OECD standards.

Therefore, gains realized on an immovable property or on a “land rich” company should be taxed in the country where the real estate assets are located.

A company should be considered as a “land rich” entity if at any time over the 365 days preceding the disposal of its shares or units, more than 50% of the value of its shares or units derives directly or indirectly from real estate assets.

This definition is in line with the OECD standards may become a standard in the double tax treaties which will most probably be negotiated by France in the future but remains an exception in the Grand-Duchy tax treaty network. Interestingly however the definition differs from French domestic rules so that in practice, cases could arise where due to the timing of certain disposals a company qualifies as a French real estate company under the DTT but not under French domestic rules. In any case, the right to tax can only be attributed to France if the conditions required by the DTT are met.

Entry into force

The provisions of the currently existing treaty would no longer apply when the new treaty enters into effect. The new treaty and protocol would enter into force once the two countries mutually exchange their respective ratification instruments (following their respective ratification procedures).

In light of the clause regulating the entry into force, the treaty provisions would enter into effect as from 1st January of the calendar year following its entry into force. In practice, the provisions of the treaty would become applicable at the earliest on 1st January 2019 and otherwise, probably on 1st January 2020.

It also has to be noted that some of the provisions chosen by France and/or Luxembourg under the MLI, such as the mandatory arbitration for example, have not been introduced into this treaty. Therefore, it can be expected that the two countries would opt for the application of the MLI to this convention, therefore introducing these MLI provisions into the content of the new DTT.

Contacts

Deloitte Luxembourg

Francisco Da Cunha
Partner | Real Estate Tax Leader
T +352 45145 2337
fdacunha@deloitte.lu

Yves Knel
Partner | Mergers & Acquisitions - Real Estate
T +352 45145 2260
yknel@deloitte.lu

Christophe Masset
Partner | Cross Border Tax
T +352 45145 4431
cmasset@deloitte.lu

Benjamin Toussaint
Partner | Cross Border Tax - Mergers & Acquisitions
T +352 45145 2890
btoussaint@deloitte.lu

TAJ France

Sarvi Keyhani
Partner | Real Estate - International Tax - Corporate Tax
T +33 1 40 88 70 23
skeyhani@taj.fr

Soufiane Jemmar
Director | Global Business Tax | Real Estat
T +33 1 55 61 68 65
sjemmar@taj.fr

Deloitte is a multidisciplinary service organisation which is subject to certain regulatory and professional restrictions on the types of services we can provide to our clients, particularly where an audit relationship exists, as independence issues and other conflicts of interest may arise. Any services we commit to deliver to you will comply fully with applicable restrictions.

Due to the constant changes and amendments to Luxembourg legislation, Deloitte cannot assume any liability for the content of this leaflet. It shall only serve as general information and shall not replace the need to consult your Deloitte advisor.

About Deloitte Touche Tohmatsu Limited:

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/lu/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and deep local expertise to help clients succeed wherever they operate. Deloitte has in the region of 200,000 professionals, all committed to becoming the standard of excellence.

© 2018 Deloitte General Services

Designed and produced by MarCom at Deloitte Luxembourg