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New double tax treaty signed between Luxembourg and the United Kingdom

On June 7th, 2022, the Luxembourg and the United Kingdom decided to replace the current double tax treaty ("DTT") by a new DTT taking into account all the latest OECD standards.

The current DTT was initially signed in 1967 and both Luxembourg and the United Kingdom decided to sign a new version from scratch rather than having additional protocols. **Most of the changes are aligned with the OECD standards, notably regarding real estate investments, with some interesting additional elements for investment vehicles.**

Based on the new DTT, the main changes are the following:

- *Dividends:*
    - **Full withholding tax** ("**WHT**") **exemption** on dividends distributed to the extent that the **recipient is the beneficial owner** of the income (also for recognized pension funds);
    - **Dividends distributed by investment vehicles** and deriving directly or indirectly from immovable properties does not benefit from the WHT exemption, but the **WHT should not exceed 15%.**

- *Interests and royalties:*
  - **No changes** compared to the current DTT as no WHT should apply on interests as long as it is received by the beneficial owner;
  - **No WHT** on royalties.

- *Capital gains:* **introduction of the real estate rich company clause** where capital gains realized upon disposal of companies held in a Contracting State which derives more than 50% of its value from real estate assets in the other Contracting State should be taxed in that other State. This is one of the most significant change in the DTT.

- *Tax residency:*
  - **In case of dual resident companies**, the determination will **not only be based on the place of effective management** but on a mutual agreement from both countries;
  - The mutual agreement will rely on **various criteria which notably include general substance requirements**, i.e., location of the senior management of the companies, the place where the board of directors are held, the location of headquarters, and the economic nature of the companies in each country;
  - The provision will be **applied on a case-by-case basis** by the tax authorities.

- *Collective investment vehicles ("**CIVs**"):*
  - Under the new DTT, CIVs established and treated as body corporates for tax purposes in Luxembourg could **benefit from the provision of this DTT to the extent that they are owned by "equivalent beneficiaries"**;
  - However, if (i) **at least 75%** of the beneficial interests in the CIVs **are owned by equivalent beneficiaries**, or if (ii) the CIVs are **undertakings for collective investment in transferable securities ("UCITS"),** the CIVs should be treated as residents of Luxembourg;
  - **"Equivalent beneficiary"** means a resident of Luxembourg and, a resident of any other jurisdiction with which the United Kingdom has arrangements that provide for effective and comprehensive information exchanges;
  - **CIVs** mean (i) UCITS subject to Part I or Part II of the law of December 17th, 2010, (ii) specialized investment funds ("**SIF**") and (iii) reserved alternative investment funds (if subject to the SIF tax regime).

The above-mentioned elements are not the only provisions being modified in the new DTT but correspond to the most significant ones. As previously mentioned, most of the provisions are aligned on the OECD Model Convention, notably regarding the real estate investments. However, some provisions were also negotiated and designed to accommodate with the United Kingdom and Luxembourg market (e.g., inclusion of recognized pension funds and benefit from the DTT for Luxembourg CIVs).

Even if there are quite significant positive changes for Luxembourg companies (i.e., CIVs), the new DTT and its related application should be carefully reviewed and analyzed on a case-by-case basis by the various group/funds to anticipate any tax impacts following the change of DTT and related provisions.

One of the key provision that will notably have to be monitored relates to dual resident companies as it is currently unsure how the tax authorities will review the various criteria and related tax residency notably in the light of the latest international tax developments.

Our Mazarian tax team is at your disposal should you have any questions relating thereto or should you need assistance to assess impacts on your business.

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