

The new tax treaty between Luxembourg and India is largely based on the OECD model, with some notable deviations. The main features of the treaty are discussed below.

Background

On June 2, 2008, Ambassador Marc Court and R.S. Mathoda, president of the Indian Central Board of Direct Taxes, signed the agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital between the Grand Duchy of Luxembourg and the Indian Republic.

The Luxembourg parliament (*Chambre des Députés*) ratified the agreement in May 2009. The agreement entered into force on January 1 for Luxembourg. For India, it will enter in force on April 1.

Permanent Establishment

The definition of a permanent establishment provided in the agreement is more precise and wider in scope than the definition in the OECD model.

A building site or construction or installation project constitutes a PE only if it lasts for more than 9 months, while the OECD model dictates 12 months. The provision of services, including the services of consultants, may be considered as a PE if those services are provided for more than 183 days in a 12-month period.

An insurance company resident in a contracting state constitutes a PE in the other contracting state if it levies premiums or covers risks on the territory of the other contracting state through a person, other than an independent agent, as a broker or general commission agent.

Dividends and Interest

The rate of withholding tax on dividends paid by a company that is a resident of a contracting state to a resident of the other contracting state may not exceed 10 percent of the gross amount of the dividends, regardless of the level of shareholding in the company that distributes the dividends. Exemption from Luxembourg withholding tax on dividends paid to treaty country corporate shareholders may, however, apply based on domestic law.

Similarly, withholding tax on interest may not exceed 10 percent of the gross amount of the interest. The withholding tax will not apply on interest paid to a government, a political subdivision, a local authority, or specific national banks named in the agreement. Luxembourg does not withhold on interest except for specific situations.

According to article 8.4 of the agreement, interest in connection with investments directly linked to the operation of ships or aircrafts in international traffic is considered as profit and does not fall within the scope of article 11. The profit is taxable only in the state in which the operator is resident.

Royalties and Technical Services

Unlike as provided in the OECD model, royalties and fees for technical services arising in a contracting state and beneficially owned by a resident of the other contracting state will be subject to a 10 percent withholding tax in the first state. Luxembourg does not levy withholding tax on royalties.

Capital Gains

Where the general rule is that capital gains are subject to tax in the seller's state of residence, the agreement provides the following exceptions:

- gains derived by a resident of a contracting state from the alienation of immovable property and located in the other contracting state may be taxed in that other state;
- gains from the alienation of movable property forming part of the business property of a PE that an enterprise of a contracting state has in the other contracting state may be taxed in that other state; and

- gains derived by a resident of a contracting state from the alienation of shares deriving directly or indirectly from immovable property in the other contracting state may be taxed in that other state.

Contrary to the OECD model, gains derived from the alienation of shares in a company (other than a real estate company) that is resident of a contracting state may be taxed in the other contracting state.

Based on Luxembourg law, however, capital gains on the disposal of shares held in a Luxembourg resident company by a nonresident taxpayer will not generate taxation in Luxembourg if the shares were held for at least six months and the shares represented 10 percent or less of the company's capital during the previous five years.

Double Taxation

Indian law provides for the credit method of eliminating double taxation on foreign-source income. Luxembourg provides for the exemption-with-progression method to avoid double taxation for most types of income, and the credit method for dividends, royalties, and income earned by artists and athletes. The resulting tax credits may be offset only against the corporate income tax and not against the municipal business tax.

Exchange of Information

Exchange of information between both contracting states is provided by the agreement. An addendum to article 27 grants the same rights to India regarding the exchange of information as those rights Luxembourg grants or will grant to other European members states.

Limitations of Benefits

This article provides that companies that were set up solely to take advantage of the agreement shall be excluded from the benefit of the agreement. Each contracting state remains entitled to apply its domestic antiabuse legislation. The lack of clarity of the scope and the practical implications of this article will introduce considerable uncertainty for

taxpayers, but if sufficient attention is paid to the issue, a reasonable level of certain can be achieved.

Entities Excluded

The agreement does not apply to Luxembourg 1929 holding companies and companies subject to a similar tax regime. Although Luxembourg SICAV funds (*société d'investissement à capital variable*) are not explicitly excluded from the benefit of the agreement, further clarification is needed to determine whether special investment entities may benefit from the agreement.



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He heads the tax department advising a worldwide clients database on both corporate and individual tax planning opportunities involving Luxembourg. Jean-Luc has specific expertise in corporate financing – including innovative hybrid instruments, M&A transactions, funds structuring, venture capital and private equity vehicles through dedicated SICARs and SPFs, securitization, tax due diligence and real estate investment.