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The New France-Luxembourg Double Tax Treaty: First Comments Relating to Investment in French Real Estate

On 20 March 2018, the Governments of France and Luxembourg signed a new French-Luxembourg treaty (the “New Treaty”), which will have an impact for certain investments in French real estate.

Several changes were anticipated since the fourth amendment dated 5 September 2014 to the France-Luxembourg treaty dated 1 April 1958 (the “Treaty”) did not align certain provisions with the OECD model (see our tax alert September 2014), but it is a fully revised New Treaty which has been signed.

As a preliminary remark, the preamble of the New Treaty states that it aims at avoiding double taxation but not creating non taxation opportunities, and it introduces a specific anti-abuse clause.

As far as French real estate investments are concerned, we would like to draw the attention of investors on the following changes:

Tax residence :

The New Treaty aligns the tax residence with the OECD definition i.e. residents for the New Treaty application are those liable to tax. Entities have their tax residency in the State of their effective place of management. An apparent owner of income will not be deemed tax resident in a State and will be excluded from the tax treaty benefits if the income benefits to a non-tax resident in such State.

Real estate gains:

The New Treaty does not change the rule introduced in the fourth amendment to the Treaty which allocates to the State where the real estate assets are located, the right to tax capital gains from the disposal of shares of which value derives directly or indirectly for more than 50 % from such real estate. But the New Treaty adds that this rule applies when the 50% ratio has been reached in the 365 days preceding the disposal of the shares.

Dividend distributions:

As a reminder, dividend distributions are subject to a 30% withholding tax under French domestic law, that can be reduced under the current Treaty to 15% or to 5% if holding at least 25% of the share capital, subject to substance and beneficial

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ownership considerations. The 5% reduced rate also applies currently to SIIC and OPCI distributions.

Under the New Treaty, dividend definition now includes deemed distributions and the withholding tax rate is reduced to 0% if the beneficiary is the beneficial owner and holds at least 5% of the share capital of the distributing entity in the 365 days preceding the distribution, or 15% in the other cases.

The New Treaty introduces a new paragraph for SIIC and OPCI distributions, allowing the application of the 15% withholding tax rate to dividends “paid out of income or gains derived from immovable property within the meaning of Article 6 by an investment vehicle (a) which distributes most of this income annually; and (b) whose income from such immovable property is exempted from tax” to a beneficial owner holding less than 10 % of the capital of the paying vehicle.

When the beneficial owner holds 10% or more of the paying vehicle, the withholding tax rate applicable is the domestic law rate, i.e. currently 30% in France (and 25% from 2022). A reduced 15% rate applies pursuant to Article 119 bis 2 of the French tax code for distributions that are drawn from the exempt income realized by SPPICAV, in favor of French and foreign undertakings for collective investment (UCI) provided that their management seat is in the EU or in a country or territory which has concluded, with France, a convention on administrative assistance to fight tax evasion and avoidance and that the UCI meets both of the following conditions:

- (i) it raises capital from a certain number of investors in view of investing it, under a defined investment policy, in the interest of those investors, and
- (ii) it has characteristics similar to the French undertaking for collective investment vehicles expressly enumerated in Article 119 bis of the FTC (notably OPCVMs, SICAFs, OPCIs, e.g. supervision by a regulatory authority, protection of investors, the existence of a management company and a depository, regular publication of accounts).

The date of entry into force of the New Treaty is not known yet. It will be on the first day following the day the last notification of ratification is received by the France or Luxembourg and will apply for France i) from the beginning of the calendar year following its ratification by both states, in the case of income for which tax is withheld at source, or ii) on financial year opened after the calendar year following its entry into force for taxes on income not withheld at source. It would therefore be applicable as from 1 January 2019 if both states proceed to ratification and notification before 31 December 2018.

We will keep you informed of developments in the ratification process in both France and Luxembourg and would be pleased to discuss with you these changes, consequences and solution more in details.

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