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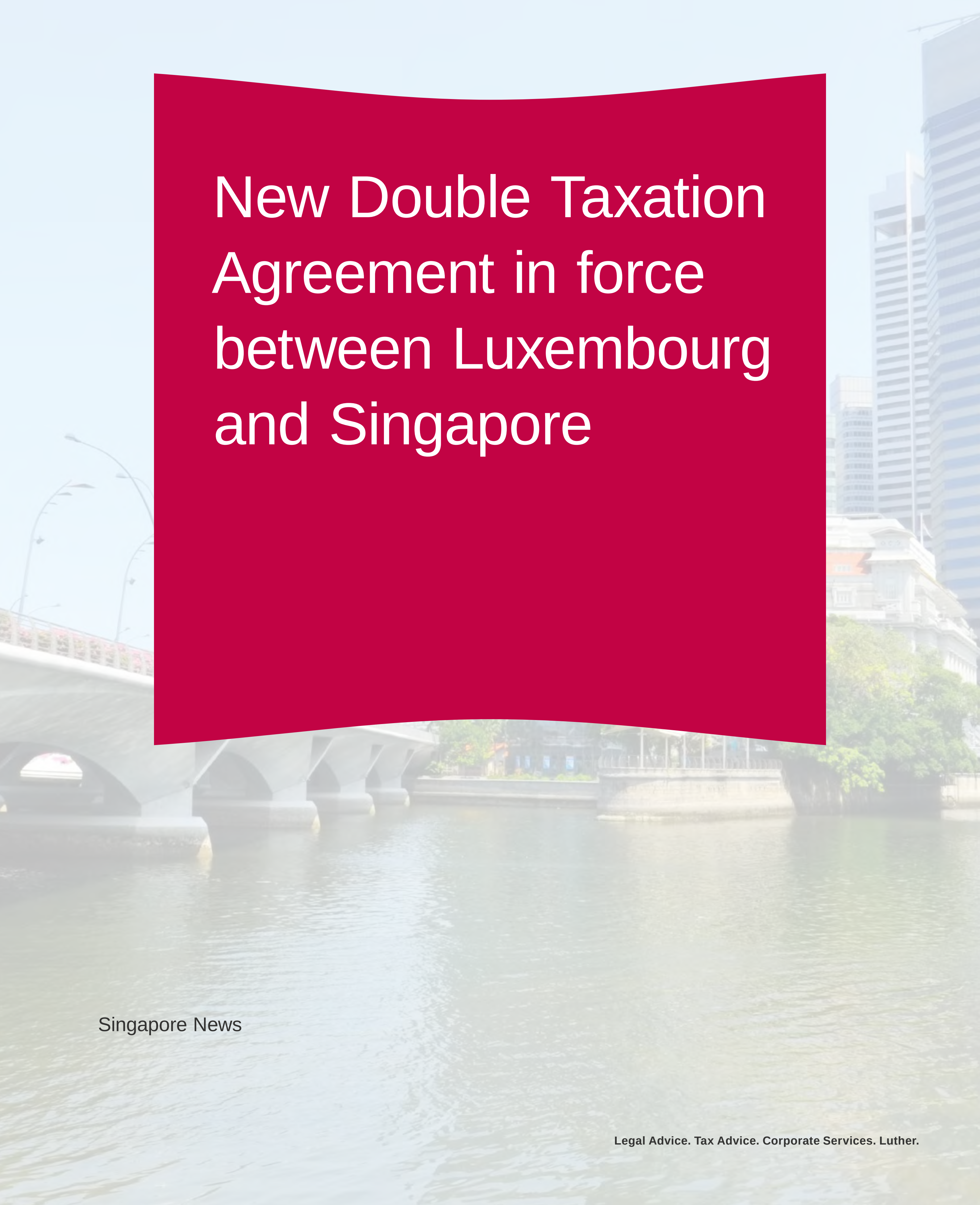

New Double Taxation Agreement in force between Luxembourg and Singapore

Singapore News

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Singapore and Luxembourg ("the Contracting States") signed a revised Avoidance of Double Taxation Agreement ("DTA") on 9th October 2013 which entered into force on 28th December 2015.

The DTA was negotiated and signed before the final reports on the OECD base erosion and profit shifting (BEPS) project were released on 5th October 2015 and, as a result, the DTA does not include the recommendations of the OECD regarding the necessary changes to be brought to existing and future tax treaties in order to tackle more efficiently base erosion and profit shifting.

In particular, the DTA does not include any anti-treaty abuse and/or anti-treaty shopping provisions. In this respect, the DTA does not provide for a limitation-on-benefits ("LOB") rule, which limits the availability of treaty benefits to entities that meet certain conditions based on the legal nature, ownership in, and general activities of the entity. The DTA does also not provide for a so-called "principal purpose test" clause, whereby treaty benefits will be denied, if one of the principal purposes of a transaction or arrangement is to obtain treaty benefits, unless it is established that granting these benefits would be in accordance with the object and purpose of the provisions of the treaty. Similarly the DTA does not include the revised definition of a "permanent establishment", intended to prevent the artificial avoidance of permanent establishment status (which will be more extensively discussed hereinafter).

According to the Inland Revenue Authority of Singapore ("IRAS"), the DTA is expected to enhance trade and investments between the two Contracting States by reducing and/or eliminating withholding taxes on passive income (dividends, interest and royalties) and by improving the tax treatment of income derived from the shipping and air transportation industry.

Singapore and Luxembourgish investors may therefore wish to review the current structure of their investments in the Southeast Asia and European markets in light of the new DTA so as to identify potential benefits under the new DTA.

Please find a summary of the most relevant provisions of the DTA, as follows:

Reduction and elimination of withholding tax on passive income - dividends, interest and royalties

The new provisions on reduction and elimination of withholding tax on dividends, interest and royalties apply to withholding tax levied on income derived on or after 1st January 2016.

It is also worth noting that a trustee who is liable to tax in a Contracting State is entitled to benefit from the provisions of the DTA relating to dividends, interest and royalties, as if he is the beneficial owner of such incomes.

Dividends

Pursuant to the DTA, dividends are exclusively taxable in the country of residence of the recipient, if he is the beneficial owner of the dividends. As Singapore normally does not tax dividends, Singapore residents receiving dividends from a Luxembourgish company are therefore usually fully exempt from tax in both Contracting States. Prior to the new DTA, such dividends from Luxembourg were subject to a 5%-withholding tax where the recipient was a company holding at least 10% of the capital of the distributing company and 10% in all other cases.

Interest

Under the DTA, interest income is also exclusively taxable in the country of residence of the recipient, if he is the beneficial owner of the interest income. Under the old treaty, the taxing right of the source country by reason of interest payments was limited to 10%. As Luxembourg is now prevented from withholding tax on interest income sourced in Luxembourg and Singapore does not tax foreign-sourced interest income received by its individual residents, such interest income received by an individual resident of Singapore from a Luxembourgish borrower should not be subject to tax in either Contracting States anymore. Singapore corporate lenders will remain taxable in Singapore on such interest income if it is remitted into Singapore. Reciprocally, a Singapore borrower does not have to withhold tax on interest payments to a Luxembourgish lender.

Royalties

Withholding tax on royalties has been reduced from 10% under the old treaty to 7% in the new DTA. The definition of "royalty" under the DTA has not been modified and is in accordance with the OECD Model of Tax Convention. The royalty provision does still not include fees paid for "show-how" and "technical services", so that these are generally not subject to tax in the source country, unless such services were rendered through a permanent establishment or a fixed base in the source country.

Taxation of active income - permanent establishment and service income of individuals

Permanent establishment

The permanent establishment definition in Article 5 of the DTA does not include the recent recommendations of the OECD intended to prevent the artificial avoidance of a permanent establishment status:

- The benefit of the specific activities exception provided under Article 5-4, whereby the carrying on by an enterprise of a Contracting State through a fixed place in the other Contracting State of an activity listed under Article 5-4 does not constitute a permanent establishment, is not restricted to activities of a "preparatory or auxiliary" character, as recommended by the OECD.

- The DTA does not include the so-called "anti-fragmentation" provision recommended by the OECD, which is intended to deny to the taxpayer the benefit of the specific activities exception provided under Article 5-4, if such activities constitute complementary functions of a cohesive business operation and are split between different legal entities or different locations.

- The new definition recommended by the OECD of a dependent agent of an enterprise of a Contracting State triggering the existence of a permanent establishment of that enterprise in the other Contracting State is not included in the new DTA. As a result, the definition of a dependent agent in the DTA has not been extended to the case of a person (other than an independent agent) who acts in the other Contracting State on behalf of the enterprise and "habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise", as suggested by the OECD. However, an enterprise of a Contracting State is still deemed to have a permanent establishment in the other Contracting State by reason of having in such other Contracting State a person (other than an independent agent) who acts on behalf of that enterprise and has, and habitually exercises, in that other Contracting State an authority to conclude contracts in the name of that enterprise.

Besides, the definition of permanent establishment in Article 5 of the new DTA has substantially remained unchanged as compared to the former version of Article 5.

Service income derived by individuals

A new Article 14 "Independent personal services" has been inserted in the DTA to deal on its own with the taxation of income derived by individual residents of a Contracting State from the performance of professional services (e.g. independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants). Previously, income derived from the performance of such services was included in the "personal services" article.

Individual residents of a Contracting State rendering professional services in the other Contracting State will be exclusively taxable in their State of residence, unless they perform their services in the other Contracting State through a fixed base regularly available to them, or, spend more than 365 days in a 15-month period in the other Contracting State. In those latter cases, the source country is also granted the right to tax so much of the income that is attributable to that fixed base or that is derived from the performance of the professional services in the source country.

Enhancement of the tax treatment for international air transport and shipping income

Under the old treaty between Singapore and Luxembourg, profits derived from the operation of ships or aircraft in international traffic by an enterprise resident in a Contracting State was taxable in the State of residence of that enterprise. In addition, such profits could also be taxed in the other Contracting State to the extent that they were derived from that other Contracting State. However, the tax charged on such profits in the source country was reduced by 50%.

The new DTA now provides that profits derived from the operation of ships or aircraft in international traffic are to be exclusively taxed in the operator's country of residence, thus preventing the other State from taxing such profits at all.

Moreover, the DTA has clarified that the definition of "profits from the operation of ships or aircraft in international traffic" includes:

- profits from the rental on a bareboat basis of ships or aircraft;
- profits from the use, maintenance or rental of containers used for the transport of goods or merchandise, where such rental or such use, maintenance or rental, is incidental to the operation of ships or aircraft in international traffic; and
- interest on funds connected with the operations of ships or aircraft, where such interest is incidental to the operation of ships or aircraft in international traffic.

Exchange of information

The DTA incorporates the internationally agreed standard for exchange of information for tax purposes in its Article 26, which has been written in accordance with the provisions of the OECD Model of Tax Convention.

As a result, the competent authorities of Luxembourg and Singapore have now the obligation to exchange such information as is foreseeably relevant to secure the correct application of the provisions of the DTA or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the two States or of their local authorities.

The concept of "foreseeably relevant information" shall ensure that all information pertaining to tax matters is covered by the exchange of information provision. The information that can be exchanged by Luxembourg and Singapore under the DTA is not limited to information pertaining to specific taxpayers only and can therefore relate to tax administration, tax avoidance or evasion schemes encountered by the two States.

By reason of its wording, Article 26 allows the Contracting States to exchange information in the three following manners:

- Exchange of information on request of a Contracting State to the other Contracting States. In implementing the exchange of information on request, some safeguards have been provided for in the DTA so as to avoid that the requesting State engages in "fishing expeditions" by requesting information without sound reasons. In this respect, a list of information must be provided by the State requesting information from the other State in order to demonstrate the foreseeable relevance of the information.
- Automatic exchange of information, which could for instance be related to the tax treatment of a specific income in one State.
- Spontaneous exchange of information, where for instance a Contracting State has collected information which it considers to be of interest for the other Contracting State.

The DTA also provides that the tax administration of the requesting State will treat the information received from the other State as secret and in the same manner as information obtained under its own domestic laws. The requesting State has further the obligation not to disclose to any person such information received from the other State, except to persons concerned with the enforcement, assessment and collection of taxes or the determination of tax appeals.

In implementing the exchange of information the requested State is not obliged to perform and disclose more than what is permitted under its own laws or to disclose information which is business, industrial or professional secrets. However, the DTA makes clear that a Contracting State will not be permitted to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person. Bank secrecy is therefore not an argument accepted by either States to refuse an exchange of information.

Other relevant provisions

Taxation of capital gain on shares in real property companies

The new DTA does not include an article preserving the taxing rights of the State of source on capital gain realized on the disposition of shares in real property companies commonly found in other tax treaties. As a result, capital gain realized on the disposition of shares in a real property company will remain exclusively taxable in the State of residence of the alienator. However, if, instead of disposing of shares in a real property holding company, a resident of a Contracting State directly disposed of a real estate situated in the other Contracting State, any gain arising out of such disposition would be subject to tax in that other Contracting State where the real estate is situated. A Singapore tax resident would therefore have interest to structure a real property investment in Luxembourg through a company rather than holding directly the underlying real property. Indeed, any gain arising out of the disposition of the shares in the Luxembourgish holding company would not be taxable in either Contracting States, whereas any gain resulting from the direct disposition of the real property situated in Luxembourg would attract taxation in Luxembourg.

Tie-breaker rule for dual residence of individuals

A new tie-breaker criterion has been inserted in Article 4 of the DTA, defining the term “resident” within the meaning of the DTA, in order to solve a conflict of dual residence of an individual. In the case where all other tie-breaker criteria (permanent home, centre of vital interests and habitual abode) have been applied without success, the last criterion of the citizenship of the dual resident should now be applied. As a result, when an individual is still considered a tax resident of both Contracting States after applying the criteria of the permanent home, centre of vital interests and habitual abode, the dual resident will be considered to be a resident of the State of which he is a citizen. In the event that the dual resident is a citizen of both Contracting States, the question will be settled by mutual agreement of the competent authorities.

Deletion of the “Limitation on relief” Article

The article on limitation of relief existing under the old treaty between Singapore and Luxembourg has not been reproduced in the DTA. The old article on limitation on relief provided that Luxembourg would grant exemption from tax or reduced withholding tax rate on income sourced in Luxembourg pursuant to the treaty, only if such income was remitted to or received in Singapore.

Residence of collective investment vehicles

The DTA expressly mentions that collective investment vehicles are entitled to benefit from the provisions of the DTA as tax residents of a Contracting State, provided that under the domestic laws of that State such collective investment vehicles are liable to tax in that State by reason of their domicile, residence, place of management or any other criterion of a similar nature. From a Singapore point of view, the entitlement to treaty benefits will therefore depend on the structure used (private limited, partnership and/or type of trust) to conduct the collective investment.

For more information, please contact:

Alexandre Gourdan, LL.M. International Taxation (New York University)

Attorney-at-law (Paris Bar) (New York)

Luther LLP

Singapore

Phone +65 64088104

alexandre.gourdan@luther-lawfirm.com

Imprint

Luther Rechtsanwaltsgesellschaft mbH, Anna-Schneider-Steig 22, 50678 Cologne, Phone +49 221 9937 0, Fax +49 221 9937 110, contact@luther-lawfirm.com

Editors: Alexandre Gourdan, LL.M. International Taxation, New York University, Attorney-at-Law, Luther LLP, 4 Battery Road, Bank of China Building, #25-01, 049908 Singapore , Phone +65 64088104, Fax +65 6408 8001, alexandre.gourdan@luther-lawfirm.com

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