Amendment of the Luxembourg-US double tax treaty regarding permanent establishment

Bill n° 7006 was filed with the Luxembourg Parliament on 22 June 2016. According to the Bill, the Luxembourg-US double tax treaty signed on April 3, 1996 ("DTT") will be amended to prevent abusive tax planning leading to double non-taxation due to divergent domestic legislation regarding the concept of permanent establishment ("PE").

US-source income attributed to a PE located in the US and paid to a Luxembourg resident company is currently tax-exempt in Luxembourg according to Luxembourg tax laws. Such income may also not by taxable in the US according to US tax laws. To prevent the double non-taxation regarding US-source income involving PE, under the DTT to be amended by a Protocol, US-source income attributed to a foreign PE under Luxembourg laws (thus, not taxable in Luxembourg) will no longer benefit from the DTT in the following cases:

1. The cumulated effective tax rate (i.e. ETR in Luxembourg and ETR in the State of the PE) applicable to the US-source income attributed to the PE does not reach the lower of i) 15% and ii) 60% of the statutory income tax rate applicable in the contracting State (i.e. Luxembourg).

2. Income is attributed to a PE located in a third country which has no tax treaty with one of the contracting States (e.g. the US), unless such income is included in the taxable income of the head office located in the other contracting State (e.g. Luxembourg).

The main impact of the denial of the application of the DTT for existing structures is that withholding tax should be levied in the US at the standard rate on interest paid by US borrowers to a Luxembourg company when the interest is attributed to a US PE.

A mutual procedure clause is added to the DTT under which a contracting State can apply the DTT, after consultation with the other State, where the above-mentioned conditions are not satisfied due to specific circumstances (e.g. the ETR threshold is not met because of tax losses).

The Bill must still be approved by the Luxembourg Parliament. According to the Bill, the new provision will be applicable to amounts paid or credited as from the third day following the publication of the Luxembourg law into the Mémorial (Luxembourg Official Journal), irrespective of the signing date of the Protocol.

This new provision is in line with the current US Model Income Tax Treaty. Other provisions of the DTT are still under negotiation between the US and Luxembourg Government.

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