Tax alert

Opportunities for exemption from withholding tax on dividends under the Hong Kong - Luxembourg Double Taxation Agreement (DTA)

TAX

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The Hong Kong - Luxembourg DTA allows payments by a Luxembourg company to a company resident in Hong Kong, regardless of the place of incorporation, to be exempt from dividend withholding tax.

Luxembourg is a common holding jurisdiction for private equity, real estate and fund investments. Typically, for a Luxembourg company to remit profits free of withholding tax to a non-resident company, various types of debt instruments are used. However, the Hong Kong - Luxembourg DTA, which has retrospective effect from 1 January 2008 for Luxembourg and from 1 April 2008 for Hong Kong, offers another option.

The DTA provides that a company which is normally managed or controlled in Hong Kong is a resident of Hong Kong, i.e. even if it is incorporated outside Hong Kong. The DTA provides that the withholding tax on dividends from a Luxembourg company may be reduced from 15 percent to 0 percent. The 0 percent rate is applicable where the Hong Kong resident is a company that directly holds at least 10 percent of the capital of the Luxembourg company paying the dividend or participates with an acquisition cost of at least EUR 1.2 million in the Luxembourg company. If a company normally managed or control in Hong Kong does not meet these requirements, it may only be eligible for the reduced dividend withholding tax at 10 percent.

To benefit from the reduced dividend withholding tax rate under the Hong Kong – Luxembourg DTA, the Luxembourg tax authorities will request the company receiving the dividend to provide a certificate of residence. The Hong Kong Inland Revenue Department (IRD) will generally issue a tax residence certificate when it considers the company is "normally managed or controlled" in Hong Kong. In assessing this, the Hong Kong IRD provides its views in Departmental Interpretation and Practice Notes N° 44 (Revised) "Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income" ("DIPN 44").

In DIPN 44, the IRD considers that the phrase "normally managed or controlled" has a broader meaning than that of "central management and control", as the former does not require that both management

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and control be exercised in Hong Kong. "Management" refers to management of daily business operations or implementation of the decisions made by top management, etc., while "control" refers to control of the whole business at the top level (including formulating the central policy of the business, making strategic policies, choosing business financing, evaluating business performance).

Going forward, companies that are normally managed or controlled in Hong Kong - regardless of where they are incorporated - should be able to make use of the treaty between Hong Kong and Luxemburg with respect to investment opportunities. However, prior to making a decision to set up a company which is normally managed or controlled in Hong Kong, investors will need to carefully consider any Hong Kong tax implications that may arise.

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