

## **BILATERAL TAX TREATY NEGOTIATIONS BETWEEN THE UNITED STATES AND LUXEMBOURG**

The United States and the Grand Duchy of Luxembourg are currently negotiating a protocol to amend a number of provisions of the U.S.-Luxembourg tax treaty, signed at Luxembourg on April 3, 1996, and entered into force on December 20, 2000 (the “Convention”). As part of the negotiation, the negotiators have agreed to a specific change to the Convention that is vital to carry out the object and purpose of the Convention, which is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.

Specifically, it has come to the attention of the Treasury Department and the Luxembourg Ministry of Fiscal Affairs that U.S. source income is being paid to Luxembourg residents that, for purposes of Luxembourg tax law, treat the income as attributable to a permanent establishment in the United States, and therefore as exempt from tax in Luxembourg, while at the same time treating the income as exempt from tax in the United States. Therefore, the U.S. source income may be exempt from tax in both Luxembourg and the United States.

The Treasury Department and the Luxembourg Ministry of Fiscal Affairs agree that it is not consistent with the object and purpose of the Convention for the United States to reduce its domestic taxing rights under the Convention in this circumstance. Accordingly, in connection with the negotiation of amendments to the Convention, the Government of the Grand Duchy of Luxembourg introduced to its Parliament Bill Number 7006 (the “Bill”), which reads as follows:

“The Convention between the Government of the Grand Duchy of Luxembourg and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital, done at Luxembourg on April 3, 1996, as corrected by exchange of letters between both Governments on August 23 and 28, 1996 (the “Convention”), was approved by law of March 5, 1999, and entered into force upon the exchange of instruments of ratification at Washington, with reservation by the United States accepted by Luxembourg, on December 20, 2000. If the Convention is amended by a protocol to the Convention containing the provision below, and if the protocol so provides, upon entry into force of such protocol, the following provision would have effect for amounts paid or credited on or after the third day following publication of this law in the Official Gazette:

“Where an enterprise of a Contracting State derives income from the other Contracting State, and the first-mentioned Contracting State treats that income as profits attributable to a permanent establishment situated outside of that Contracting State, the benefits of this Convention shall not apply to that income if:

- a) the income that is treated as profits attributable to the permanent establishment is subject to a combined aggregate effective rate of tax in the first-mentioned Contracting State and the state in which the permanent establishment is situated that is less than the lesser of (i) 15 percent or (ii) 60 percent of the general statutory rate of company tax applicable in the first-mentioned Contracting State; or



b) the permanent establishment is situated in a third state that does not have a comprehensive convention for the avoidance of double taxation in force with the Contracting State from which the benefits of this Convention are being claimed, unless the first-mentioned Contracting State includes the income treated as profits attributable to the permanent establishment in its tax base.

However, if a resident of a Contracting State is denied the benefits of this Convention pursuant to this paragraph, the competent authority of the other Contracting State may, nevertheless, grant the benefits of this Convention with respect to a specific item of income if such competent authority determines that such grant of benefits is justified in light of the reasons such resident did not satisfy the requirements of this paragraph (such as the existence of losses). The competent authority of the Contracting State to which a request has been made shall consult with the competent authority of the other Contracting State before either granting or denying the request made under this paragraph by a resident of that other Contracting State.”

Consistent with the Bill, the negotiators intend to include the amendment to the Convention described above in the protocol, with effect for amounts paid or credited on or after the third day following publication of the law reflecting the Bill in the Official Gazette in Luxembourg.

