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Insights

TAX CHANGES TO LUXEMBOURG STRUCTURES INVESTING IN UK REAL ESTATE

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SUMMARY

The UK and Luxembourg have renegotiated their double tax treaty. The new treaty has been published, but is not yet in force. Significant changes have been made to the capital gains tax article amongst other provisions.

Significantly for Luxembourg investors in UK real estate the capital gains tax article of the treaty has been changed. Previously the treaty allowed Luxembourg tax resident investors to avoid paying UK tax on a capital gain from an indirect investment in UK property. This benefit has been removed from the new treaty where the Luxembourg shareholder sells shares, or an interest in a partnership or trust, where the investment derives more than 50% of its value directly or indirectly from UK property. It seems the 50% value test is assessed at the time of the sale, rather than by reference to a historic period. The UK tax charge on capital gains arising on the sale of UK property rich vehicles applies when the vehicle derives, directly or indirectly, at least 75% of its gross value from UK property, so the change is only really effective for those holdings.

The change is not unexpected. The UK has been looking to renegotiate the treaty with Luxembourg since 2019, when the UK introduced tax on capital gains for non-residents investing in commercial UK property. Accordingly, for post 2019 structures the treaty change has been anticipated, although some may be surprised at how soon it has come. The change may, therefore, have a greater impact on structures put in place before 2019.

The change will not take place before 1 April 2023. Both jurisdictions will need to bring the new treaty into force before the treaty will have effect. Any Luxembourg entity looking to sell UK property in the near future will need to be mindful of the 1 April 2023 date as the treaty change will have a cliff edge effect. Any capital gain accruing from as early as April 2019 may be brought into charge, not just the capital gain accruing since 1 April 2023. The 1 April 2023 date will apply if both Luxembourg and the UK ratify the treaty by the end of 2022.

Other changes have been made to the treaty as well. For example, the changes to the dividend article are largely beneficial to taxpayers. Generally there will be an exemption from withholding tax on dividends. However, the treaty still keeps the 15% UK tax on a property income distribution ("PID") by a REIT unless it is made to a "recognised pension fund" established in Luxembourg (in which case the PID would be free of UK tax). The dividend changes are more likely to assist shareholders in Luxembourg companies because of the Luxembourg withholding tax on dividends.

The treaty sets out the dates that the changes take effect once both jurisdictions have gone through the ratification process. The start dates are in the year following the ratification. For UK tax the withholding tax changes take effect from 1 January, 6 April for income tax and CGT and 1 April for corporation tax.

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MEET THE TEAM

Elizabeth Bradley

London

elizabeth.bradley@bclplaw.com
+44 (0) 20 3400 2323

Anne Powell

London

anne.powell@bclplaw.com
+44 (0) 20 3400 2162
