Aspen Group Limited

A GUIDE TO HONG KONG & LUXEMBOURG DOUBLE TAX TREATY

HONG KONG PANAMA PRAGUE

Hong Kong and Luxembourg double tax agreement

On 2 November 2007 Hong Kong and Luxembourg signed a double tax agreement. This Agreement is the fourth that Hong Kong has signed with other countries or territories. This agreement intends to attract companies to invest into Asia by way of Hong Kong and Luxembourg.

This paper focuses on withholding tax on passive income and capital gains as the key features of the Tax Agreement.

Key features of the Agreement

Dividends

There is a great opportunity with regards to withholding tax-free repatriation of profits from Luxembourg to Hong Kong. This will be of particular interest to Hong Kong investors and multinationals with operations in Hong Kong or Luxembourg.

Luxembourg's domestic rate on dividend withholding tax is 15%. Generally, Luxembourg provides in its domestic law an exemption from withholding tax over dividend payments to a parent company resident in another EU Member State or Switzerland, as long as the recipient holds, or commits to hold, at least 10% of the share capital (or the acquisition cost is at least €1.2 million--about US$1.8 million) of the Luxembourg company for at least 12 months.

Article 10 of the Tax Agreement, states that dividends received by a Hong Kong resident investor who holds 10% or more of the dividend paying company in Luxembourg, or whose acquisition cost of the Luxembourg share investment is at least €1.2 million), will be exempt from Luxembourg dividend withholding tax. In all other cases, the dividend withholding tax levied in Luxembourg will be limited to 10%.

There is no holding period requirement. The Tax Agreement also has a much lower holding threshold compared to the Belgium-Hong Kong tax agreement.

Hong Kong resident companies are defined in the agreement as being not only companies incorporated under the laws of Hong Kong, but also companies incorporated outside Hong Kong that are normally managed or controlled in Hong Kong.

There is no withholding tax on dividend distribution in Hong Kong.

Interest

Although the tax Agreement states that interest arising in Luxembourg received by a Hong Kong resident will not be subject to Luxembourg withholding tax, under Luxembourg domestic law, generally, interest withholding tax is not levied. Moreover, in Hong Kong, there is no withholding tax on interest.

Interest income is taxable only in the state of residence of the beneficiary. Therefore, interest income should be able to flow between Luxembourg and Hong Kong free of withholding tax.

Royalties

Royalty withholding tax is not levied in Luxembourg paid for use of patents, trademarks, designs, or models, commercial, or industrial equipment.

Royalties arising in Hong Kong received by a Luxembourg resident will be subject to a withholding maximum rate of 3% in Hong Kong. This is lower than the normal Hong Kong royalty withholding rates of 5.25% or 4.8% applicable to nonresident corporate or individual recipients respectively.

Capital Gains

In Luxembourg, under limited circumstances, a gain on the disposal of shares in a Luxembourg entity is subject to tax. Under the Tax Agreement, Luxembourg will not be able to exercise this limited taxation right if a Hong Kong resident investor realizes a capital gain upon disposing of its share investment in a Luxembourg company, provided that not more than 50% of the asset value of the Luxembourg company being disposed of is composed of, directly or indirectly, immovable property located in Luxembourg. Under Hong Kong domestic tax law, there is no capital gains tax.

Gains earned by a Luxembourg resident from disposing of investments in Hong Kong would only be taxable in Hong Kong if the gains are Hong Kong sourced revenue income and are attributable to a permanent establishment maintained by the Luxembourg resident in Hong Kong.

Capital gains made by a Luxembourg parent company on the sale of the shares of its Hong Kong subsidiary will be taxable in Luxembourg only. However, pursuant to Luxembourg domestic tax law, such gains shall benefit from a full tax exemption if the conditions required for the domestic participation exemption regime are met.

Residency

Hong Kong's definition of a resident omits the terms "subject to tax" or "tax liable"; however it introduces the notion of management or control as factors to determining a person's residency. For the purposes of the Tax Agreement, resident refers to a company or person incorporated or constituted under the laws of Hong Kong or, if a foreign entity, one that is usually managed or controlled in Hong Kong.

Permanent Establishment (PE)

Article 5 of the Tax Agreement includes a provision for the rendering of services, including consultancy services by an entity of one State directly or through employees or other personnel in the other State, but only if the activities of that nature continue for the same or related project for a period or periods aggregating more than 180 days within any 12-month period.

The treaty allows Asian investors to hold European and non-European shareholdings through a Luxembourg subsidiary of a Hong Kong parent. The Tax Agreement also provides an avenue to use Luxembourg as a gateway to Asia via Hong Kong.

Luxembourg has a very favorable holding regime and an extensive tax treaty network. Luxembourg's internal important participation exemption, the EU's parent subsidiary directive, and membership in the European Union join to make Luxembourg an interesting proposition. These features united with Hong Kong's state of the art banking facilities, economic stability, favorable tax environment, and vast international experience are an ideal platform to route European investments and vice versa.

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If you would like additional information on this jurisdiction or our current shelf list, please contact us at enquiries@aspenoffshore.com; or contact any of our offices.

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