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## *New Double Tax Treaty Between France and Luxembourg Significantly Impacts Existing Real Estate Holding Structures*

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On March 20, the Luxembourg and French governments signed a new double tax treaty (the "NDTT").

The NDTT will enter into force once both France and Luxembourg complete the ratification process. The new withholding tax provisions will apply to dividends distributed the year following the one during which the NDTT enters into force (*i.e.*, any distribution made after January 1, 2019 if the treaty is ratified before the end of 2018).

Several provisions of the NDTT will significantly affect existing French real estate investments held through French tax exempt real estate investment vehicles called "OPCIs."

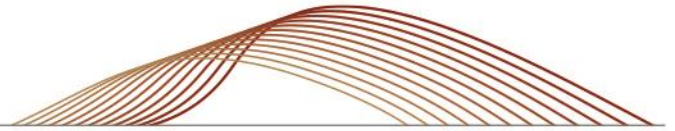
Subject to certain conditions, an OPCIE established as a *société de placement à prépondérance immobilière à capital variable* ("SPPICAV") is exempt from French corporate income tax on its real estate income/gains.

One area in which the current DTT provisions have been especially relevant is in the context of dividends distributed to a Luxembourg company by an OPCIE usually set up in the form of a SPPICAV. Under the current DTT, where a Luxembourg company ("Soparfi") holds at least 25% of the capital of the OPCIE and receives a dividend from such OPCIE, the Soparfi is in principle subject to a reduced 5% French withholding tax and is exempt from any further Luxembourg income taxes. As a result, both current rental income and gains arising from disposals of French real estate owned through a SPPICAV itself held by a Soparfi are subject to a mere overall 5% tax charge, which is obviously quite attractive. Such proceeds are then generally upstreamed to non-treaty protected investors almost entirely tax free.

This explains the widespread use of the OPCIE/Soparfi structure amongst non-French investors holding French real estate.

This favorable treatment will no longer be available under the NDTT.

Article 10.6.a of the NDTT provides that dividend distributions from French real estate-related income made by any fund vehicle or company that distributes most of its exempt real estate income and gains on an annual basis (such as a SPPICAV) are taxable without limitation both in France and in the recipient country. As the Luxembourg domestic so-called "participation exemption" regime does not in principle apply to holdings in OPCIEs for their portion of exempt real



estate income, this NDTT measure leaves distributions from OPCIs fully subject to Luxembourg income taxes.

More importantly, under the NDTT, such dividend distributions will be subject to much higher withholding taxes in France than is currently the case. Article 10.6.b of the NDTT allows a reduced 15% withholding tax rate, but only where the beneficial owner of the dividends holds directly or indirectly less than 10% of the OPCI share capital.

When the beneficial owner of the dividends holds 10% or more of the OPCI (which is the case in most of the OPCI/Soparfi holding structures, where the OPCI is 100% owned by a Soparfi), under Article 10.6.c of the NDTT, dividends are not granted a reduced treaty rate of withholding tax and are thus subject to withholding tax at the full French domestic withholding rate (i.e., 30%).

In conclusion, the main provisions of the NDTT clearly target a very typical form of real estate investment in France, where a Soparfi holds French property through an interposed OPCI in the form of a SPPICAV.

Under the provisions of the NDTT, dividends distributed by a SPPICAV to a Soparfi will be subject to a 30% withholding tax (as opposed to 5% under the current DTT).

The holding of a SPPICAV by an appropriate form of Luxembourg fund vehicle could be amongst others considered as an alternative, in order to potentially mitigate (with a 15% withholding tax, as opposed to a French domestic 30% withholding tax rate) this significant tax leakage.



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