

Luxembourg-Russia Double Tax Treaty Amendments to Have Impact on Investments

The recent changes to the double tax treaty between Luxembourg and Russia were made in 2011 and provide a reduction of some tax rates as well as an introduction of the new rules on information exchange. Those changes were called, on one hand, to improve the investment climate between the two countries and, on the other hand, to make a step towards the transparency of investments. We further discuss the changes and their possible impact on Luxembourg-Russia investments. In particular we will discuss whether Luxembourg is capable of keeping or even strengthening its position as a safe harbor for investments originated from Russia, and what are the advantages of Luxembourg against its biggest competitors in a fight for the Russian capitals.

The double tax treaty between Russia and the Grand Duchy of Luxembourg of 28 June 1993 entered into force on 7 May 1997 and remains in force today. The protocol amending the Treaty was signed on 21 November 2011 (the Protocol), but has not been ratified by the contracting states and thus is not in force yet. Russia showed its willingness to adopt the changes by completion of the ratification procedure by the very end of last year¹⁾. Luxembourg is still in the process of adopting the Protocol and the respective law project is being scrutinized by the legislators at the moment²⁾.

The changes, if properly ratified, will come into effect on the 1st of January of the year following the year of ratification, which is now expected to be the year 2014. Among the novelties of the Protocol is the reduced 5% tax on dividends which applies if the level of

the direct shareholding is at least 10% and the invested amount is at least 80,000 euro, and the tax on immovable property income is extended to the income from the undertakings for collective investment investing primarily in immovable property. Those changes approximate the tax regime between Luxembourg and Russia to the regimes set up by the double tax treaties between Russia and other European low tax jurisdictions such as Cyprus and the Netherlands.

Another novelty of the Protocol is the new rules on tax information exchange between the two countries. Those rules are brought into conformity with the post-crisis trend aiming to turn the most opaque offshore jurisdictions into the transparent ones. This trend is reflected in the article 26 of the OECD model tax treaty. Both, Russia and Luxembourg, had their own reasons to amend the existing double tax treaty with regard to the tax information disclosure. Luxembourg began adding suchlike provision to its double tax treaties starting in 2010 due to a significant pressure of the EU Members and the rest of international community, that accused Luxembourg of facilitating the tax evasion. Russia, on the other hand, desired to reduce factors allowing the understating of base taxable, whereas the old secrecy rules of the low tax jurisdictions, such as Luxembourg, were clearly among such factors.

The tax information to be disclosed under the Protocol includes, among other: information held by the trustee/fiduciary, including the one held by the attorneys when acting as trustee/fiduciary or as tax consultant; information held by the agents/services providers; information held by the Luxembourg authorities; and, importantly, the banking information.

The procedure that Luxembourg will use for execution of the request made under the Protocol, was already introduced for the similar treaties by the law of 31 March 2010. It is a relatively new procedure which has not been referred to much, and therefore there are some uncertainties as to its practical appli-

cation and interpretation. For instance, such uncertainty concerns the liability of the holder of information for non-providing of the requested information. The law of 31 March 2010 set up the fine of maximum of 250,000 euro for failure to comply with the information request. In the situation when, as a matter of example, the bank fails to satisfy the request the law is silent whether the requested information can be consequently seized by the Luxembourg authorities. In this regard the following opinion of the OECD experts seems to be justified: there is no liability beyond that fine and the Luxembourg tax administration has no rights to seize the requested documents in case the holder refused to provide them³⁾.

The investors from Luxembourg as a group are many years and steadily presented among the largest foreign investors to the Russian economy. After the financial crisis of 2008 Luxembourg returned with regard to foreign investments in Russia Great Britain and Germany, and since then it holds the 3rd place after Cyprus and the Netherlands (the share of investments coming from all three of them – Luxembourg, Cyprus and the Netherlands – is over 45% of total amount of foreign investments in Russia in 2011).

The accumulated foreign investments in Russia from Luxembourg as on the end of 2011 amounted approximately 37,000 mln US dollars⁴⁾. As for the features of the Russian-Luxembourg investments, they normally constitute not only a transfer of gain from Russia to Luxembourg, but also transfer of assets and capitals. Luxembourg is among the large receivers of Russian direct investments, which is reported to be about 12,000 mln US dollars as on the beginning of 2011⁵⁾. Thereupon, the large part of investments once made from Russia to Luxembourg is returning back in Russia by way of the Luxembourg investments.

It appears that when the Russian investors are looking for a safe harbor to protect their capitals against related risks back in Russia, as well as an attractive tax regime, Luxembourg may compete with Cyprus and the Netherlands by providing the variety of special

investment vehicles and low taxes, especially after the Protocol will be given the full effect.

Interesting in this regard that in 2011 foreign investments from Luxembourg in Russia showed growth in the financial sector which might be a tendency. Oppositely, major part of the investments, received by Russia from Cyprus and the Netherlands in 2011, was made into the real sector of economy by way of direct investments. Finally, Luxembourg still has a prominent reputation of financial stability as opposed to Cyprus that experiences continuous economic difficulties.

One should not forget that it is now as well true for Cyprus banks and attorneys that they are vulnerable in case of the proper tax information requests from Russia. However, whereas the disclosure of banking information alone seems to be enough to scare away the investors, there are other advantages that Luxembourg is in position to offer for investing and reinvesting, and those are the attractive tax regime, reputation, stability, variety of investment instruments and the high quality of services. Those advantages seem to keep the Russian capital in Luxembourg in 2012. This proves that the Luxembourg capacities are significant and Luxembourg will further compete for the leading positions among countries-investors in the Russian economy.

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1) The instrument ratifying the Protocol in Russia: Federal Law N301-FZ dated 30.12.2012 entered into force on 11.01.2013.

2) Project de loi portant approbation de conventions fiscales et protocole de procédure applicable en matière d'échange de renseignements sus demandé N6501, Session ordinaire 2012-2013.

3) Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Reviews: Luxembourg 2011 Phase 1, by OECD, §192.

4) According to the Russian State Statistics Service www.gks.ru

5) Central Bank Russia www.cbr.ru