

Luxembourg implementation of the EU Directive setting new transparency rules for intermediaries



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On 8 August 2019, a draft law implementing the Council Directive (EU) 2018/822 of 25 May 2018 as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements ("DAC 6") was submitted by the government to the Luxembourg parliament.

As expected, the wording of draft law largely resembles the wording of the DAC 6 and the commentaries to the draft law provide only few explanations on how it will be interpreted and applied in practice. In this newsletter, we outline the content of the draft law and the related commentaries.

What type of arrangement will need to be reported?

Under the draft law, EU tax intermediaries such as tax advisers, accountants and lawyers that design and/or promote tax planning schemes, will have to report potentially aggressive tax planning cross-border arrangements to the tax authorities.

The term arrangement may also include a series of arrangements and an arrangement may comprise more than one step. Hence, the understanding of the term "arrangement" within the meaning of the draft law is very broad. An arrangement is considered as cross-border if it concerns either (i) more than one EU Member State or (ii) an EU Member State and a third country.

Cross-border arrangements may be reportable if they contain at least one of the hallmarks listed in an annex to the draft law. These hallmarks describe characteristics or features of cross-border arrangements that might present an indication of a potential risk of tax avoidance.

In order to be taken into account, certain Hallmarks must fulfil a main benefit test ("MBT"). The

draft law provides that this test will be satisfied if “it can be established that the main benefit or one of the main benefits which a person may reasonably expect to derive from an arrangement, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage”.

The draft law shall apply to all “direct” taxes of any kind levied by, or on behalf of, a Member State or the Member State’s territorial or administrative subdivisions, including the local authorities but also by a third country. However, this draft law shall not apply to value added tax and customs duties, nor to excise duties covered by other European Union legislation on administrative cooperation between Member States. This draft law shall also not apply to compulsory social security contributions.

What are the hallmarks used to determine reportable cross-border arrangements?

The draft law follows the logic of DAC 6 and sets out the following five categories of hallmarks:

- General Hallmarks linked to the MBT;
- Specific Hallmarks linked to the MBT;
- Specific Hallmarks related to cross-border transactions;
- Specific Hallmarks concerning automatic exchange of information and beneficial ownership; and
- Specific Hallmarks concerning transfer pricing.

Neither the draft law nor the commentaries to the draft law provide much explanation on the interpretation of these hallmarks. However, given that the mandatory disclosure regime (DAC 6) is inspired by the Final Report on BEPS Action 12 (Mandatory disclosure rules) that is also referred to in the commentaries to the draft law, the guidance provided in this report may be a source of interpretation.

What is the main benefit test?

Many of the hallmarks set out in the annex to the draft law are subject to an additional threshold test. This means that many of the hallmarks only trigger a reporting obligation when an arrangement meets the main benefit test (“MBT”), reducing the risk of excessive or defensive filings. This should enhance the usefulness of the information collected because the focus will be on arrangements that have a higher probability of truly presenting a risk of tax avoidance.

The MBT is fulfilled if “it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage”. Hence, this test compares the value of the expected tax advantage with any other benefits likely to be obtained from the transaction. According to the Final Report on BEPS Action 12, the MBT sets a relatively high threshold for disclosure.

It is interesting to note that the draft law (in accordance with DAC 6) explicitly states that the tax treatment of a cross-border payment at the level of the recipient cannot be the sole reason for concluding that an arrangement satisfies the MBT. Thus, it does not matter per se (i) if the jurisdiction of the recipient of a payment does not impose any corporate tax or imposes corporate tax at a rate of zero or almost zero or (ii) if the payment benefits from a full exemption or (iii) a preferential tax regime.

Which information will be reported?

If a cross-border arrangement is treated as reportable under the draft law, the information to be communicated to the Luxembourg tax authorities shall contain the following, as applicable:

- the identification of intermediaries and relevant taxpayers;
- details on the Hallmarks that make the cross-border arrangement reportable;
- a summary of the content of the reportable cross-border arrangement;
- the date on which the first step in implementing the reportable cross-border arrangement was made or will be made;
- details of the national provisions that form the basis of the reportable cross-border arrangement;
- the value of the reportable cross-border arrangement;
- the identification of the Member State of the relevant taxpayer(s) and any other Member States which are likely to be concerned by the reportable cross-border arrangement; and
- the identification of any other person in the Member State, if any, likely to be affected by the reportable cross-border arrangement.

The information reported under the draft law to the Luxembourg authorities can be used for taxation purposes, for tax collection purposes and for the verification of the CRS reporting duties.

Who will be subject to the new Luxembourg reporting duties?

The reporting responsibilities regarding cross-border arrangements that fall within the scope of the draft law generally rest with the tax intermediary, unless such reporting would be a breach of the intermediary's legal professional privilege. In the latter case, the intermediary should notify any other intermediary or, if there is no such intermediary, the relevant taxpayer that the reporting obligation would then fall to them.

An intermediary is defined as any person that designs, markets, organises or makes available for implementation or manages the implementation of a reportable cross-border arrangement. This may include, in particular, tax advisers, lawyers and accountants. The draft law further extends the circle of intermediaries to "any persons that know, or could be reasonably expected to know that they have undertaken to provide, directly or by means of other persons', aid, assistance or advice with respect to designing, marketing, organising, making available for implementation or managing the implementation of a reportable cross border arrangement". Accordingly, the understanding of the term tax intermediary is very broad, and includes any professional that provides tax advisory services.

This broad definition of the term "intermediary" may likely result in overlapping reporting obligations. According to the draft law, when there is more than one intermediary, the obligation to file information on the reportable cross-border arrangement lies with all intermediaries involved. Intermediaries should only be exempt from their reporting obligations to the extent they can prove that the same arrangement has already been filed by another intermediary.

Thus, it does not suffice to prove that another intermediary has committed to do the reporting. It is necessary to prove the effective reporting by another intermediary. This obviously requires a certain extent of coordination between advisers in order to determine whether or not a cross-border arrangement is reportable and, if so, to ensure that only one intermediary files a report so as to avoid multiple filings in relation to the same arrangement. The reporting obligations under the draft law are limited to intermediaries that have a link to the EU based on tax residency, incorporation, etc. Hence, non-EU intermediaries do not have any reporting obligations under the Directive. In these circumstances, a potential reporting obligation would be shifted to the taxpayer benefiting from the cross-border arrangement.

Likewise, when there is no tax intermediary because, for instance, the taxpayer designs and implements a scheme in-house, the reporting obligation rests with the taxpayer who benefits from the arrangement.

Who will have a right to the right to benefit from the professional secrecy limitation?

According to the draft law, lawyers subject to the law of 10 August 1991 may rely on their professional secrecy and have the right to a waiver from filing information on a reportable cross-border arrangement. In such circumstances, lawyers acting as intermediary in the sense of the draft law must notify, within 10 days, their waiver to any other intermediary or, if there is no such

intermediary, to the relevant taxpayer. In that case, the obligation to file information on a reportable cross-border arrangement will lie with the other notified intermediary, or, if there is no such intermediary, with the relevant taxpayer.

According to DAC 6, Luxembourg could have extended this right to a waiver to any intermediary subject to legal professional privilege under the Luxembourg law such as auditors, insurers or bankers. However, the draft law limits the scope of this right to the strict minimum. Moreover, even if the waiver is applicable, the draft law provides that lawyers are nevertheless required to provide general information about cross-border arrangements that do not allow the identification of the related taxpayers.

Finally, in their quality of relevant taxpayers subject to the reporting obligations, clients can still mandate their lawyers to perform the reporting duties on their behalf. In such cases, the reporting will be done by the lawyer acting as special proxy of the taxpayer.

From a practical perspective, this choice is very disappointing as it will make it more difficult for taxpayers to coordinate potential reporting obligations (or the absence of reporting obligations) with different intermediaries. Notably, the adoption of a broader interpretation of legal professional secrecy would have only resulted in a shifting of reporting obligations to the taxpayer. It can be anticipated that many intermediaries will prefer engaging in over-reporting with a view to avoid penalties. This may compromise the very purpose of the mandatory disclosure regime which aims to provide tax authorities with information on tax-motivated transactions that are likely to pose the greatest tax policy and revenue risks.

When will the reporting have to be performed?

Intermediaries, or the relevant taxpayers, will have to report to the local tax authorities within the following time limits:

- 1) Periodic reporting every 3 months when cross-border arrangements are designed, marketed, ready for implementation or made available for implementation without a need to be substantially customised.
- 2) Within 30 days beginning on the day after the reportable cross-border arrangement is made available for implementation, or on the day after the reportable cross-border arrangement is ready for implementation, or when the first step in the implementation of the reportable cross-border arrangement has been made, whichever occurs first.
- 3) Within 30 days beginning on the day after aid, assistance or advice is provided by an intermediary, directly or by means of other persons.

4) By 31 August 2020 for reportable cross-border arrangements whose first step was implemented between the 25 June 2018 and the 30 June 2020.

5) For each of the years for which the taxpayers use their arrangements, each relevant taxpayer is required to file information about such use in their annual tax return.

The local tax authorities will have to automatically exchange the information received within one month from the end of the quarter in which the information was filed. The first information shall be exchanged by 31 October 2020.

The beginning of the reporting obligations is depicted in the following chart:

What are the sanctions in case of default?

The draft law introduces fines of up to EUR 250 000 which are set on intermediaries and taxpayers who fail to comply with their reporting obligations in Luxembourg. The maximum amount of the fines corresponds to the amounts applicable in cases of non-compliance with FATCA (the amended Law dated 18 December 2015), the Common Reporting Standard (CRS) and of the law dated 23 December 2016 on country by country reporting (CbCR).

The setting of the amount of the fines will be done on a case-by-case basis, considering the intentional nature of the offense. Based on experience, the Luxembourg tax authorities generally adopt a reasonable approach when it comes to the levy of penalties. An appeal against the fine is available to the intermediary or to the relevant taxpayer.

What's next?

The measures introduced by the draft law will now have to go through the legislative process (i.e. comments from the different professional Chambers and the Council of State, potential amendments, Report of the budget and finance commission). The draft law should be voted by 31 December 2019 at the latest and the new reporting requirements should apply as from 1 July 2020.

Nonetheless, cross-border arrangements whose first step was implemented between the date of entry into force of DAC 6 (i.e. the 25 June 2018), and the date of application of this draft law (i.e. 1 July 2020) will also be reportable, by 31 August 2020. Thus, as expected, any cross-border arrangement designed and/or promoted since the 25 June 2018 is potentially reportable under the Intermediary Directive and intermediaries would need to take adequate measures in this respect.

It is common knowledge that the investments and business activities of Luxembourg companies often have a cross-border dimension. In all of these cases, the question has to be answered as to whether a particular piece of advice, or involvement in implementation, is reportable or not. As

such, the reporting obligations regarding potentially aggressive cross-border tax arrangements will become an integral part of each and every tax analysis.

This forces all parties involved to constantly consider reporting obligations under the new disclosure regime which will likely have the desired deterrence effect.