

Reproduced with permission from Daily Tax Report: International, Published August 28, 08/28/2019. Copyright © 2019 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

INSIGHT: Double Taxation Dispute Resolution Mechanisms in Luxembourg



BY ROMAIN TIFFON AND MARIE BENTLEY

Over the past few years, new tax regulations have increased significantly and have created legal uncertainty for the taxpayer. International tax issues have never been so numerous and growing international tax pressure increases the risk that two jurisdictions will seek to tax the same transactions or activities, thus resulting in a potential double taxation. While double tax treaties (DTTs) should resolve most double taxation issues directly, international double taxation may persist in cases where two jurisdictions disagree on the interpretation or application of a treaty provision.

For many years, Article 25 of the OECD Model Tax Convention has provided for a mutual agreement procedure (MAP), independent from the ordinary legal remedies available under domestic law, through which the competent authorities of the contracting states may resolve differences or difficulties regarding the interpretation or application of the relevant DTT on a mutually-agreed basis. In practice, the success of this procedure has been limited.

As a result, and in the framework of Actions 14 and 15 of the BEPS Project Reports, a mandatory binding MAP arbitration (MBMA) provision has been developed within the multilateral instrument (the MLI) to strengthen the effectiveness and efficiency of the MAP process in resolving treaty-related disputes.

For this purpose, the MLI sets up minimum standards agreed on by over 90 countries, including Luxembourg,

Romain Tiffon is Partner and Head of International and Corporate Tax, and Marie Bentley is Knowledge Manager, at ATOZ Tax Advisers (Taxand Luxembourg)

which signed the MLI on June 7, 2017, and modifies the covered DTT (28 jurisdictions have already opted to introduce an arbitration procedure to their tax treaties). On August 28, 2017, the Luxembourg tax authorities also released a circular (the Circular) on the procedures implementing the double taxation dispute resolution mechanisms provided for by DTT concluded by Luxembourg.

Simultaneously, a directive on tax dispute resolution mechanisms in the EU was adopted on October 10, 2017 (the MAP Directive) to resolve double taxation issues in the context of the proper functioning of the internal market. The Luxembourg government submitted a draft law on double taxation dispute resolution mechanisms to the Luxembourg Parliament on April 11, 2019 (the Draft Law) in order to implement the MAP Directive by the end of 2019.

Scope of the New Mechanisms

The MAP targets situations of double taxation, where such issues arise from the interpretation and application of agreements and conventions that provide for the elimination of double taxation of income and, where applicable, capital (the double taxation dispute). Double taxation disputes are related to imposition by two (or more) states of taxes in respect to the same taxable income or capital when this gives rise to either an additional tax charge, increase in tax liabilities or cancellation or reduction of losses, all of which could be used to offset taxable profits.

While they share the same purpose, the scope and means used by the MAP Directive and the MLI diverge slightly. The MAP Directive deals with disputes between EU member states concerning the interpretation and application of bilateral DTTs or of the EU Arbitra-

tion Convention. The MAP Directive must be implemented in national laws by the end of 2019.

In a different way, the MLI modifies targeted bilateral DTTs, including their MAP provision, when two contracting parties adopt the same MLI options and depending on the reservation made by each.

As EU member states are MLI signatories, when it comes to European double taxation disputes EU taxpayers should have the option to choose which procedure to follow but cannot conduct the two procedures concomitantly. As far as the U.S. is concerned, Article 27 of the DTT between Luxembourg and the U.S., providing for a MAP, has not been modified by the MLI because the U.S. did not sign the MLI.

How Do the New Mechanisms Work?

The MLI and the MAP Directive put in place a three-step double taxation dispute resolution mechanism, which forces the relevant competent authorities to resolve all disputes affecting the tax position of businesses and citizens which originate from a DTT.

The Complaint Under both the MLI and the MAP Directive, where a taxpayer considers that actions of one or both contracting states of a DTT result or will result in taxation not in accordance with the provisions of the DTT, they may present a complaint to the competent authority of either contracting jurisdiction. In principle, the complaint will be addressed to the competent authorities of the country where the taxpayer is resident. In Luxembourg, the competent authority is described in the Circular and depends on the topic of the dispute.

The complaint must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the relevant tax treaty.

The opening of the MAP is therefore subject to the prior intervention of an administrative measure which may result in either immediate taxation or taxation which is sufficiently precise in principle (i.e. taxpayer and tax concerned, taxable years, motivations) to enable the competent authorities to assess the risk of taxation not in accordance with the DTT. This could be either the first notification of the action resulting in disputed taxation, or the notification of the tax assessment (sections 100a or 210 *alinéa 1 de la loi générale des impôts modifiée* (AO)), or the notification of the taxation basis (under section 213 *alinéa 2* AO).

This alternative starting point for the computation of the three-year deadline creates legal uncertainty. It would have been better to choose the administrative measure which results in an effective taxation as the only starting point.

Once the complaint has been lodged, each competent authority decides on its admissibility without assessing its merits. The complaint will be rejected if there is no question of dispute, the relevant deadlines are not respected, or the required information is missing.

While the MAP Directive describes the information to be provided with the complaint, the MLI does not. However, in recognition of the wide variety of legal and tax systems, and the fact that each competent authority relationship is unique, the MLI requires that the competent authorities of the contracting jurisdictions settle the mode of application, including (but not limited to) the minimum information necessary for each compe-

tent authority to undertake substantive consideration of the issue.

Contracting jurisdictions should thus publish their own guidelines indicating the information that would be required for consideration of a complaint. Luxembourg describes this information in the Circular.

When a complaint is rejected at this stage, taxpayers have the right to contest the rejection under the MAP Directive provisions; however a similar right of appeal is not provided for in the MLI.

The MAP

Where each competent authority has accepted the complaint, and none of them has resolved the double taxation dispute on a unilateral basis, they will attempt to resolve it by mutual agreement, in accordance with the terms of the relevant DTT and national laws. Once the competent authorities have reached an agreement as to how to resolve the double taxation dispute, their decision is binding on the national authority and enforceable by the taxpayer.

The MAP has not been fundamentally modified by the MLI and the MAP Directive, despite the latter nevertheless providing some useful practical procedural information. The real change brought on by these regulations is that the complaint can longer fall on deaf ears. Where no agreement is reached, the taxpayer will be informed of the general reasons why the competent authorities could not reach an agreement and the taxpayer will be entitled to initiate the MBMA.

As far as specific Luxembourg/U.S. relationships are concerned, the MBMA does not apply to double taxation disputes in relation to the USA/Luxembourg. For example, if the tax authorities fail to come to a mutual agreement within the framework of the MAP provision of the U.S.-Luxembourg DTT, the taxpayers have no other means to force the authorities to find a solution to solve their double taxation issues but to use national remedies, with the risk that the double taxation never be solved in practice. If the same situation occurs between countries applying the MBMA, a solution to the double taxation must be found.

If the new double taxation dispute resolution mechanisms appear anecdotal at first sight, compared to other MLI provisions and BEPS related measures, they may well be taken into consideration by investors when they decide where to locate their business.

Mandatory Binding MAP Arbitration

Under the MLI and the MAP Directive, when the competent authorities are not able to reach an agreement to resolve a case within a period of two years (under the MLI, this period can be extended to three years, but Luxembourg did not choose such option), under the MAP, unresolved issues may be subject to the MBMA. The process diverges slightly under the MAP Directive and under the MLI, but the result is the same.

Under the MAP Directive, the dispute resolution procedure could take the form of an advisory commission, consisting of both representatives of the tax authorities concerned and independent persons of standing. The advisory commission is required to deliver an opinion based on the provisions of the applicable DTT or conventions as well as any applicable national rules within

a six- to nine-month time frame. When issuing its opinion, the commission has a consultative role, and provided that the competent authorities reach an agreement, they may take a final decision, within a six-month period, which deviates from the opinion of the commission.

If they fail to reach an agreement on how to resolve the double taxation dispute, the competent authorities should take a final binding decision with reference to the opinion of the commission. The dispute resolution procedure could also take the form of an alternative dispute resolution commission providing for more flexibility in the choice of dispute resolution methods. In the latter case, member states could choose, through bilateral agreement, to use any resolution process, such as the “final offer” arbitration process (otherwise known as “last best offer” arbitration) to solve the dispute in a binding manner.

Under the MLI, the default process chosen by Luxembourg is the “final offer” arbitration process, according to which the competent authorities must actively propose a solution to an arbitration panel. Under this approach, except when the competent authorities mutually agree on different rules, the competent authorities will each submit a proposed resolution, that may be supported by a position paper, to the arbitration panel addressing all the unresolved issues of the case in a manner consistent with any previous agreements that have been reached in the case by the competent authorities.

Each competent authority may also submit a reply submission with respect to the proposed resolution and supporting position paper submitted by the other competent authority. The arbitration panel will then select, as its decision, one of the proposed resolutions submitted by the competent authorities. This decision will be adopted by a simple majority of the panel members and will not include any rationale or explanation.

Following the receipt of this, the competent authorities will enter into a mutual agreement that in principle reflects the outcome of the arbitration decision, unless they agree on a different solution. The MLI does not provide deadlines within which the competent authorities’ final decision must be taken.

Under both the MLI and the MAP Directive, the final decision taken by the competent authorities shall not constitute a precedent but shall be binding, in principle, on the relevant States except in the three following situations:

- if a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision;

- if a person directly affected by the case pursues litigation on the issues which were resolved in the mutual agreement implementing the arbitration decision in any court or administrative tribunal. This ensures that where a state is not permitted under its domestic law to require a taxpayer to agree to forgo litigation as part of accepting a decision under the MAP, that litigation cannot be used to achieve non-taxation or reduced taxation, for example by asserting that the arbitration decision binds one contracting jurisdiction while the outcome of the litigation binds the other.

- if the arbitration decision is held to be invalid by a final decision of the courts of one of the contracting Ju-

risdictions. This may occur where there has been a procedural failure, such as a violation of the impartiality or independence required from arbitrators, a breach of the applicable confidentiality, or collusion between the taxpayer and one of the contracting jurisdictions, that has materially affected the outcome of the arbitration process. In this case, the request for arbitration shall be considered not to have been made, and the arbitration process shall be considered not to have taken place. It is not expected, however, that a court would overturn an arbitration decision simply because it disagrees with the outcome of the arbitration process.

Interaction with Other Proceedings

The MAP and MBMA are available to taxpayers irrespective of the judicial and administrative remedies provided by the domestic law of the relevant jurisdictions. As a result, taxpayers could, in principle, run two parallel proceedings simultaneously. Most tax administrations, however, will require that one process takes place before the other. To accommodate this approach, the MLI provides that where a competent authority suspends the MAP because a dispute with respect to one or more of the same issues is pending before a court or administrative tribunal, the two-year deadline to provide the mutual agreement stops running (Article 19 section 2).

In an EU context, the submission of a complaint does not preclude taxpayers from using the remedies available under domestic law but shall terminate any other ongoing MAP or dispute resolution procedure under a DTT or convention that is being interpreted or applied in relation to the relevant question of dispute.

Nevertheless, a mutual agreement concluded by the competent authority cannot override the decision of a court or administrative tribunal of that jurisdiction, either as a matter of law or as a matter of administrative policy or practice. Thus, where a judgment on the double taxation dispute has already been rendered by the Tribunal or the Administrative Court and has acquired the force of *res judicata* and the national law of that member state does not allow it to derogate from the decision, the MAP or the MBMA is to be terminated.

As per the Luxembourg Draft Law, the final decision resulting for the MAP or the MBMA will be treated as a “new fact” within the meaning of paragraph 222 of the Luxembourg General Tax Law (GTL). Paragraph 222 of the GTL allows the tax authorities to issue a corrective tax assessment due to the occurrence of a “new fact.” This will allow the rectification of the measure on which a double taxation dispute is based, notwithstanding the expiry of the statute of limitation, and regardless of whether the mutual agreement or the final decision is likely to result in a higher or lower amount of taxation than that resulting from the measure on which a double taxation dispute is based.

The fact that a MAP is initiated should not prevent the authorities from opening or continuing administrative or criminal proceedings aimed at applying administrative and criminal penalties. Where penalties have been imposed for the offenses of absence of declaration, fraud or tax evasion, the competent authority of Luxembourg may also refuse access to the MAP.

Analysis: Positives and Negatives

The new double taxation dispute resolution mechanisms are positive for taxpayers as they can now expect real and effective solutions to their various double taxation issues. Nevertheless, the average period of five to seven years within which the competent authorities may take their final decisions is far too long to ensure legal certainty and predictability in the application of the tax law for businesses. A shorter time frame would have been key to improving the effectiveness of the MAP.

Another key element that would improve legal certainty would have been for the final decision to be made available to the public, at least to a certain extent (i.e. anonymized summary of the decisions). Under the MAP

Directive, the competent authorities may agree to publish the final decisions in their entirety, subject to consent of each of the affected person concerned. Where the competent authorities or affected person concerned do not consent to publishing the final decision in its entirety, the competent authorities shall publish an abstract of the final decision. However, under the MLI, this obligation unfortunately does not exist.

Romain Tiffon is Partner and Head of International and Corporate Tax, and Marie Bentley is Knowledge Manager, at ATOZ Tax Advisers (Taxand Luxembourg).

The authors can be contacted at: romain.tiffon@atoz.lu; marie.bentley@atoz.lu

This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners