ATOZ
TAX ADVISERS LUXEMBOURG

ATOZ ALERT

DAC6 – Luxembourg implements the New Reporting Obligations of Tax Intermediaries

23 March 2020

On Saturday 21 March 2020, the Luxembourg parliament passed the law implementing the Council Directive (EU) 2018/822 of 25 May 2018 ("DAC6") regarding the mandatory exchange of information in the field of taxation in relation to reportable cross-border arrangements.

As expected, the wording of the law largely resembles the wording of DAC6 and the commentaries to the draft law provide few explanations on how it will be interpreted and applied in practice. Therefore, some of the rather vague terms and concepts used in DAC6 will continue to give rise to uncertainty and will require interpretation.

The investments and business activities of Luxembourg companies often have a cross-border dimension. In these cases, the question needs to be answered whether a particular piece of advice, or involvement in implementation, is reportable. This article provides a clear and concise overview of the new mandatory disclosure regime and the mechanism that triggers reporting obligations.

What type of arrangements will need to be reported?

Under the law, EU tax intermediaries such as tax advisers, accountants and lawyers who 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 of more than one step. Hence, the understanding of the term within the meaning of the 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 law. These hallmarks describe characteristics or features of cross-border arrangements that might present an indication of a potential risk of tax avoidance.

Certain hallmarks must fulfil a Main Benefit Test ("MBT"). The 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, is the obtaining of a tax advantage."

The 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 law shall not apply to value-added tax and customs duties, nor to excise duties covered by other EU legislation on administrative cooperation between Member States. This law shall also not apply to compulsory social security contributions.

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

Hallmarks are divided into two categories: generic and specific. Generic hallmarks target features that are common to promoted schemes, such as the requirement for confidentiality or the payment of a premium fee. Generic hallmarks can be used to capture new and innovative tax planning arrangements as well as mass-marketed transactions that promoters may easily replicate and sell to a variety of taxpayers.

Specific hallmarks are used to target known vulnerabilities in the tax system and techniques that are commonly used in tax avoidance arrangements such as the use of loss creation, leasing and income conversion schemes.

The law follows the logic of DAC6 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 law nor the commentaries to the draft law provide much explanation on the interpretation of these hallmarks. However, given that the mandatory disclosure regime (DAC6) 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 useful source of interpretation.

What is the Main Benefit Test?

Many of the hallmarks set out in the annex to the 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 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.

As mentioned above, 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 to 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. In practice, arrangements may not meet the MBT if the taxpayer can demonstrate that the value of any tax benefits was incidental when viewed in light of the commercial benefits of the transaction as a whole. Moreover, cross-border arrangements are generally taxpayer and transaction specific and not widely promoted as domestically marketed schemes.

It is interesting to note that DAC 6 explicitly states that the tax treatment of a cross-border payment at the level of the recipient cannot alone be a 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. Likewise, the "converting income scheme" hallmark is subject to the MBT despite investors may benefit from a full tax exemption (suggesting that a tax exemption does not, on its own, suffice for the MBT to be met).

Taxpayers are generally free to choose the option that results in the lowest tax liability including, amongst others, the choice of financing instruments (be it equity or debt) and, in an EU context, the choice of the EU Member State in which an entity is established and managed (also referred to as freedom of establishment). On the contrary, investment managers and multinationals have a fiduciary duty towards their investors to not pay more taxes than legally due (considering all applicable tax laws). Thus, the very fact that there exists an alternative that gives rise to a higher effective tax rate cannot inform the analysis of the MBT unless it can be established that the tax advantage defeats the object or purpose of the applicable tax law.

When there is a series of arrangements, the MBT should be applied in regard to the series of arrangements rather than singling out one specific arrangement. In addition, when a new arrangement is included in a series of arrangement, it should be the series of arrangements that is tested for the purposes of the MBT.

Overall, the MBT comes down to the assessment as to whether an arrangement or a series of arrangements is tax driven (i.e. targeting a tax benefit that is not ancillary to the commercial benefit) or the tax advantage is ancillary to the main benefit of generating on-going income and benefiting from value appreciation at the end of the investment (the latter can be referred to as optimising the tax position in accordance with all applicable tax laws).

Last but not least, the EU Anti-Tax Avoidance Directives ("ATAD I & II") required EU Member States to implement a number of anti-abuse rules in their domestic tax laws as from 2019 including hybrid mismatch rules, interest limitation rules, controlled foreign company ("CFC") rules, a general anti-abuse rule ("GAAR") and exit tax rules. Thus, explicit rules exist in all the areas that have been identified as critical and taxpayers can merely comply with the applicable rules rather than taking advantage of loopholes that may otherwise meet the MBT.

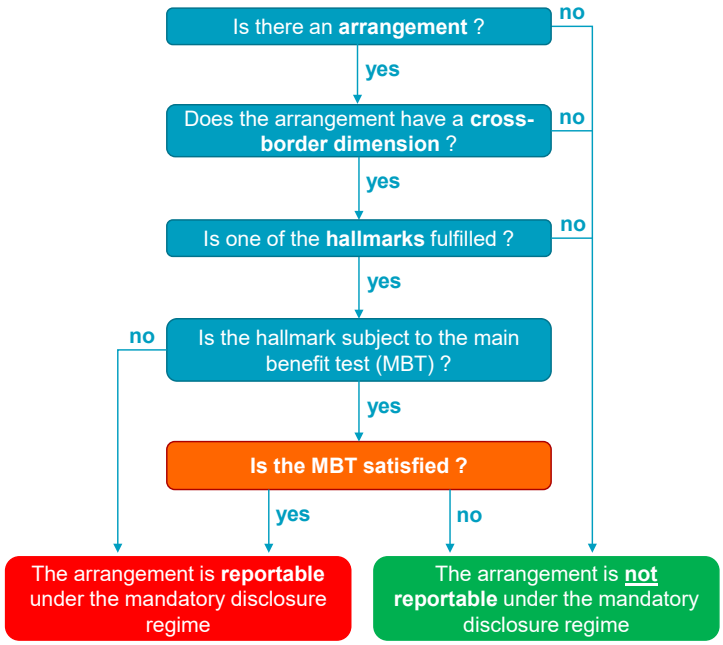
How are reportable cross-border arrangements determined?

When determining whether advice on a particular arrangement is reportable under the mandatory disclosure regime, it is first necessary to analyse whether the arrangement has a cross-border dimension, and then whether one of the hallmarks is present.

When at least one of the hallmarks is fulfilled, it is necessary to verify whether the hallmark is subject to the MBT. If this is not the case, there is an automatic reporting obligation under the mandatory disclosure regime. When the hallmark is subject to the MBT, it is necessary to perform a comprehensive analysis of all relevant facts and circumstances in order to determine whether the main benefit or one of the main benefits was the obtaining of a tax advantage.

Given that many of the hallmarks and the application of the MBT require a good understanding of international tax law and some kind of judgement, the analysis of potential reporting obligations under the mandatory disclosure regime is generally not the role of a person with a risk management profile but requires the involvement of a person with a tax background.

The analysis to be performed is depicted in the checklist below:



Which information will need to be reported?

If a cross-border arrangement is treated as reportable under the 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 law to the Luxembourg authorities can be used for taxation purposes, for tax collection purposes and for the verification of the Common Reporting Standard (CRS) reporting duties.

Who will be subject to reporting?

The reporting responsibilities regarding cross-border arrangements generally rest with the 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 on 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.

The circle of intermediaries further includes any person that knows, 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 definition of intermediaries envisages two distinct types of intermediaries:

(i) Primary intermediaries that are involved in designing, marketing, organising or managing the implementation of an arrangement; and

(ii) Secondary intermediaries who provide aid, assistance or advice in relation to the designing, marketing, organising or implementation of reportable cross-border arrangements.

It follows that the understanding of the concept of intermediary is very broad and may include, in particular, tax advisers, lawyers, financial advisers and accountants. However, as the case may be, other service providers such as consultants, banks, insurance companies or investment managers may qualify as intermediaries within the meaning of the MDR.

This broad definition of the term "intermediary" will likely result in overlapping reporting obligations. According to the 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 reported by another intermediary. In addition, Luxembourg tax intermediaries are exempt from reporting if they can prove that the same cross-border arrangement has already been reported in another EU Member State.

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. Here, taxpayers will have at a minimum to coordinate between the different intermediaries involved (in different EU Member States) in a cross-border arrangement.

In practice, it may often not be self-evident whether or not a service provider is an intermediary. This is all the more true in case of secondary intermediaries that are only remotely involved in a transaction. Intermediaries are not, however, expected to do significant extra due diligence to establish whether there is a reportable arrangement. Intermediaries are further not expected to start investigations into arrangements that they are merely aware of.

In these circumstances, the defence for service providers that they did not know and could not reasonably be expected to know that they were part of a reportable arrangement may often be validly put forward since a service provider might only be involved in a particular part of a wider arrangement, such as a bank providing finance or facilitating payments.

The reporting obligations under the 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 law. 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 stays with the taxpayer who benefits from the arrangement.

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

According to the law, lawyers subject to the law of 10 August 1991, chartered accountants subject to the law of 10 June 1999 and auditors subject to the law of 23 July 2016 may rely on their professional secrecy and have the right to a waiver from filing information on a reportable cross-border arrangement.

Nevertheless, this waiver applies only to the extent that lawyers, chartered accountants and auditors act within the limits of their own profession.

In such circumstances, lawyers, chartered accountants and auditors acting as intermediary in the sense of the law must notify their waiver within 10 days to any other intermediary or, if there is no such intermediary, to the relevant taxpayer. In this 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.

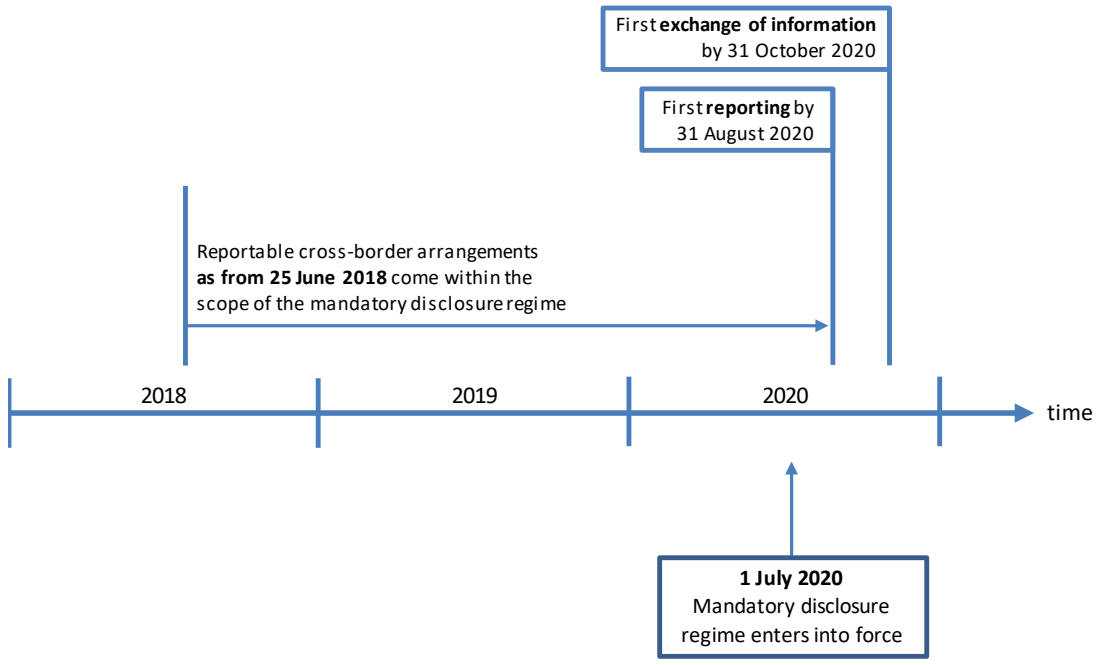
When will the reporting have to be performed?

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

- periodic reporting every three months when cross-border arrangements are designed, marketed, ready for implementation or made available for implementation without a need to be substantially customised;
- 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;
- within 30 days beginning on the day after aid, assistance or advice is provided by an intermediary, directly or by means of other persons;
- by 31 August 2020 for reportable cross-border arrangements whose first step was implemented between 25 June 2018 and 30 June 2020;
- 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:

Beginning of the reporting obligations



What are the sanctions for default?

The law introduces fines of up to EUR 250,000 (USD 276,000) for 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 CRS, and with the law dated 23 December 2016 on country-by-country reporting.

The Luxembourg tax authorities will verify whether tax intermediaries and taxpayers adopt a process for insuring compliance with the mandatory disclosure regime (Article 16 (1) of the law). Such mandatory disclosure regime process should ideally be formalised in a policy that may provide guidance for employees, set out responsibilities and consider practical aspects, such as how the reporting is managed from an operational perspective.

Based on experience, it can be assumed that the Luxembourg tax authorities will levy measured penalties in case of wrongdoing (for example, in case of CRS or FATCA reporting), taking into consideration the level of care taken by the tax intermediaries and taxpayers. When tax intermediaries and taxpayers use their best efforts and dedicate appropriate resources to the implementation of an MDR process (including training of staff) and its systematic application, there should be limited risk of penalties. However, in the absence of any efforts to comply with the MDR, it may be expected that Luxembourg tax authorities will levy penalties.

An appeal against the fine is available to the intermediary or to the relevant taxpayer.

Going forward

The new reporting requirements will apply as from 1 July 2020. Nonetheless, cross-border arrangements whose first step was implemented between the date of entry into force of DAC6 (i.e. 25 June 2018), and the date of application of this law (1 July 2020) will also be reportable by 31 August 2020. Thus, as expected, any cross-border arrangement designed and/or promoted since 25 June 2018 is potentially reportable under DAC6, and intermediaries would need to take adequate measures in this respect.

Planning points

The analysis of potential reporting obligations under the new mandatory disclosure regime will necessarily become an integral part of each and every tax analysis. This on its own will have the desired deterrence effect as both tax intermediaries and taxpayers will need to carefully consider potential reporting obligations.

With the law being voted, tax intermediaries and taxpayers are now in a position to prepare themselves for the new reporting obligations. In this regard, it would be wise to allocate a person with a good understanding of (international) taxation to the task, develop internal guidelines and processes, train staff involved and analyse potentially reportable cross-border arrangements as from 25 June 2018 to clear the backlog.

Ultimately, despite the fact that we are currently witnessing an unprecedented situation with the global pandemic of COVID-19 that will surely have a severe impact on the world economy and an immediate affect on how business is conducted in an environment of social distancing, taxpayers and intermediaries would be wise to consider 1 July 2020 (the date the MDR enters into force) and 30 August 2020 (filing of reports regarding arrangements that have been implement as from 25 June 2018) as relevant dates.

Do you have further questions?

OLIVER R. HOOR
Partner,
International & Corporate Tax
oliver.hoor@atoz.lu
T + 352 26 940 646

MARIE BENTLEY
Knowledge Director

marie.bentley@atoz.lu
T +352 26 940 903

Visit our Media Room for further reading on the DAC6 Directive and how we can help ensure compliance.