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INSIGHT: The Main Benefit Test under the Mandatory Disclosure Regime: Considerations regarding anti-abuse legislation

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In the third of a series of three articles, Oliver R. Hoor and Fanny Bueb of ATOZ Tax Advisers (Taxand Luxembourg) provide an overview of the main benefit test ("MBT") and analyze its links to anti-abuse legislation.

1. Introduction

On 8 August 2019, a draft law (the "Draft Law") implementing the Council Directive (EU) 2018/822 of 25 May 2018 as regards mandatory exchange of information in the field of taxation for reportable cross-border arrangements ("DAC 6") was submitted by the government to the Luxembourg parliament. The Draft Law is expected to be adopted soon and will apply as from 1 July 2020.

Under the mandatory disclosure regime ("MDR"), tax intermediaries such as tax advisers, lawyers and accountants that design, promote or provide assistance in regard to certain cross-border arrangements will have to report these to the Luxembourg tax authorities.

Cross-border arrangements may be reportable if they contain at least one of the hallmarks (that are characteristics or features of cross-border arrangements that might present an indication of tax avoidance) listed in the annex to the Draft Law. However, while some hallmarks trigger automatic reporting obligations, many of the hallmarks operate in conjunction with the main benefit test ("MBT") as a threshold requirement. The MBT aims to filter out irrelevant reporting that would otherwise diminish the quality of the information provided to the tax authorities.

The MBT has some features that can also be found in anti-abuse legislation such as the General Anti-abuse Rule ("GAAR") under domestic tax law and the principal purposes test ("PPT") in tax treaties. Therefore, the analysis of the MBT should not be made in isolation from the analysis of such anti-abuse rules.

2. The Main Benefit Test ("MBT")

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(s) with any other (commercial) benefits likely to be obtained from the transaction. This requires an objective analysis of all benefits obtained from an arrangement. According to the Final Report on Action 12 of the Base Erosion and Profit Shifting ("BEPS") Project, the MBT sets a relatively high threshold for disclosure.

It is interesting to note that the tax treatment of a (deductible) 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.

For those hallmarks that need to meet the MBT as a threshold condition for disclosure, the MDR can be difficult to apply in the context of cross-border arrangements that trigger tax consequences in a number of different jurisdictions. In practice, such arrangements may not meet the MBT if the taxpayer can demonstrate that the value of any (domestic) tax benefits was incidental when viewed in light of the commercial benefits of the transaction as a whole (See No. 229 of the Final Report on BEPS Action 12).

3. Considerations regarding anti-abuse legislation

3.1. The General Anti-Abuse Rule ("GAAR")

In 2019, the Luxembourg abuse of law concept, as defined in section 6 of the Tax Adaptation Law, has been amended in accordance with the GAAR provided under the EU Anti-Tax Avoidance Directive ("ATAD").

According to the GAAR, non-genuine arrangements or a series of non-genuine arrangements put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law shall be disregarded.

Arrangements are considered as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. In other words, the GAAR applies in case of artificial arrangements that lack commercial rationale. On the contrary, the existence of commercial reasons and business purpose excludes the application of the GAAR.

When the Luxembourg tax authorities can evidence an abuse in accordance with the new GAAR, the amount of taxes will be determined based on the legal route that is considered as the genuine route (i.e. based on the legal route which would have been put into place for valid commercial reasons which reflect economic reality).

Despite the scope of the MDR is broader than that of the GAAR, the existence of commercial reasons is helpful to rule out a potential application of the GAAR and to inform the analysis of the MBT.

3.2. The Principal Purposes Test ("PPT")

The PPT has been developed as part of the OECD's work on BEPS Action 6 (Prevention of tax treaty abuse) and implemented in bilateral tax treaties through the multilateral instrument ("MLI").

The PPT reads as follows: *"Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention"* (Paragraph 9 of Article 29 of the 2017 version of the OECD Model Tax Convention).

Accordingly, the PPT would deny a treaty benefit where it is reasonable to conclude that obtaining this treaty benefit was *"one of the principal purposes"* of any arrangement or transaction unless the taxpayer is able to establish that granting the benefit would be *"in accordance with the object and purpose"* of the relevant treaty provisions.

The contradictory message of the PPT is that treaty benefits are available to qualifying taxpayers unless taxpayers intend to gain from those benefits. Obviously, this injects a subjective element into every aspect of determining whether treaty benefits are available.

However, the Commentary to the OECD Model Tax Convention emphasises that it is important to undertake an objective analysis of the aims and objects of all persons involved in putting that arrangement or transaction in place or being a party to it. It is further stated that it should not be lightly assumed that obtaining a benefit under a tax treaty was one of the principal purposes of an arrangement or a transaction. Moreover, merely reviewing the effects of an arrangement will not usually enable tax authorities to draw a conclusion about its purposes (see Paragraph 178 of the Commentary on Article 29 of the OECD Model Tax Convention).

If it can be established that the main benefit (or one of the main benefits) of an arrangement or a series

of arrangements is obtaining a tax benefit, it is reasonable to conclude that this was one of the principal purposes of the arrangement. Thus, when a tax benefit is derived from an applicable tax treaty, the conclusion that the MBT is satisfied pre-empts somewhat the outcome of the PPT analysis.

3.3. Other anti-abuse legislation

Other anti-abuse legislation that may share some traits with the MBT includes, in particular, anti-Directive/anti-treaty shopping legislation that denies the benefits of an EU Directive or an applicable tax treaty (i.e. reduced or zero withholding tax rates) in case the recipient of an income (dividends, interest or royalties) lacks substance or is not the beneficial owner thereof.

Despite the differences that may exist between the MBT and such other anti-abuse legislation, the assessment that the main benefit or one of the main benefits of an arrangement or a series of arrangements was a tax advantage cannot be helpful when taxpayers defend the non-application of such anti-abuse legislation.

4. To sum up

The MBT is a threshold requirement that operates in conjunction with a number of hallmarks that only trigger reporting obligations if the MBT is met. This makes the MBT a cornerstone of the MDR.

The MBT has some features that can also be found in anti-abuse legislation such as the GAAR or the PPT. Therefore, the interpretation of the MBT cannot be seen in isolation from such anti-abuse legislation. Overall, the assessment as to whether or not a main benefit of an arrangement or a series of arrangement was a tax advantage for the purposes of the MBT should be consistent with the assessment for the purposes of anti-abuse legislation.

Nevertheless, reporting under the MDR does not mean that a taxpayer engages in illegal conduct or that the tax treatment of a cross-border arrangement can be challenged. It may, however, be assumed that reported cross-border arrangements will be more in the focus of the tax authorities, all the more when it is concluded that the MBT is met.

5. Planning points

Given that the assessment of the MBT may also be considered by tax authorities when analysing the potential application of anti-abuse legislation, it should not be easily concluded that the MBT is met. Instead, tax intermediaries need to perform a comprehensive analysis of all relevant facts and circumstances before concluding on the MBT.

When cross-border arrangements are reported under the MDR, it is imperative for taxpayers to consider this in their tax controversy management. Here, it would be wise to pro-actively prepare a defence file. Ultimately, the MDR will become an integral part of each and every tax analysis and raise the awareness about international taxation to an unprecedented level.

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