Executive summary

On 21 March 2020, the Luxembourg Parliament approved the draft law implementing the European Union (EU) Directive on the mandatory disclosure and exchange of cross-border tax arrangements (referred to as DAC6 or the Directive).

Under DAC6, taxpayers and intermediaries are required to report cross-border reportable arrangements from 1 July 2020. However, reports will retrospectively cover arrangements where the first step is implemented between 25 June 2018 and 1 July 2020 (the transitional period). The deadline for the first reporting for the transitional period is 31 August 2020.

The final Luxembourg Mandatory Disclosure Rules (MDR) legislation is broadly aligned to the requirements of the Directive.

The Luxembourg final legislation (the Law) is mostly in line with the draft legislation published in August 2019, except for the provisions which concern the reporting exemption based on legal professional privilege (LPP). These amendments have been made to address the formal oppositions that were raised by the Luxembourg State Council.

The Law will be effective from 1 July 2020.
Detailed discussion

Background

The Directive requires intermediaries (including EU-based tax consultants, banks and lawyers) and in some situations taxpayers to report certain cross-border arrangements (reportable arrangements) to the relevant EU member state tax authority. This disclosure regime applies to all taxes except value added tax (VAT), customs duties, excise duties and compulsory social security contributions. Cross-border arrangements will be reportable if they contain certain features (known as hallmarks). The hallmarks cover a broad range of structures and transactions. For more background, see EY Global Tax Alert, Council of the EU reaches an agreement on new mandatory transparency rules for intermediaries and taxpayers, dated 14 March 2018.

As discussed in EY Global Tax Alert, Luxembourg submits draft law implementing EU Mandatory Disclosure regime to Parliament, dated 21 August 2019, addressing the draft legislation, the key differences between the final Luxembourg legislation and the Directive are as summarized below. This Alert also highlights the amendments to the Luxembourg legislation since issuing draft legislation.

Scope of taxes covered
The scope of taxes covered under the Luxembourg final legislation is fully aligned with the Directive and applies to all taxes except VAT, customs duties, excise duties and compulsory social security contributions and any other taxes excluded from the scope of the Directive.

Reportable arrangements
Under the Directive, an arrangement is reportable if:

- The arrangement meets the definition of a cross-border arrangement; and
- The arrangement meets at least one of the hallmarks A-E specified in Annex IV of the Directive.

Under DAC6, cross-border arrangements are defined as arrangements concerning more than one Member State or a Member State and a third country. The hallmarks can be distinguished as hallmarks which are subject to the main benefit test (MBT), and those which by themselves trigger a reporting obligation without being subject to the MBT.

Under the Luxembourg final legislation, an arrangement is reportable under the same circumstances as described by the Directive.

The comments to the Law indicate that a case-by-case analysis is required to determine if an arrangement should be regarded as a reportable cross-border arrangement within the meaning of the law. Cross-border arrangements or schemes that potentially indicate tax avoidance are intended to be covered by DAC6. This is assumed to be the case if one or more hallmarks are triggered (in some cases in combination with the MBT).

Hallmarks A-E of the Directive
Most elements of the hallmarks included in DAC6 are not expressly defined. The Luxembourg final legislation does not provide clarification on these elements.

The final legislation does not extend the list of hallmarks beyond those listed in DAC6. Purely domestic transactions or arrangements are not subject to reporting.

Main benefit test
In accordance with DAC6, the MBT will be satisfied 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.”

The comments to the Law provide some clarification on the methodology to perform when applying the MBT and refer specifically to the OECD\(^4\) BEPS\(^5\) Action 12 Final Report (2015) on Mandatory Disclosure Rules, inasmuch as it prescribes a comparison of the expected tax benefit with all other advantages which might ensue from the cross-border arrangement, on the basis of an objective assessment of the tax advantages.

In accordance with the comments to the Law, the MBT criterion is not met if the tax advantage is obtained by means which are consistent with the aim of the applicable legislation and the intention of the legislator. To determine if a given arrangement is consistent with such intention, all the elements of the arrangement must be considered. An arrangement, viewed as a whole, which is not consistent with the intention of the legislator, for example, by making use of the subtleties of a tax system or of the inconsistencies
between two or more tax systems in order to reduce the tax to be paid, will still be regarded as meeting the criterion of the MBT.

According to the comments to the Law the MBT is to be assessed in respect of worldwide direct taxes.

Intermediaries

Under the Directive, intermediaries with EU nexus have the primary obligation to report arrangements to the tax authority. The Directive gives Member States the option to exempt intermediaries from the obligation to report where the reporting obligation would breach LPP. If there are no intermediaries which can report, the obligation will shift to the taxpayers.

The final Luxembourg law defines an “intermediary” as any person that designs, markets, organizes or makes available for implementation or manages the implementation of the reportable cross-border arrangement (promoters) as well as any person that has undertaken to provide, directly or by means of other persons, aid, assistance or advice (service providers) with respect to such activities mentioned immediately above, provided it meets at least one of the following criteria:

1. Is resident for tax purposes in a Member State.
2. Has a permanent establishment in a Member State, through which it provides the services related to the reportable cross-border arrangement.
3. Is incorporated under the laws of a Member State or is subject to the legislation of a Member State.
4. Is registered with a professional organization of a Member State, related to the provision of legal, tax or advisory services.

Only intermediaries with nexus in Luxembourg (as defined by the nexus conditions listed in 1-4 above) have a reporting obligation to the Luxembourg tax authorities.

In accordance with the comments to the Law, it is also understood that where an intermediary exclusively undertakes intermediary type activities as foreseen in the definition of “intermediary,” the intermediary would generally not qualify as a participant to the arrangement, unless it is also “active” in the arrangement.

The draft legislation initially provided for an exemption from reporting only for Luxembourg intermediaries covered by Article 35 of the modified Law on the Legal Profession of 10 August 1991, i.e., lawyers registered with the Luxembourg Bar.

According to explanatory statements, such exemption granted to the lawyers was in particular justified by the fact that a lawyer may be called on to represent the interest of his/her clients in a court procedure in the context of a litigation directly or indirectly linked to a reportable cross-border arrangement. However, as highlighted by the State Council in its opinion on the draft legislation, litigants, whether individuals or corporates, are authorized under Luxembourg law to also, in tax matters, be represented or assisted before the administrative tribunal by a certified accountant (expert-comptable) or an independent auditor (réviseur d’entreprises). Since granting the exemption only to lawyers would have led to unequal treatment in the field of tax advisory services (which was regarded as incompatible with the constitutional principle of equality before the law), the State Council formally requested that the exemption from reporting owing to LPP be extended to all intermediaries subject to professional secrecy, at least in tax matters.

As a result, lawyers, certified accountants and independent auditors are now exempt from reporting under the Law.

The exemption from reporting owing to LPP does not however apply if the intermediary acts outside the limits applicable to the legal profession as prescribed by the applicable legislation.

Intermediaries covered by the reporting exemption are still required to notify, within 10 days, other intermediaries of their obligation to report and, in the absence of an intermediary that has a reporting obligation, to notify relevant taxpayers of their obligations to report (see Reporting deadlines).

Furthermore, in order to allow relevant taxpayers to more easily fulfill their disclosure obligations, the Law provides that intermediaries who qualify for exemption owing to LPP must provide the relevant taxpayers with the relevant information they need to comply with their reporting obligation. The comments to the Law clarify that the relevant information in this case refers to all information listed in Paragraph 14 of Article 8ab (transposed into Article 10 of the Luxembourg law), insofar as it is available to or known by the intermediary.

The draft legislation also initially envisaged an obligation for intermediaries who qualify for exemption owing to LPP to file, with the Luxembourg tax authorities, specified information on a reportable cross-border arrangement. This information was envisaged to include the identification of the relevant intermediary, detailed information on the relevant hallmark rendering the cross-border arrangement reportable,
summary of the content of the reportable cross-border arrangement and detailed information on the legal provisions on which the reportable cross-border arrangement is based. The State Council, however, emphasized that a transmission of information, even anonymized, infringes the LPP, as the LPP covers all information that the professional has obtained in the framework of the exercise of his/her profession. In addition, in the State Council's opinion, the Luxembourg tax authorities may, in certain cases, based on the detailed information on the relevant hallmark(s), be able to identify a particular transaction and the name of the taxpayer concerned.

To address the concerns raised by the State Council, this obligation of anonymized reporting by intermediaries to the Luxembourg tax authorities has been removed from the final legislation.

**Reporting deadlines**

Under DAC6, for intermediaries (and relevant taxpayers), the trigger events for reporting under the Directive (from 1 July 2020) are when the reportable arrangement is “made available for implementation”; or when the reportable arrangement is “ready for implementation”; or when “the first step of implementation has been made,” whichever occurs first. Reporting will have to be made within 30 days. The Luxembourg Law stipulates the same deadlines and reporting trigger events.

In addition, in line with the Luxembourg Draft Law, the Law requires intermediaries who are exempt from reporting pursuant to LPP to notify, within 10 days beginning on the day of the occurrence of the reporting triggering event, any other intermediary (and/or the relevant taxpayer depending on the case) of their reporting obligations.

Under the Directive, reporting starts from 1 July 2020 and exchanges between Member States from 31 October 2020. However, reports will retroactively cover arrangements where the first step is implemented between 25 June 2018 and 1 July 2020.

The Luxembourg reporting deadlines are fully aligned with DAC6.

**Declaration of the use of an arrangement in the tax returns**

In accordance with Article 8ab, Paragraph 11 of the Directive, Luxembourg taxpayers to whom a reportable cross-border arrangement is made available for implementation, or who are ready to implement or have implemented the first step of such an arrangement, are required to declare their use of the arrangement in their annual income tax returns for each of the years where the arrangement is used.

**Penalties**

Monetary penalties for intermediaries and taxpayers not exceeding a maximum of €250,000 will be imposed for failures to report, failures to report in accordance with the statutory deadlines, cases of incomplete reporting or inexact reporting. Intermediaries exempt from reporting owing to LPP may also be fined up to the same amount for failing to notify other intermediaries or relevant taxpayers of their obligation to report within the 10-day prescribed timescale, or for failing to comply with the obligation to provide the concerned taxpayers with the relevant information they need to comply with their disclosure obligation.

According to the comments to the Law, the amount of the penalty will depend on the facts and circumstances of the case and will be determined by whether the infringement was intentional. Any such penalties should meet the requirements of being effective, proportionate and dissuasive.

Both intermediaries and taxpayers may appeal against the penalty in front of the administrative courts.

**Next steps**

Given the extended reporting exemption, in many cases the reporting obligation will be shifted to the taxpayers. Determining if there is a reportable cross-border arrangement raises complex technical and procedural issues for taxpayers and intermediaries. Taxpayers and intermediaries who have operations in Luxembourg should therefore review their policies and strategies for logging and reporting tax arrangements so that they are fully prepared for meeting their obligations within the specific deadlines.
Endnotes

1. For further information on the Luxembourg State Council opinion, see EY Global Tax Alert, Luxembourg State Council issues opinion on draft MDR legislation - Application of legal professional privilege to be revised, dated 28 January 2020.

2. For background on MDR, see EY Global Tax Alert, EU publishes Directive on new mandatory transparency rules for intermediaries and taxpayers, dated 5 June 2018.

3. DAC6 sets out a minimum standard. Member States can take further measures; for example, (i) introduce reporting obligations for purely domestic arrangements; (ii) extend the scope of taxes covered; (iii) bring forward the start date for reporting.


5. Base Erosion and Profit Shifting.
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