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Global Tax Alert

OECD releases Luxembourg Stage 2 peer review report on implementation of Action 14 minimum standard

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Executive summary

On 9 April 2020, the Organisation for Economic Co-operation and Development (OECD) released the Stage 2 peer review report of Luxembourg relating to the outcome of the peer monitoring of the implementation of the Base Erosion and Profit Shifting (BEPS) minimum standard under Action 14 on improving tax dispute resolution mechanisms. Stage 2 focuses on monitoring the follow-up of any recommendations resulting from Luxembourg's Stage 1 peer review report. Luxembourg requested that the OECD also provide feedback concerning their adoption of the Action 14 best practices, and therefore, in addition to the peer review report, the OECD has released an accompanying document addressing the implementation of best practices.¹

The outcome of the Stage 1 peer review process was that overall Luxembourg met most of the elements of the Action 14 minimum standard. Where deficiencies were identified, Luxembourg worked to address them, which has been monitored in Stage 2 of the process. In this respect, Luxembourg has addressed almost all identified deficiencies.

Detailed discussion

Background

In October 2016, the OECD released the peer review documents (i.e., the Terms of Reference and Assessment Methodology) on Action 14 on Making Dispute Resolution Mechanisms More Effective.

The Terms of Reference translated the Action 14 minimum standard into 21 elements complemented by 12 best practices. The Terms of Reference assess a Member's legal and administrative framework, including the practical implementation of this framework to determine how its Mutual Agreement Procedure (MAP) regime performs relative to the 21 elements in four key areas: (i) preventing disputes; (ii) availability and access to MAP; (iii) resolution of MAP cases; and (iv) implementation of MAP agreements.

The Assessment Methodology establishes detailed procedures and guidelines for a two-stage approach to the peer review and monitoring process. Stage 1 involves the review of a Member's implementation of the minimum standard based on its legal framework for MAP and the application of this framework in practice. Stage 2 involves the review of the measures taken by the Member to address any shortcomings identified in its Stage 1 peer review. In light of the above, the OECD has also released a schedule for Stage 1 of the peer review and a questionnaire for taxpayers. The schedule catalogues the assessed jurisdictions into 10 batches for review.

Both of these stages are desk-based and are coordinated by the Secretariat of the Forum on Tax Administration's (FTA) MAP Forum. In summary, Stage 1 consists of three steps or phases:

- (i) Obtaining inputs for the Stage 1 peer review
- (ii) Drafting and approval of a Stage 1 peer review report
- (iii) Publication of Stage 1 peer review reports

Input is provided through questionnaires completed by the assessed jurisdiction, peers (i.e., other members of the FTA MAP Forum) and taxpayers. Once the input has been gathered, the Secretariat prepares a draft Stage 1 peer review report of the assessed jurisdiction and sends it to the assessed jurisdiction for its written comments on the draft report. When a peer review report is finalized, it is sent for approval of the FTA MAP Forum and later to the OECD Committee on Fiscal Affairs' to adopt the report for publication.

For Stage 2, there are two steps or phases: (i) approval of the Stage 2 peer monitoring report of an assessed jurisdiction; and (ii) publication of the Stage 2 peer review reports. More specifically, an assessed jurisdiction should within one year of the adoption of its Stage 1 peer review report by the CFA submit a detailed written report (Update Report) to the FTA MAP Forum. The Update Report should contain: (i) the steps that the assessed jurisdiction has taken or is taking to address any shortcomings identified in its peer review report; and (ii) any plans or changes to its legislative or procedural framework relating to the implementation of the minimum standard. Members of the FTA MAP Forum should also provide their comments on the Update Report provided by the assessed jurisdiction. Based on the Update Report submitted by the assessed jurisdiction and the input from the peers, the Secretariat will revise the Stage 1 peer review report of the assessed jurisdiction with a view to incorporate these updates in the Stage 2 peer monitoring report of the assessed jurisdiction. After adoption by the CFA, the Stage 2 peer monitoring report will be published.

Minimum standard peer review reports

The report is divided into four parts, namely:

- (i) Preventing disputes
- (ii) Availability and access to MAP
- (iii) Resolution of MAP cases
- (iv) Implementation of MAP agreements

Each part addresses a different component of the minimum standard.

Overall the report concludes that Luxembourg addressed almost all the shortcomings identified in its Stage 1 peer review report.

Preventing disputes

The two main elements identified by Action 14 minimum standard to prevent disputes are: (i) the inclusion of a provision similar to Article 25(3), first sentence, of the OECD Model Tax Convention (MTC) as amended by the Action 14 final report in existing tax treaties, requiring tax authorities to resolve by mutual agreement any difficulties or doubts as to the interpretation or the application of the tax treaty and (ii) the provision of a "roll-back" of bilateral or multilateral advance pricing arrangements (APA) that could be relevant in determining the treatment of comparable controlled transactions in previously filed years.

Out of Luxembourg's 85 tax treaties, 84 contain a provision equivalent to (i) above. For the treaty identified that does not contain the equivalent of Article 25(3), first sentence, of the OECD MTC, the relevant peer reported not having contacted or being in contact with Luxembourg to insert the relevant provision.

However, Luxembourg signed the Multilateral Instrument (MLI) and has deposited its instrument of ratification on 9 April 2019. The MLI has for Luxembourg entered into force on 1 August 2019. In regard of the treaty identified above that is considered not to contain the equivalent of Article 25(3), first sentence, of the OECD MTC, Luxembourg listed this treaty as a covered tax agreement under the MLI and notified this treaty. The relevant treaty partner is a signatory to the MLI, listed its tax treaty with Luxembourg under that instrument and also made a notification. As the treaty partner has deposited its instrument of ratification of the MLI, the MLI has entered into force for the treaty between Luxembourg and this treaty partner. Therefore, the MLI has modified the treaty to include the equivalent of Article 25(3), first sentence, of the OECD MTC. As a result, de facto all of Luxembourg's tax treaties contain the required clause.

Luxembourg reported that since 1 April 2017, it has received one multilateral APA request as well as two bilateral APA requests. According to the report, roll-backs of bilateral APAs may be granted, subject to compliance with the applicable statute of limitations. Luxembourg further reported that a roll-back is requested in one of the bilateral APA requests and is still in the process of being reviewed.

Availability and access to MAP

The report also considers the availability and access to MAP.

It was noted that 3 out of Luxembourg's 85 tax treaties do not contain a provision that is equivalent to Article 25(1), first sentence, of the MTC. This provision allows taxpayers to submit a MAP request and present their case to the competent authority of either Contracting State, when considering that the actions of one or both of the treaty partners result or will result in taxation not in accordance with the provisions of the tax treaty, and for this action to be taken irrespective of the remedies provided by the domestic law of either jurisdiction.

Out of these three treaties, two have been modified by the MLI to include the equivalent of Article 25(1), first sentence, of the OECD MTC as amended by the Action 14 final report.

One will not be modified by that instrument to include the required provision. With respect to this treaty, no actions have been taken, but Luxembourg intends to approach the treaty partner in the near future to initiate bilateral negotiations. The report recommends that Luxembourg follow through with its intention without delay and include a provision equivalent to Article 25(1), first sentence, of OECD MTC.

All of Luxembourg's tax treaties are compliant with Article 25(3), second sentence, of the MTC under which competent authorities may consult together for the elimination of double taxation in cases not provided for in their tax treaties, with the exception of two which will be made compliant upon the MLI's entry into force.

With regards to access to MAP in transfer pricing cases, all tax treaties have, or will have through the MLI, a provision equivalent to Article 9(2) of the MTC. Luxembourg reported not having denied access to MAP in these cases and peers confirm that its updated report is in line with their experience.

No further areas of improvement were identified with respect to the availability and access to MAP.

Resolution of MAP cases

In addition to allowing taxpayers to request for a MAP, tax treaties should also include the equivalent of the first sentence of Article 25(2) of the OECD MTC, which obliges competent authorities, in situations where the objection raised by taxpayers is considered justified and where cases cannot be unilaterally resolved, to enter into discussions with each other to resolve cases of taxation not in accordance with the provisions of a tax treaty.

Out of Luxembourg's 85 tax treaties, 83 contain such a provision. Of the remaining two tax treaties one will be modified by the MLI as this treaty partner has deposited its instrument of ratification of the MLI, following which the MLI has entered into force for the treaty between Luxembourg and this treaty partner, and therefore has modified this treaty to include the equivalent of Article 25(2), first sentence, of the OECD MTC.

For the remaining tax treaty, the report recommends that Luxembourg should request the inclusion of an equivalent provision via bilateral negotiations without further delay. Luxembourg reported its intention to contact the treaty partner in the future with a view to engage in such bilateral negotiations.

534 MAP cases were started on or after 1 January 2016, 16 of which concerned attribution/allocation cases and 518 were other cases. At the end of the Statistics Reporting Period, the total post-2015 cases inventory had decreased to 115 cases, consisting of 14 attribution/allocation cases and 101 other cases. Luxembourg, in total, resolved 419 post-2015 cases during the Statistics Reporting Period, two of them being attribution/allocation cases and the remaining being other cases. The number of post-2015 cases closed represents almost 80% of the total number of post-2015 cases that started during the Statistics Reporting Period. It should be noted that the period for assessing post-2015 MAP statistics only comprises 24 months. During these 24 months, Luxembourg closed two post-2015 attribution/allocation cases in an average time of 6.22 months and closed 417 other cases in an average time of 2.25 months. This resulted in an average time needed of 2.27 months to close 419 post-2015 cases.

Some peers considered Luxembourg's update reports as reflective of their experience and their input on efficient communication with authorities did not change, with one peer noting that no difficulties were experienced in its exchanges with Luxembourg's authorities.

Implementation of MAP agreements

Agreements concluded by the competent tax authorities are implemented by Luxembourg upon the taxpayer's approval.

In order to ensure that the implementation of MAP agreements is not obstructed by any time limits under domestic law, Luxembourg should include either a provision equivalent to Article 25(2), second sentence, of the OECD MTC, or the alternative provisions in Article 9(1) and Article 7(2) of the OECD MTC. Out of Luxembourg's 85 tax treaties, 69 treaties already contain a provision in line with the former article as well as an arbitration provision based on Article 25(5) of the MTC. Of the remaining treaties, 12 have been or will be modified through the MLI to include a provision equivalent to Article 25(2), second sentence, of the MTC. For the four remaining treaties, which will not be

modified by the MLI, Luxembourg reported that it intends to contact, in the near future, the treaty partners with a view to initiate bilateral negotiations to be compliant with this standard, thereby focusing on the treaty partners that are members of the European Union and with which it has MAP cases.

The report hence recommends that Luxembourg should, for one of these treaties, initiate or continue negotiations with this treaty partner to include the required provision or be willing to accept the inclusion of both alternatives and for the remaining three treaties, without further delay request via bilateral negotiations the inclusion of the equivalent of Article 25(2), second sentence, of the OECD MTC, or be willing to accept the alternative provisions for Article 9(1) and Article 7(2).

Peers reported that they were unaware of any problems or delays with the implementation of MAP agreements in Luxembourg since 1 January 2015, which creates certainty and avoids adverse financial consequences for taxpayers and authorities alike.

Best practices peer review reports

Luxembourg has provided information and requested updated feedback by peers on how it has adopted the Action 14 best practices during both stages. However, for most of the best practices, the peers did not provide any input.

Implications

In a post-BEPS world, where multinational enterprises (MNEs) face tremendous pressures and scrutiny from tax authorities, the release of Luxembourg's Stage 2 peer review report represents the continued recognition and importance of the need to achieve tax certainty for cross-border transactions for MNEs. While increased scrutiny is expected to significantly increase the risk of double taxation, the fact that tax authorities may be subject to review by their peers should be seen by MNEs as a positive step to best ensure access to an effective and timely mutual agreement process.

Endnotes

1. <https://www.oecd.org/tax/beps/beps-action-14-peer-review-best-practices-luxembourg-2020.pdf>.

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