Executive summary

On 8 August 2019, the Luxembourg Government submitted the draft law (Draft Law) implementing the European Union (EU) Directive on the mandatory disclosure and exchange of information on cross-border tax arrangements (DAC6 or the Directive) to the Luxembourg Parliament. 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 will be 31 August 2020.

The Draft Law will now go through the legislative process, which involves the analysis of the text by a dedicated parliamentary commission, the collection of opinions from different advisory bodies (most importantly the Council of State), discussion and vote of the text in a parliamentary session and finally its publication in the Official Gazette (Memorial). The entire process may take several months and is expected to be completed before year-end.

If implemented as currently proposed, the Luxembourg Mandatory Disclosure Rules (MDR) legislation will be broadly aligned to the requirements of the Directive.
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.2 Cross-border arrangements will become 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.

EU Member States are to adopt and publish national laws required to comply with the Directive by 31 December 2019. Luxembourg will introduce domestic legislation which will take effect from 1 July 2020.

The key highlights of the Luxembourg draft legislation and the Directive are summarized below.

Scope of taxes covered

The scope of the taxes covered under the Luxembourg draft legislation is fully aligned with the Directive and applies to all taxes except VAT, customs duties, excise duties, 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 Draft Law, an arrangement is reportable under the same circumstances as described by the Directive. The comments to the Draft Law indicate that cross-border arrangements or schemes that potentially indicate tax avoidance are intended to be covered by DAC6. Such 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 Draft Law does not provide clarification on these elements.

The Draft Law does not extend the list of hallmarks beyond those listed in DAC6. Purely domestic transactions 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.”

Concerning the methodology to perform the MBT, the comments to the Draft Law refer to the final report on the MDR (Action 12) of the Organisation for Economic Co-operation and development (OECD) Action Plan on Base Erosion and Profit Shifting (BEPS), 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.

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 legal professional privilege (LPP). If there are no intermediaries that can report, the obligation will shift to the taxpayers.
The Draft Law defines intermediary as any person that designs, markets, organizes or makes available for implementation or manages the implementation of the reportable cross-border arrangement as well as any person that has undertaken to provide, directly or by means of other persons, aid, assistance or advice with respect to such activities mentioned immediately above, provided it meets at least one of the following criteria:

1. Has its tax residency 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, which is in connection with 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) will have a reporting obligation to the Luxembourg Tax Authorities. The Draft Law exempts Luxembourg intermediaries that are covered by article 35 of the modified Law on the Legal Profession of 10 August 1991, i.e. lawyers registered with the Luxembourg Bar, from reporting. This exemption does however not apply if the intermediary acts outside the limits applicable to the legal profession. The limits are set forth by the aforementioned law and pertain in particular to certain functions that are not compatible with the law profession (e.g., acting as director of a commercial company or exercising as a certified public accountant). Intermediaries falling under the reporting exemption are still required to inform other intermediaries or relevant taxpayers of their obligations to report within a determined deadline (see Reporting deadlines).

Furthermore, the lawyers’ exemption is not absolute as the Draft Law sets forth an obligation for intermediaries subject to LPP to file before the Luxembourg Tax Authorities the following general information on a reportable cross-border arrangement:

i. Identification of the relevant intermediary
ii. Detailed information on the relevant hallmark rendering the cross-border arrangement reportable
iii. Summary of the content of the reportable cross-border arrangement including the type of arrangement and a description of the commercial activities or relevant arrangement without disclosure of any commercial, industrial or professional secret, commercial process or information whose disclosure would be against public order
iv. Detailed information on the legal provisions of the Member States concerned on which the reportable cross-border arrangement is based

**Reporting deadlines**

Under DAC6, for intermediaries (and relevant taxpayers), the trigger events for reporting under the Directive (from 1 July 2020) 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 Draft Law foresees the same deadlines and trigger events.

In addition, under the Luxembourg Draft Law, intermediaries who are exempt from reporting pursuant to their LPP are required to notify, within 10 days beginning on the day defined above, any other intermediary (or the relevant taxpayer depending on the case) of their reporting obligations concerning a particular reportable cross-border arrangement. Such intermediaries must also report the aforementioned information on the arrangement to the Luxembourg Tax Authorities within 30 days beginning on the day defined above.

Under the Directive, reporting starts on 1 July 2020 and exchanges between jurisdictions from 31 October 2020. However, reports will retrospectively cover arrangements where the first step is implemented between 25 June 2018 and 1 July 2020. Such arrangements will have to be reported by 31 August 2020.

The Luxembourg reporting deadlines are fully aligned with DAC6.

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

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 will have to declare in the context of their annual income tax returns the use of the arrangement for each year where the arrangement is being used.
Penalties

Monetary penalties for intermediaries and taxpayers not exceeding a maximum of €250,000 will be imposed in the case of:

- Non-compliance
- Not reporting in time
- Incomplete reporting
- Inexact reporting
- Absence of or late notification by the intermediary exempt from reporting to notify the relevant intermediary or the relevant taxpayer

According to the comments to the Draft Law, the amount of the penalty will depend on the facts and circumstances of the case, should consider whether the infraction was intentional, and 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

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 review their policies and strategies for logging and reporting tax arrangements to make sure they are fully prepared for meeting their obligations.

As noted above, the Draft Law will now go through the legislative process, which involves the analysis of the text by a dedicated parliamentary commission, the collection of opinions from different advisory bodies (most importantly the Council of State), discussion and vote of the text in a parliamentary session and finally its publication in the Official Gazette (Memorial). The entire process may take several months and is expected to be completed before year-end.

Endnotes

1. 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.

2. 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.
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