The OECD/G20 BEPS Project – Luxembourg signs the "Multilateral Convention"

12 June 2017

In brief

The Luxembourg Government, represented by its Finance Minister, Pierre Gramegna, has on 7 June 2017 signed the OECD-sponsored Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. Luxembourg is thus among one of the 68 countries in the first group of signatories, who met at the OECD headquarters in Paris to take this key step towards implementing the OECD/G20 BEPS Project.

Once Luxembourg and its co-signatories ratify the Multilateral Convention, Luxembourg's tax treaties will be amended in several important areas. Most notably, there will be a "Principal Purposes Test" that must be satisfied if tax treaty benefits are to remain available – here taxpayers will be denied any benefit if getting the benefit was a principal purpose of an arrangement or transaction. This measure, designed to stop "treaty-shopping", puts a strong emphasis on ensuring that all operations are supported with a proper level of substance and reflect a primary commercial rationale.

Under the Convention, Luxembourg and its treaty partners also each commit to improving and speeding up processes for dealing with cross-border tax disputes. Here, Luxembourg has committed to mandatory binding arbitration.

In detail

Luxembourg's support for the Multilateral Convention

Luxembourg, represented by its Finance Minister Pierre Gramegna, was one of the countries that has signed the Multilateral Convention at the OECD in Paris on 7 June 2017. Luxembourg has unreservedly supported the "minimum standards" for treaty change. Following the signing, M. Gramegna commented "*In being among the first signatories of this multilateral instrument, Luxembourg underlines once again its commitment towards transparency in tax and the rapid implementation of the BEPS measures agreed by the G20 and the OECD. Through this instrument, Luxembourg is updating its treaty network in line with the new BEPS rules. The instrument allows loopholes that can exist in current tax treaties between the signatories to be closed, and thus constitutes an important step in building a "level playing field" globally*."

Initial indications of Luxembourg's likely more detailed stance had been seen on 23 January 2017, when M. Gramegna appeared in Luxembourg in front of the Commission on Finances and the Budget. During that hearing, it was indicated that, at least as an intermediate solution, as well as the minimum standards, some other provisions would be accepted. The 73-page formal notification made by Luxembourg on signing the Multilateral Convention – its "MLI position" – which was published by the OECD on 7 June 2017, confirms this earlier statement.

In particular, it is confirmed that Luxembourg is one of the 25 or so countries now signing the Multilateral Convention that also supports the use of the process of “mandatory binding arbitration” as a way to resolve international tax disputes.

The detail of Luxembourg’s “MLI position” is outlined further below.

Luxembourg’s MLI position

References to Articles and paras below are to those of the text of the Multilateral Convention.

Which treaties might be covered?

- The notification to the OECD follows the OECD template as requested, and starts by listing in accordance with **Article 2** the treaties that Luxembourg wishes to accept as "**Covered Tax Agreements**". The list names **all 81 of Luxembourg's treaties** that are either in force, or are signed but not yet in force (e.g. Serbia, Senegal). (Mongolia – a treaty that is understood to have been terminated – is not included.)

- However, all these treaties are not then <u>automatically</u> covered by the Multilateral Convention. As noted above, each treaty partner must also both be a co-signatory to the Multilateral Convention, and list its treaty with Luxembourg as intended to be a Covered Tax Agreement. So, for example, while Luxembourg has listed its treaty with the United States in its MLI position statement, this treaty will not be a Covered Tax Agreement unless the United States subsequently signs the Multilateral Convention, and lists its treaty with Luxembourg as covered.

How will Luxembourg meet the “minimum standards”?

- **Article 6** - para 1 revises the **preamble wording** of a tax treaty to make it explicit that a treaty is not intended to create opportunities for **non-taxation**.

- **Article 7**, concerning the prevention of **tax treaty abuse**, is arguably the key “minimum standard” of the whole OECD/G20 BEPS Project. The Multilateral Convention has, as its default option, the adoption into tax treaties of an entire, but short, new article that limits the scope of treaty benefits by imposing a “Principal Purposes Test”, or “**PPT**”. This PPT provides simply that a **treaty benefit is <u>not</u> to be granted, if obtaining that benefit was one of the principal purposes of any arrangement**.

  Luxembourg has opted to include para 4 - this brings in a mechanism that allows “competent authorities” to grant discretionary treaty relief in appropriate cases, even if the PPT is strictly in point. This is a positive and pragmatic choice.

- **Article 16** – Mutual Agreement Procedures (**MAPs**). Luxembourg has notified the OECD that all its treaties already have a basic MAP provision that is in line with the “minimum standard”. It has also notified that only a few of its treaties (notably those with Belgium, Canada, Italy and Portugal) are not in line with the “minimum standard” for time limits, insofar as the taxpayer deadline for claims is less than the three-year minimum standard in the Multilateral Convention. These few treaties are thus subject to amendment in this area. Most Luxembourg treaties do already have the three-year rule, and so the Multilateral Convention will not over-write these.

Luxembourg acceptance of some non-"minimum standards" provisions

- **Article 17** – provisions committing Luxembourg to make "**corresponding adjustments**" (i.e. agreeing that if a treaty partner imposes a transfer pricing adjustment increasing taxable profits, Luxembourg will make a corresponding downward adjustment and reduce the tax due accordingly). Luxembourg will not reserve out of this article (which is a quasi-"minimum standard" anyway), meaning that the Multilateral Convention will impose "corresponding adjustments" measures into those treaties (around 15) that Luxembourg has that currently lack them or that do not have the OECD preferred wording for dealing with transfer pricing disputes.

- **Articles 18-26** – **mandatory binding arbitration**. This relatively new approach to settling tax treaty-related disputes is one that Luxembourg has consistently and strongly supported since its inception, and where it has been an "early adopter" of other agreements in this area. Hence, as expected, Luxembourg has opted to apply all these measures, with just some minor reservations.

- **Article 35** – **entry into effect** – being a "calendar year" taxing country, Luxembourg will not deviate from any of the default rules for the timing of when measures come into effect.

An example of a provision taken on partially

Article 3 – **transparent entities**. Luxembourg will allow the Multilateral Convention to bring in the para 1 wording first recommended in Chapter 14 of the BEPS Project Action Point 2 Final Report on "hybrid mismatches". This is a largely beneficial clarification, which confirms that treaties should "look through" transparent entities and give treaty benefits to their owners. The BEPS Project however only allows this as long as the "final" recipient is then taxed in its home state on the income. This is seen as helpful, particularly for alternative fund vehicles.

What has Luxembourg opted not to apply?

In its MLI position, Luxembourg has notified the OECD that it wishes to make a full "reservation" and thus not apply – a number of other Articles in the Multilateral Convention. These are as follows.

- **Article 4** – **dual resident entities** – under the Multilateral Convention, the "tie-breaker" would become solely the competent authorities' decision.

- **Article 8** – a new **minimum holding period** rule under the Multilateral Convention, which would modify the conditions for "**substantial shareholding**" reduced treaty withholding tax rates.

- **Article 9** – "**land-rich" companies** – para 1 would provide an extension under the Multilateral Convention to existing rules, which give taxing rights over disposals of shares in "land-rich" companies to the jurisdiction where the land is sited rather than where the seller is resident. The Multilateral Convention would make these rules also "bite" if an entity had been "land-rich" at any time in the 12 months before a share transfer. Also, there is no notification made by Luxembourg that it will choose to apply para 4 (which extends "land-rich" measures to partnerships and trusts) – Luxembourg was only required to notify the OECD if it wanted to opt in to this rule.

- **Article 10 – PE's in third jurisdictions** – the Multilateral Convention would introduce a measure recommended by the BEPS Project Action Point 6 Final Report on tax treaty abuse. The situation that would have been covered is best explained by way of example. Looking at an income flow from Country A to a PE of LuxCo in Country B (the income of which Luxembourg exempts), under the Multilateral Convention Country A would deny all treaty benefits (under the Country A – Luxembourg treaty) if Country B taxes the PE at below 60% of the tax Luxembourg would have charged had the flow been to the head office.

- **Article 11** – a **"saving clause"**

- **Article 12** – the Multilateral Convention would make revisions to the PE definition, intended to not allow **"commissionaire"** arrangements to escape from causing PEs to arise.
- **Article 14** – the Multilateral Convention would make revision to the PE definition, intended to catch **splitting up of contracts**. The Multilateral Convention wording was broadly as recommended by the BEPS Project Action Point 7 Final Report on the artificial avoidance of PE status.
- **Article 15** – the Multilateral Convention makes the consequential revision to the PE definition that is needed to **define a group** when applying Articles 12-14 – the extent of "reservations" against Articles 12-14 made by Luxembourg renders this Article of no practical application.

Subscribe to our Flash News on
www.pwc.lu/subscribe

Let's talk

Wim Piot	Managing Partner, Tax Leader	+352 49 48 48 3052	wim.piot@lu.pwc.com
Valéry Civilio	Partner, Corporate Tax	+352 49 48 48 3109	valery.civilio@lu.pwc.com
Sami Douénias	Partner, Corporate Tax	+352 49 48 48 3060	sami.douenias@lu.pwc.com
Janja Ovsenik	Director, BEPS Leader	+352 49 48 48 2034	janja.ovsenik@lu.pwc.com