Implementation of BEPS related measures in Luxembourg

On 5 October 2015, the OECD adopted a final package of measures to counter Base Erosion and Profit Shifting (BEPS), which has made a substantial impact on international investments, business models and cross-border supply chains so far. The potential impact of the BEPS Action Plan to counter international tax driven structures is mixed: on a variety of topics governments have not reached consensus; those specific parts of the BEPS Action Plan will not be followed up. Other BEPS Actions however were fully endorsed and subsequently approved and have already been implemented in the domestic laws of various countries. They are now fully integrated in many respective domestic laws and regulations or will enter into force in 2016. Luxembourg has sanctioned an important part of the BEPS Action Plan and a number of Actions have been drafted into law, which will apply from 1 January 2016, with more to come during the complete tax reform of 2016/2017.

The BEPS Action Plan will have a fundamental impact on cross-border business in the coming years. TMF Group is already committing itself to become actively involved in the practical impact of BEPS for its clients; mainly as we have to comply with the amended parameters and benchmarks of these new rules. As a provider of directorship, and domiciliation services, there is an increasing need for us to become more involved in business decision management in general and monitoring compliance issues for clients in particular.

This document provides you with practical insights on the implementation of BEPS related measures in Luxembourg tax law, how it could affect your business and TMF Group’s involvement in this overall process.

What is the BEPS Action Plan?

BEPS is the term used by the OECD to describe multinational tax planning strategies that take advantage of gaps and mismatches in tax rules. These approaches make profits divert to locations where the prevailing rate of corporate tax is low or exempt, but where the company carries out little or no real activity.

The multiple point Action Plan presented by the OECD calls for the development of consistent and coherent tax rules that countries can adopt to implement efficient tax systems and covers:

- **Gaps**; as a result of which revenues are not, or not sufficiently taxed
- **Frictions**; an inconsistent use of international frameworks and concepts in order to shift revenues and profits, and
- **Transparency** proposals for tax authorities; disclose tax planning arrangements, increase tax and transfer pricing compliance and provide new rules to deal with dispute resolutions.

All detailed tax and transfer pricing issues have been highlighted in the table below, and combined, it comprises the BEPS Action Plan:
A number of law amendments were proposed in 2015, some already approved, to enter into force on 1 January 2016. Some changes in the administrative practice are also in the pipeline:

1. Measures preventing treaty abuse (Action 6),
2. Measures aiming for more transparency (Action 5/12),
3. Measures preventing harmful tax practice (Action 5),
5. Measures to ensure that transfer pricing outcomes are in line with value creation (Action 8-10).

It is further announced that a number of other BEPS initiatives will also be rolled out in 2016, such as amending double tax treaties to include anti-abuse clauses, reforming in depth, the domestic tax law, and the upcoming exchange of tax rulings with tax authorities in other EU Member States.

**Ad. 1 Measures preventing treaty abuse**

End 2014, France and Luxembourg signed a fourth protocol to the tax treaty of 1 April 1958, as amended.

The Protocol adds a new paragraph 4 to Article 3 of the Treaty which provides that gains realised from the disposal of shares, units or other rights in a company, trust or any other institution or entity, whose assets or property are made up of more than 50 per cent of their value or hold more than 50 per cent of their value – directly or indirectly through one or more other companies, trusts, institutions or entities – of real estate situated in a Contracting State or of rights in such property shall be taxable only in that State.

The ratification process in France should be completed in 2016 and enter into force as of 1 January 2017.

**Ad. 2 Measures aiming for more transparency**

Resident corporate taxpayers are now able to file their tax returns electronically. The new process applies for tax returns from the fiscal year 2014 and for corporate income tax returns, municipal business tax returns and net wealth tax returns. Excluded from the scope of e-filing:
- Entities that do not perform commercial activities (e.g., ASBL),
- Tax transparent partnerships (SCS, SNC, SCSp),
- Non-resident corporate entities.

This new process will allow the tax authorities to better follow up on taxation and tax debt collection, together with an increasing potential for automatic exchange of information.

**Ad. 3 Measures preventing harmful tax practice**

Recent draft bills repeal the current IP regime from 1 July 2016 for corporate income tax purposes. For net wealth tax purposes the IP regime will be abolished from 1 January 2017. This is done in response to comply with the new “modified nexus approach”, as agreed in BEPS Action 5. A complete new IP regime is expected to be presented in the coming months.
- Taxpayers benefitting from the current IP regime will continue to benefit from it during a transitional period until 30 June 2021,
- New taxpayers may still benefit from the existing regime until 30 June 2016.

**Ad. 4 Measures neutralizing hybrid mismatches**

A few developments on BEPS Action 2:
- On 10 July 2015, the Government’s Council approved the implementation of the EU Parent-Subsidiary Directive’s anti-hybrid and general anti-abuse rules in Luxembourg Income Tax law. A distribution from a subsidiary (‘participation’) falling within the scope of the EU Directive will no longer be exempt in Luxembourg, if it is tax deductible in another EU member state. In addition, the provisions of the Directive would no longer be granted if the transaction may be considered as abusive based on the new wording of the Directive,
- The hybrid treatment of Mandatory Redeemable Preference Shares (‘MRPS’) is not going to be accepted anymore,
- The U.S. branch of a head office in Luxembourg (LuxCo’s), and the U.S. branch of LLCs in which LuxCo’s hold a share interest may need to be replaced before the end of the year in case double non-taxation occurs, i.e. the branch is recognised as a permanent establishment (“PE”) in the U.S. for Luxembourg tax purposes, but it does not qualify as a “U.S. trade or business” from a U.S. tax perspective. If the US will subsequently modify its double tax treaty with Luxembourg to tackle this issue it seems that these changes may apply from 1 January 2016 or 1 January 2017.

**Ad. 5 Measures to ensure that transfer pricing outcomes are in line with value creation**

Further to new provisions in Luxembourg Income Tax law applicable from 1 January 2015, all companies are obliged to maintain all relevant documentation supporting the arm’s length character of the remuneration for transactions between related parties. In case this is not done, the final arm’s length determination of the revenues will be performed by the Luxembourg tax authorities.
There is no requirement for a so-called “transfer pricing policy”, however, if companies are performing intragroup activities they should of course be able to justify any remuneration computation.

**Further involvement of TMF Group**

We have elaborated on the views of some consultants and management service providers that no action is required as the government does not fundamentally change the existing rules yet. Whilst that may be true it is in our opinion unrealistic to anticipate no change at all in the assessment of the economic rational of a company in a business set-up. Therefore, TMF Group is performing various in-depth analyses to examine the impact of BEPS related law changes in Luxembourg for all of its clients. TMF Group is further assessing specific files, transactions and client documents in order to establish potential risks and future non-compliance issues that need close attention.

TMF Group is currently developing a more consistent method to further determine if your business remains BEPS proof in the near future: a thorough assessment of your complete business upon request in a close cooperation with your tax consultant, in order to establish risks that affect your Luxembourg tax position, as well as analysing compliance issues if other BEPS issues should be implemented in the near future. Such a report will provide you with solid insights on what to expect of the implementation of new BEPS Actions points and how to deal with these processes.

Even if you would not perform a BEPS analysis as such, we still strongly advise you to allow us to liaise further with you and your tax consultant, to discuss the impact of the new laws and the best way forward. In that way we will also be able to discuss the impact for your business of other BEPS measures, such as the consequences of the anticipated changes in a number of tax treaties with developing countries, or the impact of sharing the content of your tax rulings to other tax authorities or organisations.