Luxembourg Tax Alert

Luxembourg draft law ratifying the MLI published

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On 7 June 2017, under the framework of the OECD BEPS project, Luxembourg signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI), along with representatives of 67 other jurisdictions. At present, 82 jurisdictions have signed the MLI, nine of which have already ratified this Convention.

MLI will enter into force (as distinct from "enter into effect", which means the effective date of application of its provisions) gradually on a jurisdiction by jurisdiction basis. The MLI itself already entered into force on 1 July 2018 for the five jurisdictions, which have been the first to ratify it (i.e. Austria, Isle of Man, Jersey, Poland and Slovenia). The fact that the MLI has entered into force does not mean that it already applies to individual double tax treaties. For all other countries, the MLI will enter into force after three months as each country deposits its own instrument of ratification with the OECD.

The draft law transposing the MLI has just been submitted to the Luxembourg parliament for discussion and vote.

This draft law confirms the initial choice of provisions presented by Luxembourg at the signing ceremony in Paris last year. As a reminder, apart from the minimum standard measures to counter treaty abuse and to improve dispute resolution, Luxembourg also plans to adopt other provisions from the MLI in connection with transparent entities, the application of methods for eliminating double taxation, the avoidance of permanent establishment status, and the arbitration procedure.

For more details regarding the MLI provisions chosen by Luxembourg, please consult our previous communication, covering this topic in more detail.

For the changes to apply to a bilateral tax treaty concluded by Luxembourg, both parties to the bilateral tax treaty must not only ratify the MLI, but also choose such a treaty as one of their covered tax treaties (each country can introduce additional covered double tax treaties to its list at any time) and adopt the same optional provisions, unless the relevant provision of the MLI allows for an asymmetrical adoption under certain conditions.

Therefore, in order to apply a specific double tax treaty, apart from checking whether it is considered a covered tax treaty by both parties under the MLI and which provisions the parties have chosen, it also needs to be analyzed, whether and when each party ratified the MLI, in order to establish when it comes into force and when the provisions become effective.

The timing of the full Luxembourg ratification process will impact both the date of entry into force of the MLI for the country as well as the effective date of application of the MLI provisions to Luxembourg's tax treaties.

The time limit for entry into force of the MLI runs from the date when the second of the two parties to the covered tax treaty has deposited its own instrument of ratification with the OECD.

For example, if we were to consider a tax treaty between Luxembourg and one of the first five countries (i.e. Austria, Isle of Man, Jersey, Poland or Slovenia), which have already deposited their respective ratification instruments and for whom the MLI has already entered into force on 1 July 2018 (but not yet into effect), and if we assume that Luxembourg would deposit its ratification instrument the 30 November 2018; to determine the date of entry into force (and subsequently, the entry into effect) of the MLI modifications to the covered tax treaty between these countries, we would have to take into account the date of 30 November 2018.

The entry into force of the MLI would therefore take place on the first day of the month following the expiration of a period of three calendar months beginning as from the deposit of the ratification instrument (i.e., in the example at hand, if a deposit of the ratification instrument on 30 November 2018, this would mean an entry into force on 1 March 2019).

The effective date of application of the MLI provisions would then have to be determined for each covered tax treaty based on the latest date of entry into force of the MLI for the parties to this tax treaty.

With respect to taxes withheld at source, the MLI provisions would become applicable where the event giving rise to such taxes would occur on or after the first day of the next calendar year that begins on or after the latest of the dates on which the MLI enters into force for the two parties to the covered tax treaty.

With respect to all other taxes, the MLI provisions would become applicable for taxes levied with respect to taxable periods beginning on or after the expiration of a period of six calendar months from the latest of the dates on which the MLI enters into force for the two parties to the covered tax treaty.

Continuing with our example, where the date of entry into force was 1 March 2019:

- In case the 1 March 2019 was the latest date of entry into force of a covered tax treaty, the MLI would become effective with respect to all taxes withheld at source where the event giving rise to such taxes occurs on or after 1 January 2020.
  In the case of Luxembourg, due to the timing required for national

ratification procedure, as well as the timeline provided in the MLI, it is highly unlikely that the MLI provisions in respect to withholding taxes would enter into effect before 1 January 2020.

- In terms of all other taxes, if the latest entry into force date for a covered tax treaty was once again 1 March 2019, the six month period mentioned in the MLI would expire on 1 September 2019 and therefore, the provisions of the MLI would apply to taxable periods beginning at the earliest on 1 September 2019Where the taxable year corresponds to the calendar year, in the example at hand, the MLI provisions would apply as from the taxable year beginning on 1 January 2020.

Under normal circumstances, we could potentially assume that the Luxembourg ratification instrument would be presented to the OECD before the end of the current calendar year. However, due to the upcoming parliamentary holidays as well as the forthcoming legislative elections resulting in the dissolution of the current composition of the Chamber of Deputies, no clear ratification timeline can be provided at this stage.

To conclude, in order for MLI provisions to become applicable to Luxembourg tax treaties, both the internal ratification process and the timeline mentioned in the MLI itself need to be duly completed. Therefore, we can however expect that for Luxembourg double tax treaties, the MLI would most likely become effective on 1 January 2020 in respect of both withholding taxes and all other taxes (when the taxable year corresponds to the calendar year). The mutual agreement procedure and arbitration provisions are slightly different and generally become applicable once the MLI has entered into force for both parties to a tax treaty.

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