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# Implementation of the multilateral instrument in Germany and Luxembourg

http://docs.bepartners.pro/2017-06-07-mla-abkommen-mit-lux-de.pdf

**In our beinformed of 19 January 2017, we addressed the multilateral instrument (MLI) of the Organization for Economic Co-operation and Development (OECD). As a part of the BEPS (Base Erosion and Profit Shifting) project of the OECD, the MLI is meant to adopt and synchronize existing double tax treaties which are – according to the OECD – one of the major drivers of inappropriate tax avoidance strategies by abusing different tax treaties jurisdiction ("treaty shopping"). With the help of the MLI, adjustment processes of double tax treaties will be reduced significantly. After the first draft of the multilateral instrument was confirmed on 24 November 2016, ministers and other high-level representatives of over 60 states signed the international treaty on 7 June 2017 in Paris.**

## 1. Scope of the MLI and timing

Among the 68 signatories are all G20 member states except the US, Brazil and Saudi Arabia. Notably, not all double tax treaties of a signatory are subject to the MLI, but rather the member states choose between their double tax treaties that they want to have applied by the MLI. Some states have chosen all of their double tax treaties (such as Luxembourg), whereas other states selected only some of their double tax treaties (such as Germany). A double tax treaty is only then subject to the MLI when both contracting parties have chosen the respective treaty for the MLI. With the first signings in Paris, over 1,100 treaties fall under the jurisdiction of the MLI. The OECD hopes that the number will soon reach 2,000 treaties when more states have signed the multilateral instrument.

However, it will take some time until the first double tax treaties are affected by the MLI. In Germany (as in most states), the MLI has to pass through parliament in the same manner as a "normal" domestic tax act. This will happen in the next legislative period after the general election in September 2017. The German Ministry of Finance expects that first adjustments to German double tax treaties will come into effect in 2019.

## 2. Implementation in Germany and Luxembourg

As outlined in our **beinformed** dated 19 January 2017, the MLI of the OECD consists of optional and compulsory articles. In the course of the signings in Paris, the member states have stated which articles they wish to adopt and which not. An article of the MLI is only binding on an existing double tax treaty when both contracting parties have signed the MLI and both have chosen to adopt the article in the same way. In the following **beinformed**, we illustrate in which way Germany and Luxembourg have implemented the MLI for their double tax treaties.

## 2.1 Scope and Interpretation of Terms

**Article 1, 2: Scope and Interpretation of Terms**

In addition to the definitions, Article 2 demands that signing states have to list the double tax treaties for which they wish the MLI to apply.

| Germany | Luxembourg |
| --- | --- |
| Included double tax treaties (in total 35):<br>Austria, Bulgaria, China, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Hungary, Ireland, Israel, Italy, Japan, Korea, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mauritius, Mexico, Netherlands, New Zeeland, Romania, Russia, Slovakia, Slovenia, Spain, Turkey, United Arab Emirates, United Kingdom, United States of America | Included double tax treaties: All of Luxembourg's double tax treaties (in total 81)<br>• List of Luxembourg's double tax treaties |

**Equivalent implementation**

Germany and Luxembourg both wish the MLI to apply to their double tax treaty.

## 2.2 Hybrid Mismatches

**Article 3: Transparent Entities**

In the event the country of residence considers a legal entity or vehicle (such as a partnership) as fully or partly transparent for tax purposes, both contracting partners will consider it transparent insofar as the country of residence of the taxable person attributes the income to this person. This Article is optional.

| Germany | Luxembourg |
| --- | --- |
| Germany waives the implementation of the complete Article 3. | Luxembourg includes Article 3, but waives the second paragraph:<br>„Provisions of a Covered Tax Agreement that require a Contracting Jurisdiction to exempt from income tax or provide a deduction or credit equal to the income tax paid with respect to income derived by a resident of that Contracting Jurisdiction which may be taxed in the other Contracting Jurisdiction according to the provisions of the Covered Tax Agreement shall not apply to the extent that such provisions allow taxation by that other Contracting Jurisdiction solely because the income is also income derived by a resident of that other Contracting Jurisdiction.“ (Art. 3 (2) MLI)<br>Luxembourg announces that an equivalent provision is already part of their double tax treaties with Sweden, Belgium and the USA. These articles will be replaced by Article 3 (if the other states opt accordingly). |

**Equivalent implementation**

No equivalent implementation in Germany and Luxembourg.

**Article 4: Dual Resident Entities**

This provision prevents a dual residency. Both contracting parties have to agree on one country of residency for the purpose of double tax treaties. This provision is optional.

| Germany | Luxembourg |
|---|---|
| Germany waives the implementation of the complete Article 4. | Luxembourg waives the implementation of the complete Article 4. |

**Equivalent implementation**

Both Germany and Luxembourg waive the implementation of Article 4.

**Article 5: Application of Methods for Elimination of Double Taxation**

The MLI contains several options allowing a state to switch from the exemption method to the credit method in the event of qualification conflicts (Option 1) or if dividends are treated as deductible in the country where the dividends originate (Option 2). In the case of the tax credit method, the MLI offers a third option, which further modifies the conventional credit method of the OECD Model Tax Convention.

Every contracting party has the right to choose its option independently. It can also completely forego the selection of an option and leave their double tax treaties as they are.

| Germany | Luxembourg |
|---|---|
| No statement regarding Article 5 in the German version. Therefore, Germany waives the selection of an option according to Art. 5 (1) MLI. | Luxembourg chooses Option 1.<br>According to Art. 5 (9) MLI, Luxembourg does not allow the following contracting parties of double tax treaties to choose Option 3:<br>Germany, Saudi-Arabia, Austria, Belgium, Bulgaria, Estonia, France, Hungary, Island, Liechtenstein, Morocco, Monaco, Panama, The Netherlands, Poland, Slovakia, Romania, San Marino, Seychelles, Switzerland |

**Equivalent implementation**

No equivalent implementation necessary because every state is free to choose its option independently of the other state (exception: Prohibition of Option C when the contracting partner opts for Art. 5 (9) MLI).

## 2.3 Treaty Abuse

**Article 6: Preamble**

The implementation of the following preamble is compulsory:

“(…) intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions), (…)”.

| Germany | Luxembourg |
|---|---|
| Germany’s double tax treaties with Japan and the Netherlands already contain an equivalent preamble. In these cases, Germany waives the implementation of the standardized preamble according to Art. 6 (4) MLI. | Luxembourg’s double tax treaty with Senegal already contains an equivalent preamble. In this case, Luxembourg waives the implementation of the standardized preamble according to Art. 6 (4) MLI.<br>Luxembourg opts according to Art. 6 (3) in connection with (6) MLI to implement the following addition to the preamble:<br>“Desiring to further develop their economic relationship and to enhance their co-operation in tax matters, (…)”. |

| Equivalent implementation |
|---|
| As Article 6 is compulsory, both Germany and Luxembourg have implemented the provision. The current preamble in the double tax treaty between these states will therefore be replaced by this model preamble.<br>As Germany has not opted for the implementation of the addition concerning the strengthening of the economic relationships according to Art. 6 (3) in connection with (6) MLI, this addition will not form part of the preamble. |

## Article 7: General Misuse Clause

The implementation of a general misuse clause, the so called "Principal Purpose Test" (PPT), is also compulsory. According to this clause, advantages of treaties will be denied if it can be reasonably argued that the achievement of this advantage was one of the main purposes of the corporate structuring, unless it can be proven that the granting of the advantage complies with the rationale of the treaty.

However, the implementation of a simplified limitation for advantages of treaties, the so called "Simplified Limitations On Benefits Provision" as we know it in the more complex form in the double tax treaty between Germany and the United States of America, is optional.

| Germany | Luxembourg |
|---|---|
| Germany chooses the simple "Principal Purpose Test" (PPT) out of all of its available options and waives the implementation of the "Simplified Limitations on Benefits Provision".<br>The following double tax treaties already contain corresponding provisions so that, according to Art. 7 (15 b) MLI, Germany does not implement the PPT in these cases: China, Israel, Japan, Mauritius | Luxembourg chooses the simple "Principal Purpose Test" (PPT) out of all of its available options and waives the implementation of the "Simplified Limitations on Benefits Provision".<br>Furthermore, Luxembourg opts, according to Art. 7 (4) in connection with (17 b) MLI, for a limitation of the PPT, by which advantages of treaties can nevertheless be granted if the person, upon application, proves that these advantages would also have been granted without the corporate structuring.<br>The wording of this provision is as follows:<br>„Where a benefit under a Covered Tax Agreement is denied to a person under provisions of the Covered Tax Agreement (as it may be modified by this Convention) that deny all or part of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits, the competent authority of the Contracting Jurisdiction that would otherwise have granted this benefit shall nevertheless treat that person as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement. The competent authority of the Contracting Jurisdiction to which a request has been made under this paragraph by a resident of the other Contracting Jurisdiction shall consult with the competent authority of that other Contracting Jurisdiction before rejecting the request."<br>Similar to Germany, Luxembourg waives the implementation of the PPT for double tax treaties which already contain an corresponding provision. This is the case for Senegal. |

**Equivalent implementation**

Both Germany and Luxembourg have decided for the simple Principle Purpose Test. As Germany has not opted for the limitation according to Art. 7 (17 b) MLI, only the standard PPT according to Art. 7 (1) MLI will be implemented in the double tax treaty between Germany and Luxembourg.

**Article 8: Dividend Transfer Transactions**

Provisions of a double tax treaty that exempts dividends from tax, or that limit the rate at which such dividends may be taxed, will apply only if the ownership conditions described in those provisions are met during a 365-day period that includes the day of the payment of the dividends (for the purpose of calculating that period, any changes of ownership that would directly result from a corporate reorganization, such as a merger or divisive reorganization, of the company that holds the shares or that pays the dividends, will not be taken into account during the calculation). This provision is optional.

| Germany | Luxembourg |
|---|---|
| Germany opts for the implementation of Article 8<br>As the double tax treaties with Italy, Japan, Liechtenstein and USA already contain corresponding provisions with a minimum holding period, Germany will not implement the provision according to Art. 8 (3 b) MLI in these cases. | Luxembourg waives the implementation of the entire Article 8. |

**Equivalent implementation**

No equivalent implementation in Germany and Luxembourg.

**Article 9: Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property**

Gains derived by a resident of a signatory state from the alienation of shares or other rights of participation in an entity may be taxed in the state where the real estate is located, provided that these shares or rights derive more than a certain portion of their value (recommendation is 50 per cent) from immovable property (real property).

| Germany | Luxembourg |
|---|---|
| Germany opts for this provision as of Art. 9 (4) MLI.<br>If Germany's contracting partners in double tax treaties also choose to implement this provision, already existing provisions will be replaced by Art. 9 (4) MLI. Corresponding provisions exist in all double tax treaties except those with Bulgaria, Czech Republic, Italy, Mauritius, Russian, Slovakia and Slovenia. | Luxembourg waives the implementation of this provision.<br>Luxembourg opts according to Art. 9 (6 a) MLI to waive the implementation of Art. 9 (1) MLI (Provision without definite 50% immovable property quota) and simultaneously foregoes the selection of Art. 9 (4) MLI (according to Art. 9 (8) MLI an active declaration of intent is necessary in this case). |

**Equivalent implementation**

No equivalent implementation in Germany and Luxembourg. The existing double tax treaty between Germany and Luxemburg already contains a corresponding provision in Art. 13 (2) thereof.

**Article 10: Anti-Abuse Rule for Permanent Establishment in Non-Member Countries**

This provision is for cases in which a company of a member state (A) generates income out of another member state (B) for which the income in the view of member state (A) has to be attributed to a permanent establishment in a non-member country (neither A or B). If the income in member state (A) is exempt, due to the attribution to the permanent establishment in the non-member state, and the non-member state has a tax rate of less than 60% of the tax rate which normally would have applied in member state (A) – {do not forget to breathe!} –, the other member state (B) has the right to tax the income in such manner as if the income is not subject to the double tax treaty between member states (A) and (B).

For instance, member state (B) would not be limited to the rate of its national withholding tax on interests or dividends. However, exceptions exist for income derived from active permanent establishments. This provision is optional.

| Germany | Luxembourg |
|---|---|
| Germany implements Article 10.<br>If Germany's contracting partners in double tax treaties also choose to implement this provision, already existing provisions will be replaced by Article 10 MLI. Corresponding provisions exist in double tax treaties with the UK and the USA. | Luxembourg waives the implementation of the complete Article 10. |
| **Equivalent implementation** | |
| No equivalent implementation in Germany and Luxembourg. | |

| Article 11: Reserve Clause for the Taxation of Residents in the Country of Residence | |
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| The reserve clause is notable as it allows the country of residence to deny its residents any treaty advantages.<br>Exempt from this carte blanche are, among others, provisions concerning company revenues, profit adjustments at affiliated companies, public services, students, members of diplomatic missions (further exemptions and a more detailed elaboration in the MLI). This reserve clause is optional. | |
| **Germany** | **Luxembourg** |
| Germany waives the implementation of the complete Article 11. | Luxembourg waives the implementation of the complete Article 11. |
| **Equivalent implementation** | |
| Both Germany and Luxembourg waive the implementation of Article 11. | |

## 2.4 Permanent Establishments

| Article 12: Artificial Avoidance of Permanent Establishment Status Through Commissionaire Arrangements and Similar Strategies | |
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| Structuring that intends to avoid permanent establishments through commissionaire arrangements or similar strategies will be prevented. This provision is optional. | |
| **Germany** | **Luxembourg** |
| Germany waives the implementation of the complete Article 12. | Luxembourg waives the implementation of the complete Article 12. |
| **Equivalent implementation** | |
| Both Germany and Luxembourg waive the implementation of Article 12. | |

| Article 13: Artificial Avoidance of Permanent Establishment Status Through the Specific Activity Exemptions | |
|---|---|
| According to the rationale of Art. 5 (4) OECD Model Tax Convention, activities of a preparatory or auxiliary character will not constitute a permanent establishment. The member states can choose between two options: The first option is derived from the text of Art. 5 (4) OECD Model Tax Convention (Option 1), whereas the second option is based on the provision contained in paragraph 30.1 of the Commentary on Article 5 (Option 2). This provision is optional. | |
| **Germany** | **Luxembourg** |
| Germany chooses Option 1. | Luxembourg chooses Option 2. |
| **Equivalent implementation** | |
| No equivalent implementation in Germany and Luxembourg. According to Art. 13 (7) MLI, the different selection of Germany and Luxembourg results in no implications for the double tax treaty between these states. | |

| Article 14: Splitting-Up of Contracts | |
|---|---|
| In the event of construction and installation works, the period of time, in which it is determined whether a permanent establishment was constituted, may be prolonged by adding up different contracts in certain circumstances. | |
| **Germany** | **Luxembourg** |
| Germany waives the implementation of the complete Article 14. | Luxembourg waives the implementation of the complete Article 14. |
| **Equivalent implementation** | |
| Both Germany and Luxembourg waive the implementation of Article 14. | |

| Article 15: Definition of a Person Closely Related to an Enterprise | |
|---|---|
| A person will be considered to be closely related to an enterprise if such person directly or indirectly possesses more than 50% of the beneficial interest in such enterprise (or, in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person directly or indirectly possesses more than 50% of the beneficial interest (or, in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise. | |
| **Germany** | **Luxembourg** |
| Germany waives the implementation of the complete Article 15. | Luxembourg waives the implementation of the complete Article 15. |
| **Equivalent implementation** | |
| Both Germany and Luxembourg waive the implementation of Article 15. | |

## 2.5 Dispute Resolution and Arbitration

The two following Parts 5 and 6 in Art. 16-26 MLI consist of detailed provisions concerning dispute resolutions and arbitrations. We have omitted a breakdown on Germany's and Luxembourg's position on this matter.

## 3. Summary

Not very much remains after the fog has been lifted following the decoding of the rather complicated articles. Both Germany and Luxembourg regularly took advantage of the possibility to waive certain articles. That's why the impact on the current double tax treaty between these states is rather small and limited to not much more than an adjusted preamble and an introduction of the Principal Purpose Test. This in turn could lead to more questions concerning its relation to § 42 of the German Tax Code (Abgabenordnung). Certainly, international tax law has not been made easier with the introduction of the multilateral instrument. Maybe the opposite is in fact the case.

**be in touch: Any questions?**
**Please do not hesitate to contact us!**

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