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Transfer Pricing 2025

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Luxembourg: Trends and Developments

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Trends and Developments

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Loyens & Loeff is a European independent, full-service business law firm providing integrated legal and tax advice with specialists in Dutch, Belgian, Luxembourg and Swiss law. The firm's Luxembourg transfer pricing team assists clients regarding documentation, planning and strategy, and dispute resolution. More specifically, it helps clients to assess their documentation against stringent new requirements. The team also assists clients' tax departments on the formulation of sustainable transfer pricing strategies in line with their business whilst maintaining tax efficiency. Lastly, it helps clients accelerate litigation procedures and prevent double taxation. The transfer pricing team also regularly assists its clients with audits and resolves (international) transfer pricing disputes both at an administrative and court level. The team is part of a fully integrated firm with home markets in Benelux and Switzerland, and offices in all major financial centres, including London, New York, Paris and Tokyo.

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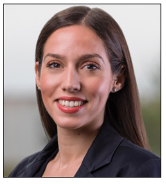

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Introduction

Although 2024 was not a year of great developments in the Luxembourg transfer pricing (TP) landscape, TP continues to be a hot topic for both taxpayers and tax authorities, domestically, at EU level and in the international arena. In this article the authors aim to provide an overview of the main trends and developments encountered in the Luxembourg TP scene.

New Circular on Interest Rates on Shareholders' Current Accounts

As a response to the decisions of 21 September 2023 in case No 48127C and of 14 November 2023 in case No 47754C of the Administrative Court of Appeal, on 29 January 2025, the Luxembourg Tax Administration (LTA) issued Circular L.I.R. No 164/1 (the *"New Circular"*) on interest rates applied on current accounts of associates or shareholders of Luxembourg-based taxpayers subject to corporate income tax (CIT). The New Circular replaced Circular L.I.R. No 164/1 of 23 March 1998 (the *"Old Circular"*).

Individual associates or shareholders

The Old Circular provided for a fixed interest rate of 5% applied on current accounts of natural persons in their capacity as associates or shareholders of entities subject to CIT in Luxembourg.

Unlike the Old Circular, the New Circular now provides that the interest rate to be applied on current accounts of individual shareholders shall be determined in accordance with the terms and conditions that would have been agreed upon for comparable loans in the market between independent parties, in line with the arm's length principle.

For the sake of simplicity, the New Circular provides for an interest rate corresponding to the annual interest rate applicable to consumer credit, which has to be proven and supported by documentation. Within this framework, the New Circular states that reference to average monthly interest rates as published by the Central Bank of Luxembourg concerning the interest rates applied by Luxembourg credit institutions to deposits and loans in euros is accepted.

In line with the Old Circular, the New Circular maintains the provisions related to the interest calculation and clarifies that the provisions of L.I.R./N.S. memo 164/1 of 9 June 1993 remain applicable, in particular with respect to the criteria for a repayable debit current account.

Legal persons as associates or shareholders

The New Circular also maintains the provisions of the Old Circular in relation to the interest rates applied on loans between related parties. The New Circular repeats that in such cases, the interest rates to be taken into account are to be determined on a case-by-case basis respecting the arm's length principle and should be a function of *"notably"* criteria such as the currency and the maturity of the loan, exchange risk, credit risk and the refinancing interest rate.

Conclusion

To summarise, the fixed interest rate of 5% on current accounts of individual associates or shareholders no longer applies. Rather, the interest rate shall be determined in line with the arm's length principle. A simplification measure allows reference to be made to the interest rate for consumer credit as published by the Central Bank of Luxembourg.

As regards shareholder loans between companies, the New Circular repeats that they must be determined on the basis of the arm's length principle, as was the case before.

Although not stated in the New Circular, the arm's length nature of intercompany transactions in general, and the terms and conditions of shareholder loans in particular, need to be properly substantiated and documented in line with the obligations laid down in the general tax law and the income tax law.

Transfer Pricing in Pillar Two

On 20 December 2023, the Luxembourg Parliament adopted the bill of law implementing the EU directive on global minimum taxation into domestic law (*"Pillar Two"*). On 19 December 2024, the Luxembourg Parliament further approved the bill of law implementing into its domestic legislation additional elements of the 2023 and 2024 OECD guidance regarding Pillar Two rules.

According to Article 16, paragraph 4(1) of the law implementing Pillar Two into Luxembourg domestic law (the *"Pillar Two Law"*), *"[a]ny transactions between constituent entities located in different jurisdictions that are not recorded at the same amount in the financial statements of both constituent entities, or that do not comply with the arm's length principle, are adjusted so that they are recorded at the same amount and comply with the arm's length principle"*, while Article 16, paragraph 4(3) of the Pillar Two Law states that *"[f]or the purposes of this paragraph, 'arm's length principle' means the principle that transactions between constituent entities should be recorded by reference to the terms that would have been obtained between independent enterprises in comparable transactions and in comparable circumstances"*.

The aforementioned Article requires transactions between group entities to respect the arm's length principle and to be recorded at the same price for all entities that are parties to the transaction. More precisely, Article 16 of the Pillar Two Law requires an adjustment to the financial accounting net income or loss to avoid double taxation or double non-taxation under the Global Anti-Base Erosion (GloBE) rules where the taxable income of one or more group entities that are parties to a controlled transaction is determined using a transfer price different from the one used in the financial accounts. According to the OECD consolidated commentary to the GloBE Model Rules as published on 25 April 2024 (the *"OECD Commentary"*), where the multinational enterprises (MNE) group has used the transfer price reflected in its financial accounts to compute local taxable income and the relevant tax authorities do not require a TP adjustment, this price should be used for the computation of GloBE income or loss. In such cases, the MNE should not make an adjustment under Article 16 of the Pillar Two Law.

Although not explicitly stated in Article 16 of the Pillar Two Law, transactions between constituent entities located in the same jurisdiction shall also be recorded at the same amount. This is the expected result from applying a common accounting standard to entities in the same jurisdiction. However, intra-group transactions between entities located in the same jurisdiction are often not required to be adjusted for tax purposes from the amounts used in the preparation of the consolidated financial statements as the shifting of income from one taxpayer to another within the same jurisdiction in principle does not impact the overall amount of income subject to tax in that jurisdiction.

Notwithstanding the above, Article 16, paragraph 4(2) of the Pillar Two Law requires the application of the arm's length principle to transactions between constituent entities located in the same jurisdiction if the sale or other transfer of an asset produces a loss which is accounted for the computation of GloBE income or loss. According to the OECD Commentary, this rule is intended to prevent MNEs from creating losses in a jurisdiction through sales or other transfers at prices that are not consistent with the arm's length principle. Nevertheless, the rule does not apply if the loss is excluded from the constituent entity's GloBE income or loss computation.

Although the TP-related provisions of the Pillar Two Law seem straightforward to apply in practice, they require complex calculations which, for the purposes of this article, will not be analysed.

Pillar One Amount B

Introduction

Released in October 2020, the OECD/G20 Inclusive Framework (the *"Inclusive Framework"*) on Base Erosion and Profit Shifting (BEPS) report on Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint (*"Pillar One"*) stated that Amount B was intended to simplify and streamline the application of the arm's length principle to baseline marketing and distribution activities (the *"Qualifying Activities"* and *"Amount B"*).

On 19 December 2024, the OECD released a pricing tool and fact sheet to facilitate the understanding and operation of the simplified and streamlined approach (the *"S&S Approach"*) to TP. On 24 February 2025, the OECD published the consolidated report on Amount B incorporating the updates released by the Inclusive Framework from February 2024 to December 2024 (the *"Report"*). The Report provides guidance on an optional application of the S&S Approach to the Qualifying Activities. The S&S Approach provides a pricing framework whereby a three-step process determines a Return on Sales (RoS) for in-scope distributors. Lastly, the Report also provides guidance on documentation, transitional issues and tax certainty considerations. No minimum revenue threshold is applicable for the S&S Approach. Jurisdictions can choose to apply the S&S Approach for fiscal years beginning on or after 1 January 2025.

The Report is incorporated in the OECD TP Guidelines for Multinational Enterprises and Tax Administrations (the *"OECD Guidelines"*) as an Annex to Chapter IV.

Scope of application

The Qualifying Activities include the following:

- buy-sell marketing and distribution transactions where the distributor purchases goods from one or more associated enterprises for wholesale distribution to unrelated parties; and
- sales agency and commissionaire transactions where the sales agent or commissionaire contributes to one or more associated enterprises' wholesale distribution of goods to unrelated parties.

The Qualifying Activities are then subject to two further scoping rules:

- the Qualifying Activities must exhibit economically relevant characteristics meaning that they can be reliably priced using a one-sided TP method, with the distributor, sales agent or commissionaire being the tested party; and
- the tested party in the qualifying transaction must not incur annual operating expenses lower than 3% or greater than an upper bound of between 20% and 30% of the tested party's annual net revenues.

However, the Qualifying Activities must not involve the distribution of non-tangible goods, services or the marketing, trading or distribution of commodities. In addition, the tested party must not conduct non-distribution activities alongside the qualifying transaction that cannot be evaluated and priced separately unless the qualifying transaction can be adequately evaluated on a separate basis and can be reliably priced separately from the non-distribution activities.

Applicable method

According to the Report, the transactional net margin method is considered as the most appropriate method under the S&S Approach with RoS as the net profit indicator without any further justifications or analysis of other TP methods. An exception is provided for instances where the internal comparable uncontrolled price method can be reliably used for pricing the Qualifying Activities.

Pricing matrix and adjustments

The arm's length remuneration for Qualifying Activities under the S&S Approach can be determined through a pricing matrix provided by the Report by assessing the tested party's (i) net operating asset intensity, (ii) operating expense intensity and (iii) industry group. The return provided in the pricing matrix will be considered acceptable with a range of tolerance of plus or minus 0.5 percentage points.

Taxpayers will apply and test the actual outcome of their Qualifying Activities to demonstrate that the conditions of these transactions were consistent with the S&S Approach on an ex-post basis. Tax administrations should use the RoS percentage derived from the pricing matrix to adjust the margin of the controlled transaction when the margin reported by the taxpayer falls outside the range. The financial data and other datapoints of the pricing matrix will be updated annually and the ranges of the pricing matrix every five years, unless market conditions mandate an interim update.

Furthermore, the Report provides two profitability adjustment mechanisms. First, the profitability of tested parties will be adjusted if the RoS of the tested party falls outside the pre-defined operating expenses cap-and-collar range specified in the Report. Secondly, in instances of no or insufficient data, taxpayers in qualifying jurisdictions, ie, jurisdictions included in the list published and updated every five years on the OECD website, will need to earn an adjusted RoS calculated based on a formula provided in the Report and are dependent on the sovereign credit rating of the qualifying jurisdiction and the operating intensity of the tested party.

Documentation

Taxpayers should have sufficient and reliable information available to allow tax administrations to assess whether the scoping criteria are met, and whether the pricing methodology has been applied properly. The following items comprise a non-exhaustive list of information that may be relevant for the application of the S&S Approach with respect to the Qualifying Activities:

- accurate delineation of the transaction (including functional analysis and context);
- written contract or agreements concluded governing the qualifying transaction and supporting the explanation on the delineation of the Qualifying Activities;
- calculations showing the determination of the relevant revenue, costs and assets allocated or attributed to the Qualifying Activities; and
- TP reconciliation, ie, allocation schedules showing how the TP method used ties to the annual financial statements.

Lastly, when taxpayers seek to apply the S&S Approach for the first time, they should include in their local file or other relevant TP documentation their consent to apply the approach for a minimum of three years, unless transactions are no longer in scope during that period, or there is a significant change in the taxpayers' business, and notify that circumstance to the tax authorities of the jurisdictions involved in the transaction.

Tax certainty and elimination of double taxation

Specific considerations on mutual assistance procedures (MAPs) concerning the application of the S&S Approach have been included in the Report. This concerns the following MAP situations:

- where one jurisdiction applies the S&S Approach and the other does not; and
- where there is a dispute on the application of the S&S Approach between jurisdictions.

If only one jurisdiction applies the S&S Approach, taxpayers and jurisdictions involved shall justify their positions under the OECD Guidelines without relying on the S&S Approach during the MAP process.

Conclusion and application to Luxembourg

As opposed to Pillar Two, the scope of Amount B is limited to the Qualifying Activities and does not set a minimum revenue threshold for taxpayers to fall in scope. Jurisdictions can choose to apply the simplified and streamlined approach for Qualifying Activities of tested parties in their jurisdictions for fiscal years commencing on or after 1 January 2025 and the list of countries applying the S&S approach should be monitored notably for those electing a mandatory approach.

To date, Luxembourg has not implemented the S&S Approach into its legislation. Nevertheless, the Report provides valuable guidance to taxpayers and the LTA on how to properly address the TP of the Qualifying Activities. Countries with developed distribution and marketing activities, like Germany and the Netherlands, have already adopted the S&S Approach in their domestic law. Despite of the fact that Luxembourg is well known for its strong financial and banking industry, it remains to be seen whether it will follow the trend of neighbouring countries, especially in light of very large taxpayers engaged, inter alia, in the distribution sector.

Public Country-by-Country Reporting

Background and timeline

Bill No 8158 transposing the provisions of Directive (EU) 2021/2101 on public country-by-country reporting (CbCR) into Luxembourg domestic law was published on 22 August 2023, in the Memorial A of the Official Gazette under number 532 (the *"Law"*). As part of EU's initiatives to enhance corporate and tax transparency and public scrutiny, public CbCR is a global action requiring MNEs to publicly disclose data of their tax activities to different stakeholders.

Scope of application

Who should disclose?

The Law provides for four categories of companies that are required to publish and provide certain information. These include Luxembourg-based MNEs and non-EU based MNEs conducting a business activity in Luxembourg through a subsidiary or a branch with a consolidated annual turnover at the balance sheet date of at least EUR750 million for each of the last two consecutive years. The in-scope entities shall be covered by the EU accounting directive and should be organised under the following legal forms:

- Luxembourg public limited company (S.A.);
- Luxembourg partnership limited by shares (S.C.A.);
- Luxembourg private limited liability company (S.à r.l.); and
- Luxembourg partnerships (S.N.C. and S.C.S.), provided their direct or indirect partners, who are indefinitely liable, are organised as limited companies or similar.

Thus, any entity organised under another legal form (such as special limited partnerships -*Société en Commandite Spéciale*- SCSp) falls outside the scope of the Law.

Carve-out for banks

Groups engaged in the banking sector are already required to publish a CbCR pursuant to the Capital Requirements Directive IV. The Law therefore avoids the double reporting in this sector by providing a general carve-out, subject to certain conditions.

What information should be disclosed?

The public CbCR for the financial year concerned should include, among others, a list of all subsidiaries included in the consolidated accounts, a brief description of the nature of their activities, the number of full-time equivalent employees, the turnover, the amount of profit or loss before tax and the amount of corporate income tax and withholding tax paid.

Omission from disclosure

Luxembourg chose to permit in-scope entities to defer, under certain conditions, the disclosure of commercially sensitive information. In cases where the disclosure of one or more of the required pieces of information would constitute a serious prejudice to the commercial position of the reporting entity, their temporary omission is allowed. Any omission shall be clearly indicated in the CbCR and accompanied by an explanation. Nevertheless, any omitted information shall be published in a subsequent CbCR within a maximum period of five years from the date of its initial omission.

To date, there is no administrative guidance as to which information is considered commercially sensitive capable of constituting a serious prejudice to the commercial position of the reporting entity. It remains to be seen whether the LTA will issue guidance on the matter, and the Luxembourg courts will take a position in their judgments.

How to disclose?

In-scope entities, in principle, shall make the CbCR available to the public in at least one of the official EU languages for free within 12 months of the balance sheet date of the financial year to which the report is drawn up by posting it on their website. The public CbCR shall remain accessible for a minimum of five consecutive years.

However, in-scope entities are exempted from publishing the public CbCR on their websites, where the report is simultaneously published in a machine-readable electronic reporting format on the website of the Luxembourg Trade Register (RCS) and made available to any third party located in the EU free of charge. In such cases, entities shall inform the public by including, on their website, the reasons for the exemption and by making reference to the RCS website.

It should be noted that the Law does not foresee the possibility to designate another group entity to publish the public CbCR. However, both the public CbCR Directive and the Law provide that the rules no longer apply provided that the non-EU ultimate parent undertaking (UPE) publishes a report that is consistent with the public CBCR and:

- it is made accessible to the public free of charge and in a machine-readable electronic reporting format:
  - (a) on the website of the UPE;
  - (b) in at least one of the official languages of the EU;
  - (c) no later than 12 months after the balance sheet date of the financial year for which the public CbC report is drawn up; and
- identifies the name and the registered office of a single subsidiary undertaking, or the name and the address of a single branch governed by the law of a member state, which has published a public CbC report.

Sanctions

Failure to comply with the provisions of the Law may lead to fines of between EUR500 and EUR25,000. A distinction is drawn between the responsibility of the administrative, management and supervisory bodies of UPEs and standalone undertakings, which are required to prepare and publish the public CbCR in accordance with the Law, and the responsibility of the administrative, management and supervisory bodies of subsidiary undertakings and branches, which are expected simply to ensure, to the best of their knowledge and ability, that the public CbCR is prepared and published.

Auditor's statement

Statutory auditor(s) or approved audit firm(s) auditing financial statements shall state in their audit report whether the taxpayer was required by the Law to publish a public CbCR for the financial year preceding the financial year being audited and whether the public CbCR was prepared and published.

Entry into force

The Law is already applicable to financial years starting on or after 22 June 2024. The public CbCR shall be published within 12 months of the closing of the financial year for which it is drawn up. For entities whose financial year follows the calendar year, ie, 1 January until 31 December, the reporting obligation only started with respect to the financial year 2025 and the public CbCR shall be published by 31 December 2026 at the latest.

Master File and Local File Obligations and Advanced Pricing Agreements (APAs)

On 28 March 2023, the Luxembourg government presented a bill of law as well as the related Grand-Ducal Regulation to reform certain tax administrative and procedural aspects, as well as TP documentation requirements.

The draft Grand-Ducal Regulation on TP documentation provides that there will be a local file and master file obligation for Luxembourg *"constituent entities"* as defined in the Luxembourg CbC law meeting certain thresholds. Both the local file and the master file shall always be available to the LTA.

Under the same legislative initiative, it was also proposed that the bilateral and multilateral APA procedure be formalised by introducing a fee ranging from EUR10,000 to EUR20,000.

Although the master file and local file obligations were supposed to enter into force as of financial year 2024, the bill of law has still not been voted on. To date, the entire legislative proposal has faced much criticism, both from stakeholders and the Council of State. It remains to be seen whether the proposal will be adopted or whether it will undergo any amendments.

More Detailed Transfer Pricing Documentation

As previously mentioned, currently Luxembourg does not impose any master file or local file obligations. However, paragraphs 171(1) and 171(3) of the general tax law of 22 May 1931 (*Abgabenordnung* or AO) demand that taxpayers must be able to prove the accuracy of the information included in their tax returns, including information related to the TP of their controlled transactions. As such, all intercompany transactions are documented in ad hoc TP reports and benchmarking analyses.

In addition, as opposed to certain other EU countries, there is no specific requirement in Luxembourg to file TP documentation as part of the filing of tax returns. Instead, TP documentation shall be provided upon request by the LTA during the process of a tax audit. Experience shows that the LTA can challenge easier taxpayers' intercompany transactions when no TP documentation is prepared or when the TP documentation is incomplete or when the TP documentation is prepared after the request for information. In an environment where more and more tax scrutiny is observed, taxpayers should make sure that all controlled transactions are duly documented and supported by ad hoc TP documentation.

The TP landscape is undoubtedly intimidating for taxpayers. Comparability can be subjective, which gives tax authorities a lot of flexibility to challenge taxpayers' controlled transactions. To that end, in an effort to mitigate the risk that the LTA challenges their intra-group transactions, the TP documentation prepared by taxpayers is becoming more and more granular and detailed compared to the level of detail contained in such documents in previous years.

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