

Luxembourg Attorney Wins Landmark Case for U.S. Investment Group

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The arm's-length standard requires that interest accrue on a loan accounted for as interest-free by the Centerbridge Partners investment group and doesn't allow the loan to be recharacterized as a capital contribution, a Luxembourg court has said.

In its November 23 decision ([No. 48125C](#)), published November 30, the Luxembourg Administrative Appeals Court (Cour Administrative) overturned a 2020 judgment of the Luxembourg Administrative Court (Tribunal Administratif) and sided with the taxpayer. The Luxembourg subsidiary of the Centerbridge Partners group had petitioned the court to allow deductions of interest on an intragroup loan, which the tax authorities had denied by requalifying the debt as an equity injection.

"If the lower court decision had been upheld, it would have cast doubt on the recognition of the debt nature not only of interest-free loans, but also other intercompany loans, especially those with some equity features," Peter Moons of Loyens & Loeff in Luxembourg, who represented the Luxembourg subsidiary at the courts, told *Tax Notes*. "This would have created unworkable uncertainty throughout Luxembourg as a holding and finance jurisdiction. This is avoided by the higher court's reversal."

The Luxembourg taxpayer, identified only as a Sàrl, a small corporation, belonging to the U.S.-based Centerbridge Partners group, provides loans and financing in any form, or grants guarantees or securities in any form, for the benefit of companies and undertakings of the group. In 2016 the sole Luxembourg shareholder granted the Sàrl an interest-free downstream loan (IFL), which it had refinanced with its only incorporated Cayman Islands-based shareholder, also an entity of the Centerbridge Partners group, under a profit participating loan. For income, trade, and wealth tax purposes, the Sàrl claimed that the arm's-length principle under article 56 of the [Luxembourg Revenue Tax Act](#) (LIR) requires the payment of interest for the granted loan, calculated under the cost-plus method, to its direct Luxembourg shareholder. After an audit, the Luxembourg tax authorities denied the interest deduction and said the IFL must be requalified as a capital contribution of Sàrl's shareholder under section 11 of the [Tax Adjustment Act](#) (StAnpG).

After an unsuccessful objection procedure, the Sàrl filed a petition with the Luxembourg Administrative Court in 2020, saying that Luxembourg granted Huhtamaki Sàrl favorable rulings in a similar IFL case; Luxembourg is still [defending](#) these in a [European Commission procedure](#) on [alleged illegal state aid](#). Disallowing the interest deduction in the plaintiff's case is therefore contradictory, the Sàrl of the Centerbridge Partners group said.

The Sàrl also argued that a comparable controlled price method could not be used because of a lack of relevant data. Further, the tax authorities' request that the taxpayer prove the nonexistence of that

data is an impossible demand for evidence of a negative fact, the Sàrl said. Thus, the burden would be on the tax authorities to establish the noncompliance of the taxpayer's transfer prices and documentation and not on the taxpayer to prove their validity. However, the tax authorities would still fail to demonstrate that the disputed transfer pricing has methodological errors, and even less, that these errors would have resulted in an undue reduction of taxable profit, by alleging only that another method would have been more appropriate, the taxpayer said.

The administrative court [did not discuss](#) the transfer pricing arguments of the taxpayer and sided with the tax authorities. The jurisprudence of the German Bundesfinanzhof that, before 1950, allowed the recharacterization of a downstream loan into equity under substance-over-form principles still applies in Luxembourg, according to the legislative history. Therefore, an IFL has to be recast as a capital contribution if this would have been the "normal financing route" considering the structuring of the loan, the court ruled.

Petitioning the Luxembourg Administrative Appeals Court, the taxpayer pursued its objective further to get the assessments overturned. The arguments of the parties shifted in focus to the details of the IFL's conditions, such as recourse in case of default, compensation for poor performance, and the loan/equity ratio, including the nonexistent interest rate. The higher court agreed with the lower court on the general application of the substance-over-form principle applicable to loans, but stressed that the intentions of the parties could not be assumed. No single condition of the loan could determine its (re-)characterization, the appeals court said, discussing in detail the relevant loan provisions contrary to only a rather cursory review by the lower instance court. It also highlighted the failure of the tax authorities to provide any argument why the interest calculated by the taxpayer is not arm's length, noting that the Sàrl's Luxembourg shareholder declared interest income for tax purposes. The court therefore allowed the interest deduction for the Sàrl.

"The decision provides helpful guidance to analyze specific loan criteria, which remained largely open to interpretation," Moons said.

The taxpayer was represented at the Luxembourg Administrative Court (No. 44902) and the Luxembourg Administrative Appeals Court (No. 48215C) by Peter Moons and Pierre-Antoine Klethi of law firm Loyens & Loeff in Luxembourg.