Chambers AND PARTNERS

CHAMBERS GLOBAL PRACTICE GUIDES

Transfer Pricing 2023

Definitive global law guides offering comparative analysis from top-ranked lawyers

Luxembourg: Law & Practice
Peter Moons and Sophie Ogden
Loyens & Loeff

Luxembourg: Trends & Developments
Peter Moons and Sophie Ogden
Loyens & Loeff

LUXEMBOURG

Law and Practice

Contributed by:
Peter Moons and Sophie Ogden
Loyens & Loeff

Contents

1. Rules Governing Transfer Pricing p.5
1.1 Statutes and Regulations p.5
1.2 Current Regime and Recent Changes p.7

2. Definition of Control/Related Parties p.7
2.1 Application of Transfer Pricing Rules p.7

3. Methods and Method Selection and Application p.8
3.1 Transfer Pricing Methods p.8
3.2 Unspecified Methods p.8
3.3 Hierarchy of Methods p.8
3.4 Ranges and Statistical Measures p.8
3.5 Comparability Adjustments p.9

4. Intangibles p.9
4.1 Notable Rules p.9
4.2 Hard-to-Value Intangibles p.10
4.3 Cost Sharing/Cost Contribution Arrangements p.10

5. Affirmative Adjustments p.10
5.1 Rules on Affirmative Transfer Pricing Adjustments p.10

6. Cross-Border Information Sharing p.11
6.1 Sharing Taxpayer Information p.11

7. Advance Pricing Agreements (APAs) p.12
7.1 Programmes Allowing for Rulings Regarding Transfer Pricing p.12
7.2 Administration of Programmes p.13
7.3 Co-ordination Between the APA Process and Mutual Agreement Procedures p.13
7.4 Limits on Taxpayers/Transactions Eligible for an APA p.13
7.5 APA Application Deadlines p.13
7.6 APA User Fees p.13
7.7 Duration of APA Cover p.13
7.8 Retroactive Effect for APAs p.13

8. Penalties and Documentation p.13
8.1 Transfer Pricing Penalties and Defences p.13
8.2 Taxpayer Obligations Under the OECD Transfer Pricing Guidelines p.14

9. Alignment With OECD Transfer Pricing Guidelines p.14
9.1 Alignment and Differences p.14
9.2 Arm's Length Principle p.14
9.3 Impact of the Base Erosion and Profit Shifting (BEPS) Project p.15
9.4 Impact of BEPS 2.0 p.15
9.5 Entities Bearing the Risk of Another Entity's Operations p.15

10. Relevance of the United Nations Practical Manual on Transfer Pricing p.16
10.1 Impact of UN Practical Manual on Transfer Pricing p.16

11. Safe Harbours or Other Unique Rules p.16
11.1 Transfer Pricing Safe Harbours p.16
11.2 Rules on Savings Arising From Operating in the Jurisdiction p.16
11.3 Unique Transfer Pricing Rules or Practices p.16

12. Co-ordination With Customs Valuation p.16
12.1 Co-ordination Requirements Between Transfer Pricing and Customs Valuation p.16

13. Controversy Process p.16
13.1 Options and Requirements in Transfer Pricing Controversies p.16

14. Judicial Precedent p.17
14.1 Judicial Precedent on Transfer Pricing p.17
14.2 Significant Court Rulings p.17

15. Foreign Payment Restrictions p.18
15.1 Restrictions on Outbound Payments Relating to Uncontrolled Transactions p.18
15.2 Restrictions on Outbound Payments Relating to Controlled Transactions p.18
15.3 Effects of Other Countries' Legal Restrictions p.19

16. Transparency and Confidentiality p.19
16.1 Publication of Information on APAs or Transfer Pricing Audit Outcomes p.19
16.2 Use of "Secret Comparables" p.19

17. COVID-19 p.19
17.1 Impact of COVID-19 on Transfer Pricing p.19
17.2 Government Response p.19
17.3 Progress of Audits p.19

Loyens & Loeff is an independent, European, 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 assist clients' tax departments on the formulation of sustainable transfer pricing strategies in line with their business whilst maintaining tax efficiency. Finally, 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.

Authors

Peter Moons is a partner in Loyens & Loeff's tax practice group and heads the Luxembourg transfer pricing team. He specialises in cross-border corporate tax advice for multinationals and funds, in particular private equity, private debt and real estate funds, their initiators and their investors. Peter also co-chairs the Luxembourg tax litigation team. He regularly speaks on the topics of international tax structuring, transfer pricing and tax litigation.

Sophie Ogden is an associate, is a member of Loyens & Loeff's tax practice group in the firm's Luxembourg office. She focuses on transfer pricing and European as well as international law. Since joining the Luxembourg tax practice group as a tax adviser in 2017, she has advised clients on financial transactions, international tax planning and intra-group restructuring.

Loyens & Loeff

18-20, rue Edward Steichen
L-2540
Luxembourg

Tel: +352 466 230
Fax: +352 466 234
Email: info@loyensloeff.lu
Web: www.loyensloeff.com

LOYENS & LOEFF
Law & Tax

1. Rules Governing Transfer Pricing

1.1 Statutes and Regulations

Preliminary Remarks

Transfer pricing issues are mostly discussed in the context of corporate income tax (CIT) and municipal business tax (MBT). Save for some specific rules, the income subject to MBT is determined generally by applying the rules followed for CIT purposes as a starting point. Transfer pricing rules are also highly relevant for withholding tax purposes in the case of a requalification of income into hidden distribution for instance.

Laws and Provisions

The legal provisions dealing with transfer pricing are limited. The arm's length principle is enshrined in several provisions of Luxembourg tax law. It is explicitly codified in Article 56 of the Luxembourg Income Tax Law (LIR) which is based on Article 9 of the OECD Model Tax Convention.

Both upwards and downwards adjustments are, in principle, allowed.

Article 56bis of the LIR implements the guiding principles set out in the OECD's Base Erosion and Profit Shifting (BEPS) Reports Actions 8–10 into domestic law. It contains the basic principles on how to apply the arm's length principle to be reflected in a transfer pricing analysis, starting with a comparability analysis and accurate delineation of the transaction. The law specifies that the fact that a particular transaction is not observed between independent parties does not necessarily mean that the transaction is not at arm's length. If a transaction or part of a transaction does not have any valid commercial rationale that has an impact on the determination of the arm's length price, then that transaction or part thereof shall be disregarded.

Article 164(3) of the LIR reclassifies as hidden profit distributions any advantage a shareholder, member or an interested party (natural or legal person) receives directly or indirectly from a company or an association that they would not have normally received in the absence of their quality as an interested party. Pursuant to case law, there is a hidden profit distribution provided that:

- there is a decrease of a company's net equity;
- the advantage is motivated by a shareholding relationship or similar;
- the advantage impacts the company's taxable income; and
- the advantage is not a regular dividend distribution.

The scope of Article 164(3) of the LIR is restricted to hidden profit distributions. Under Luxembourg law, regular dividend distribution and hidden profit distributions are subject to a 15% withholding tax (unless an exemption or reduction applies).

It is worth noting that the Luxembourg tax authorities (LTA) apply the principle of substance over form. Also, the courts apply the principle of economic reality which a judge is meant to apply to a transaction rather than stop at the contractual forms chosen.

Following the transposition of the EU Directive 2016/1164 establishing anti-avoidance rules known as "ATAD", Luxembourg introduced controlled foreign company (CFC) rules based on Article 164ter LIR, effective since 1 Janu-

ary 2019. Luxembourg is one of the few EU member states that opted for the transactional approach (model B) provided in ATAD, whereby a Luxembourg entity must include in its tax base non-distributed income of a CFC arising from non-genuine arrangements that have been put in place with the essential purpose of obtaining a tax advantage. An arrangement may not be genuine where the CFC would not own the asset, or assume the risks which generate all or part of its income, were it not controlled by a taxpayer having significant peoploe functions that are linked to the assets and/or risks, and which play an essential role in generating the CFC's income. The CFC income to be included in the tax basis of the Luxembourg company should be attributed on the basis of a transfer pricing analysis.

In terms of documentation support, since the introduction of paragraph 171(3) of the General Tax Law (AO) in 2015, transfer pricing documentation has been explicitly identified as documentation that the taxpayer should have to support the content of its tax returns. Put differently, the burden of proof that a transaction is at arm's length lies initially on the taxpayer and can be requested at any time by the LTA.

Country-by-country reporting obligations were introduced by the law of 27 December 2016 transposing the EU Directive 2016/881, which entered into force from 1 January 2017 in Luxembourg.

Lastly, it should be noted that non-arm's length transactions may not be in the corporate interest of a company and lead to corporate issues.

Administrative Guidance

In addition to the above legislation, the LTA has issued administrative guidance relevant to transfer pricing:

- Circular LIR No 56/1 – 56bis/1 of 27 December 2016 on the tax treatment of companies carrying out intra-group financing transactions (the "Financing Circular"). The Financing Circular provides transfer pricing guidance for Luxembourg companies exercising intercompany financing activities financed by debt, whether internal or external. In the absence of other Luxembourg guidance, this Financing Circular is also followed for Luxembourg companies investing in third-party loans and financed by intercompany debt.
- Internal note LIR/NS No 164/1 of 9 June 1993 on the interest rate in relation to a shareholder's current account.
- Circular LIR No164ter/1 of 17 June 2022 on the CFC rules.
- Circular L.G. – Conv. D.I. No 60) of 11 March 2021 on the modalities for a mutual agreement procedure under a double tax treaty.

A circular is issued by the director of the LTA and is binding on the LTA itself only. In practice, however, as the LTA's agents must follow the circulars, these provide useful guidance on the interpretation of the LTA in regard to a particular provision.

The OECD Guidelines

Explicit reference to the OECD Transfer Pricing Guidelines (the "OECD Guidelines") was made as early as in the 2011 Circular LIR No164/2 of 28 January 2011 where the director of the LTA states that the arm's length principle constitute the international standard for OECD members which should follow the OECD Guideline for good practice in cross-border transactions.

The parliamentary files leading to the adoption of Articles 56 and 56bis of the LIR directly refers to the OECD Guidelines, providing the OECD Guidelines some degree of authoritative status for Luxembourg CIT and MBT tax purposes.

The OECD Guidelines are recognised as soft law and constitute a source of reference for a transfer pricing analysis.

Tax Treaties
Luxembourg's extensive tax treaty network is mostly based on the OECD Model Tax Convention and the arm's length principle is included in all of them.

1.2 Current Regime and Recent Changes

The arm's length principle is enshrined in Luxembourg tax law.

The transfer pricing rules as they currently stand have been formalised in the BEPS action plan context, and as a response to the state aid investigations launched by the European Commission at the time.

The arm's length principle, as widely known today and derived from international standards, was formally codified with effect as from 1 January 2015, and the provisions dealing with the requirements a transfer pricing analysis should meet, as well as updated guidance, by way of the Financing Circular, on group financing companies were introduced with effect as from 1 January 2017.

Explicit reference to the OECD Guidelines was made as early as in the 2011 Circular 164/2 of 28 January 2011 for group financing companies. Since the codification of the arm's length principle in 2015, Luxembourg and the LTA have referred to the OECD Guidelines as the reference framework for a transfer pricing analysis.

2. Definition of Control/Related Parties

2.1 Application of Transfer Pricing Rules

In Luxembourg, whether enterprises are related is determined according to a flexible test.

The arm's length principle anchored in Article 164(3) of the LIR on the non-deductibility of hidden profit distribution applies not only to direct and indirect shareholders, but also to interested parties. The notion of hidden distribution and its scope has been shaped by Luxembourg case law.

As of 1 January 2015, Article 56 of the LIR incorporates the definition of associated enterprises provided by Article 9(1) of the OECD Model Tax Convention as follows:

"When

(a) an enterprise participates directly or indirectly in the management, control or capital of another enterprise, or that

(b) the same persons participate directly or indirectly in the management, control or capital of two enterprises,

and that in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, the profits of such enterprises will be determined under the conditions prevailing between independent companies and taxed accordingly."

In the parliamentary file to the adoption of the new Article 56 of the LIR, there is legislator comment to the effect that the existing provision tends to reflect the arm's length principle in an indirect way and that the new provision has a distinctive scope from Article 164(3) of the LIR. In practice, however, the LTA tends to invoke Articles 56 LIR and 164(3) of the LIR simultaneously. That said, Article 56 of the LIR may lead to the non-deductibility of an expense, or part thereof, in the absence of an advantage to a related party, if it can be demonstrated that the cost is higher.

The concept of "associated enterprises" can also be found in several other provisions of Luxembourg tax law: Article 164ter (2) of the LIR on CFC rules, or Article 168ter (1) 18 of the LIR on anti-hybrid rules, to name just two. However, in those cases the concept of associated enterprises will generally be limited to the application of the provision containing the rules and not to transfer pricing.

3. Methods and Method Selection and Application

3.1 Transfer Pricing Methods

Luxembourg's income tax law does not list specific transfer pricing methods applicable to (some) type of transactions, nor prescribe any hierarchy of methods.

As Luxembourg follows the OECD Guidelines, the transfer pricing methods outlined in the OECD Guidelines should be used and include the following:

- the comparable uncontrolled price method (CUP);
- the resale price method (RPM);
- the cost-plus method (CPM);
- the transactional net margin method (TNMM); and
- the profit split method (PSM).

The burden of proof on the choice of method to determine the arm's length price of a group transaction lies first on the taxpayer.

In accordance with paragraph 2.9 of the OECD Guidelines, a taxpayer is free to opt for another method provided the choice is explained in the transfer pricing documentation as to why it is the most appropriate method.

3.2 Unspecified Methods

For each transaction between related parties, the most appropriate method should be applied. As Luxembourg follows the OECD principles and the OECD Guidelines, the starting point will nevertheless be the methods contained in the OECD Guidelines.

3.3 Hierarchy of Methods

There is no hierarchy of methods. The most appropriate method should be used and the choice of method should be explained in ad hoc transfer pricing documentation.

In practice, the CUP method is generally preferred provided there are no material differences between the transaction or where reasonable adjustments can be performed to eliminate the impact on the transfer price.

3.4 Ranges and Statistical Measures

There is no specific guidance on the use of ranges or statistical measures in Luxembourg when determining an arm's length price. Hence the guidance of the OECD Guidelines should be followed in that respect.

3.5 Comparability Adjustments

Luxembourg law requires reasonable and reliable comparability adjustments in cases where no suitable direct comparables can be found, to eliminate the material differences between the compared transactions.

There is no specific guidance on how to conduct the comparability adjustments. The OECD Guidelines should be followed in that respect.

4. Intangibles

4.1 Notable Rules

Transfer Pricing

Luxembourg does not have any specific rules relating to the transfer pricing of intangibles. Guidance from the OECD Guidelines, specifically from Chapter VI, should be followed.

Luxembourg IP Regime

It is worth noting that Luxembourg tax law replaced its old beneficial IP regime (grandfathered until June 2021), with a new one, applicable since 1 January 2018 and laid down in Article 50ter of the LIR. The new IP regime has been considered compliant with the minimum standards set by the BEPS Action 5 Report, by applying a nexus approach.

Under the new IP regime, 80% of the net qualifying income and capital gain – ie, after deduction of eligible costs – derived by a corporate taxpayer from eligible IPs is exempt from CIT and MBT. In addition, the qualifying asset is an exempt asset for net wealth tax (NWT) purposes.

The eligible IP assets are intellectual property created, developed or improved after 31 December 2007 in the context of research and development (R&D) activities and which consist of, inter alia:

- any invention protected under existing national or international provisions by a patent, utility model, a supplementary protection certificate for patents for medicine or a plant protection product, an extension of a supplementary protection certificate for paediatric medicine, a plant variety certificate, or an orphan drug designation; or
- software protected by copyright under current national and international provisions.

Contrary to the former IP regime, trade marks and any marketing intangibles that do not require R&D in Luxembourg are notably excluded, as well as any IP assets which do not have a nexus with Luxembourg and assets which do not require R&D. To be eligible for the IP regime, the IP assets must have been developed or improved through R&D activities having a nexus with Luxembourg.

The eligible expenses consist of the expenses required for R&D activities directly related to the constitution, development or improvement of an eligible asset, which are incurred by the taxpayer for the R&D carried out itself or paid by the taxpayer to an unrelated enterprise or to an associated enterprise provided that it pays the remuneration obtained without retaining a margin to an entity that is not an associated enterprise. However, the eligible expenses do not cover acquisition costs, interest and financing costs, real estate costs and any other costs not directly related to the eligible asset.

The income and expenses should be identified separately for each eligible asset and the taxpayer should be able to establish the link with the eligible asset. However, where the taxpayer

has a plurality of eligible IP and the entity can demonstrate that the R&D is so complex that an asset-by-asset monitoring of income and expenses is not possible, as an exception, the corporate taxpayer may, in a nutshell, monitor the income and expenses per service of family of products.

The LTA published the Administrative Circular LIR No 50ter/1 of 28 June 2019 on the IP tax regime which specifies that the arm's length principle (enshrined in Article 56bis of the LIR) applies, thus also in the case of IP and IP eligible for the IP regime.

4.2 Hard-to-Value Intangibles

Luxembourg does not have any special rules regarding hard-to-value intangibles (HTVI). Hence the OECD Guidelines will be followed in that respect.

In order to make an after-the-fact adjustment, the LTA need to be able to demonstrate that the tax payer was in possession (or that there is sufficient evidence that the taxpayer must have been in possession) of the relevant information at the moment the related party transaction was executed but that the information was not taken into consideration during the price setting process.

Under the EU Directive 2018/822 of 25 May 2018 introducing mandatory disclosure rules for intermediaries (DAC 6) certain reportable cross-border arrangements (RCBAs) must be disclosed to the competent authorities of the relevant EU member state. For an arrangement to be reportable under DAC 6, it must (i) be considered a cross-border arrangement and (ii) satisfy one of the so-called "hallmarks" listed in the annex to the Luxembourg implementing law. The intermediary or the taxpayer, as the case may be, must file the declaration for a RCBA within 30 days beginning (i) on the day after the RCBA is made available for implementation, (ii) on the day after the arrangement is ready for implementation, or (iii) when the first step in the implementation has been made, whichever occurs first. The hallmarks under category E relate to transfer pricing. One of the hallmark concerns arrangement involving the transfer of HTVI between associated enterprises. The term HTVI covers intangibles or rights in intangibles for which, at the time of its transfer: (i) no reliable comparables exist; and (ii) at the time the transaction was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer.

4.3 Cost Sharing/Cost Contribution Arrangements

There are no special rules or guidance in Luxembourg on cost sharing/cost contribution arrangements. Therefore the guidance from the OECD Guidelines, and specifically Chapter VIII on cost contribution arrangements, should be followed.

5. Affirmative Adjustments

5.1 Rules on Affirmative Transfer Pricing Adjustments

In accordance with the arm's length principle, both upward and downward adjustments of taxable income are in principle allowed. There is no domestic legislation prohibiting year-end adjustments or adjustments made in the tax returns only when testing the outcome of a transaction.

Once the tax returns are filed, the general procedural rules apply. The taxpayer has the obli-

gation to file a new (corrective) tax return if the amount of tax due increases, while it may file a corrective tax return but should demonstrate the grounds for the adjustment if the tax charge decreases. If an assessment had already been issued, the LTA must reconsider the tax return if the tax liability increases. If there is no tax due, the LTA is not required to issue a new or corrective tax assessment if filed after the deadline.

6. Cross-Border Information Sharing

6.1 Sharing Taxpayer Information

Exchange of information can be automatic, on request or spontaneous under a number of different instruments.

Tax Treaties

Luxembourg has an extensive tax treaty network (86 as per 1 January 2023), of which all of them now include a provision on the exchange of information, and for most of them based on the OECD Model Tax Convention.

Exchanges of Information on Request

The law of 25 November 2014, as amended, laying down the procedure applicable to the exchange of information on request in tax matters is applicable to all requests for assistance made by the competent authority of a requesting state under:

- a double tax treaty;
- a bilateral agreement on exchange of information;
- the law of 21 July 2012 transposing the EU Directive 2010/24 of 16 March 2010 on mutual assistance for the recovery of claims relating to taxes, duties and other measures;
- the amended law of 29 March 2013 transposing EU Directive 2011/16 of 15 February 2011 on administrative cooperation in tax matters; and
- the law of 26 May 2014 approving the Convention on Mutual Administrative Assistance in Tax Matters and its amending protocol, signed in Paris on 29 May 2013.

The latter extended the number of jurisdictions with which Luxembourg exchanges information on request to over 147 jurisdictions.

In 2021, Luxembourg received over 1,200 requests for exchange of information, spontaneous exchanges and notifications from other jurisdictions. In practice, the number of requests keeps growing. The LTA must verify the regularity of the request and review that it is not a “phishing” expedition. Due to the number of requests, the domestic courts and tribunals, as well as the Court of Justice of the EU (CJEU) are continuously clarifying and reshaping the conditions of request for information made by a competent authority.

Automatic Exchanges

Tax rulings and advance pricing agreements (APAs) are subject to the automatic exchange of information within the EU.

During Luxembourg’s EU presidency in 2015, the EU Directive 2015/2376 (DAC 3) amending the existing Directive 2011/16 on administrative co-operation in the field of taxation was adopted as a response to the “Luxleaks” and provides for the automatic exchange of rulings within the EU.

Furthermore, country-by-country reports are also exchanged.

Automatic exchanges also take place under the OECD's Common Reporting Standard (CRS) and the US Foreign Account Tax Compliance Act (FATCA)

DAC 6 also provides for the automatic exchange of information on RCBAs between the EU jurisdictions involved in the arrangement. The hallmarks under category E relate to transfer pricing, for which the so-called "main benefit test" does not need to be met. They comprise the following:

- E1 – an arrangement which involves the use of unilateral safe harbour rules.
- E2 – an arrangement involving the transfer of HTVI (see **4.2 Hard-to-Value Intangibles** for further discussion of these).
- E3 – an arrangement involving an intragroup cross-border transfer of functions and/or risks and/or assets, if the projected annual earnings before interest and taxes (EBIT), during the three-year period after the transfer, of the transferor or transferors, are less than 50% of the projected annual EBIT of such transferor or transferors if the transfer had not been made.

Spontaneous Exchange

Under the Financing Circular, taxpayers that opt for the simplification measure provided in said circular for pure intermediary group financing companies will be subject to (spontaneous) exchange of information.

7. Advance Pricing Agreements (APAs)

7.1 Programmes Allowing for Rulings Regarding Transfer Pricing

The AO was expanded in December 2014 with paragraph 29a and the related Grand-Ducal Decree to regulate the procedure for tax rulings and make the procedure more transparent.

Unilateral APAs are subject to the same rules as regular tax rulings. Any taxpayer may request an APA in writing.

The Financing Circular on companies carrying out intra-group financing transactions lists the information and documents that an APA request in relation to financing activities should contain.

There is no specific programme for bilateral and multilateral APAs, but there are a number of instruments under which a taxpayer may request a bilateral APA or a transfer pricing mutual agreement procedure (MAP), these include (i) the EU Arbitration Convention;(ii) the law of 20 December 2019 implementing the EU Directive 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the EU; or (iii) a tax treaty. The LTA consider that bilateral and multilateral APAs can be concluded based on tax treaties, on Article 25(3) of the OECD Model Tax Convention (on MAPs) for which no filing fee is due. A bill of law is currently pending to include a specific paragraph in the AO on the procedure for bilateral and multilateral APAs.

The LTA updated its guidance on MAPs filed under a treaty (ie, not under the EU Arbitration Convention or the law on tax dispute resolution mechanisms) by way of the Circular L.G. – Conv. D.I. No 60 dated 11 March 2021 (the "MAP Circular").

While the number of transfer pricing MAPs keep increasing, the number of unilateral APAs has dropped since the publication of the Financing Circular in December 2016.

7.2 Administration of Programmes

APA requests should be addressed to the head of the relevant tax office of the taxpayer, but will, in practice be dealt with by the economic division of the LTA.

Transfer pricing MAP applications can be addressed to the directorate at the LTA (*Comité de direction*), or to the economic division of the LTA. Bilateral and multilateral APAs should in principle be addressed to the *Comité de direction*.

7.3 Co-ordination Between the APA Process and Mutual Agreement Procedures

Although an APA request is formally addressed to a different office than a MAP request, in practice there will be co-ordination between the two.

The MAP Circular further explains the relationship between a MAP and other procedures, such as a tax audit, judicial or administrative appeal, the EU Arbitration Convention, or the EU directive on tax dispute resolution.

7.4 Limits on Taxpayers/Transactions Eligible for an APA

In principle, there are no limits or restrictions on the transactions eligible for an APA. The APA is open to all taxpayers.

7.5 APA Application Deadlines

An APA must be requested before the transaction covered by the APA takes place.

A bilateral APA or a MAP must generally be requested within three years from the first notification which results or is likely to result in double taxation, depending on the instrument under which the request is filed.

7.6 APA User Fees

For an APA, a filing fee ranging between EUR3,000 and EUR10,000 is due and varies depending on the complexity of the case. In practice, corporate taxpayers generally pay EUR10,000.

In principle, no administrative fee is due for a bilateral APA or a MAP, but a bill of law is pending to introduce a filing fee ranging between EUR10,000 and EUR20,000 depending on the complexity of the case.

7.7 Duration of APA Cover

An APA can cover a maximum of five years.

7.8 Retroactive Effect for APAs

Unilateral APAs may not in principle have retroactive effect as the request must be filed prior to the transaction taking place.

Roll-backs of bilateral APAs may be possible.

8. Penalties and Documentation

8.1 Transfer Pricing Penalties and Defences

Transfer Pricing Penalties

There are no specific sanctions applicable to transfer pricing in Luxembourg. To the extent the pricing of a transaction is not at arm's length, the LTA may adjust the taxable basis.

The general sanctions applicable in tax matters apply to transfer pricing.

Incorrect or late filing of the country-by-country report or notification may lead to a discretionary fine of up to EUR250,000.

General Administrative Penalties

Late payment of taxes or advances of taxes lead to late payment interest at a rate of 0.6% per month (in most cases).

There are three types of tax fraud covered by the AO: simple tax fraud, aggravated tax fraud and tax evasion.

The LTA may levy administrative penalties in case of culpable intent to reduce the tax liability (*fraude fiscale simple*) or culpable negligence (*fraude fiscale involontaire*). The penalty for the former is set to a maximum of half of the tax due or the reimbursement unduly obtained, and cannot be lower than 10% of the eluded tax or the reimbursement unduly obtained. For the latter, the fine can be set at up to EUR125,000, although it cannot exceed 25% or be lower than 5% of the tax due or the reimbursement unduly obtained. Incomplete or inaccurate tax returns may lead to an administrative fine of 5–25% of the avoided taxes.

Aggravated Tax Fraud and Tax Evasion Constitute Criminal Offenses

On 28 July 2021, the LTA published a circular clarifying the general rules for setting administrative fines and penalties in a direct tax context, as well as the procedure for criminal tax offenses and guidelines on co-operation with judicial authorities.

8.2 Taxpayer Obligations Under the OECD Transfer Pricing Guidelines

Currently, there are no master file or local file documentation requirements in Luxembourg. A bill of law is currently pending to align the transfer pricing documentation requirements to the OECD BEPS Action 13 that taxpayers part of a group should have available upon demand.

Country-by-country (CbC) reporting has been implemented in Luxembourg in accordance with the relevant EU Directive. The ultimate parent entity controlling the MNE group with a total consolidated turnover of at least EUR750 million should file the CbC report. The Luxembourg entity, regardless of whether it is the ultimate parent or not, should file a notification indicating which entity in the group will submit the CbC report.

Note that the taxpayer should always have ad-hoc transfer pricing documentation.

9. Alignment With OECD Transfer Pricing Guidelines

9.1 Alignment and Differences

Luxembourg closely follows the OECD Guidelines. The legislative proposal (budget law 2015) leading to the adoption of Article 56bis of the LIR explicitly referred to the transposition of the guiding principles of BEPS Actions 8–10 and refers to the OECD Guidelines. As such, the OECD Guidelines constitute the base reference in a transfer pricing analysis which the LTA should follow.

9.2 Arm's Length Principle

Luxembourg tax law currently follows exclusively the arm's length principle.

For completeness, one case of formulary apportionment occurs, allocating, for MBT purposes, taxable business income between municipalities (communes) if the taxpayer carries out activities across more than one municipality within Luxembourg.

9.3 Impact of the Base Erosion and Profit Shifting (BEPS) Project

The OECD BEPS project has significantly impacted the transfer pricing landscape of not only Luxembourg, but also the EU as a whole. Luxembourg has committed to follow the OECD BEPS project.

To start, Article 56bis of the LIR providing guidance on how to apply the arm's length principle and conduct a transfer pricing analysis is the transposition of the guiding principles of the BEPS Action Plan, Actions 8–10. All companies are to maintain all relevant documentation supporting the arm's length character of the remuneration for transactions between related parties.

Further to BEPS, Luxembourg has implemented CbC reporting into domestic legislation, new instruments for the resolution of tax disputes, automatic exchange of information, or CFC legislation, to name just a few.

9.4 Impact of BEPS 2.0

The impact from Pillar One for Luxembourg mainly depends on the scope of exclusion for financial services. Regulated financial services, such as banking and insurance are expected to be fully excluded, similarly for funds, though a question mark remains on financial intermediaries in an investment advisory role. Beyond the financial sector, some MNEs that currently do not have a taxable presence under current rules, but generate above EUR1 million in revenues in the local market may need to apportion some profits to Luxembourg under amount A. Conversely, given the high global turnover and profitability thresholds, it is unlikely that many Luxembourg-based firms would be affected.

During the adoption process of the Pillar Two EU directive, it was agreed that the Commission will have to report to the Council on the progress of Pillar One, and the Commission may submit another proposal to address the challenges of the digital economy.

As for Pillar Two, the Council of the EU adopted on 15 December 2022 the Directive 2022/2523 implementing Pillar Two at EU level. EU member states have to transpose the directive ultimately by 31 December 2023. Luxembourg is yet to publish the draft bill of law. While the EU Pillar Two Directive is largely aligned to the OECD's model rules, there are some deviations introduced to ensure compliance with EU treaties. Furthermore, it is uncertain how the guidance published by the OECD after the adoption of the Directive will be taken into account across the EU member states. What is certain is that MNEs should prepare the entry into force of Pillar Two in a number of jurisdictions, including EU member states, and that the compliance burden will increase.

9.5 Entities Bearing the Risk of Another Entity's Operations

Luxembourg allows one entity to bear the risk of another entity's operations provided the transaction is at arm's length and the risk-bearing entity is remunerated by an arm's length price.

Luxembourg law follows a substance-over-form principle. The LTA may seek the economic reality of a transaction and does not have to stop at the contractual arrangements.

Luxembourg being a financial centre, guarantees are frequently encountered in financial transactions with third parties. For instance when a Luxembourg entity issues notes to the market, the notes will often be guaranteed by the ultimate

parent of the group. Whether a guarantee fee is due is to be determined in accordance with Chapter X of the OECD Guidelines.

10. Relevance of the United Nations Practical Manual on Transfer Pricing

10.1 Impact of UN Practical Manual on Transfer Pricing

The parliamentary file leading to the codification of the arm's length principle provides that the UN Practical Manual on Transfer Pricing for Developing Countries constitutes a source of information allowing to apply the arm's length principle.

In practice, however, the UN Practice Manual is only of minor importance. Luxembourg explicitly follows the OECD Guidelines.

11. Safe Harbours or Other Unique Rules

11.1 Transfer Pricing Safe Harbours

Luxembourg law does not contain safe harbour rules in tax laws.

For companies carrying out intra-group financing transactions that meet the substance criteria and are purely intermediary, the Financing Circular provides an elective simplification measure according to which the transaction is deemed to comply with the arm's length principle if the entity generates a minimum return of 2% on assets after tax on the financing.

Under DAC 6, intermediaries or taxpayers, as the case may be, must report the use of unilateral safe harbour rules, which will be automatically exchanged within the EU.

11.2 Rules on Savings Arising From Operating in the Jurisdiction

Luxembourg does not have specific rules on location savings. The OECD Guidelines should be followed in that respect.

11.3 Unique Transfer Pricing Rules or Practices

Luxembourg does not have unique transfer pricing rules or practices.

12. Co-ordination With Customs Valuation

12.1 Co-ordination Requirements Between Transfer Pricing and Customs Valuation

The arm's length principle also applies to customs values.

There is a law applicable since December 2008 providing for the exchange of information between the different tax authorities, namely the direct tax administration (*Administration des Contributions Directes*), the indirect tax administration (*Administration de l'Enregistrement, des Domaines et de la TVA*), and the customs and excise duties administration (*Administration des Douanes et Accises*).

There is no required co-ordination between transfer pricing and customs valuation by law.

13. Controversy Process

13.1 Options and Requirements in Transfer Pricing Controversies

There are several steps to the litigation process. There is no distinction in the controversy process between tax issues and transfer pricing issues.

The LTA may conduct a tax audit and review the transfer pricing documentation during said audit. There is no dedicated transfer pricing audit as such. Rather, the transfer pricing documentation will first be requested from the taxpayer. The LTA would normally raise questions, including transfer pricing questions during the review of the file.

Once the audit is conducted, the LTA may issue a tax assessment or a revised tax assessment. If the tax assessment will not be in line with the tax returns submitted by the taxpayer, the inspector must first send a notification explaining that it will deviate from the position taken in the tax returns and the rationale behind this difference. The taxpayer then has the possibility to respond to the tax authorities.

After the tax assessment is issued, the taxpayer can object to the director of the LTA within three months of the assessment being issued. The director can either issue a new assessment or reject the appeal. In the silence of the director, the appeal may be deemed rejected after six months.

Only once the appeal is (deemed) rejected can the taxpayer appeal the decision to the Administrative Tribunal, the lower court competent in direct tax matters. An appeal cannot be lodged in the absence of tax due (eg, due to losses carried forward) as the taxpayer then does not have standing in front of the tribunal. The ruling of the Administrative Tribunal may be appealed within 40 days of the decision notified to the parties. For the Court of Appeal, the taxpayer must be represented by a lawyer, which is optional for the administrative appeal and the appeal in front of the Tribunal. Both before the Tribunal and the Court of Appeal, there are in principle few written rounds of briefs, and one hearing, before a judgment is rendered.

A decision by the Administrative Court of Appeal cannot be appealed to another instance (whether as regular appeal or on questions of law) and become final.

Neither the objection, nor the appeal suspend the tax collection.

14. Judicial Precedent

14.1 Judicial Precedent on Transfer Pricing

The Luxembourg judicial system is not precedent-based. However, decisions of the Administrative Tribunal and Court do refer to previous rulings and tend to remain consistent.

The LTA generally follow the decisions taken by the tribunal and administrative court as precedence.

14.2 Significant Court Rulings

The question as to whether a purported loan is a loan for tax (and transfer pricing) purposes is not new in Luxembourg. There are a number of domestic landmark decisions with transfer pricing significance in Luxembourg, most of which relate to the financial years before the codification in 2015 of the arm's length principle. However, as the number of Luxembourg judgments purely related to transfer pricing is limited, each new case provides unique and useful insights.

Administrative Tribunal No 44902 of 23 September 2022

The Administrative Tribunal recharacterised an interest-free loan (IFL) concluded between a Luxembourg parent entity and its Luxembourg subsidiary into disguised equity. The features of the IFL were analysed in light of criteria included in the legislative file of the 1967 bill of law to the

Luxembourg income tax law, as well as criteria developed by the courts over time. Although there is no hierarchy of importance or weighting between the different criteria, the Tribunal seems to have considered the "normal way of financing dictated by serious economic and legal considerations" at the time of financing and the circumstances to the case to requalify the loan into equity. The tribunal recalled that it should seek the "economic reality" of a transaction and is not bound by the contractual forms chosen by the parties.

The case is currently subject to appeal.

Administrative Court No 46132C of 31 March 2022

Similar to the more recent case on IFL, the Court of Appeal sided with the LTA and requalified mandatory redeemable preferred shares (MRPS), considered as debt by the taxpayer for tax purposes, into disguised equity. The Court considered different criteria as indicators as to whether an instrument constitutes debt or equity, amongst which are: the accounting treatment of the MRPS as equity or liability; the fact that the holder of the instrument is the sole shareholder; the voting rights attached to the MRPS; the presence of a fixed return; the preferential right of reimbursement in case of liquidation; and the arm's length nature of the MRPS holder's remuneration, for which the existence of a transfer pricing study seems to have been interpreted as an element supporting the debt qualification.

Administrative Court No 42043C of 17 July 2019

In the case at hand, a Luxembourg company acquired French real estate and refinanced the acquisition costs in 2011 with a shareholder loan bearing an annual interest rate of 12%. The Court of Appeal confirmed the requalification made by the LTA of part of the interest paid on the shareholder loan into hidden profit distributions to which a withholding tax of 15% applied.

The taxpayer was not able to demonstrate the absence of a tax benefit, especially in light of an investment climate characterised by low interest rates and the court disputed the argument that the lack of cash flows could lower credit ratings when the purpose of the transaction concerned was to rely on a capital gain on exit.

Furthermore, the court established that the OECD Guidelines could not influence the interpretation of the provision on hidden profit distributions as (i) the domestic provision had been adopted long before the OECD Guidelines; (ii) the scope of Article 9 of the OECD Model Tax Convention is wider than Luxembourg law; and (iii) double tax treaties only allocate taxing rights to the contracting states. Yet the Court acknowledges that the OECD Guidelines may be used as an "element of appreciation".

15. Foreign Payment Restrictions

15.1 Restrictions on Outbound Payments Relating to Uncontrolled Transactions

Luxembourg law does not have restrictions regarding outbound payments relating to uncontrolled transactions. They should nevertheless be made in the interest of the company.

15.2 Restrictions on Outbound Payments Relating to Controlled Transactions

Luxembourg law does not have restrictions per se on outbound payments relating to controlled transactions.

Payments to related parties situated in a jurisdiction that is on the EU blacklist cannot be deducted. Payments in excess of an arm's length price are in principle requalified into hidden profit distribution to which withholding tax may apply.

15.3 Effects of Other Countries' Legal Restrictions

Luxembourg does not have specific rules regarding the effect of other jurisdictions' legal restrictions.

16. Transparency and Confidentiality

16.1 Publication of Information on APAs or Transfer Pricing Audit Outcomes

Agreements reached by the Luxembourg competent authority to resolve interpretation issues of application of a tax treaty of a general nature are in principle published by way of circular.

Luxembourg does not publish the content of APAs or the results of transfer pricing audits. In its annual report, the LTA (direct tax administration) nevertheless publishes the number of decisions on APAs, as well as the number of positive and negative outcomes. Statistics on APAs and MAPs, including transfer pricing MAPs, are reported to a number of international bodies, including the OECD.

16.2 Use of "Secret Comparables"

Pursuant to Luxembourg's response to the OECD Transfer Pricing Country Profile, the LTA does not use secret comparables for transfer pricing purposes.

17. COVID-19

17.1 Impact of COVID-19 on Transfer Pricing

The LTA did not publish or communicate any specific guidance on the impact of the COVID-19 crisis on transfer pricing.

As Luxembourg generally follows the OECD Guidelines, the guidance on the transfer pricing implications of the COVID-19 pandemic published by the OECD are followed.

17.2 Government Response

The LTA did not publish or communicate any specific guidance on the impact of the COVID-19 crisis on transfer pricing. However, the legislature and the LTA did provide temporary measures, including numerous extensions for filing deadlines and loosened the conditions for relief in relation to advance tax payments.

Furthermore, protocols to the bilateral tax treaties with neighbouring countries, namely Belgium, France and Germany, were concluded to allow cross-border workers to work from their home countries without tax consequences for the employers or the employees.

17.3 Progress of Audits

A wave of requests for transfer pricing documentation supporting the interest rate on intercompany loans and falling under the scope of the Financing Circular were sent to Luxembourg taxpayers by the LTA in 2020. The requests followed informal communication announced after the publication of said Financing Circular.

In the authors' experience, the COVID-19 pandemic has not significantly impacted the progress on tax audits.

Trends and Developments

Contributed by:
Peter Moons and Sophie Ogden
Loyens & Loeff

Loyens & Loeff is an independent, European, 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 assist clients' tax departments on the formulation of sustainable transfer pricing strategies in line with their business whilst maintaining tax efficiency. Finally, 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.

Authors

Peter Moons is a partner in Loyens & Loeff's tax practice group and heads the Luxembourg transfer pricing team. He specialises in cross-border corporate tax advice for multinationals and funds, in particular private equity, private debt and real estate funds, their initiators and their investors. Peter also co-chairs the Luxembourg tax litigation team. He regularly speaks on the topics of international tax structuring, transfer pricing and tax litigation.

Sophie Ogden is an associate, is a member of Loyens & Loeff's tax practice group in the firm's Luxembourg office. She focuses on transfer pricing and European as well as international law. Since joining the Luxembourg tax practice group as a tax adviser in 2017, she has advised clients on financial transactions, international tax planning and intra-group restructuring.

Loyens & Loeff

18-20, rue Edward Steichen
L-2540
Luxembourg

Tel: +352 466 230
Fax: +352 466 234
Email: info@loyensloeff.lu
Web: www.loyensloeff.com

Key Recent Cases on Transfer Pricing in Luxembourg, New Documentation Requirement Regulations and Some Considerations for the Future

Transfer pricing continues to be a hot topic, domestically, at EU level and in the international scene.

Requalification of debt instrument into equity: latest case law

As the number of purely transfer pricing-related judicial decisions in Luxembourg is relatively scarce, each one tends to bring its own new interesting interpretation. The characterisation of an instrument as debt or equity for tax purposes is not a new topic and is enshrined into Luxembourg tax law, mainly as part of discussions on hidden profit distributions. Until now, most cases related to financial years before the explicit codification of the arm's length principle into Luxembourg law with effect as of 1 January 2015, and the explicit reference in the parliamentary files to the OECD Guidelines. The criteria contained in the OECD guidance on financial transactions published in 2020 to determine whether a purported loan can be considered as a loan are broadly already part of the Luxembourg tax law landscape and have been further developed by the courts. Hence the impact of the OECD Guidelines should be more limited in that respect. The first section of this article provides the latest criteria by the court of first instance in a decision of last year.

Last September the Luxembourg Administrative Tribunal handed a new judgment relating to an interest-free loan granted by a shareholder to its subsidiary, upholding its requalification into equity by the Luxembourg tax authorities (LTA).

The judgment follows the approach taken in earlier case law of the Administrative Court (2017) and the Administrative Tribunal (2018). Those judgments confirmed a requalification of instruments, debt in form, into equity at the request of the taxpayer. In this judgment, the requalification into equity comes at the initiative of the LTA.

The tribunal applies the framework for requalifying a debt instrument into fiscal equity, that was formulated in parliamentary documents when the 1967 income tax law was introduced, and that was adopted by the Administrative Court. This framework consists of a main rule, and certain formulated "indicators."

The main rule is that where the normal way of funding a subsidiary by a shareholder, based on serious economical and legal considerations, would be to inject equity, and that instead funds

are advanced under a loan agreement solely for fiscal purposes, such funds need to be considered as equity for fiscal purposes. Characteristics of the funding – such as the absence of modalities of repayment, the absence of interest, absence of collateral, the allocation of the loan's proceeds to long-term assets, a disproportion between the company's equity and the funds provided under loans, as well as the circumstances under which the loan is granted – are indicators that can lead to the presumption that the debt instrument should be requalified as equity. The 2018 case law has formulated additional indicators, namely (absence or presence of) voting rights, participation of the lender in the profits and the risks of the borrower, right to a liquidation surplus, an elevated degree of subordination, a long-term maturity, an option for the borrower to convert the instrument into share capital, repayment in kind and the presence of a stapling provision.

In the case at hand, the Tribunal set out to analyse both the interest-free loan agreement and the circumstances under which said loan was granted.

In its analysis of the loan agreement, it concludes that there would be no real obligation to repay, given the confusion over the repayment date (in the loan agreement it was not clear whether it had an eight-year or a ten-year maturity) and the presence of a limited recourse clause that limits the obligation to repay if available assets would not be enough to do so. In its reasoning, the loan's subordination (to any creditor other than the shareholder) corroborates this finding. It held that the loan becoming immediately due and payable upon an event of default did not change this finding, as upon an event of default the borrower would not repay, also in view of the limited recourse clause.

Other features of the shareholder loan in the case at hand, such as the equity-to-debt ratio in the balance sheet and the use of the loan proceeds for short term investments, were not found to reverse this conclusion. As for the equity-to-debt ratio, first because the ratio at the date of grant of the loan was very small to begin with, and second as the loan was part of a facility with a higher committed amount, that could be drawn by the borrower at its discretion. For the use of the proceeds, the loan agreement did not stipulate a certain use of such funds. For both the ratio and the use of funds the Tribunal held that, where these items are entirely at the discretion of the borrower, the "debt-classification-favourable" actual use cannot be taken as a good indicator.

Turning to the circumstances under which the loan was granted, the tribunal held that the fact that the advance of the funds was documented in a loan agreement only months later, showed that the funds in fact were injected as equity.

An appeal has been lodged in front of the Administrative Court (final instance).

Interest-free loans are not an uncommon phenomenon in Luxembourg: taxpayers are in general recommended to review the terms and conditions of such loans, and the circumstances under which they have been attracted or granted. The criteria as formulated and applied by the Administrative Tribunal also have relevance for interest-bearing loans, especially where the interest conditions deviate from standard interest conditions.

Transfer pricing documentation requirements

In March 2023, the Luxembourg government presented a bill of law (No 8186) to reform certain administrative and litigation procedural

aspects, as well as documentation requirements ("Bill 8186"). Amongst the different measures, the government proposes to introduce a new provision to clarify the transfer pricing documentation a taxpayer should have.

Under Luxembourg tax law, all transactions between associated enterprises must be at arm's length. Currently, taxpayers are required to substantiate the correctness of their tax returns. At the same time as the codification of the arm's length principle into Luxembourg law back in December 2014, the legislature introduced a new provision to clarify that taxpayers should have transfer pricing documentation. As a result, taxpayers must have transfer pricing documentation available on demand by the LTA. In 2016, a new provision clarified the main guiding principles a transfer pricing study should follow to apply the arm's length principle, which effectively implemented the principles of BEPS Actions 8–10.

Bill 8186 introduces a new provision whereby associated enterprises will have to provide, on demand, the documentation justifying the transfer pricing policy applied. A Grand-Ducal Decree is to detail the exact scope, content and requirements of this new obligation. The purpose is to better specify the type of transfer pricing documentation the taxpayer should have in Luxembourg, compensating for the current broad wording, and to (further) comply with the documentation requirements under BEPS Action 13. Considering that Luxembourg already has a country-by-country reporting obligation, although this is not stated in the bill, it may indicate that Luxembourg will require local file and master file documentation in the future for a taxpayer forming part of a multinational group.

In Luxembourg, there is no stand-alone transfer pricing audit per se. That said, transfer pricing has become an integral part of tax audits. Given the topical focus on transfer pricing in the international environment, transfer pricing is on the radar of the LTA.

Since the publication of the Circular LIR No 56/1 – 56bis/1 of 27 December 2016 on companies carrying out intra-group financing transactions ("Circular LIR 56/1 – 56bis/1"), the LTA request almost systematically the transfer pricing documentation supporting the interest rate on loans concluded with related parties and falling under the scope of Circular LIR 56/1 – 56bis/1. After the first wave of requests initiated around 2019 for documentation on financial transactions, the LTA is now following up with new requests, generally specifying the financial years to which such requests pertain.

What transpires from recent case law is that the transfer pricing study should be prepared concomitantly with the controlled transaction as the LTA and the courts verify the date of the report, the period covered (validity) and scope.

Transfer pricing controversy – outlook

Consistent with the last years, the number of unilateral APAs remains extremely low, with only one APA application in 2022 and one negative decision. As a result of the "LuxLeaks" scandal, the number of tax rulings in general has drastically dropped in the last decade.

A recent trend, however, is the increasing number of bilateral APA (BAPA) applications.

Luxembourg concludes bilateral and multilateral APAs (hereafter, referred to together as "BAPAs") on the basis of Article 25(3) of the OECD Model Tax Convention (on which most treaties

Luxembourg has concluded are based; ie, as a mutual agreement procedure (MAP)). As of now, there is no transfer pricing-specific MAP procedure. Hence, the guidance provided in the circular L.G.–Conv. D.I. No 60 of 11 March 2021 on modalities for MAPs is followed for transfer pricing cases.

Amongst the changes proposed by the government in Bill 8186 are a new provision which would be introduced to specifically deal with BAPAs. A BAPA, filed in accordance with a bilateral tax treaty, is concluded between the competent authorities. For a BAPA request, a filing fee ranging from EUR10,000–20,000 depending on the complexity of the case would apply. A Grand-Ducal Decree should lay down further details on the procedure to follow in relation to BAPAs. In that respect, it is expected that the OECD Bilateral Advance Pricing Arrangement Manual (BAPAM) published in September 2022 will be followed by the LTA.

Last, Bill 8186, once voted into law, will provide a welcome clarification that the LTA may issue new tax assessments, beyond the statute of limitation, pursuant to a BAPA, a MAP, or an arbitration decision. While roll-backs of BAPAs are allowed by the LTA in some cases, this is not expressly stated in domestic law.

The CJEU FIAT Case

The Court of Justice of the European Union (CJEU) handed down its much awaited judgment in the FIAT appeal case back in November 2022. It is the first of the Commission state aid cases to be decided by the EU Court of Appeal. The General Court, the court of first instance, had agreed with the Commission that the arm's length principle is a principle within Article 107(1) of the Treaty on the Functioning of the EU (TFEU) as a "general principle of equal treatment in taxation". The CJEU, on the other hand, found that the Commission and the General Court erred in identifying the correct reference framework when analysing selectivity.

As a reminder, the Fiat case relates to the remuneration confirmed by the LTA in an APA of a Luxembourg financing and treasury company within the Fiat/Chrysler group. The Commission tried to establish the existence of a European arm's length principle derived from the 2006 Forum 187 CJEU decision. Their objective was to give themselves a broad mandate to apply their own methodology to APAs.

The ruling, in favour of Fiat, has reset expectations around the bar the Commission has to meet to prove state aid in tax and transfer pricing cases. The member state's exclusive right to choose its own tax policy and its own standards of analysis seems to have prevailed. The Court also stated that the OECD Guidelines are not legally binding if not incorporated into domestic law.

The Commission may test again the APA against Luxembourg domestic tax and transfer pricing rules, the correct reference system.

Rising interest rates

The current economic environment is marked by high inflation due to post-covid boosted demand, energy prices and the invasion of Ukraine. As a response, central banks have increased their interest rates. With the rising cost of borrowing and volatility in the financial markets, debt financing has become less attractive and groups are turning to intercompany financing. Current interest rates should also be reflected in intercompany loans, and the inclusion of market practice covenants should be better considered. Another transfer pricing aspect to consider is the

impact of financial guarantees that parent entities may have to further provide in order for the operating companies to have access to better conditions from third-party lenders, leading in some cases to a guarantee fee. The debt capacity of a company will also need to be (re)considered together with interest deduction capacity.

Upcoming legislative updates

Next to the above-mentioned Bill 8186, the following legislative changes with relevance to transfer pricing are expected.

On 15 December, the EU Council adopted the Pillar Two directive. Member states have until 31 December 2023 to implement the directive into national law. The Luxembourg transposition bill has not been published yet. At this stage, implementation is expected to be a faithful transposition of the Pillar Two directive, even though in the meantime, the OECD has released some additional guidance which contains interpretation that may be seen as new rules.

On 24 February 2023, the bill of law transposing the Directive on public country-by-country reporting (CbCR) was published. EU member states are required to implement public CbCR by 22 June 2023, meaning that public CbCR should be applicable to companies whose accounting periods start on or after 22 June 2024 and that are part of multinationals with a consolidated annual revenue of at least EUR750 million.

CHAMBERS GLOBAL PRACTICE GUIDES

Chambers Global Practice Guides bring you up-to-date, expert legal commentary on the main practice areas from around the globe. Focusing on the practical legal issues affecting businesses, the guides enable readers to compare legislation and procedure and read trend forecasts from legal experts from across key jurisdictions.

To find out more information about how we select contributors, email Katie.Burrington@chambers.com