The Transfer Pricing Law Review

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Editors
Steve Edge and Dominic Robertson

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PREFACE

It has been a great privilege to edit this second edition of *The Transfer Pricing Law Review*, and in particular to welcome additional contributions from a range of countries including India, Japan and Switzerland.

This publication aims to give readers a high-level overview of the principal transfer pricing rules in each country covered. Each chapter summarises the substantive transfer pricing rules, explains how a transfer pricing dispute is handled – from initial scrutiny to litigation or settlement – and discusses the interaction between transfer pricing and other parts of the tax code, such as withholding taxes, customs duties and attempts to prevent double taxation.

With the notable exception of Brazil, which adopts a formulary approach (discussed in detail in the Brazil chapter), all countries covered in this review apply an arm's-length standard and adhere, at least to some extent, to the OECD Transfer Pricing Guidelines. However, as these chapters make clear, there remains significant divergence both in countries' application of the arm's-length standard (e.g., which transactions does it apply to? Which pricing methods are preferred? Are secondary adjustments required?) and in the documentation requirements imposed. Transfer pricing practitioners, therefore, cannot simply assume that the OECD Guidelines contain all the answers, but must engage with their detailed application in each country.

This review contains contributions from 23 countries, covering four continents and eight of the world's 10 largest economies. We are very grateful to all the authors for lending their time and expertise to this project.

Transfer pricing rules are, of course, a central plank in governments' fight against profit shifting, and the application and evolution of these rules will (rightly) continue to be high up the corporate tax agenda for many years to come. It appears that, over the next year or so, there will be three principal areas of focus:

a Tax authorities are beginning to get to grips with the first set of country-by-country reports disclosed to them. This is likely to lead to more disputes in the short to medium term. In particular, many tax authorities will now take a greater interest in businesses' full value chain, and whether the reward for all of the countries in the value chain is commensurate with their contribution. Merely looking at the provision between the local company and its contractual counterparty will no longer suffice.

b As Edward Froelich and Jessica Stern note in the United States chapter, the sweeping tax reforms passed in the US at the end of 2017 will have a significant impact on transfer pricing worldwide. Many public controversies surrounding transfer pricing have involved US companies that historically have been entitled to leave profits from overseas sales in low- or no-tax countries until the relevant cash was distributed back to

the US, even where those profits were properly attributable to DEMPE functions based in the US. The 2017 US tax reforms have removed the ability to do this, substantially reducing the benefits that US businesses could derive from allocating too much profit to IP owners and too little profit to local distributors. However, this new regime has retained a preferential tax rate for overseas sales through the FDII and GILTI regimes. Given change in law risk, it looks likely that many US businesses will continue to keep their IP offshore and pay tax under the GILTI rules, rather than onshoring it to the US.

c Similar public controversies have also driven a number of countries to advocate special tax regimes for digital businesses, which move away from the arm's-length standard. Digital taxes have already been enacted in India, Israel and Italy, and furthermore, both the European Union and United Kingdom have proposed 'interim' tax solutions for digital businesses, which involve some form of revenue-based tax. This has the potential to take some of the political heat out of the transfer pricing debate; equally, however, it could prompt other countries to ask whether, like Brazil, a non-arm's length standard should be applied for industries outside the digital arena.

Finally, we would like to thank the publishing team at Law Business Research for their diligence and enthusiasm in commissioning, coordinating and compiling this review.

Steve Edge and Dominic Robertson
Slaughter and May
London
June 2018

Chapter 15

LUXEMBOURG

Alain Goebel[1]

I OVERVIEW

The Luxembourg tax system distinguishes between the taxation of individuals and companies. Resident individuals are subject to income tax, which is levied on eight categories of income:

a business income;
b agriculture and forestry income;
c income from independent professional services;
d employment income;
e pension and annuities income;
f investment income (i.e., interest and dividends);
g rental and royalty income; and
h miscellaneous income including capital gains.

Companies limited by share capital are subject to corporate income tax (CIT), which generally follows the computation rules of business income. Both income tax and CIT are governed by the Income Tax Law (ITL).[2] In addition, business income is subject to municipal business tax (MBT), which is broadly levied on the same basis as the business income determined for income tax or CIT purposes. Companies are furthermore subject to a net worth tax (NWT). Withholding tax may be levied on dividends distributed by companies in cases where the participation exemption does not apply, as well as on directors' fees (interest and royalties are not subject to any withholding taxes).

The Luxembourg transfer pricing legislation closely follows the OECD guidelines and is provided by Articles 56, 56 *bis* and 164 of the ITL, as well as Paragraph 171 of the General Tax Law (GTL).[3] Accordingly, the transfer pricing rules apply to business income subject to either income tax or CIT and to MBT. Transfer pricing adjustment may, however, also affect NWT and trigger dividend withholding tax (e.g., in the case of a requalification of a controlled transaction into hidden profit distribution – see below). Partnerships and trusts being as a rule tax-transparent entities (save for the purposes of MBT), transfer pricing issues are generally dealt with at the level of their partners or beneficiaries to the extent they are engaged in activities generating business profits. As a general principle, the determination of the business profits for income tax and CIT purposes is based on the commercial accounting

1 Alain Goebel is a partner at Arendt & Medernach.
2 Income Tax Law, dated 4 December 1967.
3 General Tax Law, dated 22 May 1931.

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under Luxembourg Generally Agreed Accounting Principles and hence the accounting treatment of a transaction may impact the tax and transfer pricing treatment thereof. Non-arm's length controlled transactions may also trigger corporate interest issues.

Article 56 ITL enshrines the arm's-length principle into Luxembourg tax law, following the wording of Article 9 of the OECD Model Tax Convention.[4] Accordingly, if (1) an enterprise participates directly or indirectly in the management, control or capital of another enterprise, or (2) if the same persons participate directly or indirectly in the management, control or capital of two enterprises, and in either case, the two enterprises are, within their commercial or financial relations, bound by conditions agreed or imposed that differ from those that would be made between independent enterprises, the profits of these enterprises are determined and taxed on the basis of the conditions agreed upon between independent enterprises.

Article 56 *bis* ITL provides further guidance as to the methodology regarding the application of the arm's-length principle, based on the conclusions of Actions 8–10 of the OECD Base Erosion and Profit Shifting (BEPS) Report that revise Chapter I, Section D of the OECD Transfer Pricing Guidelines (TPG).[5]

Article 164(3) ITL requalifies any advantage that a shareholder, member or other interested party receives directly or indirectly from a company or an association, which he or she would normally not have received absent his or her quality, as a hidden profit distribution.

Finally, Paragraph 171 GTL requires that, upon request, taxpayers have to evidence the accuracy of their tax return and provide clarifications, including the relevant documentation. This includes transfer pricing documentation in case of transactions between associated enterprises.

In addition, the administration for direct taxes[6] has issued certain circular letters and internal notes regarding transfer pricing:

a Circular Letter LIR No. 56/1 – 56 *bis*/1, dated 27 December 2016 relating to the transfer pricing rules applicable to companies engaged in intra-group financing transactions;

b Circular Letter LIR 164/1, dated 23 March 1998 relating to the interest rates on shareholders' corporate current accounts; and

c Internal Note LIR/NS-No. 164/1, dated 9 June 1993 relating to hidden profit distributions within the context of shareholders' corporate current accounts.

II FILING REQUIREMENTS

Paragraph 171 GTL requires that, upon request from the Luxembourg tax authorities, taxpayers have to provide their transfer pricing documentation for controlled transactions. Strictly speaking, there is no mandatory requirement to file the transfer pricing documentation with the annual tax returns, but the tax authorities may, at any time, request the taxpayer to disclose it. Hence, taxpayers are required to duly document compliance with the arm's-length principle of all intra-group transactions.

4 OECD Model Tax Convention on Income and on Capital 2017.

5 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, dated July 2017.

6 *Administration des contributions directes*.

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The transfer pricing documentation must further be compliant with Article 56 *bis* ITL, which refers to the arm's-length principle and the OECD TPG. The transfer pricing documentation must be updated if the factual or legal circumstances change. Where the arm's-length pricing of a controlled transaction is secured by an advance pricing agreement (APA), the validity of the APA is limited to five years in accordance with Paragraph 29a GLT.

Note that Paragraph 171 GLT operates a reversal of the burden of proof whereby the taxpayers must prove that the pricing of their controlled transaction is at arm's length. This is an exception to the general principle according to which the burden of proof regarding the facts that trigger a tax liability lies with the tax authorities while the proof of facts that releases the taxpayer from such tax liability or reduces said tax liability lies with the taxpayer.[7]

In addition, Luxembourg has implemented with effect from 1 January 2017 the conclusions of Action 13 of the OECD's BEPS Action Plan regarding country-by-country reporting obligations. Accordingly, Luxembourg entities falling within the scope of the CbCR Law, dated 27 December 2016, will be required to communicate economic, financial and tax information for financial years as of 1 January 2016 in the form of a country-by-country report (CbCR) to the Luxembourg tax authorities, which will in turn exchange the information received with the other EU and non-EU jurisdictions concerned. If a Luxembourg resident reporting entity fails to file the CbCR, files it late or files false or incomplete information, or fails to inform the Luxembourg tax authorities that the ultimate parent refuses to provide key information for the purpose of the CbCR filing, it could be fined up to €250,000.

III PRESENTING THE CASE

i Pricing methods

Article 56 *bis* ITL follows the OECD TPG. Accordingly, it requires that an enterprise must, within the context of its transfer pricing documentation, determine a price that complies with the arm's-length principle. The fact that a given transaction may not be observed between independent parties does not, however, necessarily mean that said transaction is not at arm's length.

The determination of the arm's-length price is based on the comparability analysis.[8] A comparison has to be made between the conditions of a controlled transaction and those that would have been imposed to a comparable transaction between independent parties. In order for the comparison to be significant, the economically relevant characteristics of the considered transactions must be sufficiently comparable. Transactions are sufficiently comparable if there are no material differences between the compared transactions that could have a significant influence from the point of view of the methodology on the determination of the price or if reasonable reliable adjustments may be operated in order to eliminate the incidence on the determination of the price.

The methods retained for determination of the comparable price have to take into account the identified comparability factors and must be coherent with the nature of the transaction that has been accurately delineated. The price identified through the comparison

7 Article 59 of the Law, dated 21 June 1999.

8 The same principles have been retained in particular in financing transactions within the scope of Circular Letter LIR No. 56/1 – 56 *bis*/1.

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of the analysed transaction with transactions between independent enterprises represents the arm's-length price. The choice of the method of comparison must correspond to the method allowing for the best approximation of the arm's-length price.

If all or part of a transaction includes elements that in substance do not contain a commercial valid rationality and that have a negative impact on the determination of the arm's-length price, the transaction has to be ignored in whole or in part for the determination of the arm's-length price.

Article 56 *bis* ITL does not impose any specific transfer pricing method to be used. Based on the existing practice, the comparable uncontrolled price (CUP) method, the transactional profit split (TPS) method and transactional net margin (TNM) method seem to be the most frequently used methods in Luxembourg, although all methods provided for by the OECD TPG are acceptable. The use of a particular method primarily depends on the activity performed by the enterprise:

a the CUP method is mainly used for the determination of arm's-length pricing where sufficient comparables are available. Given the size of Luxembourg, it will be difficult to base a comparability analysis on mere domestic comparables. Therefore, pan-European comparables are generally accepted to the extent that the markets from which these comparables are derived are not completely different from the market conditions prevailing in Luxembourg;

b the TPS method is likely to be applied when a multinational entity's business operations are highly integrated. Also, the TPS method is typically used for the pricing of the fees of the various service providers (managers, advisers, distributors, etc.) in the asset management industry;

c the TNM method, and in particular the net cost-plus method, is most often applied for manufacturing and certain intra-group services (e.g., human resources, IT, marketing, advertising, accounting); and

d the resale price method is usually deemed more useful for determining an arm's-length price for distribution or selling functions.

ii Authority scrutiny and evidence gathering

The Luxembourg tax authorities typically review the transfer pricing documentation within the course of the verification of the tax return,[9] unless the documentation has been provided previously (e.g., in the case of an APA request). Since they follow the OECD TPG,[10] they expect to see within the functional analysis information as to the organisation and structure of the multinational enterprise (MNE) group and how it operates, in particular how value is generated by such MNE group. Circular Letter LIR No. 56/1 – 56 *bis*/1 requires, for example, that an APA request must include, among others, a description of the group, the relations between the functions of the parties to the controlled transaction and the rest of the

9 Pursuant to Paragraph 100a GTL the tax authorities may issue a provisional tax assessment on the basis only of a tax return and such assessment remains subject to a later verification within the five-year statute of limitation. Accordingly, the transfer pricing documentation may in certain cases only be reviewed by the tax authorities up to five years after the filing thereof.

10 In particular the requirements regarding the functional analysis provided for by Actions 8–10 of the BEPS (1.51).

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group, as well as the value chain, the precise limits of the analysed transactions, an indication of any advance transfer pricing requests concluded with other states regarding the companies and transactions that are still in force at the time of the application.

Luxembourg has also implemented CbCR obligations (see Section II). CbCRs are, however, not publicly available.

In the event the taxpayer has not spontaneously provided the transfer pricing documentation (generally as an appendix to the annual tax return), the tax authorities can request the production thereof in accordance with Paragraph 171 GTL. Also, if they have reasonable doubts regarding the tax return, they must request the taxpayer to provide the necessary information to clarify the situation[11] and in a second step to communicate relevant supporting documents.[12] Once they have used all other means at their disposal to receive the necessary information from the taxpayer, they may request it from a third party.[13] It should be noted that an international exchange of information upon demand may be requested by the tax authorities from other EU Member States, treaty countries and other OECD member countries. In the event the taxable income may still not be determined, the tax authorities may proceed to a lump-sum estimation thereof.[14,15]

IV INTANGIBLE ASSETS

The Luxembourg tax authorities follow the TPG, which give a balanced definition of intangibles: an intangible is depicted in the final reports on Actions 8–10 of the BEPS Action Plan as 'something which is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities'. The accounting definition of intangibles is not always in line with the one used for transfer pricing purposes. Legal ownership, transferability or the availability of any protection are not decisive conditions to delineate intangibles. Indeed, the OECD lays emphasis on the effective control and management over the intangible.

From a Luxembourg standpoint, the practice shows that the arm's-length character of the valuation of intangibles must be determined according to a technical approach in line with the OECD standards. To assess the value of an intangible, the most relevant transfer pricing methods to be used would be either the CUP or the TPS method. However, as transactions involving intangibles are usually very specific, the CUP method is not suitable in most cases. As a consequence, a comparability analysis must be supplemented with a case-by-case valuation of the intangible to support the arm's-length character of the analysed transaction.

The OECD has incorporated in the TPG a definition of 'unique and valuable' intangibles to tackle situations where no comparables are available on the market. Following the OECD principles, the transfer pricing analysis involving intangibles should primarily rely on scientific valuation methods such as the techniques developed by corporate finance (discounted cash flow, dividend discount, super-profit or replacement costs methods). In addition, the OECD is now allowing the use of *ex post* data to assess the arm's-length character of an *ex ante* pricing

11 Paragraph 206(2) GTL.

12 Paragraph 207 GTL.

13 Paragraph 209 GTL.

14 Paragraph 217 GTL.

15 See also Alain Goebel and Monique Adams, 'The practical protection of taxpayers' fundamental rights', *IFA Cahiers de droit fiscal international*, Volume 100B.

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arrangement in the context of hard-to-value intangibles in certain cases. The final reports on Actions 8–10 of the BEPS Action Plan also state that there is no automatic return on account for mere legal ownership of an intangible. To achieve entitlement to the returns from intangibles, an entity is required to perform directly or to control the performance of developments, enhancement, maintenance, protection and exploitation (DEMPE) functions and related risks regarding the intangibles. Therefore, the returns that an entity retains in an MNE group depend on the contributions it makes through DEMPE functions to the anticipated value of the intangible, relative to contributions made by other group members. The DEMPE approach has already been implemented in certain cases in Luxembourg (e.g., the steel industry) and has led to relevant value allocation between the parties. Such approach could be used more often in Luxembourg.

V SETTLEMENTS

Tax law is part of public policy and accordingly settlements on the application of tax law, including transfer pricing regulations, are prohibited. Should such a settlement nevertheless be reached, it would be void.

Settlements may, however, be reached in factual matters, even if they have an impact on taxation, as well as on penalties, late interest and other charges that do not constitute taxes. No public data on the occurrence and terms of such settlements is, however, available. The Luxembourg tax authorities are subject to very strict fiscal secrecy that prohibits them from disclosing any information regarding a taxpayer to third parties.

VI INVESTIGATIONS

The collection of income tax and CIT in Luxembourg is based on a reporting system, whereby the taxpayer completes a tax return which is reviewed by the tax authorities.[16] The tax authorities have to investigate the factual and legal situation that is substantial for the determination of the tax[17] and have a duty of an objective and impartial control in this regard.

In case of reasonable doubts as to the truth and completeness of the tax return – and hence of the transfer pricing documentation – the tax authorities are obliged to further investigate and verify the accuracy thereof, both in favour of and against the taxpayer. The fundamental principle of *audiatur et altera pars* has to be observed throughout the process: the tax authorities first have to invite the taxpayer in writing to complete the missing information and if this fails to be conclusive, they may summon him or her to their offices for a hearing. Finally, where they find deviations from the tax return, they have to notify the taxpayer of the points of deviation.[18] The taxpayer must have sufficient time to review the deviations and to collect the necessary elements to submit his or her position before the administrative decision is taken. In the event the tax authorities do not observe the aforementioned principle, the tax assessment is voidable.

16 Paragraph 166 GLT.
17 Paragraph 204 GLT.
18 Paragraph 205 GLT.

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The tax authorities must also observe the principle of proportionality throughout the verification process:

a they may only use means that are appropriate to achieve the relevant goal;
b within the means at their disposal they have to select the one that least impairs the private interests; and
c the gravity of the chosen measure has to be compared to the expected impact regarding public interest.

In case of a violation of the principle of proportionality, the administrative decision of the taxation office is voidable.

The tax assessment also has to observe several formal conditions;[19] for example, it has to be made in writing,[20] contain the amount of taxes assessed and indicate how, when and where an appeal may be lodged. Once the tax assessment notice has been issued, the tax authorities may only amend it in limited cases (e.g., new facts have emerged that would change the taxation).[21] In the event the taxpayer objects to the tax assessment, he or she must lodge a written claim within three months following the notification thereof of the direct tax authorities.

The tax authorities may decide, in the event they have reasonable doubts on the accuracy of the tax return – and hence on the transfer pricing documentation – to proceed to an in-depth revision or tax audit in accordance with Paragraph 195 GTL. The tax audit may be ordered within the course of the verification of the tax return or at a later stage when the tax assessment notice has already been issued, subject to the applicable statute of limitation. The taxpayer and its employees have an obligation to cooperate and to provide the tax authorities with the necessary information.

Tax audits may only be performed within the statute of limitation. Regarding income tax and CIT, the statute of limitation is generally five years after the end of the year in the course of which the tax claim is established. It may, however, be extended to 10 years when no tax return has been filed or the tax return filed was incorrect or incomplete.

VII LITIGATION

i Procedure

In Luxembourg, the litigation on income tax and CIT – and hence on transfer pricing issues – has been entrusted to the administrative courts. However, taxpayers who wish to contest their tax assessment must first lodge a complaint with the head of the administration for direct taxes, although the latter is not a judicial power. The seizure of the head of the administration for direct taxes is a mandatory but extrajudicial administrative act.

The procedure for seizing the head of the administration for direct taxes is not very formalistic. The taxpayer has to lodge his or her claim in writing within three months following the notification of the tax assessment notice. The taxpayer may act by him or herself and is not obliged to mandate a representative (e.g., lawyer, accountant or auditor). The head of the tax administration is then obliged to review the tax assessment from both a formal and factual perspective.

19 Paragraph 211 GLT.
20 Paragraph 210b GLT.
21 Paragraph 222 GLT.

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The decision of the head of the administration for direct taxes may be challenged before the administrative tribunal within three months as from its notification. In the event the head of the administration for direct taxes does not respond within six months of the filing of the claim, the taxpayer is allowed to directly seize the administrative tribunal. In such a case, no delay of foreclosure applies.

The administrative tribunal performs a material examination of the whole case, although it does not re-examine the global situation of the taxpayer. The procedure before the administrative tribunal is predominantly in writing, and the litigation procedure does not suspend the obligation to pay the tax claimed by the tax authorities. The state is represented by a governmental delegate and the taxpayer may appear in person, through a lawyer, a chartered accountant or an auditor.

The judgment of the administrative tribunal is subject to an appeal before the administrative court within 40 days as from the notification of the judgment. The administrative court re-examines the judgment of the administrative tribunal, taking into account both the factual and legal background. During the course of the procedure before the administrative court, the taxpayer has to be represented by a lawyer admitted before the courts of appeal. The administrative court is the highest and final judicial power in tax matters. It renders its decision in the last resort and no further revision is possible. Hence, from a timing perspective, a tax dispute in Luxembourg may usually be settled within 20 months as strict deadlines are followed.

ii Recent cases

Luxembourg courts have issued abundant case law in transfer pricing matters over the past decades. A considerable amount thereof regard adjustments on the basis of the recognition of hidden profit distributions[22] (e.g., excessive interest payments between affiliated companies, advantages granted to shareholders, goods or services provided to affiliates at non-arm's length prices, and the proof thereof).[23]

Transfer pricing disputes tend, however, to become increasingly complex. A debatable decision was recently rendered[24] in relation to a hybrid financing under the form of an interest-free loan granted by a Luxembourg parent company to its Italian subsidiary. The hybrid was considered from an Italian tax perspective as equity and the Luxembourg parent followed this treatment, while the tax authorities considered the absence of a remuneration as not compliant with the arm's-length principle. The administrative court decided that the interest-free loan had to be considered as a debt instrument, as it was booked as such in the commercial accounts of the Italian subsidiary, and that hence the absence of a remuneration was indeed not arm's-length compliant. The adjustment of the taxable profits of the company was thus confirmed, but the decision was based on the recognition of a hidden profit distribution to the Italian subsidiary. The position of the judges is questionable since it was not in line with the traditional application of the hidden distribution doctrine by scholars and case law, which only conceive a hidden profit distribution in cases where an undue advantage is granted to a shareholder or a shareholder-related beneficiary (as opposed to the granting of an undue advantage to a subsidiary, which may be constitutive of a hidden capital contribution).

22 See, e.g., administrative court, 26 March 2015, 34024C; administrative court, 19 January 2012, 28781C; administrative court 12 February 2009, 24642C.

23 See, e.g., administrative court, 1 February 2000, 11318C, administrative court 17 February 2011, 27172C.

24 Administrative court, 5 July 2015, 36888C.

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VIII SECONDARY ADJUSTMENT AND PENALTIES

Luxembourg has not enacted any specific legislation or other regulations on secondary adjustments. However, depending on the case, the tax authorities may impose secondary adjustments in the form of hidden profit distributions or hidden capital contributions (see Section VII). Accordingly, any non-arm's length advantage granted by a Luxembourg company to an affiliate may be requalified into a hidden profit distribution (in case of an affiliation through the shareholder) or hidden capital contribution (in case of an affiliation through a subsidiary).

Hidden profit distributions and contributions are non-deductible. Hidden distributions are further subject to a 15 per cent dividend withholding tax in the event the participation exemption does not apply. No further penalties are foreseen.

IX BROADER TAXATION ISSUES

i Diverted profits tax

Luxembourg has not enacted any diverted profit tax.

ii Double taxation

Luxembourg tax treaties generally follow Article 25 of the OECD Model Tax Convention that provides for a mutual agreement procedure. In such case, if none of the contracting states provide for unilateral relief, the latter shall endeavour to reach a mutual agreement, even though, practically speaking, there is no obligation to reach such an agreement.

In addition, for transactions between enterprises of different Member States of the European Union, the resolution of double taxation disputes resulting from transfer pricing adjustments can also be made through the EU Arbitration Convention (90/436). The EU Arbitration Convention provides for mandatory arbitration where Member States cannot reach mutual agreement on the elimination of double taxation. The competent authorities have to reach an agreement within two years from the date on which the file was submitted to one of the competent authorities. In Luxembourg, the Minister of Finance is the competent authority. In the event the Member States were not able to reach an agreement within this two-year period, the competent authorities shall set up an advisory commission whose opinion on the elimination of the double taxation ultimately binds the competent authorities.

Luxembourg has also signed the multilateral instrument (MLI) developed by the OECD under Action 15 of the BEPS Action Plan. Article 14 of the MLI introduces a mandatory mutual agreement procedure: a person who considers that the actions of one or both of the contracting states result in taxation not in accordance with the provisions of the covered treaty may present the case to the competent authority of either contracting state within three years. The competent authority must then resolve the case, either by itself or by mutual agreement with the competent authority of the other contracting state. Article 17 of the MLI further introduces a mandatory corresponding adjustment of tax charged on profits in one contracting state in case the other contracting state includes a portion of those taxable profits under applicable transfer pricing rules. An optional clause for mandatory binding arbitration is contained in the MLI, which will allow participating countries to limit the cases eligible for arbitration (based on reciprocal agreements).

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iii Consequential impact

The Luxembourg tax authorities are divided into three administrations, each being responsible for a particular area of competence:

a the administration for direct taxes is mainly competent for CIT, MBT and NWT, as well as withholding taxes;

b the administration for registration duties and valued added tax (VAT)[25] is mainly competent for VAT and registration duties; and

c the administration for customs and excise duties[26] is mainly competent for customs and excise duties.

Since 2008, information that is relevant for the accurate assessment of taxes must be exchanged between the tax administrations. Accordingly, in the case of transfer pricing adjustments, the relevant tax administration could proceed to a corresponding adjustment in respect of the taxes or duties for which it is competent if such adjustment is not barred by the expiry of the statute of limitation.

X OUTLOOK AND CONCLUSIONS

The Luxembourg financial centre originally developed as a private banking centre and has grown to become a diversified hub for investment funds, banks, insurance and reinsurance companies, holding companies and family offices. The Luxembourg transfer pricing environment is hence largely focused on financial services.

Transfer pricing is, however, developing rapidly in Luxembourg and its latest amendments evidence the political attachment to a timely implementation of the OECD developments. Precise transfer pricing regulations were first introduced in Luxembourg in 2011 with respect to intra-group financing transactions. Since then, the legislation has been completed and rendered BEPS compliant. Transfer pricing now applies to all controlled transactions in all industries. In practice, the authors are most often solicited on controlled transactions in the asset management industry, although banking and insurance, as well as the manufacturing industries are increasingly active in establishing their transfer pricing documentation.

As the TPS method is very often used in determining the arm's-length pricing in the asset management industry, and with Luxembourg being a hub for investment funds, the OECD developments in this respect are closely followed by local transfer pricing practitioners. Also, the practical impacts of the Actions of the OECD's BEPS Action Plan may significantly change the Luxembourg transfer pricing environment in the future.

Given that Luxembourg has a transfer pricing legislation, the need to file for an APA in order to obtain certainty as to the tax treatment has mostly gone and consequently, the number of APA requests is expected to diminish over time. However, given the complexity of the rules and the lack of more precise guidance, it is equally expected that transfer pricing audits and disputes will increase.

25 *Administration de l'enregistrement et des domaines.*

26 *Administration des douanes et accises.*

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