The Transfer Pricing Law Review

Sixth Edition

Editors
Steve Edge and Dominic Robertson

The Law Reviews

THE TRANSFER PRICING LAW REVIEW

SIXTH EDITION

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PREFACE

It has been a great pleasure to edit this sixth edition of *The Transfer Pricing Law Review*. This publication aims to give readers a high-level overview of the principal transfer pricing rules in each country covered in the *Review*. Each chapter summarises the country's substantive transfer pricing rules, explains how a transfer pricing dispute is handled, from initial scrutiny through 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).

Other than Brazil, all the countries covered in this *Review* apply an arm's-length standard and adhere, at least to some extent, to the Organisation for Economic Co-operation and Development Transfer Pricing Guidelines (the OECD Guidelines); and Brazil itself is considering aligning its TP rules with the OECD norm by 2024. However, as the chapters make clear, there remains significant divergence, both in countries' interpretation of the arm's-length standard (e.g., the transactions it applies to, the pricing methods preferred and whether secondary adjustments are imposed) and in the administration of the rules (e.g., the documentation requirements imposed and the availability of advance pricing agreements). Therefore, transfer pricing practitioners cannot simply assume that the OECD Guidelines contain all the answers but must engage with their detailed application within each country.

Given their economic importance, transfer pricing rules will be high on the corporate tax agenda (and the broader political agenda) for many years to come, and they are continuing to evolve at a rapid pace. Over the next few years, we expect the following to be among the main areas of focus.

First, as many of the chapters make clear, litigation over transfer pricing disputes is expected to increase (almost) everywhere over the next few years, as tax authorities become more confident in their interpretation of transfer pricing guidelines, and ever more alert to public pressure to make big business pay its 'fair share'. Some countries have a long record of transfer pricing litigation, and have resolved many of the procedural hurdles in asking a court to rule on exactly where value is created in a multinational; for example, the approach to handling (often conflicting) expert evidence, and the challenge of developing factual evidence in a proportionate but comprehensive way. However, it is clear that asking for a ruling results in lengthy – and costly – hearings before the tax tribunals, and many other countries will find themselves grappling with transfer pricing litigation for the first time soon.

Second, some of these disputes will concern the extent to which transfer pricing can be used to recharacterise transactions, rather than merely to adjust the pricing of transactions. For example, the German courts have recently held that transfer pricing rules are not limited to pricing adjustments alone; and Ireland introduced rules that enable the Irish Revenue to impose a ’substance over form principle. In contrast, the Canadian courts ruled, in the *Cameco* case, that TP recharacterisation was permitted only where the underlying transactions were ‘commercially irrational’.

Third, many countries are strengthening the requirements for contemporaneous transfer pricing documentation, either aligning with the OECD master file or local file model (as in Israel and Portugal), or potentially going beyond this (as the United Kingdom has proposed).

Finally, the OECD/G20 project to address the tax consequences of digitalisation continues to progress apace (at least within the OECD itself), with consultations on aspects of the two pillars being launched (seemingly) weekly, normally with absurdly short deadlines for comments. In particular, Pillar One marks a pivot away from the arm’s-length standard for large and highly profitable multinationals, under which a portion of their profits (above a 10 per cent hurdle rate) would automatically be reallocated to market jurisdictions. This would, of course, be a radical shift away from the traditional arm’s-length standard, but the arm’s-length principle will continue to play a crucial role for large businesses and tax authorities. First, it is not yet clear whether Pillar One, in particular, will ever become law, and the prospects of the US Congress approving it seem limited in the current political circumstances there. Furthermore, even if (or where) Pillar One becomes law, the arm’s-length standard will continue to apply (1) to the vast majority of businesses that fall outside the reallocation rule, either because of size or profit margins; and (2) to the majority of the profits of those businesses that are subject to the reallocation rule.

We would like to thank the authors of all of the country chapters for their comprehensive and illuminating analysis of each country’s transfer pricing rules; and 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 2022

Chapter 11

LUXEMBOURG

Alain Goebel and Danny Beeton[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 Organisation for Economic Co-operation and Development Transfer Pricing Guidelines (the OECD Guidelines)[3] and is provided by Articles 56, 56 *bis* and 164 of the ITL, as well as Paragraph 171 of the General Tax Law (GTL).[4] 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 as a 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 that they are engaged in activities generating business profits. As a general

1 Alain Goebel is a partner and Danny Beeton is of counsel at Arendt & Medernach.
2 Income Tax Law, dated 4 December 1967.
3 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, published 20 January 2022.
4 General Tax Law, dated 22 May 1931.

principle, the determination of the business profits for income tax and CIT purposes is based on the commercial accounting 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.[5] 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 based on 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 the Report on Actions 8–10 of the Base Erosion and Profit Shifting (BEPS) Action Plan, revising Chapter I, Section D of the OECD Guidelines.

Although Articles 56 and 56 *bis* ITL follow the OECD Guidelines, it is generally admitted that the OECD Guidelines are 'soft law' only and have no direct binding effect on taxpayers. This being said, the Luxembourg Inland Revenue and courts usually refer to the OECD Guidelines regarding the application of the Luxembourg transfer pricing rules. For the sake of a continued legal security, the OECD Guidelines applicable at the time the transaction was entered into or occurred are typically relevant in this context. Therefore, any transactions entered into before the publication of the OECD guidance on financial transactions (February 2020) or the pandemic (December 2020) will not be considered in the light of those publications.

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

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

In addition, the Luxembourg Inland Revenue has issued certain circular letters and internal notes regarding transfer pricing:

a Circular letter LIR No. 164 *ter*/1, dated 4 March 2020 on controlled foreign companies' rules;

b 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;

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

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

5 OECD Model Tax Convention on Income and on Capital, published 18 December 2017.

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.[6]

The transfer pricing documentation must further be compliant with Article 56 *bis* ITL, which refers to the arm's-length principle and the OECD Guidelines. 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 release the taxpayer from such a tax liability or reduce the 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 Guidelines. 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 the 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

6 At the time of submission of their income tax returns, taxpayers must disclose whether they have entered into any related-party transactions, whether these include financing, and if so whether the permitted 'simplified approach' has been used. The answers will be used in the taxpayer's transfer pricing risk assessment.

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.

would have been imposed on a comparable transaction between independent parties. 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 to eliminate the incidence on the determination of the price. Well-founded comparability adjustments are accepted and indeed expected.

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 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.[9] On the basis of 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 Guidelines 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;[10]

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

9 However, the Circular of December 2016 (LIR No. 56/1 – 56 *bis*/1) on related-party financing requires credit scoring and calculation of loss-given-default, and the application of a cost of equity to be recovered in the interest rate.

10 It is notable that Article 28 Section 3 of the Luxembourg VAT Law introduces a new concept of 'open-market value', which applies to transactions between related parties. It allows the valued added tax (VAT) authorities to disregard the consideration between related parties if it differs from the open-market value, where the consideration produces underpayments of VAT by one of the parties. This could happen where a low consideration is charged to a party that does not have a full right to deduct input VAT, or where a low consideration is charged, the supplier does not have a full right of deduction of input VAT and the supply is VAT exempt, or where a high consideration is charged by a supplier that does not have a full right of deduction. Experience in other EU jurisdictions suggests that this will have the effect of bringing the CUP method into Luxembourg VAT law.

c the TNM method and, in particular, the net cost-plus method are most often applied for manufacturing and certain intra-group services (e.g., human resources, IT, marketing, advertising and 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,[11] unless the documentation has been provided previously (e.g., in the case of an APA request). Since they follow the OECD Guidelines,[12] 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 the 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 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 that 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. In addition, if they have reasonable doubts regarding the tax return, they must request the taxpayer to provide the necessary information to clarify the situation[13] and in a second step to communicate relevant supporting documents.[14] 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.[15] 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 that the taxable income may still not be determined, the tax authorities may proceed to a lump-sum estimation thereof.[16, 17]

The Luxembourg courts admit that transfer pricing documentation may be prepared and submitted as late as during the litigation itself.

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

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

13 Paragraph 206(2) GTL.

14 Paragraph 207 GTL.

15 Paragraph 209 GTL.

16 Paragraph 217 GTL.

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

IV INTANGIBLE ASSETS

The Luxembourg tax authorities follow the OECD Guidelines, 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 Guidelines 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 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. This approach could be used more often in Luxembourg.[18]

On 22 March 2018, the Luxembourg Parliament passed a law to introduce a new regime in relation to intellectual property (IP) and intangibles – the IP Box regime – featuring the 'modified nexus' approach. The calculation of the income that will benefit from the special tax treatment involves the calculation of the income that should be attributed to

18 Luxembourg has implemented the Controlled Foreign Company (CFC) component of the EU Anti-Tax Avoidance Directive through the 'artificial diversion' approach. The resulting new article of the Luxembourg ITL allows for the taxation of any undistributed income of a CFC that arises from 'non-genuine' arrangements that have been put in place for the essential purpose of obtaining a tax advantage; non-genuine here means an entity or permanent establishment owning assets or undertaking risks for which the 'significant people functions' (SPFs) are carried out by its Luxembourg parent company. Clearly, where the SPFs relate to intangibles, they will be DEMPE functions, so the DEMPE concept will be applied in both transfer pricing and CFC cases.

any marketing intangibles (as opposed to the technical intangibles created by the qualifying research and development expenditure). This is likely to require a transfer pricing analysis of the licence fees that could have been charged for any such marketing intangibles).

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 to third parties regarding a taxpayer.

VI INVESTIGATIONS

The collection of income tax and CIT in Luxembourg is based on a reporting system, whereby the taxpayer completes a tax return that is reviewed by the tax authorities.[19] The tax authorities have to investigate the factual and legal situation that is substantial for the determination of the tax[20] and have a duty of an objective and impartial control in this regard.

In the event of there being 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.[21] 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 that the tax authorities do not observe the aforementioned principle, the tax assessment is voidable.

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

19 Paragraph 166 GLT.

20 Paragraph 204 GLT.

21 Paragraph 205 GLT.

The tax assessment also has to observe several formal conditions;[22] for example, it has to be made in writing,[23] 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).[24] In the event that the taxpayer objects to the tax assessment, he or she must lodge a written claim with the direct tax authorities within three months of the notification of the assessment.

The tax authorities may decide – in the event that 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 limitations. 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 limitations. Regarding income tax and CIT, the statute of limitations 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 of 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.

The decision of the head of the administration for direct taxes may be challenged before the administrative tribunal within three months of its notification. In the event that 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

22 Paragraph 211 GLT.

23 Paragraph 210b GLT.

24 Paragraph 222 GLT.

chartered accountant or an auditor. Luxembourg courts have admitted that transfer pricing documentation could be prepared and submitted as late as during the litigation proceedings. Expert witnesses are, however, generally not requested before courts.

The judgment of the administrative tribunal is subject to an appeal before the administrative court within 40 days of 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

Over the past decade, Luxembourg courts have issued abundant case law on adjustments based on the recognition of hidden profit distributions[25] (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).[26] Notably, OECD's concept of the arm's-length principle had only been introduced in Luxembourg tax law from 2015 through an amendment of Article 56 ITL[27] and, until then, controlled transactions were usually not documented by transfer pricing reports (except regarding the determination of the profit margin of a company engaged in intragroup financing, which was regulated by a circular letter[28] applicable from 2012). Therefore, these cases were decided on the existence of a hidden profit distribution but not necessarily on the precise amount thereof.

More recently, the courts have been asked to verify whether the quantum of interest paid by a Luxembourg company to an affiliate was arm's length. In a well-known case,[29] a Luxembourg company financed the acquisition of a French real estate property by means of a 12 per cent shareholder loan. The tax authorities partially dismissed the interest, considering that the arm's-length rate was limited to 3.57 per cent for 2011 and 2.52 per cent for 2012, with the excess being a hidden profit distribution subject to 15 per cent withholding tax. The taxpayer filed a complaint and produced a transfer pricing analysis that had been prepared after the reassessment. This first analysis, however, indicated an interquartile range for the arm's-length interest of between 2.39 per cent and 7.88 per cent and the tax authorities confirmed their position, since their valuation was within that range. During the court proceedings, the taxpayer had a second transfer pricing report prepared, which indicated an increased interquartile range of between 9.95 per cent and 19.95 per cent. Although the administrative tribunal also accepted the second report for consideration, it concluded that the taxpayer had failed to explain the difference between the two transfer pricing analyses and hence had not brought any evidence as to the absence of a hidden profit distribution, so the

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

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

27 Article 9 of the Law dated 19 December 2014.

28 Circular letter LIR No. 164/2 dated 28 January 2011 relating to the tax treatment of companies engaged in intra-group financing transactions.

29 Administrative tribunal, 22 October 2018, 40348.

case was dismissed. The taxpayer filed an appeal against the judgment and the administrative court reviewed the case. The court concluded that the comparables used in the second report could not be transposed to the case at hand, since they related to important economic operators and not to a company with a single shareholder holding a single property.[30] Therefore, the case was dismissed. There are two results of this case: first, the courts accept that a transfer pricing report is produced *ex post*, although the risk is obviously that the report may not be able to justify the pricing used; and second, the comparables used in the transfer pricing analysis must be chosen with great care to be transposable to the case at hand.

In a more recent case,[31] a Luxembourg company financed 85 per cent of a shareholding with a profit participating loan that carried a fixed and variable yield corresponding to 99 per cent of the net profits derived from that shareholding. The tax authorities challenged the arm's-length rate of the yield, arguing that the arm's-length rate would be capped at 85 per cent of the net profits derived from the participation. The taxpayer provided, however, an interest rate benchmark that demonstrated that the amount paid under the loan as fixed and variable yield over the outstanding years was within the range of an arm's-length fixed interest that would have accrued on the loan over the same period. The administrative tribunal confirmed that the yield under the profit participating loan was not excessive and that in accordance with the OECD Guidelines any point in the range satisfies the arm's-length principle, provided that the range comprises results of relatively equal and high reliability.[32]

The administrative court[33] also had the opportunity to clarify that the OECD's concept of the arm's-length principle has only been enshrined in Luxembourg tax law from 2015 through Article 56 ITL and from 2017 through Article 56 *bis* ITL and that these provisions were not yet in force at the time of the litigated case. However, the arm's-length principle was expressed in Article 164 (3) ITL on hidden profit distributions.[34]

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 as a hidden profit distribution (in the 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 that the participation exemption does not apply. No further penalties are foreseen.

30 Administrative court, 17 July 2019, 42043C.

31 Administrative tribunal, 13 July 2021, 43264.

32 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, Chapter III, Section 3.62.

33 Administrative court, 12 October 2021, 45260C.

34 Administrative court, 23 December 2021, 45696C.

IX BROADER TAXATION ISSUES

i Diverted profits tax, digital sales taxes and other supplementary measures

Luxembourg has not enacted any diverted profit tax or digital sales tax.

ii Tax challenges arising from digitalisation

Luxembourg has not commented on Pillars One or Two of the OECD/Inclusive Framework recommendations, but it has officially confirmed its support for the project. There is no local digital sales tax that would have to be repealed if the proposals are agreed.

iii Transfer pricing implications of covid-19

Luxembourg has not issued any guidance on the transfer pricing implications of the covid-19 pandemic, although it is likely to apply the OECD guidance issued in December 2020. However, the European Commission has approved a Luxembourg scheme of grants to companies that suffered a monthly turnover decline between November 2020 and March 2021 of at least 40 per cent compared with the same period in 2019. The payment will be equal to 70 per cent of the fixed costs that are not covered by revenues, up to €1 million per undertaking.

iv Double taxation

Luxembourg tax treaties generally follow Article 25 of the OECD Model Tax Convention, which provides for a mutual agreement procedure. In cases where none of the contracting states provide for unilateral relief, they 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.[35] 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 of 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 that the Member States are 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)[36] 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

35 EU Convention No. 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.

36 The OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (Multilateral Instrument or MLI).

in one contracting state if 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).

v Consequential impact for other taxes

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 Indirect Tax Authority is mainly competent for valued added tax and registration duties; and

c the Customs and Excise Agency is mainly competent for customs and excise duties.

As from 2008, information that is relevant for the accurate assessment of taxes must be exchanged between 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 the adjustment is not barred by the expiry of the statute of limitations.

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. 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.

Notably, the number of unilateral APA requests has diminished while transfer pricing audits and disputes have significantly increased. The new OECD Guidelines on financial transactions, which were published on 11 February 2020, further impact certain aspects of the Luxembourg transfer pricing practice, in particular regarding acceptable debt-to-equity ratio, classification of financial instruments as debt or equity and more generally the content of the transfer pricing documentation. Finally, mutual agreement procedures in transfer pricing matters also seem to be increasing, a trend that could change through broader reliance on bilateral or multilateral APAs.

Appendix 1

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Alain Goebel is a partner in the tax law practice of Arendt & Medernach, where he advises an international clientele on the tax and transfer pricing aspects of Luxembourg and cross-border transactions, in particular corporate reorganisations, acquisitions and financing structures. Alain has been a member of the Luxembourg Bar since 2002. He is a member of ALFI, LPEA, IFA and AIJA. He acted as president of the Young IFA Network (YIN) from 2013 to 2016 and as Luxembourg national representative for AIJA from 2012 to 2015. He was a lecturer in business taxation at the University of Luxembourg from 2009 to 2016 and is a regular speaker at tax seminars. He has published several papers on tax law, including national reports for IFA and AIJA, and is co-author of the Luxembourg chapter of *The International Guide to the Taxation of Holding Companies* published by IBFD (Amsterdam).

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