

Transfer Pricing Country Summary Luxembourg

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Legislation

Existence of Transfer Pricing Laws/Guidelines

The Luxembourg law on transfer pricing is concisely expressed in article 56 of the Luxembourg Income Tax Code and in the general tax law.

As of the new Law of 19 December 2014, a more detailed framework for transfer pricing was added. This brings changes to the article 56 of the Luxembourg Income Tax Code (ITL), which now states: "When an enterprise participates, directly or indirectly, in the management, control or capital of another enterprise, or where the same individuals participate, directly or indirectly, in the management, control or capital of two enterprises and where, in either instance, the two enterprises are, within their commercial or financial relations subject to conditions made or imposed which differ from those which would be made between independent enterprises, the profits of these enterprises are to be determined under conditions prevailing between independent enterprises and taxed in consequence."

The law of 19 December 2014 introduces a new sub-article in paragraph 171 of the general tax law, which clarifies that entities will find it mandatory to provide documentation when the tax authorities are seeking the verification of transfer prices. Further on, there is no clear specification of the documentation required.

This law applies as of 1 January 2015 and defines the arm's length principle according to Article 9 of the OECD Tax Model Convention. Furthermore, this implies that the arm's length principle applies to transactions between a local entity and a foreign entity, as well as two entities located and taxed in Luxembourg.

Moreover, the Income Tax Code embraces 2 circulars, Circular ITL no 164/1 dated 9 June 1993, and Circular ITL no. 164/1 dated 23 March 1998, which refer to shareholders accounts and define transactions that can be seen as hidden distribution of profits and hidden contribution. Article 164 specifies that the hidden distribution and hidden contribution of profits shall be included in the taxable basis.

"A hidden distribution of profits is considered when a shareholder or an interested person receives directly or indirectly advantages which he normally would not have received if this relationship had not existed."

The following transactions may, inter alia, be treated as hidden distribution profits:

- Increased buying prices or reduced selling prices;
- Loans made to shareholders either free of interest or at an unreasonably low rate of interest, or loans given without the intention of repayment;

- Loans from shareholders at an unreasonably high interest rate.

The advantage granted is included in the taxable basis and the funds not received are considered to have been distributed to the shareholders as a dividend subject to the standard withholding tax rate unless a reduction or exemption applies. This distribution is not automatically deemed to be net of withholding tax. To tax using this basis, the Luxembourg tax authorities would have to show that the payer was willing to pay the withholding tax.

A hidden contribution is deemed to take place if a parent company grants an advantage to a subsidiary because of their group relationship.

The following transactions may, inter alia, be treated as hidden contribution:

- Reduced buying prices or increased selling prices;
- Loans from shareholders either free of interest or at an unreasonably low rate of interest;
- Loans to shareholders at an unreasonably high interest rate.

If the parent is a Luxembourgish company and the subsidiary a foreign company in line with arm's length principles sufficient interest should be calculated on the receivable in the hands of the Luxembourgish parent company. In the situation where a foreign parent grants an interest – free loan to a Luxembourg subsidiary, the interest – free character of the loan is perfectly possible from a Luxembourg tax point of view.

Circulars 164/2 of January 28, 2011 and 164/2 bis LITL of April 8, 2011 replaced by Circular nr 56/1-56bis/1 of December 27, 2016, specifically focusing on intra- group financing activities (the “2017 Circular”).

Definition of Related Party

Article 56 and 56bis LITL follow the definition of related party included in Article 9 of the OECD model tax treaty: “two enterprises are deemed associated when one enterprise participates, directly or indirectly, in the management, control or capital of the other, or if the same persons participate, directly or indirectly, in the management or share capital of both enterprises.”

The following situations can be considered as evidence to determine this relation:

- direct or indirect majority (more than 50%) shareholding (voting rights);
- common direct or indirect majority shareholder;
- one is able to appoint or dismiss the majority of the key management or the supervisory board of the other enterprise;
- foreign entrepreneur with domestic branch;
- domestic entrepreneur with foreign branch;
- same management.

Transfer Pricing Penalties

Penalties applied on transfer pricing assessments can reach up to four times the amount of the tax evaded, in case of tax evasion or ten times the tax evaded, in the case of fraud.

in the absence of sufficient documentation, the burden of proof shifts from the tax authorities to the taxpayer.

Advance Pricing Agreement (APA)

The Law of 19 December 2014 introduces new regulated APAs procedures, aiming to provide legal certainty to the taxpayers and increase transparency of the transfer pricing system. By this matter, the APA practice applies also to other intra-group services, as an extent to the Circular letter of 2011, which imposes APAs only for intra-group financing transactions. It is also understood that tax rulings and APA's may be subject to exchange of information, in particular with the relevant authorities of other EU Member States.

In order to obtain a tax ruling, the taxpayer needs to formulate a sufficiently reasoned written request, mentioning the following details:

- full information of the applicant (name, residence and file number, if any), the parties and other concerned third parties, as well as a description of their respective activities;
- a detailed description of the intended transactions;
- a detailed analysis of the legal issues, as well as a duly motivated assessment of the legal situation of the applicant; and
- the confirmation that all information which is submitted is complete and correct.

The law also specifically mentions the administrative fees that apply, between €3,000 and €10,000, according to the level of complexity of the case. The fees are due in one month following the confirmation of the tax authorities and are not reimbursable.

The tax inspector may issue an advance decision relating to the application of Luxembourg tax law to one or more transactions envisaged by a taxpayer. The validity of the advanced decision is five years from the date of the agreement and it is binding only in the following situations:

- the situations are incorrect or have errors;
- the resulting situation is different from the one described in the request;
- the advanced decision is not compliant, or no longer compliant, with the law.

As of the Law of 19 December 2014, a tax ruling commission is created, namely the Advance Decision Commission, and it is in charge of providing advice for advanced tax confirmations, assuring an equal treatment between taxpayers. A summary of these advance decisions is going to be anonymously published.

Rulings are subject to mandatory exchange. To this effect a form 777 E must be filed electronically, and this form contains a summary of the ATA / APA.

Companies wishing to seek for a confirmation have to introduce a formal request, through a process defined in the Circular of 19/12/2014, and for content related information, refer to section 5 of the 2017 Circular. Filing fees are applicable and range between EUR 3K to EUR 10K depending on the complexity of the file. As from January 1, 2017, all administrative decisions that were based on rules applicable before the entry into force of article 56bis LITL, are no longer binding the tax authorities.

Documentation And Disclosure Requirements

Tax Return Disclosures

The Form 500 requires disclosing the following new information related to transfer pricing as from fiscal year 2017: (1) Did the company engage into transactions with related parties (articles 56 and 56bis L.I.R. of the Luxembourg Income Tax Law (LITL))? (2) Did the company opt for the simplification measure stated in section 4 of the Circular of the Director of the tax administration L.I.R. 56/1 - 56bis/1 as of 27 December 2016? The second question relates to companies that are engaged in intercompany lending financed by borrowings. The Circular of the Director of the tax administration L.I.R. 56/1 - 56bis/1 allows for a simplification measure whereby a taxpayer does not have to determine an arm's length compensation but can opt for a fixed "safe-harbour" compensation. Taxpayers applying this simplification measure are required to indicate this in their tax return and this option being chosen, will be exchanged with the other countries concerned.

It follows that even one is not obliged to attach TP documentation to the tax return, one should announce in the tax return whether the taxpayer is / was involved in related party transactions and whether it has chosen for the simplification regime. Consequently, on the basis of the answers provided and the positions taken in the tax return the Luxembourg tax authorities will have information and may use same to initiate tax audits.

Level of Documentation

The Master File discloses general information relating to the Group (Group TP policy, allocation of activity between the group entities etc.).

The main focus is, nevertheless on the Local File, which needs to be organized as follows:

Industry analysis

- a) Activity of the Group and main competitors
- b) Description of the Company activity
- c) Intercompany transactions overview
- d) Functions

Economic analysis

- a) Selecting the method to be applied
- b) Application of the Transfer Pricing Method
- c) Benchmark description
- d) Results
- e) Adjustments
- f) Determination of the "arm's length" remuneration

Record Keeping

Luxembourg income tax legislation does not include any specific rules relative to keeping transfer pricing records or documentation, so the general income tax rules relative to keeping records and documentation apply. Accordingly, all documentation useful to determine the taxable profit should be kept for a period of ten years.

Language for Documentation

The Luxembourg tax authorities accept any transfer pricing documentation drafted in Luxembourg's official languages: Luxembourgish, French and German. Nevertheless, English language is also accepted.

Small and Medium Sized Enterprises (SMEs)

There are no special transfer pricing rules for small and medium sized enterprises deviating from the general regime of transfer pricing.

Deadline to Prepare Documentation

As the tax law does not contain specific transfer pricing documentation regulations, Luxembourg tax law does not include a deadline to produce transfer pricing documentation. Therefore, TP documentation should be prepared by due date for filing corporate tax return, which is 31 May.

Deadline to Submit Documentation

The deadline for submitting transfer pricing information, upon request, to the Luxembourg tax authorities is 28 days.

For APAs process, the required documentation needs to be attached to the APA application at the date of submission.

Statute Of Limitations

The general statute of limitations is five to ten years depending upon the case.

Transfer Pricing Methods

The Luxembourg legislation follows the recommendation of the OECD TP Guidelines. The following methods are accepted:

- Comparable Uncontrolled Price Method
- Resale Price Method
- Cost Plus Method
- Transactional Net Margin Method
- Profit Split Method

If none of them is applicable, the taxpayer has the opportunity to define and use another approach if adequately justified.

Comparables

Local comparables are preferred. However, if the reliability of these comparables is not sufficient, other comparable data with similar economic conditions from different geographical regions, are acceptable as well.

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