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Luxembourg

Luxembourg Proposes Revised Transfer Pricing Rules

By Linda A. Thompson

Oct. 20 — Luxembourg lawmakers aim to place revised OECD standards on transfer pricing into their country's law.

The draft law, released Oct. 12 as part of Luxembourg's 2017 budget, revises a provision of the country's Income Tax Law and gives guidance on how to implement the arm's-length principle when conducting transfer pricing analyses. The draft reflects changes the Organization for Economic Cooperation and Development made to its transfer pricing guidance through the project to combat tax base erosion and profit shifting (BEPS).

Snapshot

- Draft law released as part of 2017 budget
- Inserts OECD guidelines into Luxembourg law

Practitioners told Bloomberg BNA the revised rules will have a limited impact on corporate taxpayers because they merely codify transfer pricing principles Luxembourg, an OECD member country, already adheres to.

Luxembourg's transfer pricing legislation until now has been limited to a provision under Article 56, introduced in 2015, of the country's Income Tax Law that replicates principles outlined in Article 9 of the OECD Model Tax Convention.

The revisions now proposed under Law Nr. 7050 aim to integrate changes the OECD adopted in late 2015 as part of the BEPS project and implement the key principles behind the updated transfer pricing guidance into Luxembourg law. At the heart of both the recent and prior OECD transfer pricing guidance is the comparability analysis of controlled and uncontrolled actions in applying the arm's-length principle. The new OECD guidance, contained in the final reports on Actions 8, 9 and 10 of the BEPS project, places added importance on remuneration for risk.

Reasonable Setups

Oliver R. Hoor, a partner at the international and corporate tax department of tax advisory firm ATOZ Luxembourg, told Bloomberg BNA the arm's-length principle already applies under Luxembourg tax law.

“The OECD transfer pricing guidelines have always been authoritative in Luxembourg and were followed by tax advisers and Luxembourg tax authorities,” Hoor said in a phone interview Oct. 19. “This is more like formalizing something that was already in place.”

Luxembourg tax officials are unlikely to make adjustments to their auditing methods and techniques when examining transfer pricing documentation in response to the changes implemented under the draft law, Hoor said.

“If taxpayers were to not be consistent with international standards, they would look into it, but it's not like in other jurisdictions where tax authorities are hungry for tax revenue and challenge reasonable setups in order to increase tax revenue.”

Risk Management Tool

Hoor noted that the new OECD guidance on the importance of and remuneration for risk would further increase the importance of a detailed and comprehensive functional analysis in transfer pricing documentation.

He added that “the threshold” for when transfer pricing documentation should be produced has significantly decreased in recent years. “Transfer pricing documentation is not just a means to determine arm's-length prices anymore; it also allows investors and taxpayers to somehow tell a story about the investment structure," he said. "Transfer pricing documentation is like the new tax risk management tool."

But Hoor cautioned that the trend toward increasing transfer pricing documentation should not be followed blindly and called on taxpayers to make a cost-benefit analysis of producing the documentation.

Documentation "can help make a setup more robust and make it immune to transfer pricing challenges, but one does not need to overreact and act like each and every transaction needs to be documented," he said. "That's nice for the tax adviser but, on the other hand, we do not need to oversell the topic."

Every Action

Philippe Neefs, a partner at KPMG Luxembourg, told Bloomberg BNA that the draft law slightly departs from the guidance under BEPS Actions 8, 9 and 10 in two respects. First, the draft law calls for taxpayers to conduct a transfer pricing analysis for each and every controlled transaction, he said in a phone interview Oct. 19.

"Normally, according to OECD transfer pricing guidelines, you have to do your documentation taking into account cost-benefits, so you have to document what is worth it," he said. The wording of the draft law suggests, however, that "it is the wish of the Luxembourg tax authorities to say to every taxpayer: 'You have to assume that we can ask you for documentation for any transactions between related parties and you are supposed to have that documentation when we are asking.'"

In addition, paragraph 7 of the draft law should in principle be understood as an "exceptional" rule under BEPS Actions 8 to 10, Neefs said. This paragraph notes that accurately defined transactions between related parties can be disregarded when determining the arm's-length principle when those transactions or part of those transactions don't have the commercial rationality of arrangements that would have been undertaken between unrelated parties under similar economic circumstances.

Neefs noted that practitioners have been debating the scope and meaning of this paragraph since the draft law was released Oct. 12. "We can think about cases where the Luxembourg tax authorities may for instance apply this exceptional rule," he said.

Burden of Proof

He expressed hope that the meaning of "transactions that do not have commercial rationality" will become clearer in time and said the uncertain scope of this phrase should be factored in when performing transfer pricing analyses.

"I guess we will need to indicate what the arguments are for the commercial rationality and then the burden of proof will be with the Luxembourg tax authorities."

Several types of transactions might have no commercial rationality "to the outside world," Neefs said, "but when you are doing the functional analysis, interviewing people, then you understand a specific transfer pricing transaction" was motivated by a group's strategy or specific commercial reasons, he said.

Hoor said he expects the bill to "pass smoothly" in parliament. "It's a very generic text; I don't see anyone challenging anything there," he said.

The bill, if approved, will come into force Jan. 1, 2017.

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For More Information

The draft law, in French, is at http://src.bna.com/jwf.

http://www.bna.com/corp/index.html#V