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Transfer Pricing 2025

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Luxembourg: Law and Practice

Oliver R Hoor and Fanny Addouda
ATOZ Tax Advisers

LUXEMBOURG

Law and Practice

Contributed by:
Oliver R Hoor and Fanny Addouda
ATOZ Tax Advisers

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ATOZ Tax Advisers was founded in 2004 and is a high-end independent advisory firm based in Luxembourg, offering a comprehensive and integrated range of direct and indirect tax solutions as well as transfer pricing, corporate and aviation finance and tax litigation services to both local and international clients. ATOZ has a team of carefully selected professionals who possess extensive experience in serving the local market as well as multinational corporations. Its entire team works together to ensure consistently high standards of client service from beginning to end. Confirmed experts in their respective fields, its partners share a common and rigorous approach of researching and understanding the facts before drawing conclusions. They lead each engagement with a steadfast commitment to objectivity and the highest professional, legal, regulatory and ethical standards.

Authors

Oliver R Hoor is a partner in the international and corporate tax department at ATOZ. Oliver has experience in Luxembourg and international taxation with a focus on alternative investments, M&A and multinational groups. He advises clients on all direct tax aspects regarding deal structuring, maintenance, reorganisations and exit planning. He is the author of over 300 articles and books (see: www.atoz.lu/media-room). Oliver is also a regular speaker at conferences as well as a lecturer with Legitech and ILA.

Fanny Addouda is a transfer pricing director at ATOZ. With 12 years' experience in the transfer pricing domain, Fanny is involved in cross-border transactions with a focus on intra-group financing activities. She provides transfer pricing advisory and compliance services for a wide range of Luxembourg and international clients, including investment funds, private equity, asset management, financing, real estate, oil and gas and operational companies. She is a professional with demonstrated experience in Big Four and law firm practices in both Luxembourg and the United Arab Emirates.

ATOZ Tax Advisers

1B, Heienhaff
L-1736
Senningerberg
Luxembourg

Tel: +352 26 940
Fax: +352 26 940 300
Email: info@atoz.lu
Web: www.atoz.lu

1. Rules Governing Transfer Pricing

1.1 Statutes and Regulations

Opening Comments

Luxembourg tax legislation does not provide for any integrated transfer pricing legislation. Instead, according to different tax provisions and concepts applicable under Luxembourg domestic tax law, transfer pricing adjustments can be made in order to restate arm's length conditions.

Luxembourg Tax Law and Administrative Guidelines

Article 56 of the Luxembourg Income Tax Law (LITL)

Article 56 of the LITL formalises the application of the arm's length principle under Luxembourg tax law in accordance with Article 9 of the OECD Model Tax Convention and provides a legal basis for transfer pricing adjustments (upward and downward adjustments) when associated enterprises deviate from the arm's length standard.

Article 56bis of the LITL

Article 56bis of the LITL formalises the authoritative nature of the OECD Transfer Pricing Guidelines. It provides definitions of several terms that are relevant in a transfer pricing context (eg, controlled transaction, comparable uncontrolled transaction, arm's length price) and guiding principles in relation to the application of the arm's length principle which closely follow some of the key paragraphs of Chapter I (arm's length principle) of the OECD Transfer Pricing Guidelines. It clarifies that the arm's length principle has to be met whenever a Luxembourg company enters into a controlled transaction with an affiliate. This requires a calculation of the taxable income that may reasonably be expected if the parties are dealing with one another at arm's length. It does this by contrasting the choices made and the outcomes achieved by the taxpayer with those that would have resulted from market forces.

Article 56bis explicitly addresses transactions that may not be observed between independent enterprises. It provides that the fact that a specific transaction cannot be observed between independent enterprises does not mean that a transaction does not adhere to the arm's length standard. This is a provision of great importance as related parties may, in practice, enter into transactions that are not undertaken by independent enterprises. Article 56bis of the LITL introduces the concept of the comparabil-

ity analysis through a replication of some of the guidance provided in the OECD Transfer Pricing Guidelines. Article 56bis of the LITL also deals with circumstances in which a transaction, as structured by a taxpayer, may be disregarded because there is a lack of valid commercial rationality, and a third party would not have entered into a specific transaction. Nevertheless, the non-recognition of a transaction should only occur in very exceptional situations.

Circular 56/1 – 56bis/1 of the Luxembourg tax authorities (LTA) on the tax treatment of intra-group financing activities

The Circular of the LTA, dated 27 December 2016, provides guidance on the practical application of the arm's length principle to intra-group financing activities. It also details some specific formal requirements applicable to financing companies when requesting an APA.

Concepts of hidden dividend distributions and hidden capital contributions and their interaction with Article 56 of the LITL

The concepts of hidden dividend distributions (Article 164 (3) of the LITL) and hidden capital contributions (Article 18 (1) of the LITL) also play an important role in ensuring that associated enterprises adhere to the arm's length standard.

According to Article 164 (3) of the LITL, hidden dividend distributions arise when a shareholder partner or interested party receives advantages directly or indirectly from a company that a third party would not have received. Article 164 (3) of the LITL states that such profit distributions have to be included in the company's taxable income, meaning that they are not deductible for tax purposes and may be subject to withholding tax if no exemption applies.

A hidden capital contribution refers to an advantage shifted by a shareholder to a company. While the concept is not defined in Luxembourg tax law, hidden capital contributions bear the following characteristics in accordance with the relevant case law:

- a shareholder or a related party of the shareholder;
- grants, motivated by the shareholding relationship; and
- an advantage to a company that may be reflected in the balance sheet – ie, either an increase in assets or a decrease in liabilities (insofar as the shareholder does not receive an arm's length compensation), and the contribution is not a regular contribution (pursuant to Luxembourg commercial law).

In principle, contributions increase the net equity in the receiving company's balance sheet. The object of a hidden capital contribution should therefore directly relate to balance sheet items, namely an increase in assets or a decrease in liabilities. In contrast, any advantage (including free services) shifted by the company to its shareholder(s) should be classified as a hidden dividend distribution. Consequently, the scope of hidden capital contributions and that of hidden dividend distributions do not mirror each other, though both concepts share the same objective, namely the separation of the realm of the company from its shareholders.

Article 56 of the LITL and the concepts of hidden dividend distributions and hidden capital contributions operate independently of one another and may apply concurrently. In case of an overlap, however, the concepts of hidden dividend distributions and hidden capital contributions should take precedence over Article 56 of the LITL. This is because the only tax consequence

of Article 56 of the LITL is an adjustment of the taxable income of the company (in order to restate arm's length conditions), whereas the concepts of hidden dividend distributions and hidden capital contributions may require additional tax adjustments at the level of the company and the shareholder.

Transfer pricing documentation

Duty of co-operation of taxpayers

Since the introduction of Section 3 of paragraph 171 of the Luxembourg General Tax Law (LGTL), the duty of co-operation of taxpayers set out in paragraph 1 thereof has been expressly extended to transactions between associated enterprises. This means that transfer pricing documentation is identified in Luxembourg tax law as information which taxpayers should provide to the LTA upon request in order to support the positions they take in their tax returns.

Country-by-country reporting

The Law of 23 December 2016 implemented the provisions of Council Directive (EU) 2016/881 of 25 May 2016 into Luxembourg law which extended administrative co-operation in tax matters to country-by-country (CbC) reporting. MNE groups with a consolidated revenue exceeding EUR750 million are required to prepare a CbC report. The entity of the group in charge of the reporting is either the Luxembourg resident ultimate parent entity of the MNE group or, in certain circumstances, any other reporting entity (a Luxembourg subsidiary or a Luxembourg permanent establishment) as defined in Annex 2 of the law. The CbC report follows the OECD recommendations provided in Chapter V of the OECD Transfer Pricing Guidelines.

Article 164ter of the LITL – transfer pricing aspects of the Controlled Foreign Company (CFC) rule

Article 164ter of the LITL, which implemented the CFC rules of the Council Directive (EU) 2016/1164 into Luxembourg tax law with effect as from 1 January 2019, includes some transfer pricing-related aspects. This is because Luxembourg is one of the few EU member states which decided to opt for the transactional approach when introducing the CFC rules. Article 164ter of the LITL provides that a Luxembourg corporate taxpayer or a Luxembourg permanent establishment (PE) of a non-Luxembourg tax resident entity will be taxed on the non-distributed income of an entity or PE which qualifies as a CFC, provided that the non-distributed income arises from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage. An arrangement or a series thereof will be regarded as non-genuine if the entity or PE does not own the assets or has not undertaken the risks that generated all or part of its income if it were not controlled by a Luxembourg corporate taxpayer when the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the CFC's income. While no further clarification is provided on the concept of significant people functions and the interaction between the Luxembourg transfer pricing rules and the CFCs rules, in Circular 164ter/1 of 17 June 2022, the tax authorities are imposing an additional documentation requirement, not required by the law, according to which a transfer pricing analysis following the OECD Transfer Pricing Guidelines has to be performed for each of the CFCs of the taxpayer and has to be updated on an annual basis. Based on the circular, even though the taxpayer does not assume any people function generating the CFC's income, transfer pricing

documentation needs to be available and updated on an annual basis.

Luxembourg Double Tax Treaty Network

Almost all Luxembourg double tax treaties are based on the OECD Model Tax convention and thus include the arm's length principle, as further defined in the OECD Transfer Pricing Guidelines.

OECD Transfer Pricing Guidelines

As a member of the OECD, Luxembourg adheres to the organisation's Transfer Pricing Guidelines which reflect the consensus of OECD member countries towards the application of the arm's length principle, as provided in Article 9 (1) of the OECD Model Tax Convention. Since the Luxembourg legislation does not provide for any integrated transfer pricing legislation, the OECD Transfer Pricing Guidelines play an extremely important role for Luxembourg taxpayers, when analysing their transactions from a transfer pricing point of view. Reference to these guidelines is made in both the parliamentary documents (such as the ones related to the draft laws introducing Article 56 and Article 56bis of the LITL) and in Circular 56/1 – 56bis/1 of the LTA on the tax treatment of intra-group financing activities.

1.2 Current Regime and Recent Changes

Over the past few years, transfer pricing and the need for related documentation have become increasingly important in Luxembourg. Before 2011, Luxembourg domestic tax law did not provide any specific transfer pricing rules or documentation requirements. On 28 January 2011, the LTA issued the first circular dealing with transfer pricing, Circular 164/2, which provided guidance on how Luxembourg companies performing financing activities should determine their arm's length margin. This circular already explicitly referred to the OECD Transfer Pricing Guidelines.

The Law of 19 December 2014 amended Article 56 of the LITL in order to formalise the application of the arm's length principle and provided a legal basis for transfer pricing adjustments when associated enterprises do not meet the arm's length standard. The same law also amended paragraph 171 of the LGTL in order to explicitly extend the duty of co-operation of taxpayers to transactions between associated enterprises, reflecting the increasing importance of transfer pricing documentation.

The Law of 23 December 2016 introduced Article 56bis of the LITL which provided, for the first time, definitions and guiding principles in relation to the application of the arm's length principle. These definitions and guiding principles are in line with the OECD Transfer Pricing Guidelines. In order to reflect the changes introduced by Article 56bis of the LITL, on 27 December 2016, the LTA released a new circular, Circular 56/1 – 56bis/1, on the tax treatment of intra-group financing activities, which provides guidance on the practical application of the arm's length principle to intra-group financing activities and repealed and replaced the former Circular of 28 January 2011 with effect from 1 January 2017.

Further changes are in the pipeline with draft law No 8186, presented to Parliament on 28 March 2023, which would introduce a new procedure for requesting an advanced bilateral or multilateral agreement on transfer pricing pursuant to the double tax treaties concluded by Luxembourg and additional transfer pricing documentation requirements (master file and local file, in line with Action 13 of the Base Erosion and Profit Shifting (BEPS) Action Plan).

2. Definition of Control/Related Parties

2.1 Application of Transfer Pricing Rules

The scope of Article 56 of the LITL is limited to transactions between associated enterprises and does not apply to transactions between individual shareholders and Luxembourg companies. Article 56 of the LITL further applies to both cross-border transactions and transactions between Luxembourg companies.

Article 56 of the LITL defines *"associated enterprise"* in accordance with Article 9 (1) of the OECD Model Tax Convention, namely:

- an enterprise which participates directly or indirectly in the management, control, or capital of another enterprise; or
- the same persons participate directly or indirectly in the management, control or capital of two enterprises.

Thus, Article 56 of the LITL includes a flexible definition, which is not defined further (neither in the related parliamentary documents, nor in the related Circular 56-56bis of the LTA).

As far as the concepts of hidden dividend distributions and hidden capital contributions are concerned, they apply not only to shareholders but also to related parties of the shareholder.

"Associated enterprise" is also defined in other provisions of Luxembourg tax law, such as the CFC rules of Article 164ter of the LITL and the anti-hybrid rules of Article 168ter of the LITL, which, for some of them, include more technical control criteria of 50% or 25% as the case may be).

3. Methods and Method Selection and Application

3.1 Transfer Pricing Methods

The Luxembourg transfer pricing provisions of Luxembourg tax law do not include any specific lists of transfer pricing methods to be applied. However, paragraph 6 of Article 56bis of the LITL defines general principles to be followed in respect of the transfer pricing method to be used: the methods to be used to determine the appropriate comparable price must take into account identified comparability factors and must be consistent with the nature of the transaction precisely defined. The price thus identified, by comparing the precisely defined transaction with comparable transactions on the open market, will be the arm's length price applicable to the transaction under analysis, in order to comply with the arm's length principle. The choice of comparison method must be the one that provides the best possible approximation of the arm's length price.

The parliamentary documents related to the draft law which introduced Article 56bis of the LITL state that paragraph 6 of Article 56bis of the Luxembourg income tax law (L.I.R.) implements Chapters II and III of the OECD Transfer Pricing Guidelines into Luxembourg tax legislation. Chapters II and III set out the various techniques and methods to be used, the transaction having been analysed in accordance with the instructions in Chapter I of the OECD Transfer Pricing Guidelines, in order to determine the arm's length price. Thus, reference first has to be made to the five methods, as defined in the guidelines, that can be used to establish whether a controlled transaction adheres to the arm's length standard and which are divided into two groups, namely the traditional transaction methods and the transactional profit methods. However, in

addition to these five methods, as stated in the commentary to the draft law introducing Article 56bis of the LITL, the OECD Transfer Pricing Guidelines also allow any other method to be applied, as long as it enables a price to be set that satisfies the arm's length principle. In such case the taxpayer will have to evidence why this other method is the most appropriate method.

3.2 Unspecified Methods

As a principle, the most appropriate method has to be applied, using either one of the methods defined in the OECD Transfer Pricing Guidelines or any other method which enables a price to be established that is in line with the arm's length principle.

3.3 Hierarchy of Methods

Since the Luxembourg legislation only refers to the OECD Transfer Pricing Guidelines without specifying the different methods, the only principle which should be followed is that the most appropriate method should be applied, meaning there is no hierarchy of methods. In practice the most commonly used method is the comparable uncontrolled price (CUP) method, mainly for a wide range of financial transactions and license fees. However, other methods such as the cost-plus method (for low value-adding services) as well as the profit split method (eg, for highly integrated fund management activities) are regularly relevant in practice as well.

3.4 Ranges and Statistical Measures

The Luxembourg legislation does not require the use of ranges or statistical measures. However, since the LTA follow the OECD Transfer Pricing Guidelines, reference has to be made to these in this respect.

3.5 Comparability Adjustments

Based on paragraph 4 of Article 56bis of the LITL, transactions are sufficiently comparable when there are no material differences between the transactions being compared that could have a significant methodological influence on the determination of the price, or when reasonably reliable adjustments can be made to eliminate the impact on price determination. Thus, comparability adjustments have to be reliable and reasonable and may be performed (*"in accordance with internationally recognised standards"*, as Circular 56-56bis states) if they are necessary to improve the reliability and quality of the comparability analysis.

4. Intangibles

4.1 Notable Rules

Luxembourg tax legislation does not include any specific rules relating to the transfer pricing of intangibles. Thus, reference has to be made to Chapter VI of the OECD Transfer Pricing Guidelines in this respect. However, Circular 50ter/1 of 28 June 2019 dealing with the Luxembourg intellectual property regime (ie, 80% corporate income tax and municipal tax exemption of the net qualifying income and capital gains derived from eligible IP assets and 100% exemption of qualifying IP assets for net wealth tax purposes) specifies that the arm's length principle defined in Article 56 and Article 56bis of the LITL apply in case of application of the IP regime.

4.2 Hard-to-Value Intangibles

Luxembourg tax legislation does not include any specific rules relating to hard-to-value intangibles (HTVI), so the OECD Transfer Pricing Guidelines have to be followed in this respect. Based on the Luxembourg questionnaire on the Implementation of the HTVI Approach included

in the Luxembourg country profile released by the OECD, even though the HTVI approach defined in Chapter VI is to be considered as not implemented in domestic legislation, the general provisions of Chapters I-III can be used for audit purposes with regard to transactions on intangibles.

Attention should be paid to the fact that arrangements involving the transfer of HTVI between associated enterprises belong to the transfer pricing arrangements which may have to be reported under the Luxembourg Law of 25 March 2020 implementing Council Directive (EU) 2018/822 (DAC6), as amended, regarding reportable cross-border arrangements. HTVI are defined in Part 2 of the Annex to the Law of 25 March 2020, which deals with the *"hallmarks"* (ie, characteristics or features of a cross-border arrangement that indicate a potential risk of tax avoidance) as follows: *"Intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises, (a) no reliable comparables exist and (b) at the time the transaction was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible, are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer."*

4.3 Cost Sharing/Cost Contribution Arrangements

Luxembourg tax legislation does not include any specific rules relating to cost sharing or cost contribution arrangements. Therefore, the guidance included in the OECD Transfer Pricing Guidelines in this respect (ie, Chapter VIII) has to be followed.

5. Adjustments

5.1 Upward Transfer Pricing Adjustments

While both upward and downward adjustments may be made in application of the arm's length principle, according to the LGTL, amended tax returns may only be filed (or may even have to be filed) by taxpayers under certain limited conditions and circumstances.

- As long as no tax assessment has been released, the taxpayer has the possibility to file an amended tax return, reflecting the adjustment, no matter whether the adjustment is positive for the taxpayer or not. Based on paragraph 85 of the LGTL, the tax authorities will have to assess the taxpayer based on the newly filed tax return.
- Once a tax assessment has been released, based on paragraph 94 of LGTL, at the taxpayer's request, the tax office may amend the tax assessment, but only to the extent that the deadline for challenging this tax assessment (ie, three months by means of a so-called *réclamation*) has not elapsed.
- Once the three month-deadline for challenging the tax assessment has elapsed, the tax authorities have no obligation to take the amended tax return into consideration, even if it includes a correct adjustment – ie, even in case the initial tax assessment (which did not take this adjustment into consideration) was wrong.
- Lastly, every time a tax assessment has been issued based on a wrong tax return and the mistake made in the tax return lowered the tax due by the taxpayer, there is an obligation for the taxpayer to file an amended tax return reflecting the adjustment. This obligation remains as long as the statute of limitations of five years has not elapsed.

5.2 Secondary Transfer Pricing Adjustments

Luxembourg's domestic tax law does not include explicit provisions regarding secondary transfer pricing adjustments, such as deemed dividends and constructive loans. However, such adjustments may arise indirectly through other tax provisions, particularly in the context of hidden dividend distributions, hidden capital contributions and interest-free loans. For more information, please refer to sections **1.1 Statutes and Regulations** and **14.2 Significant Court Rulings**.

In a cross-border context, tax treaties concluded by Luxembourg generally include a provision drafted along the lines of Article 9 of the OECD Model Tax Convention. This allows for primary adjustments in the case of non-arm's length conditions and requires secondary adjustments to consider arm's length conditions. Should the tax administrations of the contracting states not be able to agree on an arm's length pricing, taxpayers may set in motion a mutual agreement procedure (MAP). Please refer to sections **7. Advance Pricing Agreements (APAs)** and **16. Transparency and Confidentiality** for more information.

6. Cross-Border Information Sharing

6.1 Sharing Taxpayer Information

There is a multitude of legal instruments for exchanging information on Luxembourg taxpayers with foreign tax authorities. The exchange can take place upon request, automatically or spontaneously.

Exchange of Information Upon Request

As far as exchange of information upon request is concerned, it can mainly take place either on the grounds of the double tax treaty (Luxembourg has an extensive tax treaty network and almost all tax treaties include a provision on exchange of information in line with Article 26 of the OECD Model Tax Convention) concluded by Luxembourg with the jurisdiction of the foreign requesting authority or based on Council Directive 2011/16/EU of 15 February 2011 on administrative co-operation in the field of taxation (DAC) if the exchange is requested by an authority of another EU member state. The procedure for exchanging information on request in these cases, as well as under the Law of 26 May 2014 approving the Convention on Mutual Administrative Assistance in Tax Matters, is governed by the Law of 25 November 2014. In order to avoid so-called *"fishing expeditions"*, only *"foreseeably relevant"* information can be exchanged. In 2023, the Luxembourg authorities received 911 requests from other jurisdictions, compared to 1189 requests in 2021 and 1038 requests in 2022. Thus, the number of requests has been decreasing since 2021, which is most probably due to the fact that foreign authorities already receive an ever-increasing amount of information automatically.

Automatic Exchange of Information

The scope of information to be exchanged on a mandatory and automatic basis has been increasing consistently over the past few years through several amendments of the DAC, each of them having been implemented into Luxembourg law.

The most important scope extensions for transfer pricing purposes are as follows.

- Advance pricing agreements (APAs) – Council Directive (EU) 2015/2376 (DAC3), implemented by the Law of 23 July 2016, which extend-

ed the automatic exchange to tax rulings and APAs.
- CbC reporting – Council Directive (EU) 2016/881 (DAC4), implemented by the Law of 23 December 2016, which extended the automatic exchange to CbC reports; and
- Cross-border arrangements – DAC6, implemented by the Law of 25 March 2020, which introduced mandatory disclosure rules for intermediaries on certain reportable cross-border arrangements. The following cross-border transfer pricing arrangements are covered: arrangements which involve the use of unilateral safe harbour rules (Hallmark E1) and arrangements involving the transfer of Hard-to-Value Intangibles (Hallmark E2), as well as arrangements involving intragroup cross-border transfers of functions and/or risks and/or assets, if the projected annual earnings before interest and taxes (EBIT), during the three-year period after the transfer, of the transferor(s) are less than 50% of the projected annual EBIT of such transferor(s) if the transfer had not taken place.

Spontaneous Exchange of Information

The LTA may also exchange information spontaneously with other jurisdictions based on the DAC (in an EU context) or based on the Convention on Mutual Administrative Assistance in Tax Matters (which 147 jurisdictions have signed as of today). Information can only be exchanged if the LTA have grounds for supposing that there may be a loss of tax in the other jurisdiction.

Circular 56/1 – 56bis/1 of the LTA on the tax treatment of intra-group financing activities states that companies which opted for the simplification measure that may apply to Luxembourg companies acting as mere intermediaries will be subject to spontaneous exchanges of information.

6.2 Joint Audits

While transfer pricing joint audits are not yet widespread in Luxembourg, the country participates in EU and OECD initiatives that promote them, as follows.

EU Joint Audit Initiatives

- Under the EU Joint Audit Framework, Luxembourg can engage in joint audits with other EU member states as part of the Fiscalis 2020 and Fiscalis 2027 programmes.
- The Directive on Administrative Cooperation (DAC 7) enhances tax transparency and co-operation among EU tax authorities, facilitating more joint audits.

OECD and BEPS Initiatives

- Luxembourg adheres to the OECD BEPS Action 13, which promotes international tax co-operation and joint audits.
- The OECD's Forum on Tax Administration (FTA) encourages the use of joint audits to improve tax compliance in cross-border transfer pricing cases.

In addition, Luxembourg has an extensive tax treaty network with more than 80 jurisdictions, which includes MAP provisions that allow for joint tax examinations.

Luxembourg is also part of the Joint International Taskforce on Shared Intelligence and Collaboration (JITSIC), which enables global tax authorities to co-ordinate on high-risk tax issues, including transfer pricing.

7. Advance Pricing Agreements (APAs)

7.1 Programmes Allowing for Rulings Regarding Transfer Pricing

Unilateral APAs – with effect as from 2015, Luxembourg has formalised its procedure applicable to tax rulings, including those related to transfer pricing (unilateral APAs). This procedure is included in paragraph 29a of the LGTL, as well as in Grand Ducal Regulation of 23 December 2014. On top of the requirements applicable under the procedure of paragraph 29a, Luxembourg companies performing intra-group financing activities have to provide additional information listed in Circular 56/1 – 56bis/1 of the LTA dated 27 December 2016.

Bilateral or multilateral APAs – based on the legal provisions currently in force, no formal programme has been implemented by Luxembourg for bilateral and multilateral APAs and Luxembourg considers that these can be concluded by its competent authority based on the first sentence of Article 25(3) of the OECD Model Tax Convention. Circular L.G. – Conv. D.I. No 601 of the LTA dated 11 March 2021 provides guidance in this respect.

Draft law No 8186 introduces a new procedure (new paragraph 29c of the LGTL and related Grand-Ducal Regulation) for requesting an advanced bilateral or multilateral agreement on transfer pricing pursuant to the double tax treaties concluded by Luxembourg. However, it is uncertain at this stage whether this draft law will ever become law since the draft provision on bilateral and multilateral APAs belongs to a broader piece of draft legislation which has been giving rise to discussions and criticism over the legislative process on many of its aspects.

Still, Luxembourg taxpayers are able to request bilateral or multilateral agreements in transfer pricing based on the EU Arbitration Convention, the Law of 20 December 2019 implementing Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the EU, or based on a double tax treaty.

7.2 Administration of Programmes

APA requests have to be sent to the head of the tax office in charge of the taxpayer. However, if the APA request deals with company taxation issues, the request will first be submitted for opinion to the advance tax clearance commission (*Commission des décisions anticipées*).

Based on Circular L.G. – Conv. D.I. No 601 of the LTA dated 11 March 2021, transfer pricing MAP requests have to be sent to the economic division of the LTA (which is the authority in charge of transfer pricing cases) or to the *Comité de Direction* of the LTA, which is in charge of all MAP cases.

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

While there is no provision dealing with this question, in practice, there should be co-ordination between the APA process and the MAP, even though the competent authorities administrating the two are not the same. Co-ordination between the MAP procedure and other procedures (such as a legal procedure before the administrative courts) is also covered in Circular L.G. – Conv. D.I. No 601 of the LTA dated 11 March 2021.

7.4 Limits on Taxpayers/Transactions Eligible for an APA

An APA can be requested by any type of taxpayer and can deal with any type of transaction.

7.5 APA Application Deadlines

Unilateral APA requests have to be filed before the transaction takes place. As far as bilateral and multilateral APAs are concerned, they generally have to be requested within three years starting from the first notification of the action resulting (i) in taxation not in accordance with the provisions of the covered tax agreement, (ii) in the question in dispute or (iii) in double taxation, depending on whether the request is made during a MAP initiated based on a double tax treaty, based on the law implementing the EU Directive on tax dispute resolution mechanisms in the EU, or based on the EU Arbitration Convention.

7.6 APA User Fees

In the same was as any other advance tax clearance dealing with company taxation issues, unilateral APAs are subject to a fee which is determined by the LTA upon receipt of the request and ranges between EUR3,000 and EUR10,000, depending on the complexity and the amount of work required. In practice, in transfer pricing matters, the fee very often reaches EUR10,000. The fee is payable within one month.

Based on the legislation in force, no fee applies to bilateral or multilateral APAs. However, should draft law No 8186 (introducing a new procedure for requesting an advanced bilateral or multilateral agreement on transfer pricing pursuant to the double tax treaties) become law in its current form, a fee ranging between EUR10,000 and EUR20,000 (depending on the level of complexity and the amount of work required) would apply.

7.7 Duration of APA Cover

The APA is valid for a time period of maximum five tax years and has a binding effect on the tax authorities, except in the following situations: (i) the situation or operations described are not accurate, (ii) the situation or operations performed differ from the ones described in the APA request, or (iii) it appears that the APA is not, or no longer, in line with Luxembourg, EU or international tax law.

7.8 Retroactive Effect for APAs

Given that unilateral APA requests have to be filed before the transaction they relate to takes place, in principle, there is no possible retroactive effect.

8. Penalties and Documentation

8.1 Transfer Pricing Penalties and Defences

Luxembourg legislation does not provide for penalties which are transfer pricing specific or which are linked to the preparation and maintaining of transfer pricing documentation. If a transaction has been priced in such a way that it does not reflect the arm's length principle, the tax authorities will perform an adjustment based on Article 56 of the LITL.

However, penalties might apply in the context of mandatory reporting requirements, which include transfer pricing data, such as under the CbC reporting requirements, where the LTA may levy, on a discretionary basis, a fine of up to EUR250,000 in cases of non-filing, late filing or incomplete or incorrect filing of the CbC report, as well as in cases of non-compliance with the filing rules. The same level of penalties also applies in case of breach of the reporting requirements under the law implementing DAC6, which also covers transactions which are transfer pricing related.

As far as transfer pricing documentation is concerned, based on paragraph 171 of the LGTL, it only has to be provided to the tax authorities

upon request and there is no general obligation to prepare such documentation. However, given that taxpayers have to be in the position to justify the positions they take in their tax returns, including when they enter into transactions with related parties, they have to be in the position to present, upon request, documentation illustrating how the arm's length price of these transactions was determined. Therefore, from a practical point of view, even if it is not required by the law, taxpayers should prepare their transfer pricing documentation upfront.

Lastly, the general administrative penalties which apply in any other tax matters – ie, in the case of late filing of the tax returns, late payment of the tax due or in the case of fraud – might also apply.

8.2 Transfer Pricing Documentation

There is a requirement to file CbC reports, based on the the Law of 23 December 2016 implementing Council Directive (EU) 2016/881 of 25 May 2016. This obligation applies to MNE groups with a consolidated revenue exceeding EUR750 million, whereby the entity of the group in charge of the reporting is generally the ultimate parent entity of the group. Luxembourg entities that are members of an MNE group are also required to notify the LTA of the identity and tax residence of the reporting entity (whether this reporting entity is the Luxembourg entity itself or any other entity of the group).

Based on the legislation currently in force, there is no requirement to prepare a master file or a local file, as defined in Action 13 of the BEPS Action Plan. However, a draft law (No 8186) complements paragraph 171 of the LGTL, adding that associated enterprises are required to present, on request, documentation justifying the transfer pricing policy they applied. The scope, content and extent of the documentation referred to in this new draft provision is laid down in a draft Grand-Ducal regulation which refers to the local file and the master file and details their content, in line with the standards defined in Action 13 of the BEPS Action plan. Thus, as soon as this draft law is in force, master files and local files will have to be prepared by taxpayers and will have to be provided to the tax authorities upon request.

9. Alignment With OECD Transfer Pricing Guidelines

9.1 Alignment and Differences

Since Luxembourg legislation does not provide for any integrated transfer pricing legislation, the OECD Transfer Pricing Guidelines play an extremely important role for Luxembourg taxpayers when analysing their transactions from a transfer pricing point of view and for tax authorities to assess the transfer pricing policy of taxpayers. Reference to these guidelines is made in the parliamentary documents related to the Luxembourg transfer pricing legislation, as well as in the related guidance of the LTA. Therefore, the position of the LTA should be fully aligned with the OECD guidelines and taxpayers should use these guidelines as a reference.

9.2 Arm's Length Principle

Luxembourg tax law follows the arm's length principle.

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

The development of the Luxembourg transfer pricing legislation as from 2015 is the direct impact of the outcome of the BEPS project in transfer pricing matters. As such, the BEPS project has impacted Luxembourg legislation significantly. The wording of Article 56bis of the

LITL closely follows some of the key paragraphs of Chapter I (arm's length principle) of the OECD Transfer Pricing Guidelines, which were updated in order to reflect the outcome of Actions 8-10 of the BEPS Action Plan.

9.4 Impact of BEPS 2.0

Luxembourg has implemented the EU Pillar Two directive by means of the Law of 22 December 2023, so the Pillar Two rules of the Directive are now in force in Luxembourg.

As far as Pillar One is concerned, its impact will mainly depend on the scope of exclusions for the financial services industry.

9.5 Entities Bearing the Risk of Another Entity's Operations

A Luxembourg entity may bear the risk of another entity's operations, to the extent that the transaction is concluded under arm's length conditions providing the risk-bearing entity with an arm's length remuneration. Explicit guarantees in financial transactions have to be remunerated in line with Chapter X of the OECD Transfer Pricing Guidelines.

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

10.1 Impact of UN Practical Manual on Transfer Pricing

While the UN Practical Manual on Transfer Pricing may be used as a source of information (reference is even made to it in the commentary to draft law No 6722 introducing Article 56 of the LITL), in practice, it is not relevant since Luxembourg closely follows the OECD Transfer Pricing Guidelines.

11. Safe Harbours or Other Unique Rules

11.1 Transfer Pricing Safe Harbours

Luxembourg tax law does not include any transfer pricing related safe harbours. However, as far as Luxembourg companies performing intra-group financing activities are concerned, Circular 56/1 – 56bis/1 provides for the following simplification measure for Luxembourg companies acting as mere intermediaries – ie, on-lending funds received without bearing any significant risks: transactions entered into by these companies are deemed to comply with the arm's length principle if the analysed entity realises a minimum return of 2% after tax on the amount of the financing volume. In practice, this simplification measure is never applied as the 2% after-tax margin is significantly higher than the arm's length remuneration for such activity.

Attention should be paid to the fact that arrangements involving the use of unilateral safe harbour rules belong to the specific arrangements concerning transfer pricing which may have to be reported under the Luxembourg Law of 25 March 2020 implementing DAC6 regarding reportable cross-border arrangements. However, given that Circular 56/1 – 56bis/1 of the LTA on the tax treatment of intra-group financing activities states that companies which opt for the simplification measure that may apply to Luxembourg companies acting as mere intermediaries will already be subject to spontaneous exchanges of information, reporting under DAC6 in this specific situation would mean that the information would be exchanged twice (once under the spontaneous information exchange and once under the automatic exchange of DAC6).

11.2 Rules on Savings Arising From Operating in the Jurisdiction

Luxembourg does not have any specific rules governing savings that arise from operating in Luxembourg.

11.3 Unique Transfer Pricing Rules or Practices

Luxembourg does not have any notable unique rules or practices applicable in the transfer pricing context.

11.4 Financial Transactions

Luxembourg has issued specific local guidance on financial transactions, as outlined in Circular 56/1 – 56bis/1 of the LTA (see section **1.1 Statutes and Regulations**). This Circular provides detailed instructions on the transfer pricing treatment of intra-group financing activities. According to the Circular, a financing entity should possess the capacity to assume risks related to its financial intermediation activities, exercise control over risks (including credit risk management) and maintain sufficient equity levels to absorb potential losses.

From a wider perspective, Luxembourg generally adheres to the OECD Transfer Pricing Guidelines, particularly Chapter X, which emphasises the accurate delineation of financial transactions and the assessment of risk control functions.

12. Co-Ordination With Customs Valuation

12.1 Co-Ordination Requirements Between Transfer Pricing and Customs Valuation

While there is no specific provision in Luxembourg law in respect of the arm's length value for customs duty purposes, Article 70-3 (d) of the Union Customs Code applies the arm's length principle in order to determine the customs value, stating that the transaction value shall apply provided that *"the buyer and seller are not related or the relationship did not influence the price"*.

The Law of 19 December 2008 provides a legal framework for the exchange of information between the different LTA – ie, the direct tax authorities (*Administration des contribution Directes*), the indirect tax authorities (*Administration de l'Enregistrement, des Domaines et de la TVA*) and the customs and excise duties administration (*Administration des Douanes et Accises*), as well as with other public authorities, such as the supervisory authority of the financial sector (*Commission de Surveillance du Secteur Financier*). However, in practice, to date, the use of transfer pricing documentation for customs duty purposes is uncommon.

13. Controversy Process

13.1 Options and Requirements in Transfer Pricing Controversies

There is no dedicated procedure applicable to transfer pricing matters, meaning that the same procedure as for any other direct tax matters applies when it comes to transfer pricing audits or to legal proceedings.

In a first step, the tax authorities may consider performing a tax audit which can take the form of either a general information request or a more formal tax audit, including several steps. In practice, we are seeing an increasing number of tax audits (in the form of a general information request) performed, especially when it comes to intra-group financing transactions. The tax audit is performed by the local inspector in charge of

the taxpayer. Besides the statute of limitations (of five years in principle), there is no timeline for performing a tax audit and the tax authorities set the deadline for the taxpayer to provide the information requested (generally two to four weeks). The taxpayer has the obligation to provide the information requested and must answer any additional questions the tax authorities may ask during the audit process. In practice, the tax authorities request the transfer pricing documentation supporting the intra-group transactions performed by the taxpayer as well as the related agreements. They often also request information related to substance.

Once the audit is completed, the tax authorities will release a tax assessment (or a revised tax assessment if the taxpayer has already been taxed automatically based on its tax return in a first place, as it is the case for companies, in principle). If the tax assessment differs from the position taken in the tax return, the tax authorities will first have to send a notification to the taxpayer explaining that they will deviate from the position taken in the tax returns and briefly explain the rationale behind this deviation. The taxpayer is able to take position on the envisaged deviation. Then, the tax assessment is released. The taxpayer then has three months to challenge the tax assessment before the Director of the direct tax authorities. Even though the tax assessment is challenged, the tax fixed in the tax assessment must be paid. The Director can then either issue a new tax assessment, reject the claim of the taxpayer or even remain silent. If the Director remains silent, the appeal is deemed to be rejected after six months. As soon as the appeal is rejected or deemed to be rejected, the taxpayer has the possibility to appeal against the decision (or deemed decision) of the Director of the tax authorities before the Administrative Tribunal (first instance in direct tax matters). The taxpayer can appeal against the decision of the Administrative Court (second instance in direct tax matters) within 40 days following the notification of the decision. The decision of the Administrative Court is final and cannot be appealed as the Administrative Court is the highest instance in direct tax matters.

Draft law No 8186 aims to simplify and modernise the rules governing the direct tax procedure in Luxembourg and amends, among others, some aspects of the formal conditions to challenge tax assessments.

14. Judicial Precedent

14.1 Judicial Precedent on Transfer Pricing

Luxembourg does not recognise the rule of precedent so the Luxembourg courts are not bound by decisions handed down in other cases, even when these cases are very similar. Still, decisions of the Director of the tax authorities very often make reference to the case law of the administrative courts, which is generally followed by the tax authorities.

14.2 Significant Court Rulings

Besides the rulings of the administrative courts regarding hidden dividend distributions and hidden capital contributions which are very numerous, the Luxembourg case law in transfer pricing matters is rather limited. There is some case law on the computation of interest rates on financing activities, but their relevance is reduced since these rulings concern tax years prior to 2015, so before Luxembourg introduced its transfer pricing legislation. There is, however, some recent case law on intra-group financing transactions and the qualification (as debt v equity) of the related instruments, including, in particular, one

case regarding the qualification of an interest-free loan.

Administrative Court No 48125C, 23 November 2023 and Administrative Tribunal No 44902, 23 September 2022 – Interest-Free Loan (IFL)

On 23 November 2023, the Luxembourg Administrative Court held a decision in a case concerning an IFL which was granted by a Luxembourg company to its wholly-owned Luxembourg subsidiary. The case involved a company resident in the Cayman Islands (CayCo) that invested via a Luxembourg investment platform into (distressed) debt owed by third parties. CayCo financed its Luxembourg subsidiary (LuxParentCo) by a mixture of equity and a profit-participating loan (PPL). LuxParentCo used the funds received to finance its Luxembourg subsidiary (*"LuxSubsidiary"*, the taxpayer) by a mixture of equity and (mainly) an IFL. LuxSubsidiary (the borrower) invested the funds received from LuxParentCo (the lender) mainly into distressed debt instruments.

In its corporate tax return, in accordance with Article 56 of the LITL, LuxSubsidiary performed a downward adjustment in relation to the IFL in order to account for deemed interest expenses that would have been due at arm's length. LuxParentCo recognised deemed interest income in its corporate tax return (corresponding to the amount of the deemed interest expenses reflected in the corporate tax return of LuxSubsidiary). The upward adjustment was also performed in accordance with Article 56 of the LITL.

Both the LTA and the Administrative Tribunal denied the downward adjustment on the grounds that the IFL was to be considered as an equity instrument. The equity qualification by the tax authorities and the Tribunal was mainly based on the fact that the IFL included a limited recourse clause providing for no or limited risk in case of default. One additional element was that the loan was only formalised several months after the cash had been made available, so, according to the Administrative Tribunal, the intention of the parties was to make a hidden capital contribution.

The Administrative Court overturned the judgment of the Tribunal and recalled that the classification of a financing instrument follows the economic approach (so-called *wirtschaftliche Betrachtungsweise*). This approach involves, for tax purposes, the economic reality prevailing over the legal form (also referred to as the *"substance over form"* principle). The Administrative Court performed an overall analysis of the transaction and an analysis of all relevant features of the IFL. Since most of the relevant features of the IFL were debt features, the Administrative Court classified the loan as a debt instrument. As the subject matter of the case was the classification of the IFL as debt or equity and the Administrative Court is limited by the grounds on which it has been involved, it could not itself review the downward (and upward) adjustment in principle (ie, notional interest) and the arm's length nature of the notional interest rate declared by the borrower. However, the Administrative Court stated that it is led to hold that it was wrong to recharacterise the IFL as equity and to refuse to admit the amount put forward as notional interest. Hence, the Administrative Court re-established long-standing principles with respect to the classification of financial instruments as debt or equity (ie, economic approach, substance over form).

15. Foreign Payment Restrictions

15.1 Restrictions on Outbound Payments Relating to Uncontrolled Transactions

The Luxembourg legislation does not include any restrictions on payments relating to uncontrolled transactions. There are only restrictions on the tax deduction of payments, which, in certain cases, like in the case of the interest limitation rules of the EU Anti-Tax Avoidance Directive (ATAD), also apply to payments to third parties.

15.2 Restrictions on Outbound Payments Relating to Controlled Transactions

Luxembourg legislation does not restrict the possibility to make payments relating to controlled transactions. However, certain limitations exist on the possibility to deduct such payments from a tax point of view. This is the case, for example, of interest and royalty payments made to entities located in a jurisdiction considered as non-co-operative, based on the list released and updated twice a year by the EU Council. Restrictions may also apply when the anti-hybrid rules of the ATAD, as implemented into Luxembourg law, apply. Lastly, restrictions will apply to the part of the remuneration which exceeds the arm's length price or when a payment is requalified into a hidden distribution. In such case, withholding tax might also apply on the payment.

15.3 Effects of Other Countries' Legal Restrictions

In Luxembourg, there are no specific rules regarding the effects of other countries' legal restrictions.

16. Transparency and Confidentiality

16.1 Publication of Information on APAs or Transfer Pricing Audit Outcomes

According to the Grand-Ducal Regulation of 23 December 2014 (related to paragraph 29a of the LGTL), advance tax agreements, including those covering transfer pricing aspects – ie, unilateral APAs – are published in a summarised and anonymised form in the annual report of the direct tax authorities. However, in practice, the information published only includes the number of decisions taken on APA requests and whether the decision was positive or negative. Luxembourg taxpayers usually do not rely on the APA procedure but rather on the preparation of robust transfer pricing documentation supporting the positions they take in their tax returns. The very low number of APAs (one single APA in 2023 based on the 2023 annual report of the direct tax authorities) illustrates this quite well.

As far as bilateral MAPs are concerned, the annual report of the direct tax authorities also indicates the number of MAPs launched and closed during the year, including those related to transfer pricing. However, no information is included on the content, outcome, etc. Lastly, in line with its commitment under Action 14 of the BEPS Action plan (*"Making Dispute Resolution Mechanisms More Effective"*), Luxembourg provides data and statistics to the OECD on its MAP procedure on a regular basis, including on bilateral APAs. This information is then analysed and published in the form of a peer review report by the OECD.

16.2 Use of "Secret Comparables"

Luxembourg does not use *"secret comparables"* for transfer pricing assessment purposes.

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