

# TRANSFER PRICING

## Luxembourg



# Transfer Pricing

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Quick reference guide enabling side-by-side comparison of local insights into principal legislation; enforcement authority; role of OECD Transfer Pricing Guidelines and BEPS project; transfer pricing methods; documentation and reporting; adjustments and settlement; relief from double taxation; advance pricing agreements; special topics, such as recharacterization, comparables, secondary adjustments, non-deductible intercompany payments, anti-avoidance, location savings, branches and permanent establishments, exit charges, and temporary exemptions and reductions; and recent trends.

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# Table of contents

## OVERVIEW

Principal legislation  
Enforcement agency  
OECD guidelines  
Covered transactions  
Arm's-length principle  
Base erosion and profit shifting

## PRICING METHODS

Accepted methods  
Cost-sharing  
Best method  
Taxpayer-initiated adjustments  
Safe harbours

## DISCLOSURES AND DOCUMENTATION

Documentation  
Country-by-country reporting  
Timing of documentation  
Failure to document

## ADJUSTMENTS AND SETTLEMENT

Limitation period for authority review  
Rules and standards  
Disputing adjustments

## RELIEF FROM DOUBLE TAXATION

Tax-treaty network  
Requesting relief  
When relief is available  
Limits on relief  
Success rate

## ADVANCE PRICING AGREEMENTS

Availability

**Process**

**Time frame**

**Duration**

**Scope**

**Independence**

**Advantages and disadvantages**

## **SPECIAL TOPICS**

**Recharacterisation**

**Selecting comparables**

**Secret comparables**

**Secondary adjustments**

**Non-deductible intercompany payments**

**Anti-avoidance**

**Location savings**

**Branches and permanent establishments**

**Exit charges**

**Temporary exemptions and reductions**

## **UPDATE AND TRENDS**

**Tax authority focus and BEPS**

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## OVERVIEW

### Principal legislation

Identify the principal transfer pricing legislation.

Luxembourg's principal transfer pricing rules are provided for in articles 56 and 56-bis of the Luxembourg Income Tax Law (LITL).

- Article 56 expressly provides that Luxembourg transfer pricing will follow the arm's-length principle by incorporating the definition of article 9(1) of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on Income and on Capital.
- Article 56-bis incorporated into Luxembourg law the key principles of the OECD Transfer Pricing Guidelines, as amended by the 2015 OECD's base erosion and profit shifting (BEPS) reports on Action Points 8 to 10.

The OECD Transfer Pricing Guidelines are the base reference in domestic legislation and constitute the framework for any transfer pricing analysis.

The LITL contains other articles regarding compliance with the arm's-length principle. These include such concepts as hidden dividends (article 164(3)) and hidden capital contributions (article 18(1)).

Pursuant to recent amendments in article 171(3) of the General Tax Law, a taxpayer's duty of cooperation with the Luxembourg tax authorities (LTA) has now been extended to apply to transactions between associated enterprises, which includes the obligation of the taxpayer to provide, upon request by the LTA, appropriate transfer pricing documentation.

The LTA has also issued a circular specifically addressing transfer pricing rules related to intragroup financing activities (Circular No. 56/1–56bis/1 of 27 December 2016).

Other circulars issued by the LTA focusing on transfer pricing topics include:

- Circular LG – Conv DI No. 60 of 11 March 2021 on the mutual agreement procedure (MAP) with respect to Luxembourg's double tax treaties; and
- Circular No. 164-ter/1 of 17 June 2022, updating guidance on Luxembourg's Controlled Foreign Company Rules.

*Law stated - 20 June 2023*

### Enforcement agency

Which central government agency has primary responsibility for enforcing the transfer pricing rules?

The transfer pricing rules are audited by the economic division of the LTA.

*Law stated - 20 June 2023*

### OECD guidelines

What is the role of the OECD Transfer Pricing Guidelines?

Article 56 of the LITL is explicit in stating that the arm's length principle is applicable in Luxembourg, whereas the OECD

Transfer Pricing Guidelines generally can be considered as highly persuasive for Luxembourg transfer pricing purposes.

*Law stated - 20 June 2023*

## Covered transactions

To what types of transactions do the transfer pricing rules apply?

All transactions between associated enterprises are within the scope of Luxembourg's transfer pricing rules. Article 56 of the LITL defines associated enterprises as:

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

*Law stated - 20 June 2023*

## Arm's-length principle

Do the relevant transfer pricing rules adhere to the arm's-length principle?

The LTA generally apply the arm's-length principle as provided for in the OECD Transfer Pricing Guidelines.

*Law stated - 20 June 2023*

## Base erosion and profit shifting

How has the OECD's project on base erosion and profit shifting (BEPS) affected the applicable transfer pricing rules?

Luxembourg generally applies all OECD BEPS action items related to transfer pricing to its own transfer pricing rules including the OECD Transfer Pricing Guidelines. Article 56-bis of the LITL provides guidance on the application of the arm's-length principle based on the OECD BEPS Report's Actions 8 to 10.

Further to BEPS, Luxembourg transposed Council Directive (EU) 2016/881 regarding country-by-country reporting (CbCR) into its domestic law, as well as new instruments for the resolution of tax disputes and CFC rules.

Additionally, the OECD BEPS 2.0 Initiative, consisting of two pillars, may have additional impact on Luxembourg transfer pricing. By way of background, in 2021, the OECD/G20 Inclusive Framework on BEPS has agreed to a two-pillar solution to address the tax challenges arising from the digitalisation of the economy. Pillar One is limited to multinational enterprises with global revenue above €20 billion and allocates 25 per cent of profits in excess of 10 per cent of revenue (residual profit) to market jurisdictions with nexus using a revenue-based allocation key. Pillar Two establishes model global anti-base erosion rules (GloBE Rules). Both of these 2 Pillars taxation policies will be implemented across the EU.

With respect to Pillar One, the Council of the European Union still has not yet issued a proposed directive at the time of writing. However, on 15 December 2022, the Council of the European Union adopted Directive 2022/2523 implementing Pillar Two, which requires that EU member states must transpose this directive by 31 December 2023. At the time of writing, Luxembourg has not yet published a draft law on the transposition of the aforementioned Pillar Two Directive.

*Law stated - 20 June 2023*

## PRICING METHODS

### Accepted methods

What transfer pricing methods are acceptable? What are the pros and cons of each method?

In Luxembourg, the five OECD methods are generally allowed and comprise:

- the comparable uncontrolled price method (CUP);
- the resale price method;
- the cost-plus method;
- the transactional net margin method; and
- the transactional profit split method.

The taxpayer has the burden of establishing which method is the most appropriate based on the transaction's facts and circumstances. In practice, the CUP method is the most popular.

*Law stated - 20 June 2023*

### Cost-sharing

Are cost-sharing arrangements permitted? Describe the acceptable cost-sharing pricing methods.

Luxembourg permits cost-sharing arrangements provided they comply with the OECD Transfer Pricing Guidelines. Luxembourg has not released any specific guidance on cost-sharing arrangements.

*Law stated - 20 June 2023*

### Best method

What are the rules for selecting a transfer pricing method?

Generally, the CUP method is preferred. This should be combined with proof that the comparables are appropriate to the transaction.

The Luxembourg tax authorities (LTA) expect an analysis of the most appropriate method for that particular type of transaction.

*Law stated - 20 June 2023*

### Taxpayer-initiated adjustments

Can a taxpayer make transfer pricing adjustments?

There is no official LTA position on making adjustments after books are closed but before the tax return is filed. As best practice, transfer pricing documentation should be applied to the economics of the transaction prior to filing the Luxembourg tax returns.

The LTA request transfer pricing documentation to be provided by the taxpayer within 15 days, and Luxembourg tax law requires documentation to be prepared and maintained in respect of all related-party transactions.



**Safe harbours**

Are special 'safe harbour' methods available for certain types of related-party transactions? What are these methods and what types of transactions do they apply to?

Luxembourg has no safe harbour rules per se; however, for intragroup financing activities, Circular No. 56/1–56bis/1 of 27 December 2016 provides for an elective simplified method requiring a minimum 2 per cent return that is generally calculated on the taxpayer's financial assets. This simplified method is available if the taxpayer is performing only an intermediary function.

The 2 per cent margin can be reassessed by the LTA on an ongoing basis. The election will also be automatically shared with the relevant tax authorities in other jurisdictions where related counterparties are located.

Law stated - 20 June 2023

**DISCLOSURES AND DOCUMENTATION****Documentation**

Does the tax authority require taxpayers to submit transfer pricing documentation? Regardless of whether transfer pricing documentation is required, does preparing documentation confer any other benefits?

Luxembourg has not issued any specific requirements in terms of the form of the documentation for transfer pricing purposes. Luxembourg has yet to require master files and local files as defined in Action 13 of the Organisation for Economic Co-operation and Development's (OECD) base erosion and profit shifting (BEPS) project.

However, there is a documentation obligation for transfer pricing purposes, meaning that all taxpayers subject to the provisions of the arm's-length principle must document how the arm's-length price has been determined. The Luxembourg tax authorities (LTA) frequently request such documentation as part of their audit procedures. Failure to provide transfer pricing documentation to the LTA upon request can risk an assessment adjusting the tax base.

Law stated - 20 June 2023

**Country-by-country reporting**

Has the tax authority proposed or adopted country-by-country reporting? What are the differences between the local country-by-country reporting rules and the consensus framework of Chapter 5 of the OECD Transfer Pricing Guidelines?

Luxembourg transposed Council Directive (EU) 2016/881 regarding country-by-country reporting (CbCR) into its domestic laws with effect from the 2016 tax year onwards. Luxembourg's CbCR law generally reflects the requirements as provided in the aforementioned EU Directive.

Accordingly, there are generally no differences between what is in the directive and Luxembourg domestic law; however, Luxembourg's domestic CbCR law provides for penalties of up to €250,000 for:

- failure to file;
- late filing;

- incomplete or inaccurate information; and
- failing to inform the LTA of the parent's inability to provide such information.

*Law stated - 20 June 2023*

### **Timing of documentation**

#### **When must a taxpayer prepare and submit transfer pricing documentation?**

In Luxembourg, there is no obligation for yearly submissions of transfer pricing documentation; however, as of 2017 Luxembourg corporate tax returns contain a specific question asking whether the company has engaged in transactions with related parties. This means the LTA are put on notice for all taxpayers when transfer pricing is applicable.

The General Tax Law was amended by the Law of 19 December 2014 and now requires all taxpayers engaged in related-party transactions to prepare documentation showing that the transaction conforms to the arm's-length principle. This documentation must be retained by the taxpayer and provided to the LTA in the event of an inquiry or audit.

*Law stated - 20 June 2023*

### **Failure to document**

#### **What are the consequences for failing to submit documentation?**

A taxpayer's failure to provide documentation to the LTA upon request can result in a tax assessment adjusting the tax base and may also prove that the taxpayer has not complied with the General Tax Law's requirement to prepare and maintain records documenting the arm's-length principle.

The LTA usually only allow 15 days to respond to queries regarding proof of transfer pricing documentation. If a taxpayer has not yet prepared documentation by the time of the LTA request, there may not be sufficient time between the request and the tax assessment for the taxpayer to complete the required transfer pricing documentation.

*Law stated - 20 June 2023*

## **ADJUSTMENTS AND SETTLEMENT**

### **Limitation period for authority review**

#### **How long does the tax authority have to review an income tax return?**

The statute of limitations is generally for five years in Luxembourg; however, this period can be extended to 10 years in the case of tax evasion, fraud or incomplete tax returns.

Additionally, the Luxembourg tax authorities (LTA) may request voluntary extensions of the statute of limitations by written consent of the taxpayer.

*Law stated - 20 June 2023*

### **Rules and standards**

## What rules, standards or procedures govern the tax authorities' review of companies' compliance with transfer pricing rules? Does the tax authority or the taxpayer have the burden of proof?

The main rule is found in article 171(3) of the General Tax Law, which requires taxpayers to both disclose transactions with related parties and document compliance with the arm's-length standard in respect of those transactions. There is no published guidance from the LTA in this regard. In practice, it is recommended that taxpayers prepare and retain documentation that is consistent with the OECD Transfer Pricing Guidelines.

The taxpayer has the burden of proof of compliance with the arm's-length standard as required by article 171(3). The LTA may request such documentation from the taxpayer at any point before the statute of limitations has expired.

In the event that the LTA find that the documentation provided by the taxpayer is not sufficient to support the arm's-length character of the related-party transaction, the LTA have the power to challenge and issue an adjusted tax assessment.

If the taxpayer fails to produce any transfer pricing documentation for related-party transactions, the LTA can impose an assessment, in which case the taxpayer would also be in violation of tax law for failing to comply with the documentation requirements.

*Law stated - 20 June 2023*

## Disputing adjustments

### If the tax authority asserts a transfer pricing adjustment, what options does the taxpayer have to dispute the adjustment?

The taxpayer can contest the transfer pricing adjustment materialised by a tax assessment notice by filing a claim addressed to the director of the LTA within three months. If denied, the taxpayer can introduce a claim before the Lower Administrative Court. An appeal against the Lower Administrative Court decision must be made before the Higher Administrative Court.

*Law stated - 20 June 2023*

## RELIEF FROM DOUBLE TAXATION

### Tax-treaty network

#### Does the country have a comprehensive income tax treaty network? Do these treaties have effective mutual agreement procedures?

As of June 2023, Luxembourg's tax treaty network has expanded to 86 active tax treaties. Luxembourg is currently negotiating new double tax treaties with five jurisdictions, including Chile, Egypt, Mali, New Zealand and Pakistan. Currently, there are nine jurisdictions with which Luxembourg has signed and are pending ratification, consisting of Kuwait, Oman, Rwanda, Albania, Argentina, Cape Verde, Ethiopia, Ghana and Kyrgyzstan. This extensive tax treaty network includes all G20 countries except Australia. Generally, Luxembourg tax treaties contain effective mutual agreement procedures.

On 11 March 2021, the Luxembourg tax authorities (LTA) issued Circular LG - Conv DI No. 60, which provides practical guidance on the process for initiating the mutual agreement procedure under double tax treaties.

*Law stated - 20 June 2023*

## Requesting relief

How can a taxpayer request relief from double taxation under the mutual agreement procedure of a tax treaty? Are there published procedures?

On 11 March 2021, the LTA published practical guidance on the procedure for mutual agreement procedures (the MAP Guidelines) with regard to tax treaties (Circular LG - Conv DI No. 60).

The MAP Guidelines provide that while the Minister of Finance may be the official designated competent authority, in practice requests for this procedure should be made to:

- the Direction Committee for procedural matters;
- the Economic Division for transfer pricing matters; or
- the International Relations Division for all other matters.

The MAP Guidelines expressly state that the threshold for eligibility is relatively low, and refusal will occur if:

- the time period for introducing a procedure has expired; or
- the residency condition is not fulfilled when the taxpayer has to submit its request to the authority of its own contracting.

*Law stated - 20 June 2023*

## When relief is available

When may a taxpayer request assistance from the competent authority?

The MAP Guidelines generally follow the guidance found in article 25 of the Organisation for Economic Co-operation and Development Model Tax Treaty. The Guidelines generally provide a large field of application.

The grounds for initiating the MAP can apply when the taxpayer believes such taxation would not be in conformity with the terms of the applicable tax treaty. The MAP submission must include, among other things:

- the taxpayer's information, including tax ID number, official name, address and contact person;
- the non-conforming tax in question;
- the relevant tax treaty partner country involved; and
- the year of the tax in question.

*Law stated - 20 June 2023*

## Limits on relief

Are there limitations on the type of relief that the competent authority will seek, both generally and in specific cases?

The MAP is independent of other legal remedies and can be initiated in parallel with such remedies (administrative, judicial or arbitral).

If the MAP results in a potential agreement with the state treaty partner authorities, the taxpayer must provide its

consent and waive all other relevant domestic or foreign remedies before the agreement is executed.

In addition, the filing of a claim within the meaning of the Law of 20 December 2019 establishing a tax dispute resolution mechanism between European countries terminates any other ongoing mutual agreement procedure or dispute resolution procedure dealing with the same dispute and initiated under a tax treaty.

*Law stated - 20 June 2023*

## Success rate

How effective is the competent authority in obtaining relief from double taxation?

In 2021, the OECD released updated MAP statistics per jurisdiction ( Mutual Agreement Procedure Statistics per jurisdiction for 2021 ).

In terms of success, 79 per cent of all of Luxembourg's post-2016 MAP transfer pricing cases resulted in an agreement that either eliminated double taxation or resolved any taxation not in conformity with the applicable tax treaty.

*Law stated - 20 June 2023*

## ADVANCE PRICING AGREEMENTS

### Availability

Does the country have an advance pricing agreement (APA) programme? If so, is the programme widely used? Are unilateral, bilateral and multilateral APAs available?

Luxembourg law has an APA programme that is usually unilateral, covering the tax treatment in Luxembourg of transactions involving tax-resident enterprises; however, there is no limitation with regard to the enterprises and transactions that can be covered by an APA. Unilateral, bilateral and multilateral APAs are all potentially available.

*Law stated - 20 June 2023*

### Process

Describe the process for obtaining an APA, including a brief description of the submission requirements and any applicable user fees.

The APAs are subject to the ruling procedure requirements introduced in the Grand Ducal Decree of 23 December 2014 . Unilateral APA requests should be addressed to the head of the relevant tax office. Bilateral APA requests should be addressed to the Direction Committee.

Any transactions covered by an APA must fulfil the requirements of the arm's-length principle and include, among other things:

- designation of the taxpayer and the parties involved;
- a factual description of all intragroup transactions to be addressed in the APA;
- transfer pricing documentation in line with the Organisation for Economic Co-operation and Development's Transfer Pricing Guidelines (including updates); and
- a description of the applicable law and questions for which the taxpayer wishes to obtain clarity.

The fees for filing an APA range from €3,000 to €10,000, depending on the complexity. These fees are non-refundable and payable in advance of the decision regardless of its outcome.

Information regarding the process for obtaining an APA can be found in paragraph 29 of the General Tax Law, in the Grand-Ducal decree of 23 December 2014 and in Circular No. 56/1–56bis/1 of 27 December 2016, as well as in the administrative newsletter of 3 December 2019 of the Luxembourg tax authorities (LTA).

*Law stated - 20 June 2023*

### **Time frame**

How long does it typically take to obtain a unilateral and a bilateral APA?

It may take at least three months to get an APA.

*Law stated - 20 June 2023*

### **Duration**

How many years can an APA cover prospectively? Are rollbacks available?

In Luxembourg, APAs are valid for a maximum of five years. There are circumstances pursuant to which the APA may be invalidated earlier, including changes in the underlying economics of the APA or if the APA's terms and conditions violate subsequent changes to Luxembourg, EU or international law.

Rollbacks for APAs are permitted under certain conditions; however, the term of the APA can still not exceed five years in total.

*Law stated - 20 June 2023*

### **Scope**

What types of related-party transactions or issues can be covered by APAs?

There is no limit or restriction on the types of related-party transactions that can be covered by an APA, provided the taxpayer properly prepares the application and duly pays the filing fees.

*Law stated - 20 June 2023*

### **Independence**

Is the APA programme independent from the tax authority's examination function? Is it independent from the competent authority staff that handle other double tax cases?

The LTA do not have a dedicated APA team that exclusively focuses on the APA process. It is therefore possible that the same staff can be involved with the APA programme and a tax audit.

*Law stated - 20 June 2023*

### **Advantages and disadvantages**

## What are the key advantages and disadvantages to obtaining an APA with the tax authority?

The principal advantage for a taxpayer in obtaining an APA is confirmation of the tax treatment of complex related-party transactions. A substantial number of related-party transactions, particularly those in respect of cross-border financing, are often sufficiently covered by Luxembourg tax circulars and OECD Transfer Pricing Guidelines and should not usually require an APA.

*Law stated - 20 June 2023*

### SPECIAL TOPICS

#### Recharacterisation

Is the tax authority generally required to respect the form of related-party transactions as actually structured? In what circumstances can the tax authority disregard or recharacterise related-party transactions?

The Luxembourg tax authorities (LTA) apply the concept of substance over form (ie, economic approach) where the legal form differs from the economics of a transaction.

The concept of substance over form is not only used to prevent potential abuse, it also applies to other cases, such as related-party transactions where the economic reality is presumed to be different, having regard to the particular circumstances. It provides guidance for cases where a financial instrument has features of both equity and debt.

*Law stated - 20 June 2023*

#### Selecting comparables

What are some of the important factors that the tax authority takes into account in selecting and evaluating comparables? In particular, does the tax authority require the use of country-specific comparable companies, or are comparables from several jurisdictions acceptable?

There is no preference in Luxembourg for domestic comparables over foreign comparables.

*Law stated - 20 June 2023*

#### Secret comparables

What is the tax authority's position and practice with respect to secret comparables? If secret comparables are ever used, what procedures are in place to allow a taxpayer to defend its own transfer pricing position against the tax authority's position based on secret comparables?

The LTA do not use secret comparables.

*Law stated - 20 June 2023*

#### Secondary adjustments

Are secondary transfer pricing adjustments required? What form do they take and what are their tax consequences? Are procedures available to obtain relief from the adverse tax consequences of certain secondary adjustments?

Yes, Luxembourg has officially communicated to the Organisation for Economic Co-operation and Development (OECD) that excessive payments from an enterprise to a parent company that exceed the arm's-length price can be recharacterised as 'hidden dividends'.

These payments can be denied deductibility for tax purposes and also be subject to withholding tax if treated as dividends; however, in the case of recharacterisation as a dividend, such payments may still be eligible for domestic or treaty-based withholding tax reductions or exemptions (conditions apply).

*Law stated - 20 June 2023*

### **Non-deductible intercompany payments**

Are any categories of intercompany payments non-deductible?

No, there are no listed specific categories of payments that are expressly non-deductible for Luxembourg tax purposes that would otherwise be deductible according to Luxembourg generally accepted accounting principles (GAAP).

A general principle of Luxembourg tax law is that the Luxembourg tax accounting treatment follows the Luxembourg GAAP accounting treatment (ie, the commercial accounts). Accordingly, if an item of expense is deductible for Luxembourg GAAP purposes, it is presumed deductible under the general rule for Luxembourg tax purposes.

This general rule is subject to various applicable tax rules, including respecting the arm's-length principle on related-party transactions and the anti-abuse rules promulgated under domestic law and recently under the OECD base erosion and profit shifting (BEPS) initiatives and the EU anti-tax avoidance directives (ATADs).

Complex disallowance and recapture rules may be applicable to an item of expense if linked to tax-exempt assets, capital gains or income. For example, interest may be disallowed in the year in which an exempt dividend is received if the item of interest is related to the financing of the exempt participation giving rise to the dividend.

Likewise, tax-exempt capital gains on a disposal of a participation can cause prior year expenses related to the participation to be recaptured in the year of its disposal. Such disallowance and recaptures are still effective even if the items of expense respect the arm's-length principle.

*Law stated - 20 June 2023*

### **Anti-avoidance**

What legislative and regulatory initiatives (besides transfer pricing rules) have the government taken to combat tax avoidance with respect to related-party transactions? What are the penalties or other consequences for non-compliance with these anti-avoidance provisions?

Council Directive (EU) 2016/1164 of 12 July 2016 (ATAD I) entered into force in Luxembourg on 1 January 2019 and applies new anti-abuse rules addressing, among other things:

- controlled foreign companies;
- intra-EU hybrid payments;



- interest expense limitations; and
- general anti-abuse rules.

Council Directive (EU) 2017/952 of 29 May 2017 (ATAD II) entered into force in Luxembourg on 1 January 2020 and aims mainly to deny tax benefits (eg, interest deductions) in respect of hybrid entities, hybrid permanent establishments and hybrid financial instruments between associated enterprises as defined in ATADs I and II.

Luxembourg has implemented the DAC6 Directive 2018/822/EU, which addresses the European Union's Mandatory Disclosure Rules relating to certain cross-border arrangements that are considered to involve potentially aggressive tax planning arrangements.

Furthermore, with effect from 1 March 2021, Luxembourg has implemented a law disallowing the deduction of interest and royalties paid by Luxembourg corporate taxpayers to associated enterprises in a jurisdiction included in Annex I of the EU list of non-cooperative jurisdictions for tax purposes. Such disallowance is valid even if the arm's-length principle is respected on the deductible items of interest or royalties, unless the taxpayer provides evidence that his or her interest or charge corresponds to a transaction that is put in place for valid business reasons that reflect economic reality ( Circular L.I.R. No. 168/2 from 31 May 2022 ).

This law results from recommendations by Ecofin to implement at least one of four proposed defensive measures (eg, non-deductibility of costs paid, inclusion of undistributed profits of subsidiaries, higher withholding tax and limitation to participation exemption) against jurisdictions of Annex I.

*Law stated - 20 June 2023*

## **Location savings**

How are location savings and other location-specific attributes treated under the applicable transfer pricing rules? How are they treated by the tax authority in practice?

Luxembourg generally follows the OECD Transfer Pricing Guidelines with respect to location savings and location-specific attributes.

*Law stated - 20 June 2023*

## **Branches and permanent establishments**

How are profits attributed to a branch or permanent establishment (PE)? Does the tax authority treat the branch or PE as a functionally separate enterprise and apply arm's-length principles? If not, what other approach is applied?

Consistent with the OECD Transfer Pricing Guidelines, Luxembourg will generally treat the PE under the separate enterprise theory.

Further, the transactions of the PE with related parties are priced according to the arm's-length principle as promulgated by the OECD Transfer Pricing Guidelines. Such application is by analogy to other transactions, risks, assets or the allocation of functions performed by the PE as if it were a separate entity for transfer pricing purposes.

*Law stated - 20 June 2023*

## Exit charges

Are any exit charges imposed on restructurings? How are they determined?

Pursuant to ATAD I, Luxembourg recently amended its exit tax rules, which now apply to the cross-border transfers of assets, changes of tax residency for companies and transfers of activities involving PEs.

Outbound exit tax charges are generally calculated on the going concern value of the asset on the date of transfer less its tax value (historic acquisition cost, which can include adjustments upwards and downwards, such as depreciation or amortisation, as of the date of transfer).

*Law stated - 20 June 2023*

## Temporary exemptions and reductions

Are temporary special tax exemptions or rate reductions provided through government bodies such as local industrial development boards?

Tax credits are available for investments made by Luxembourg businesses subject to income tax, except for the case of businesses that do not hold any tangible fixed assets (eg, holding and financing companies).

Luxembourg implemented a new IP box regime in January 2018 in line with Action 5 of the OECD BEPS, which generally grants an 80 per cent exemption on the income and 100 per cent of the value for net worth tax purposes on the qualifying IP that complies with the modified nexus approach (substantial economic activities in Luxembourg in connection with the income benefiting from the regime are performed in Luxembourg).

The country also has an expatriate regime for highly skilled and qualified workers where the costs incurred with moving such workers that are borne by the employer can be reported as operating expenses of the company (and not as a benefit in kind of the employee).

A maritime flag regime is also available that generally exempts Luxembourg shipping companies operating vessels in international waterways from municipal business tax. Tax credits for investment can also be applicable to vessels operating abroad.

*Law stated - 20 June 2023*

## UPDATE AND TRENDS

### Tax authority focus and BEPS

What are the current issues of note and trends relating to transfer pricing in your country? Are there particular areas on which the taxing authority is focused? Have there been any notable legislative, administrative, enforcement or judicial developments? In particular, how is the OECD's project on base erosion and profit shifting affecting both policymakers and tax administrators?

### Relevant practice updates

There has been a continuous increase in requests from the Luxembourg tax authorities (LTA) relating to transfer pricing documentation, focusing on the economic and organisational substance of Luxembourg companies. In particular, the LTA's audits focus often on whether the facts as described in the documentation are reflective of the actual economic substance and activities.

In light of the overall global increase in interest rates over the past year, tax payers should consider an update of their transfer pricing documentation covering generally intra-group financing, guarantee fees and debt capacity analysis.

## **New EU Directive on regarding the Disclosure of Income Tax Information by Certain Undertakings and Branches**

On 24 February 2023, a new bill (8158) was submitted to the Luxembourg parliament transposing the new EU Directive regarding the Disclosure of Income Tax Information by Certain Undertakings and Branches (Public CbCR Directive). This new directive must be implemented into domestic law by EU Member States before 22 June 2023 and will be effective for accounting years beginning on or after 22 June 2024.

The Public CbCR Directive expands the obligation of large multinational groups (ie, annual consolidated revenue of at least €750 million) to disclose specific tax and related group information on an EU member state's business register. These new CbCR reporting requirements include a short description of activities, net turnover, profit or loss before tax, tax accrued and paid, accumulated earnings and the number of employees on the Luxembourg Business Register.

## **New Rules on Transfer Pricing including the MAP**

A new bill (8186) has been presented to the Luxembourg parliament which proposes changes to the General Tax Law and includes also new tax procedural aspects applicable to taxpayers in general. Additionally, the new bill introduces new procedures regarding both bilateral and multilateral advance pricing agreements, as well as procedures to amend tax assessments further to mutual agreement procedures or arbitral decisions.

Regarding transfer pricing, the bill proposes the introduction of new procedures for transfer pricing, which can be summarised as follows:

- The bill introduces new provisions that clarify transfer pricing documentation requirements, including that LTA information requests should be shared in a readable electronic format whenever possible. Further details on this will be specified in a grand Ducal Decree.
- Taxpayers who are part of a group will be required to provide additional documentation to substantiate their transfer pricing policy (local file) upon request. For Luxembourg tax resident companies and permanent establishments with a turnover exceeding €100 million or assets worth more than €400 million (calculated individually), a master file would also be required.

These provisions are not final and may be subject to change before the bill's formal adoption.

## **EU State Aid update: Luxembourg and Fiat Chrysler**

In the matter of Luxembourg and Fiat Chrysler Finance Europe v the European Commission (EC), the Court of Justice of the European Union rendered its decision on 8 November 2022, thus annulling both the EU General Court's judgment and the EC's original decision, alleging that Luxembourg had unlawfully granted State Aid to Fiat. The court held that the EC's assessment, which relied on a reference system to ascertain whether a selective advantage existed, was erroneous in its logic and conclusions.

Previously, in October 2015, the EC determined that a tax ruling that had been granted to Fiat Chrysler Finance Europe by Luxembourg in 2012, sanctioning specific transfer pricing methodologies used to evaluate the annual taxable profits, configured State Aid. As a result, the EC ordered Luxembourg to recover the unlawful and incompatible aid from Fiat Chrysler Finance Europe. In 2019, the EU General Court rejected challenges made by both Fiat Chrysler Finance Europe and Luxembourg, thus affirming the validity of the EC's decision.

A key takeaway from this case is the importance of transfer pricing in Luxembourg. The LTA have long since emphasised the importance of transfer pricing documentation in Luxembourg, and have made transfer pricing documentation requests a frequent focus of information requests and field audits with taxpayers.

*Law stated - 20 June 2023*

## Jurisdictions

	<b>Canada</b>	McCarthy Tétrault LLP
	<b>Cyprus</b>	Kinanis LLC
	<b>Ireland</b>	Matheson LLP
	<b>Italy</b>	Chiomenti Studio Legale
	<b>Japan</b>	TMI Associates
	<b>Luxembourg</b>	Maples Group
	<b>Netherlands</b>	Taxand
	<b>South Korea</b>	Lee & Ko
	<b>Switzerland</b>	Bär & Karrer
	<b>Taiwan</b>	Lee and Li Attorneys at Law
	<b>United Kingdom</b>	Joseph Hage Aaronson LLP
	<b>USA</b>	Step toe & Johnson LLP
	<b>Zambia</b>	Mulenga Mundashi Legal Practitioners