

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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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 Income Tax Law (ITL).

- 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 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 ITL 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.

Luxembourg has also issued a Grand Ducal circular (the equivalent of a regulation) specifically addressing transfer pricing rules related to intragroup financing activities: Circular No. 56/1–56bis/1 of 27 December 2016.

Law stated - 06 April 2022

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 - 06 April 2022

OECD guidelines

What is the role of the OECD Transfer Pricing Guidelines?

The LTA rely on the OECD Transfer Pricing Guidelines when applying transfer pricing rules.

Law stated - 06 April 2022

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 ITL 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 - 06 April 2022

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 - 06 April 2022

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. Article 56-bis of the ITL provides guidance on the application of the arm's-length principle based on the OECD BEPS Report's Actions 8 to 10.

Law stated - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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.

If an appropriate comparable cannot be found, the Luxembourg tax authorities (LTA) expect an analysis of the most appropriate method for that particular type of transaction.

Law stated - 06 April 2022

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.

Law stated - 06 April 2022

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 - 06 April 2022

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 OECD's base erosion and profit shifting 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 - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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 2021, Luxembourg's tax treaty network has expanded to 84 active tax treaties, six pending ratification and eight under negotiation. 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 - 06 April 2022

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 - 06 April 2022

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 OECD 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 - 06 April 2022

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 - 06 April 2022

Success rate

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

In 2020, the OECD released MAP statistics per jurisdiction (Mutual Agreement Procedure Statistics per jurisdiction for 2020). These statistics are generally divided between the outcomes of transfer pricing cases and 'other cases'.

According to this report, Luxembourg had a total of 175 (compared to 180 in 2019) MAP cases since 1 January 2016. Of those, there were 38 (compared to 37 in 2019) transfer pricing cases and 137 (compared to 143 in 2019) other cases. This is a notable and dramatic increase when compared to only 31 cases for all years prior to 2016.

In terms of success, 43 per cent of all 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. Further, 21 per cent of such cases were withdrawn by the taxpayer, and 7 per cent were granted unilateral relief. The remaining 29 per cent were denied MAP access.

Law stated - 06 April 2022

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 - 06 April 2022

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 OECD 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 - 06 April 2022

Time frame

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

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

Law stated - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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 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 - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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.

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 - 06 April 2022

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 - 06 April 2022

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 - 06 April 2022

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

Recently, there has been an increase in requests from the Luxembourg tax authorities (LTA) relating to transfer pricing documentation, focusing on the economic and organisational substance of Luxembourg companies. The LTA's focus on audits increasingly tends to concentrate on whether the facts as described in the documentation are reflective of the actual economic substance and activities.

Additionally, there has been an increase in audits by the LTA of the arm's-length principle regarding related-party interest payments and management fees.

Documentation in support of related-party transactions involving holding and financing activities should be mindful of applying the 2020 OECD Chapter X Guidelines on Financial Transactions. The determination of the debt-to-equity ratios of Luxembourg companies, including holding companies, is to be based on this new OECD chapter. Similarly, taxpayers who only base debt-to-equity ratios on arbitrary fixed ratios without underlying transfer pricing support should be at risk of potential challenge and scrutiny.

With regard to the controlled foreign corporation (CFC) rules in Council Directive (EU) 2016/1164 of 12 July 2016 (ATAD I), transfer pricing documentation may be required to demonstrate that there are no substantial people functions that may be attributable to the otherwise taxable undistributed profits of CFCs held directly or indirectly by a Luxembourg company.

Relevant case law involving transfer pricing

On 16 December 2020, a Luxembourg court ruled in favour of granting a contested information exchange requested by Belgian tax authorities pursuant to a transfer pricing audit. The court agreed with the LTA to dismiss a challenge by a Luxembourg company related to requests for tax information and exchange.

The Luxembourg company attempted to argue that the Belgian tax authorities' request was lacking in sufficient motivations and reasons; however, the court dismissed this objection for lack of sufficient grounds and ordered the requested exchange of information.

This case illustrates how transfer pricing-based audits by EU tax authorities are increasing and demonstrates the LTA's willingness to cooperate with such information requests from neighbouring EU tax authorities (see Case No. 45072).

Amazon wins appeal against the EC

On 12 May 2021, the General Court of the European Union (the General Court) ruled in favour of Amazon on its appeal against EU state aid charges citing that the European Commission (EC) had failed to prove any specific tax advantage in its transfer pricing-focused strategy of attack.

This case relates to the tax years from 2006 to 2014, during which Amazon had a Luxembourg-transparent limited partnership (LuxSCS) that held valuable IP rights related to technology, trademarks and customer lists. The LuxSCS

received substantial royalty payments from its wholly owned Luxembourg tax-resident subsidiary (LuxOpCo).

These tax-deductible royalty payments resulted in a large portion of Amazon's European-related profits being outside Luxembourg taxation (and EU taxation as a whole) owing to the transparent nature of the LuxSCS for Luxembourg tax purposes. The EC's arguments included the following:

- the LuxSCS did not have any physical presence or employees in Luxembourg and had only one function, which was to passively hold the IP rights;
- the LuxOpCo functioned as the European headquarters of Amazon, with a substantial physical presence and several key functions, including operating Amazon's European online retail and sales business and managing inventory;
- Luxembourg should have applied more appropriate transfer pricing methodologies, which, had they been applied, would have resulted in lower royalty payments and thus a higher taxable base for the LuxOpCo;
- the LuxSCS was only providing a mere intermediary function and Luxembourg should therefore have applied the transactional net margin method (ie, costs plus a percentage markup); and
- the Luxembourg tax authorities agreed erroneously via a Luxembourg tax letter on applying inappropriate methods of transfer pricing, including the comparable uncontrolled price method and the residual profits split method.

As a result of these alleged positions, the EC argued that Luxembourg conferred on the Amazon Luxembourg entities an unfair selective tax advantage by excessively eroding the LuxOpCo's tax base and thereby shifting too much profit to the tax-transparent LuxSCS in violation of the arm's-length standard.

The EC also relied heavily on applying the 2017 OECD Transfer Pricing Guidelines, even though the tax years in question were related to years prior to the issuance of those guidelines.

Despite all the EC's arguments, the General Court ruled that the EC had simply not provided a convincing case – based on its challenges of transfer pricing methods – that Luxembourg awarded a selective tax advantage to the Amazon Luxembourg entities.

The Amazon case highlights the ever-increasing importance of applying OECD transfer pricing methodologies correctly to all related-party transactions.

These days, use of such a transparent Luxembourg limited partnership may result in adverse tax consequences owing to, among other things, the recent anti-abuse measures found in ATAD I and Council Directive (EU) 2017/952 of 29 May 2017 (ATAD II). Particularly relevant is ATAD II's reverse hybrid rule, which can trigger Luxembourg corporate income tax at the level of the otherwise transparent LuxSCS, given its hybrid nature (the LuxSCS was tax-transparent for Luxembourg tax purposes but tax-opaque from a US tax point of view, the jurisdiction of its shareholder in Amazon) (see General Court, Case Nos. T-816/17 and T-318/18).

Law stated - 06 April 2022

Jurisdictions

	Canada	McCarthy Tétrault LLP
	Germany	Linklaters LLP
	Ireland	Matheson
	Israel	Herzog Fox & Neeman
	Italy	Chiomenti Studio Legale
	Japan	TMI Associates
	Luxembourg	Maples Group
	Netherlands	Taxand
	Switzerland	Bär & Karrer
	Taiwan	Lee and Li Attorneys at Law
	United Kingdom	Joseph Hage Aaronson LLP
	USA	Morgan, Lewis & Bockius LLP