

# LUXEMBOURG

## LEGISLATION

### Existence of Transfer Pricing Laws/Guidelines

The Luxembourg law on transfer pricing is concisely expressed in article 56 of the Luxembourg Income Tax Code (Loi concernant l'impôt sur le revenu (LIR)) which states:

“Without regard to the result reported ...(a civil servant of a sufficient rank) ... may estimate the financial result, when the transfer of profits is rendered possible by the fact that the entrepreneur has a special economic relationship, be it direct or indirect, with a physical or corporate person who is not a taxable resident.”

This article has almost no limitation in its potential application.

The application of this article is not limited to transactions with foreign enterprises but applies as well to transactions with Luxembourg 1929 holding companies (a type of holding corporation which does not pay any income tax – 1929 holding companies will cease to exist from 1 January 2011).

In case the arm's length principle is not met, profits will be adjusted, unless proof can be delivered that the transaction was based on sound business reasons, for example to protect a market position.

### Hidden distribution

Article 164 (3) LIR states:

“Hidden distributions of profits have to be included in the taxable basis. There is a hidden distribution of profits when a shareholder or an interested person receives directly or indirectly advantages which he normally would not have received if this relationship had not existed.”

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

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

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

### Hidden contribution

A hidden contribution is deemed to take place if a parent company grants an advantage to a subsidiary because of their group relationship. Such hidden contribution causes a capital contribution of 0.5% (as from 1 January 2008, before 1%) to become due.

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

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

Interest-free loans from a parent to its subsidiary are in certain circumstances possible without triggering a correction by the Luxembourg tax authorities.

<p><b>Transfer Pricing Scrutiny</b></p>	<p>Given Luxembourg’s low corporate income tax rates, taxpayers generally have no interest in transferring profits abroad from Luxembourg. Transfer pricing investigations for manufacturers are therefore rather rare.</p> <p>However, since Luxembourg is a financial centre, the Luxembourg tax authorities are quite experienced in assessing financial transactions. Tax inspectors pay particular attention to the interest rates applied in intra-group loans. They can look up the relevant market interest rates for loans of a certain period taking into consideration the currency, the amount of the principal, the credit and currency risk, the duration, the lender’s equity and the guarantees. The Luxembourg tax authorities expect that intra-group loans are at market rate, and that such loans, if financed by borrowings, generate a profit margin commensurate to the additional risk assumed and the value added. The arm’s length margin generally varies from 0.25% to 0.30% and can be as high as 0.50%. Advance confirmation from the tax authorities of the applicable interest rates may be worth considering.</p> <p>The Luxembourg tax authorities also pay attention to intra-group services and prefer a mark-up based on a cost-plus method in order to determine the price for such services.</p>
<p><b>Definition of Related Party</b></p>	<p>The only requirement is for “a special economic relationship” which is a very broad notion. There is no need for the parties to be directly or indirectly linked by way of ownership. In practice, there is always a control factor in the relationship between the parties.</p>
<p><b>Transfer Pricing Penalties</b></p>	<p>When transactions are determined to be hidden profit distributions, withholding tax on these distributions may apply. Where withholding tax on the hidden distribution should have been declared and paid, but was not, the tax authorities may assess against the paying company a penalty for late filing or non-filing, amounting up to 10% of the withholding tax payable.</p> <p>However, in practice this is seldom the case, as the Luxembourg exemption from or reduction of withholding tax generally applies (through application of the parent subsidiary directive within the EU or of a double tax treaty).</p>
<p><b>Advance Pricing Agreement (APA)</b></p>	<p>Luxembourg legislation does not provide a specific legal basis for a general ruling system. However, in practice, taxpayers can enter into an APA with the Luxembourg tax authorities. The Luxembourg tax authorities respect APAs provided the information presented by the taxpayer is consistent with the terms negotiated in the APA. APAs are however not binding before the Luxembourg courts.</p>
<p><b>DOCUMENTATION AND DISCLOSURE REQUIREMENTS</b></p>	
<p><b>Tax Return Disclosures</b></p>	<p>There are no formal disclosure requirements regarding transfer pricing.</p>
<p><b>Level of Documentation</b></p>	<p>Luxembourg tax legislation does not provide for specific documentation requirements or other obligations in relation to transfer pricing.</p> <p>Taxpayers are, however, advised to maintain records of their transfer pricing policy to prove the adequacy of the fixed prices in anticipation to a possible challenge by the tax authorities.</p> <p>Case law has confirmed that the taxpayer has the burden of proof in cases of hidden distributions; the same may apply by inference to hidden contributions. Examples of the types of information that may be requested by the authorities in the event of a transfer pricing investigation include records of related party transactions, documentation about methods and market prices used to determine an intra-group price, and an organisational structure.</p>

	In case of international transfer pricing abuses, the Luxembourg tax authorities are less demanding as compared to other tax authorities. As a result, the documentation required for foreign tax audits should in most cases suffice for Luxembourg transfer pricing purposes.
<b>Record keeping</b>	Luxembourg income tax legislation does not include any specific rules relative to keeping transfer pricing records or documentation, so the general income tax rules relative to keeping records and documentation apply. Accordingly, all documentation useful to determine the taxable profit should in principle be kept during ten years as from 1 January following the yearend date of the accounting year.
<b>Language for documentation</b>	The Luxembourg tax authorities accept any transfer pricing documentation drafted in an in the Grand Duchy of Luxembourg commonly understood language (e.g. French, German, English).
<b>Small and medium sized enterprises (SMEs)</b>	There are no special transfer pricing rules for small and medium sized enterprises deviating from the general regime of transfer pricing.
<b>Deadline to Prepare Documentation</b>	There is no requirement that transfer pricing documentation be prepared by a certain deadline. It is not a prerequisite that transfer pricing documentation has been prepared before the corporate income tax return is filed, although this can be advisable.
<b>Deadline to Submit Documentation</b>	The deadline for submitting transfer pricing information to the Luxembourg tax authorities is determined on a case by case basis.

### STATUTE OF LIMITATIONS

The general statute of limitations is five or ten years depending upon the case. It can even be extended to fifteen years in certain cases of tax evasion.

### TRANSFER PRICING METHODS

In determining the arm's length price, the Luxembourg tax authorities make reference to the OECD Transfer Pricing guidelines and the methods mentioned there: the CUP method, the resale price method, the cost plus method, the profit split method and the transactional net margin method.

### COMPARABLES

The Luxembourg tax authorities have, based on their long-standing experience, an in depth knowledge of financial transactions and the applicable market rates in this area.

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