

Luxembourg Tax Alert

New tax measures to support Luxembourg as a prime financial center – New Group Finance Circular

28 December 2016

The 2017 budget law has been published on 27 December 2016 in the official gazette. As mentioned in [our previous alert](#), this law includes a new set of rules for the transfer pricing practice in the form of the new article 56bis of the Luxembourg Income Tax Law ("LITL"). The new article 56bis LITL is complemented by a new [Circular n°56/1-56bis/1](#)¹ ("Circular") published on 27 December 2016 by the Luxembourg tax authorities, including new guidance and clarification on transfer pricing regulations inspired by the OECD Transfer Pricing Guidelines for Luxembourg entities engaged in intra-group financing activities.

These new tax measures intend to ensure the sustainability of the group financing structures from a direct tax standpoint in order to continue to build a strong and long-lasting Luxembourg financial center.

Key elements of the Circular are highlighted hereafter:

1. No minimum requirements relating to equity at risk

Based on the Circular, the previously required minimum amount of equity (1% of the nominal amount of the loan[s] granted, or 2 million €) is no longer mandatory. Therefore, it is necessary to evaluate the transaction on the basis of facts and circumstances specific to each individual case.

When the comparability analysis shows that the profile of a group financing company is comparable to the one of entities subject to the EU regulation on prudential requirements for credit institutions and investment firms, the company has sufficient equity for transfer pricing purposes if its equity complies with the solvency requirements detailed in these regulations. Otherwise, when the functional profile deviates from the one of a credit institution, the level of equity may be assessed based on usually applied credit analysis methods.

2. No minimum margin

The Circular does not require a minimum margin, therefore for the purpose of its determination the conditions between "controlled transaction" and "transaction between third parties" should be comparable. It is necessary to identify comparable transactions. For this, the processes should be transparent and systematic.

If a taxpayer who is engaged in group financing activities as a financial intermediary does not intend to prepare a transfer pricing document (e.g., limited group financing activities), it may choose in its annual tax return to benchmark its remuneration based on return on asset (RoA)².

3. Organizational Substance requirements

Similar to the previous circulars, a company engaged in group financing transactions must have certain operational substance in Luxembourg to sustain that the strategic or key decisions have been effectively taken in Luxembourg, e.g., the majority of board members being Luxembourg residents.

4. Entry into force and validity of existing advance pricing agreement

The above described measures will be applicable to all intra-group financing activities as of 1 January 2017.

Any advance pricing agreement (APA) issued before the new article 56bis LITL and based on the previous rules will no longer be binding for the Luxembourg tax authorities as of 1 January 2017, for any tax year subsequent to 2016.

Taxpayers can continue to request new APAs going forward based on the updated requirement of the new Circular.

We welcome these new measures, which demonstrate the willingness of the government to support the development of Luxembourg as a prime financial center in the long term.

We can assist you in reviewing your current group financing arrangements as to comply with the above mentioned new measures.

¹ From 1 January 2017, replacing the existing circulars n°164/2 dated 28 January 2011 and n°164/2bis dated 8 April 2011

² 2% after tax if no specific benchmark is prepared by the taxpayer

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