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Luxembourg Tax Alert.

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Draft law submitted to the Luxembourg parliament on Transfer Pricing

As part of the 2015 budget's tax package, the Luxembourg government submitted a few days ago a draft law (n°6722) to the parliament including clarifications and amendments of the current transfer pricing provisions of the Luxembourg Income Tax Law (LITL) as a matter of constant improvement of the Luxembourg transfer pricing framework.

These amendments are motivated by an alignment of the current provisions of the law on international standards like the OECD and are inspired by transfer pricing legislations of other European countries, as the one applicable in the Netherlands.

Arm's length principle

The current provisions of the law allow an upward adjustment of the taxable base based on the arm's length principle under the concept of hidden dividend distribution as laid down in article 164 section 3 LITL. A special case under article 56 LITL allows also an upward adjustment for special relations with an entity located abroad. This specific rule limits the upward adjustment to cross border transactions and has a broader scope than the arm's length principle to be applied in an intra-group context.

The draft law introduces a new article 56 to replace the old one giving a separate legal ground for transfer pricing adjustments based on the OECD standards while keeping article 164 section 3 LITL under its current form to cover the recast of transactions on the basis of hidden dividend distributions.

Documentation

Luxembourg did not have so far specific documentation requirement for transfer

pricing purposes. Documentation in matter of transfer pricing could be requested in case the taxpayer:

- (i) was required to provide more detailed information as part of the review process of its annual tax return;

or

- (ii) as from 2011, was seeking an upfront direct tax agreement with the tax authorities on remuneration to be left on its intra-group financing activities.

To avoid any doubt that transfer pricing documentation may be requested from the taxpayer, a specific reference was inserted into the existing general legislation.

Highlights of the new draft law

- The draft article 56 LITL includes definition of “Associated Enterprise” that is based on article 9 of the OECD Model Convention with Respect to Taxes on Income and on Capital and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax administrations according to which *any direct or indirect participation in the management, control or capital could lead to classification as an associated enterprise;*
- The draft article 56 allows an adjustment of the direct tax base in case the conditions made or imposed between two related enterprises differ from those which would have been made between independent enterprises in similar circumstances;
- The draft law adds a new section (3) to Art. 171 of the procedural part of the tax law stipulating that, upon request, the taxpayer should be able to provide an evidence sustaining that its related party transactions comply with the transfer pricing requirements. The legislator confirms the shift of the burden of proof in particular when doubts can be raised on whether related party transactions allow shift of profits to another party. No details were provided by the law on the nature, scope and timing of such documentation but the lawmaker already made clear in its comments that such burden has to be proportionate to the abilities of the taxpayer.

Next steps

We believe that the above mentioned amendments are a first but major step to improve the Luxembourg framework in the matters of transfer pricing and as such paves the way for more guidance to be issued by the Luxembourg tax authorities on specific matters. Further developments could in particular arise in matters of documentation from the revision of chapter 5 of the OECD Guidelines on documentation (action 13 of the current Base Erosion and Profit Shifting (BEPS) initiative led by the OECD).

The Luxembourg parliament should now review, discuss and, if necessary, modify this draft law before it can be approved for an entry into force projected for the 1st of January 2015.

We will keep you updated on future developments in connection with this matter. Should you have any query in this respect, please feel free to contact us.

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