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Luxembourg
Transfer Pricing

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This country-specific Q&A provides an overview of transfer pricing laws and regulations applicable in Luxembourg.

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Luxembourg: Transfer Pricing

1. What is the legal framework (legislation, regulations or administrative guidance) governing transfer pricing in your jurisdiction?

Luxembourg tax law does not provide for integrated transfer pricing legislation. Instead, transfer pricing adjustments aimed at restoring arm's length conditions can be made on the basis of various applicable tax provisions and concepts under Luxembourg tax law.

However, the arm's length principle is firmly embedded in Luxembourg's tax law, and its transfer pricing legal framework encompasses several provisions, a transfer pricing circular and various other provisions referring to fair market value.

Furthermore, when applying the arm's length principle, the Luxembourg tax authorities generally rely on the OECD Transfer Pricing Guidelines.

The most important tax provisions and concepts are outlined below:

Article 56 of the LITL

Article 56 of the LITL formalises the application of the arm's length principle under Luxembourg tax law. It provides a legal basis for transfer pricing adjustments (both upward and downward) when associated enterprises deviate from the arm's length principle.

The scope of Article 56 of the LITL is limited to transactions between associated enterprises and does not apply to transactions between individual shareholders and a Luxembourg company. Moreover, Article 56 of the LITL applies to cross-border transactions and transactions between Luxembourg companies alike. In a tax treaty context, tax adjustments made under Article 56 of the LITL are generally permitted under a provision that replicates Article 9 (1) of the OECD Model Tax Convention.

Article 56bis of the LITL

As an OECD member, Luxembourg adheres to the OECD Transfer Pricing Guidelines, which reflect the OECD member countries' consensus on applying the arm's length principle, as set out in Article 9 (1) of the OECD Model Tax Convention.

Article 56bis of the LITL begins with the definition of several terms relevant in a transfer pricing context, such as "controlled transaction", "comparable uncontrolled transaction" and "arm's length price". These definitions are very similar to those in the OECD Transfer Pricing Guidelines glossary.

Paragraph 2 of Article 56bis of the LITL clarifies that the arm's length principle must be adhered to whenever a Luxembourg company enters into a controlled transaction with an affiliate. Conceptually, the arm's length principle requires the calculation of taxable income that would be expected if the parties were dealing with one another at arm's length. This is achieved by contrasting the choices made and the outcomes achieved by the taxpayer with the results that would have been achieved by market forces. In effect, it uses open market results or the behaviour of independent parties dealing with each other at arm's length as a benchmark. Article 56bis of the LITL explicitly addresses transactions that cannot be observed between independent enterprises. It states that the absence of observable transactions between independent enterprises does not mean that transactions do not adhere to the arm's length standard. This provision is important because related parties may enter into transactions that independent enterprises do not undertake in practice.

Paragraphs 3–5 of Article 56bis of the LITL introduce the concept of comparability analysis, replicating some of the guidance provided in paragraphs 1.33–1.36 of the OECD Transfer Pricing Guidelines. A comparability analysis is essential for applying the arm's length principle and is fundamental to transfer pricing. Chapter III of the OECD Guidelines provides detailed guidance on comparability analyses and how to conduct them.

The application of the arm's length principle generally involves comparing the prices or margins used or obtained by non-arm's length parties with those used or obtained by arm's length parties engaged in similar transactions. The purpose of the comparability analysis is to identify the most reliable comparables. For a comparison of prices or margins to be useful, the economically relevant characteristics of the transactions being compared must be sufficiently similar to permit reasonably accurate adjustments to be made for any differences in these characteristics.

Article 56bis of the LITL sets out five factors that may be relevant when establishing comparability, including:

- the terms and conditions of the contract;
- the functions performed by the parties to the transaction, taking into account the assets used and the risks assumed.
- the characteristics of the property or services;
- the economic circumstances;
- the business strategy.

For controlled and uncontrolled transactions to be considered comparable, it must be possible to confirm either:

(i) that there are no differences between the transactions which would materially affect the price in the open market; or, if there are material differences,

(ii) that reliable adjustments can be made to eliminate the material effects of any differences.

A comparability analysis is, by its nature, twofold, as it includes an examination of the factors affecting both the taxpayer's controlled and uncontrolled transactions.

Multinational enterprises ("MNEs") may apply several internationally accepted methodologies to determine arm's length prices. The OECD Guidelines distinguish five major transfer pricing methods that provide the conceptual framework for determining arm's length prices. These methods are divided into two groups: the traditional transaction methods, including the comparable uncontrolled price ("CUP") method, the cost-plus method, and the resale price method; and the transactional profit methods, including the transactional net margin method ("TNMM") and the profit split method.

Regarding the selection of a transfer pricing method, Article 56bis of the LITL explicitly states that the most appropriate method should be used. To this end, the selection process should consider the respective strengths and weaknesses of the methods recognised by the OECD.

Traditional transaction methods are considered the most straightforward way of determining whether the conditions of controlled transactions align with the arm's length principle. Therefore, when applicable, a traditional transaction method would take precedence over a transactional profit method. Furthermore, if the CUP method and another transfer pricing method can both be applied equally reliably, the CUP method is to be preferred.

Article 56bis of the LITL includes language regarding circumstances in which a taxpayer's transaction structure may be disregarded due to a lack of valid commercial rationale, such that a third party would not have entered into the transaction. However, non-recognition of a transaction should only occur in exceptional circumstances. This aligns with the updated guidance set out in the OECD Transfer Pricing Guidelines.

The concepts of hidden dividend distribution and hidden capital contribution

Hidden dividend distributions (Article 164 (3) of the LITL) and hidden capital contributions (Article 18 (1) of the LITL) also play an important role in ensuring that Luxembourg companies adhere to the arm's length principle.

• Hidden dividend distributions

Luxembourg tax law does not provide for an exhaustive definition of hidden dividend distributions. The term hidden dividend distribution is only mentioned in Article 164 (3) of the LITL which provides that hidden dividend distributions arise when a shareholder receives directly or indirectly advantages from a company that a third party would not have received. In addition, the said article states that such profit distributions must be included in the company's taxable income.

According to the relevant case law, hidden dividend distributions within the meaning of Article 164 (3) of the LITL bear the following characteristics:

- a decrease (or adverted increase) of a company's net equity
- that is motivated by the shareholding relationship
- that impacts the company's taxable income (i.e. either in the form of expenses or abandoned income) and
- that does not constitute a regular dividend distribution (under Luxembourg commercial law).

Therefore, advantages granted to a shareholder may be classified as hidden dividend distributions. This concept applies to advantages transferred by a company to corporate and individual shareholders, and is not limited to cross-border cases.

For Luxembourg tax purposes, hidden dividend distributions require tax adjustments at company and shareholder level. These tax adjustments need to be analysed on a case-by-case basis. Generally, however, the company's taxable income should be increased by the fair market value of the advantage transferred to its shareholders.

This advantage is also classified as income under Article 97 (1) No. 1 of the LITL, which is generally subject to Luxembourg withholding tax at a standard rate of 15%. Under certain conditions, corporate shareholders may benefit from a withholding tax exemption under domestic tax law. In a cross-border context, tax treaties concluded by Luxembourg may provide for a reduced or zero withholding tax rate. At the level of a Luxembourg shareholder, hidden dividend distributions are treated as regular dividend distributions. This deemed income may be eligible for full or partial tax exemption under domestic tax law.

- **Hidden capital contributions**

Broadly, hidden capital contributions refer to advantages shifted by a shareholder to a company. Although not defined in Luxembourg tax law, hidden capital contributions bear the following characteristics, according to the relevant case law:

- a shareholder or a related party of the shareholder
- grants, motivated by the shareholding relationship,
- an advantage to a company that may be reflected in the balance sheet, i.e. either an increase in assets or a decrease in liabilities (insofar as the shareholder does not receive an arm's length compensation), and
- the contribution is not a regular contribution (pursuant to Luxembourg commercial law).

In principle, contributions increase the net equity in the receiving company's balance sheet. The object of a hidden capital contribution should therefore directly relate to balance sheet items, namely an increase in assets or a decrease in liabilities. In contrast, any advantage (including free services) transferred by the company to its shareholder(s) should be classified as a hidden dividend distribution.

Consequently, the scope of hidden capital contributions and that of hidden dividend distributions do not mirror each other, although both concepts share the same objective, namely the separation of the realm of the company from that of its shareholders.

Hidden capital contributions may require complex tax adjustments at company and shareholder level, and must be analysed on a case-by-case basis. In general, income realised by the company in relation to the hidden capital contribution should be excluded from its taxable income. At shareholder level, the book value of participation in the receiving company should be increased by the fair market value of the contribution, and deemed income corresponding to the amount of the hidden capital contribution should be considered when determining taxable income.

- **Hierarchy of norms**

Article 56 of the LITL and the concepts of hidden dividend distribution and hidden capital contribution operate independently of one another and may apply concurrently. However, in case of an overlap, the concepts of hidden dividend distribution and hidden capital contribution should take precedence over Article 56 of the LITL.

This is because the only tax consequence of Article 56 is an adjustment to the company's taxable income (to ensure arm's length conditions are met), whereas hidden dividend distributions and hidden capital contributions may require additional tax adjustments at company and shareholder level.

Therefore, the scope of Article 56 of the LITL should be limited to cases where the advantages transferred between related companies cannot be categorised as hidden dividend distributions or hidden capital contributions. For example, Article 56 of the LITL may serve as a basis for downward adjustments in accordance with the arm's length principle when a Luxembourg company receives an interest-free loan or free services from an associated company.

Transfer Pricing Circular on financing activities

Circular 164/2 (the 'Circular'), dated 27 December 2016, provides guidance from the Luxembourg tax authorities on applying the arm's length principle to intra-group financing activities. The Circular sets out the transfer pricing regime applicable to Luxembourg finance companies from 1 January 2017. Under this regime, finance companies must have a physical presence in Luxembourg, determine the equity at risk on a case-by-case basis and report arm's length remuneration for their financing activities in accordance with the OECD Transfer Pricing Guidelines.

The Circular covers entities engaged in intra-group financing transactions. The term 'intra-group financing transaction' is interpreted broadly to include any activity involving the granting of loans (or advance of funds) to associated enterprises, whether financed by internal or external debt (e.g. intra-group financing, bank loans or public issuances). The Circular applies to both cross-border and domestic transactions.

It provides fundamental guidance on applying the arm's length principle. It follows the international trend towards more comprehensive transfer pricing documentation.

Other provisions under Luxembourg tax law

Several other provisions of Luxembourg tax law require the fair market value to be recognised. For instance, Article 22 (5) of the LITL provides that, in the event of an asset exchange, the fair market value of the transferred asset must be taken into account.

Furthermore, Article 169 of the LITL relates to the liquidation of Luxembourg companies and stipulates that assets and liabilities must be recognised at their fair market value.

Together with Articles 56 and 56bis of the LITL and the concepts of hidden dividend distribution and hidden capital contribution, these provisions form a legal framework that ensures related-party transactions adhere to the arm's length standard.

2. To what extent are the OECD Transfer Pricing Guidelines incorporated into or relied upon in your jurisdiction?

As an OECD Member State, Luxembourg's tax authorities generally align with the OECD Transfer Pricing Guidelines.

Article 56bis of the LITL explicitly emphasises the importance of these guidelines within the framework of Luxembourg tax law.

3. How are "related parties" and "control" defined in your jurisdiction, and how do these concepts affect the application of the arm's length principle and the scope of the transfer pricing rules?

Article 56 (1) of the LITL defines "associated enterprises" as follows: "(a) an undertaking is directly or indirectly involved in the management, control or capital of another undertaking, or (b) the same persons are directly or indirectly involved in the management, control or capital of two undertakings."

However, this provision does not define a relevant shareholding threshold for determining 'control'. As a general rule, a shareholding percentage of 50% is generally considered the threshold for control.

Alternatively, control may be indicated by voting rights of 50%, direct or indirect capital ownership of 50%, or profit entitlement of at least 50%.

Even below the 50% threshold, it is necessary to analyse whether an intra-group transaction is driven by market forces or could be influenced by the shareholding relationship between the entities involved. In cases where shareholding percentages are between 25% and 50%, a careful analysis is warranted to determine whether the transaction is at arm's length or should be subject to the arm's length principle.

4. Do transfer pricing rules apply to both cross-border and domestic transactions?

The arm's length principle applies to both cross-border and domestic transactions. While Article 9 of the OECD Model Tax Convention focuses on cross-border situations, Luxembourg tax law does not distinguish between domestic and cross-border transactions for transfer pricing purposes.

5. Are there any exemptions or exclusions from the transfer pricing rules in your jurisdiction (for example, for small and medium sized enterprises, specific transaction types, or materiality thresholds)?

Luxembourg tax law does not provide any exemptions or exclusions from the arm's length principle, such as a safe harbour rule.

However, as transfer pricing documentation is, to some extent, a risk management tool, it is reasonable that significant transactions require more effort in terms of documentation than insignificant ones.

While significant transactions should be priced at arm's length and documented in comprehensive transfer pricing reports, truly insignificant transactions may be based on reasonable assumptions. For small transactions, it may be possible to conduct a transfer pricing analysis focusing on the economic analysis. This is a matter of practical proportionality, not a legal exclusion.

6. Are there any notable deviations from OECD principles in local law or practice?

While the Luxembourg tax authorities generally rely on and accept transfer pricing documentation that is based on the OECD Transfer Pricing Guidelines, in some instances, the transfer pricing requirements in Luxembourg are more flexible.

For instance, whereas Chapter V of the OECD Transfer Pricing Guidelines stipulates the use of Masterfile and Local File formats for transfer pricing documentation, Luxembourg allows taxpayers to prepare separate transfer pricing reports for individual intra-group transactions. However, taxpayers may choose to use the Masterfile/Local File format.

7. What transfer pricing methods are recognised under local law?

For Luxembourg tax purposes, the five transfer pricing methods set out in the OECD Transfer Pricing Guidelines can generally be relied upon: the comparable uncontrolled price method, the cost-plus method, the resale price method, the transactional net margin method and the profit split method.

However, in specific cases, other economic methodologies may be applied if they can be demonstrated to be more appropriate than the five standard methods.

8. Is there a prescribed hierarchy or priority among the transfer pricing methods?

Article 56bis (6) of the LITL requires the taxpayer to select the most appropriate transfer pricing method—i.e., the method that provides the best possible approximation of an arm's length price.

The OECD Transfer Pricing Guidelines consider traditional transaction methods the most straightforward way of determining whether the conditions of controlled transactions align with the arm's length principle.

Therefore, when applicable, a traditional transaction method takes precedence over a transactional profit method. Furthermore, if both the CUP method and another transfer pricing method can be applied equally reliably, the CUP method is to be preferred. If none of these methods can be applied, other economic methodologies can be used to determine an arm's length price.

9. How are arm's length ranges determined in your jurisdiction, and do domestic tax rules, guidelines, or case law prescribe specific statistical methodologies or calculation approaches for interquartile ranges?

Neither Luxembourg tax law nor case law provides a specific methodology for determining an arm's length range.

However, it is common practice to determine an interquartile range by eliminating the upper and lower quartiles to exclude extreme values.

Unless there is a reason to deviate from the median value, the median is generally relied upon by the Luxembourg tax authorities.

10. To what extent are comparability adjustments permitted in your jurisdiction, and which types of adjustments are most commonly applied or rejected by tax authorities?

Comparability adjustments are appropriate when there are material differences between controlled and uncontrolled transactions and it is possible to make reliable adjustments to eliminate the material effects of these differences.

The Luxembourg tax authorities generally accept these adjustments when properly documented and justified.

11. What rules apply to year end transfer pricing adjustments in your jurisdiction, particularly in relation to statutory accounting requirements and their recognition for tax purposes?

Transfer pricing adjustments are typically made in the corporate tax return of the relevant Luxembourg company, rather than through separate statutory accounting entries or dedicated adjustment forms.

12. Are secondary adjustments applied/included in the legislation in your jurisdiction?

Secondary adjustments are not expressly provided for in Luxembourg tax law. However, secondary adjustments may arise indirectly when another jurisdiction performs a primary adjustment that is challenged by a Luxembourg company—for example, through a mutual agreement procedure—and the discussions between the Luxembourg and foreign tax authorities concerned conclude that the primary adjustment was justified.

13. What statutory provisions, regulations, or administrative guidance govern the transfer pricing treatment of transactions involving intangibles in your jurisdiction, including any specific references to OECD Transfer Pricing Guidelines Chapter VI?

Luxembourg tax law does not provide specific transfer pricing guidance regarding intangibles. However, the Luxembourg tax authorities generally rely on the guidance provided in the OECD Transfer Pricing Guidelines.

14. How does your jurisdiction apply the DEMPE concept (Development, Enhancement, Maintenance, Protection, and Exploitation) when determining entitlement to intangible related returns?

Although intangible-related transactions are less common in Luxembourg today, the Luxembourg tax authorities generally rely on the guidance provided in the OECD Transfer Pricing Guidelines.

In practice, the Luxembourg tax authorities are likely to be more flexible than other tax authorities with regard to the DEMPE concept, which has faced criticism for raising issues of legal certainty and can lead to double taxation by replacing actual transactions with theoretical discussions.

15. What legal or administrative criteria determine which entity is entitled to intangible related returns (e.g., entities controlling economically significant DEMPE related risks)?

The starting point is typically legal ownership of intangibles. However, a DEMPE analysis is also required to determine the appropriate return. In a cross border context, consideration should also be given to how foreign tax authorities interpret the DEMPE concept.

16. Does local law or administrative guidance provide specific rules for hard to value intangibles, including whether ex post outcomes may be used as presumptive evidence for testing ex ante assumptions?

Neither Luxembourg tax law nor guidance sets out specific rules for hard-to-value intangibles. In such cases, Luxembourg companies should refer to the guidance set out in the OECD Transfer Pricing Guidelines.

17. Does local law or administrative guidance expressly recognise cost sharing or cost contribution arrangements for the development or use of intangibles, and what requirements must such arrangements meet under applicable rules?

Neither Luxembourg tax law nor guidance provides any specific rules regarding cost-sharing or cost-contribution arrangements. Instead, Luxembourg companies should rely on the guidance provided in Chapter VIII of the OECD Transfer Pricing Guidelines. In practice, however, such arrangements are not common.

18. What transfer pricing information may be exchanged cross border, and subject to what legal conditions or limitations?

The Luxembourg tax authorities should engage in the automatic exchange of information when a Luxembourg company relies on a simplification measure set out in the Luxembourg transfer pricing circular concerning the tax treatment of financing activities.

If this measure is applied, the Luxembourg company can use a net margin of 2% (after tax) without needing to prepare a transfer pricing study, and it will be considered a financial intermediary that does not bear any risks relating to its on-lending activity.

As the finance margins of Luxembourg finance companies that bear all the credit risk are generally much lower than this 2%, it can be assumed that this measure has seldom, if ever, been applied (Luxembourg companies have a strong incentive to prepare a transfer pricing study to determine an arm's length finance margin).

In other circumstances, the Luxembourg tax authorities do not engage in automatic exchange of information. However, information may still be exchanged upon request under tax treaties or the Directive on Administrative Cooperation (DAC).

19. To what extent may exchanged information be relied upon in transfer pricing assessments or litigation?

If the Luxembourg tax authorities receive information (for example, from transfer pricing audits) involving Luxembourg companies, they may initiate an investigation. Exchanged information may serve as a basis for initiating or supporting a transfer pricing audit.

However, the Luxembourg tax authorities cannot rely solely on exchanged information to make an adjustment; they must conduct their own assessment and give the taxpayer an opportunity to respond. As in other cases, the burden of proof ultimately rests with the taxpayer to substantiate their transfer pricing position.

20. What statutory or regulatory transfer pricing documentation requirements apply in your jurisdiction (including any master file, local file, or country by country reporting obligations)?

Luxembourg companies are not required to structure their transfer pricing documentation in the Master File/Local File format. Instead, they are free to prepare separate documentation for different controlled transactions.

However, under the Law of 23 December 2016, Luxembourg implemented EU Directive 2016/881 of 25 May 2016 into its tax legislation. This extended administrative cooperation in tax matters to include country-by-country reporting.

The law requires MNE groups with a consolidated turnover exceeding €750 million to prepare a CbCR. Luxembourg entities that are members of an MNE group must notify the Luxembourg tax authorities of the identity and tax residence of the reporting entity (whether this is the Luxembourg entity itself or another group entity) by the last day of the MNE group's reporting fiscal year.

21. Who is required to prepare transfer pricing documentation, and what thresholds or conditions trigger the obligation?

All intra-group transactions must, in principle, adhere to the arm's length principle. The practical question for Luxembourg companies is whether the investment in documentation is justified by the transactions, and if so, what constitutes appropriate documentation.

However, there are no thresholds or conditions that would trigger or exempt companies from transfer pricing documentation requirements. Instead, transfer pricing requires taxpayers to balance the level of certainty desired against the cost of preparing documentation.

To this end, companies should review their intra-group transactions to identify issues that might raise questions among the tax authorities and assess the level of tax risk involved. Taxpayers can then conduct a cost-benefit analysis, weighing the cost of transfer pricing documentation against the potential tax risks (i.e. transfer pricing adjustments). This decision requires careful judgement on a case-by-case basis and the reasoning behind it should be documented where possible.

22. What are the timing requirements for preparing and submitting transfer pricing documentation, and must documentation be contemporaneous?

Luxembourg tax law does not specify when transfer pricing documentation should be prepared. However, taxpayers should consider whether their transfer prices are appropriate for tax purposes before setting them, rather than years later when questions arise.

This does not mean that every transaction, regardless of size or risk, requires a full transfer pricing study at inception. Whether to prepare formal documentation should be guided by a cost-benefit analysis – taking into account the materiality of the transaction and the level of tax risk involved. The critical point is that the thought process, underlying assumptions, and supporting data should be in place when the pricing decision is made.

The Risks of Delaying Transfer Pricing Documentation

The Luxembourg tax authorities may review transfer pricing several years after a transaction has taken place. From a practical standpoint, this presents significant challenges for taxpayers who did not produce transfer pricing documentation for the following reasons:

- Fading evidence: The individuals who negotiated and implemented the transaction may no longer be available.
- Lost context: The commercial rationale, market conditions, and strategic considerations that informed the pricing become harder to reconstruct.
- Shifting benchmarks: Data from comparable transactions in the same year may no longer be readily accessible, which makes retrospective benchmarking difficult or unreliable.

These difficulties are not merely administrative; they directly affect the taxpayer's ability to defend their transfer pricing position. Contemporaneous documentation captures the facts and circumstances as they existed at the time, preserving evidence that would otherwise degrade over time.

The frequency of updates depends on the nature of the underlying controlled transaction. For instance, the interest rate on an interest-bearing debt instrument is typically set when the loan is granted, and it typically does not require amendment before maturity unless specific clauses are included in the loan agreement. In contrast, an arm's length finance margin is expected to be updated every three years, unless the activity changes materially, in which case the transfer pricing analysis must be updated earlier.

The Problem with Post-Hoc Documentation

Experience shows that transfer pricing documentation prepared in response to a challenge is significantly less valuable and far more vulnerable to attack. Tax authorities may view such documentation with suspicion. If a taxpayer produces a transfer pricing analysis years after the event that conveniently confirms the original prices, the authorities may reasonably question whether the analysis was designed to reach a predetermined conclusion.

A study prepared without contemporaneous records may lack credibility, as it cannot reliably demonstrate what the taxpayer knew, considered, or intended when the pricing decision was made. To an auditor, it may appear less like evidence and more like ex post facto justification.

23. What penalties or sanctions apply for failure to prepare, maintain, or submit compliant transfer pricing documentation?

Luxembourg tax law does not impose specific penalties for failing to comply with transfer pricing documentation requirements.

That said, if a transfer pricing adjustment is successfully upheld, Luxembourg companies may be subject to general tax penalties and late payment interest. General penalties typically apply in cases of negligence, gross negligence, or fraud. Late payment interest is calculated based on the outstanding tax amount and the applicable statutory interest rate (i.e. 0.5% per month, 6% per year).

24. Are there specific transfer pricing reporting requirements in relation to the filing of the corporate tax return (e.g. specific forms on intra group transactions or special disclosures on compliance)?

Luxembourg tax law does not impose specific transfer pricing reporting requirements in connection with the filing of the corporate tax return.

However, the corporate tax return form includes two questions on transfer pricing. Taxpayers are required to answer the questions: "Does the company apply the simplification measure provided in the Transfer Pricing Circular?" and "Are you involved in intra-group transactions?" This indicates that the Luxembourg tax authorities consider transfer pricing a significant issue.

25. Are advance pricing agreements (APAs) available under the laws or administrative guidance of your jurisdiction, and what is their legal basis?

In accordance with Paragraph 29a of the Luxembourg General Tax Code, Luxembourg companies may file a request for advance certainty (i.e., advance pricing agreements (APAs)) with the Luxembourg tax authorities.

Such APAs may bind the Luxembourg tax authorities for a period of five years if the facts and circumstances remain unchanged. A filing fee of EUR 10,000 applies.

However, APAs are uncommon in practice. Properly drafted contemporaneous transfer pricing documentation generally provides strong protection against potential challenges from the Luxembourg tax authorities.

26. What types of APAs are permitted (unilateral, bilateral, and/or multilateral), and are there any statutory or treaty based limitations on their use?

Companies in Luxembourg may request unilateral advance pricing agreements (APAs) from the Luxembourg tax authorities. However, bilateral and multilateral APAs are extremely rare in practice, and there is limited experience with them in Luxembourg.

27. What are the safe harbour rules or simplified measures available for certain transactions or taxpayers, if any?

Luxembourg tax law does not provide for any safe harbour rules or simplified measures in relation to specific transactions or taxpayers.

28. How has the nature of transfer pricing audits evolved in your jurisdiction over the past two to three years—more targeted, or more expansive and data driven?

The Luxembourg tax authorities review transfer pricing as part of both routine corporate tax return reviews and formal multi-year tax audits. Experience shows that transfer pricing is systematically scrutinised whenever the tax position of a Luxembourg company is reviewed.

Transfer pricing audits are generally selected based on risk indicators, such as the nature and volume of intra-group transactions. The tax authorities may reassess corporate tax returns within the general five-year statute of limitations, or up to ten years in cases of non-disclosure.

Documentation prepared after a challenge or specifically for litigation carries far less evidentiary value. This approach prioritises ex ante compliance over ex post justification, with courts treating contemporaneous analysis as strong evidence of arm's length conduct.

If the tax authorities can demonstrate that the pricing does not adhere to the arm's length principle, the burden of proof shifts to the taxpayer. Without appropriate contemporaneous documentation, substantiating the arm's length nature of intra-group pricing can be extremely difficult, especially if documentation is prepared years after the transaction, when information and comparable data may be difficult to trace.

Overall, however, the Luxembourg tax authorities tend to be reasonable when it comes to transfer pricing audits and related challenges, particularly compared to their counterparts across Europe. Appropriate transfer pricing documentation and the proper implementation of transactions generally protect a Luxembourg company from such challenges.

29. How developed is domestic case law, and does it meaningfully shape practice, or are outcomes still driven primarily by tax authorities?

Luxembourg is a relatively small jurisdiction with limited case law. However, a number of tax cases have been brought before the Luxembourg courts in recent years, as fewer transactions are covered by tax rulings.

While there have been several decisions concerning transfer pricing, it would be an exaggeration to say that the case law meaningfully influences Luxembourg's transfer pricing practice.

30. What types of transactions or structures (e.g., IP migration, platform contributions, financing, residual profit allocations) have most frequently triggered transfer pricing adjustments or disputes with the tax authority?

As Luxembourg's economy is driven by finance and banking, as well as cross-border investments and financial transactions such as intra-group loans, debt instruments, financing activities and cash pooling, these areas are generally subject to close scrutiny. Intra-group services, such as fund management, also face close scrutiny, particularly with regard to value creation.

Cross-border investments, such as financing foreign companies or real estate, are the most complex. They often provoke challenges from the investment jurisdiction's tax authorities, where significant debt-funded investment may override a strict arm's length analysis, and where local revenue needs may take precedence. This creates a significant risk of double taxation and legal uncertainty.

However, when Luxembourg companies prepare appropriate transfer pricing documentation, the risk of being challenged by the Luxembourg tax authorities is relatively low.

31. Looking five years ahead, which development is likely to reshape transfer pricing practice most profoundly in your jurisdiction—digital business models, fiscal and political pressure on tax authorities, administrative capacity, or other structural changes?

Looking ahead five years feels more uncertain than ever. Geopolitical conflicts, unprecedented deficit spending, the rapid development of AI and a looming energy crisis due to the situation at the Strait of Hormuz are all coming together to reshape the global economic landscape.

The World Economic Forum ("WEF") has warned of multiple crises, and governments have reached record debt-to-GDP levels that are likely to rise further due to higher interest rates and additional spending projects.

In this volatile environment, transfer pricing practices will be profoundly affected by fiscal pressures and the digital transformation of business and tax administrations.

Fiscal pressures and deficit spending by EU member states

Firstly, the fiscal pressures currently facing EU member states are likely to result in more aggressive tax enforcement across the European Union. Following years of substantial deficit spending and higher government bond returns, tax authorities across Europe will be under increasing pressure to maximise revenue.

This will inevitably lead to more rigorous transfer pricing audits and disputes, particularly in countries that receive significant cross-border investment. Companies in Luxembourg with operations in these jurisdictions should expect heightened scrutiny of their transfer pricing positions.

In this context, Luxembourg's position remains relatively favourable. The Luxembourg tax authorities are likely to continue their pragmatic and reasonable approach to transfer pricing, particularly where companies have prepared robust contemporaneous documentation. However, Luxembourg companies must be prepared for increased challenges from foreign tax authorities.

The Digital Transformation and AI

The rapid development of AI will have a transformative impact on transfer pricing in two key respects.

Firstly, AI will reshape business models and reduce the need for routine staff functions. This will necessitate a re-evaluation of value creation and the allocation of functions, assets, and risks. These are central elements of any transfer pricing analysis.

Secondly, AI is set to transform transfer pricing documentation. Preparing comprehensive, data-driven transfer pricing reports will become significantly easier. This should make the process more affordable, thereby reducing the cost barrier to comprehensive transfer pricing analysis.

However, at the same time, tax authorities will increasingly use AI to analyse data, identify outliers and target audits more effectively. While the use of AI may reduce the need for extensive staff, it will not reduce the need for robust documentation and substance on the part of the taxpayer.

Ultimately, AI will most likely be used to review work prepared by AI, bringing the relationship between taxpayers and tax authorities to a whole new level, where the quality and credibility of AI-generated documentation will be tested by AI-powered audits and the reverse will also hold true.

Key take-away
Over the next few years, the way companies approach transfer pricing will be shaped by a combination of fiscal pressures, digitalisation and AI. Companies in Luxembourg that maintain robust, contemporaneous documentation and adapt to these trends will be best placed to overcome the challenges ahead. Those that fail to prepare may find themselves at a significant disadvantage.

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