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Transfer pricing

Financier Worldwide canvasses the opinions of leading professionals around the world on the latest trends in transfer pricing.





Luxembourg ■

OLIVER R. HOOR

ATOZ Tax Advisers S.A.

Tax Partner – Head of Transfer Pricing and the German Desk

+352 26 940 646

oliver.hoor@atoz.lu

A tax professional since 2003, Oliver Hoor has experience in Luxembourg and international taxation with a focus on alternative investments, mergers & acquisitions and multinational groups. He advises clients on all direct tax aspects regarding deal structuring, maintenance, reorganisations and exit planning.

He is the author of more than 250 articles and books on Luxembourg and international taxation, including transfer pricing and related documentation requirements, the Organisation for Economic Co-operation and Development (OECD) base erosion and profit shifting (BEPS) Project and the EU Anti-Tax Avoidance Directives.

■ **Q. Could you outline some of the significant developments in the transfer pricing arena over the last 12 to 18 months? In what ways have these developments impacted how organisations go about implementing their tax planning strategies?**

HOOR: Luxembourg companies are often involved in financial transactions, such as debt funding, financing activities, guarantees, cash pooling and so on. Therefore, the adoption of the new OECD guidance on transfer pricing aspects of financial transactions is of particular importance from a Luxembourg transfer pricing perspective and may require a revision of existing transfer pricing documentation. The severe economic downturn resulting from the measures taken by governments in Europe and around the globe to manage the COVID-19 situation may have a significant impact on the economic parameters that are relevant to transfer pricing analysis. Thus, it should be verified whether existing transfer pricing assessments need to be updated to reflect these changes in 2020 and beyond. Furthermore, given the expected negative impact of the global economic downturn on Luxembourg's state finances, it can be expected that transfer pricing will be under even greater scrutiny in the tax assessment process and during tax audits.

■ **Q. To what extent are the tax authorities in Luxembourg placing greater importance on the issue of transfer pricing? Have they increased their monitoring and enforcement activities?**

HOOR: In the past, tax audits have not been a common phenomenon in Luxembourg. However, since the creation of a new tax audit division, tax audits are now performed more systematically by the Luxembourg tax authorities. As tax assessments in Luxembourg may generally be revised for a period of five years, potential tax risks may span several years, which requires an appropriate and active tax risk management function. Experience shows that transfer pricing is frequently put under the microscope during tax audits. Tax authorities can more easily challenge transfer pricing when no transfer pricing documentation has been prepared. How could taxpayers make informed decisions if no transfer pricing analysis was performed before the pricing of intra-group transactions was determined?

■ **Q. Could you outline the challenges that companies face as they try to maximise their tax efficiencies while staying within the bounds of transfer pricing regulations? Is it becoming tougher to balance the drive for efficiency with compliance requirements?**

HOOR: Managing a company's tax position and compliance obligations have probably never been more complex than today. In this ever-changing tax environment, transfer pricing cannot be viewed in isolation. Instead, taxpayers should consider tax rules, transfer pricing and

substance requirements at the same time to organise their business activities and investments in a way that is consistent with all applicable laws and regulations. As far as it concerns the optimisation of the overall tax position, the basic premise of transfer pricing is that arm's length remuneration generally depends on the functional and risk profile of the participants to a controlled transaction. However, taxpayers might have some leeway as to how they organise their affairs and intra-group transactions in practice. Thus, while the application of the arm's length principle may not leave much room regarding the determination of transfer prices, in some cases it might be possible to change the fact pattern to arrive at different transfer pricing outcomes.

■ **Q. What kinds of challenges arise in calculating appropriate transfer prices, both for tangible and intangible assets? How crucial is it to have consistent supporting documentation?**

HOOR: Luxembourg is a prime fund location and the jurisdiction of choice for many multinational groups when implementing a regional investment platform. As such, transfer pricing is often focused on financial transactions such as intra-group debt funding, financing activities and guarantees where arm's length interest rates, finance margins and guarantee fees must be determined. Moreover, intra-group services such as administrative services and, in a fund context, fund management services, are of great importance. Regarding the transfer of assets, the fair market value of participations, debt instruments and intangibles are essential in Luxembourg transfer pricing. Luxembourg taxpayers are under a duty to cooperate with the Luxembourg tax authorities and are required



to evidence facts and provide information regarding statements made in their tax returns. The arm's length pricing of material intra-group transactions should always be substantiated in sound transfer pricing documentation.

■ **Q. Have you seen an increase in transfer pricing disputes between companies and tax authorities in Luxembourg?**

HOOR: With the increased focus on transfer pricing, disputes between companies and the tax authorities are becoming more common. Nevertheless, transfer pricing disputes are most likely to occur in situations where companies did not prepare appropriate transfer pricing documentation regarding material intra-group transactions. Conversely, preparing robust transfer pricing documentation generally offers effective protection against challenges by the Luxembourg tax authorities. Transfer pricing inevitably compels taxpayers to find a balance between a comfortable level of security and the cost of preparing relevant documentation. In practice, Luxembourg companies should screen major intra-group transactions to identify specific issues that could raise suspicion on the part of the tax authorities and assess the magnitude of related tax risks. On this basis, taxpayers can perform a cost-benefit analysis and weigh the cost of creative transfer pricing documentation against the amount of potential tax risks.

■ **Q. What steps should companies take if they become the subject of a tax audit or investigation?**

HOOR: Taxpayers should ideally take a proactive approach to transfer pricing and

prepare documentation, where appropriate, at the time they enter a controlled transaction, rather than waiting until a transaction is picked up during a tax audit. While transfer pricing documentation may also be prepared during a tax audit, the level of scrutiny regarding the assumptions, the transfer pricing approach and the benchmarking that may be expected is much higher. After all, it might be considered a coincidence if the transfer pricing analysis confirms the pricing of the intra-group transaction. When the Luxembourg tax authorities can reasonably prove that the transfer pricing of an intra-group transaction does not adhere to the arm's length principle, it is the responsibility of the taxpayer to disprove this assumption. However, in the absence of appropriate transfer pricing documentation, it is difficult to substantiate the arm's length character of intra-group pricing. When transfer pricing documentation is prepared for the purposes of a tax audit, potentially years after a transaction has been entered into, it might also be difficult to trace back all relevant information and relevant comparables data.

■ **Q. In general, what advice would you give to companies on reviewing and amending their transfer pricing policies and structures?**

HOOR: Taxpayers should not consider the preparation of transfer pricing documentation as a compliance exercise. Instead, in the current international tax environment of heightened transparency and scrutiny, Luxembourg companies would be wise to take it one step further and integrate the documentation of transfer prices in their wider tax strategy, using it to reflect the business rationale behind

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their investment structures and intra-group transactions. It is also important that transfer pricing policies are not disregarded after their implementation. As a matter of best practice, taxpayers should review their transfer pricing documentation at least once a year to assess whether the fact pattern is still consistent with reality and to determine whether an update might be necessary. In this regard, the severe economic downturn resulting from the COVID-19 measures taken by governments and their impact on economic parameters need to be considered. ■

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OLIVER R. HOOR
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and the German Desk
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