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Global tax

Financier Worldwide canvasses the opinions of leading professionals around the world on the latest trends in global tax.

Luxembourg

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A tax professional since 2006, Romain Tiffon has experience in structuring pan-European alternative investment funds across all asset classes, as well as coordinating tax structuring advice and implementation for a wide range of institutional investors. He also has extensive experience in structured finance, M&A transactions and sovereign wealth funds, and is currently responsible for ATOZ's DAC6 initiatives, working closely with Taxand and ATOZ Digital Solutions.

Q. What do you consider to be among the key developments affecting corporate tax in Luxembourg over the last year or so?

TIFFON: The legislative arsenal in Luxembourg has been massively enhanced over the past year or so, and more is to come before year-end, with the primary objectives being tackling tax avoidance, tax evasion and the use of shell entities. Following the base erosion and profit shifting (BEPS) initiative, Luxembourg transposed the first anti-tax avoidance directive (ATAD1), which introduced several anti-abuse rules, namely controlled foreign companies, interest deduction limitation rules, exit taxation and a general anti-abuse rule. The second anti-tax avoidance directive (ATAD2) was also transposed into domestic law, expanding the hybrid mismatch rules introduced by ATAD1 to third countries. Moreover, the fifth amendment to the directive on administrative cooperation (DAC6) was also set in motion. Finally, Luxembourg was among the first signatories of the multilateral convention to implement tax treaty related measures to prevent BEPS, further to which it adopted, in addition to the preambles, a principal purpose test to be met to be treaty eligible.

Q. To what extent have tax authorities in Luxembourg increased their monitoring and enforcement activities?

TIFFON: The past two years are unlikely to be representative of typical monitoring and enforcement activities. Indeed, because of the pandemic, the Luxembourg legislator and the tax authorities have extended the filing deadlines for tax returns. However, they have certainly expanded their monitoring and enforcement activities by digitalising corporate tax return filings, thereby alleviating the administrative work of tax inspectors who thus have more time to focus on tax monitoring and enforcement. Moreover, Luxembourg tax authorities have created a dedicated tax audit division which has to be appreciated from a broader standpoint. Since 2010, the Luxembourg tax authorities have generally issued preliminary tax assessments based on the tax returns that are filed. By the same token, it gives the tax authorities the ability to review and revisit tax returns within a five-year period.

Q. How are tax authorities approaching the issue of transfer pricing? In your experience, do companies tend to underestimate the risks and challenges in this area?

TIFFON: Luxembourg is a renowned financial centre in Europe and a prime location for holding entities. A natural consequence of this is that Luxembourg companies are frequently counterparties to intragroup transactions. Consequently, transfer pricing is at the heart of Luxembourg taxation and the Luxembourg tax authorities are cognisant of that. Accordingly, companies operating in Luxembourg have fully adhered to this growing norm and, over the years, have become more inclined to transfer price all intragroup arrangements. For example, where a company performs an intragroup financing activity, the remuneration it earns for that activity is determined based on transfer pricing principles. This is also the case when convertible bonds are issued, in which case the coupon is transfer priced with factoring the embedded conversion option. Another example is the remuneration earned by alternative investment fund managers, which is now transfer priced considering the functional and risk profile.

Q. How would you describe tax laws in Luxembourg as they relate to foreign entities? Are there any unique regulatory aspects, whether positive or negative, that need to be considered?

TIFFON: Over the past two decades, Luxembourg has been very proactive in designing a toolbox that favours the setup of investment funds across all asset classes. The AIFM law of 12 July 2013 introduced the special limited partnership, which has gained a lot of traction from sponsors. This regime is now a genuine contender to English limited partnership vehicles, and has likely surpassed them as part of an onshoring trend. More recently, the law of 23 July 2016 introduced reserved alternative investment funds, allowing sponsors to reduce their time to market by setting up such a fund whereby regulation is put on the alternative investment fund manager rather than the fund itself. This has clearly made Luxembourg uniquely creative and further anchored its pivotal role in the alternative investment fund space.

Q. Have you seen an increase in tax disputes in Luxembourg? What lessons can companies learn from recent settlements, prosecutions, penalties and court rulings?

TIFFON: Over the past few years, we have witnessed two moving variables regarding tax controversy. On the one hand, rulings, as a risk management tool issued by the Luxembourg tax authorities, decreased by 90 percent between 2015 and 2020 to 44 requests. On the other hand, there has been a profound overhaul of tax legislation, which has often been hastily enacted, with minimal, if any, guidelines for taxpayers. Taxpayers therefore had to take filing positions which could possibly be challenged by the tax authorities. So, while it is undisputable that this has led to more tax controversy, we cannot conclude that it has been a massive surge. All this has also led to greater sophistication of parties' behaviour when it comes to tax affairs. The most striking element is tax liability insurance.

Q. What is your advice to a company that finds itself subject to a tax-related audit, investigation or enquiry?

TIFFON: Luxembourg is a business-friendly environment where all administrations remain approachable. The tax code requires Luxembourg taxpayers to cooperate with the tax authorities in the event of an audit. More specifically, taxpayers are under an obligation to evidence facts and provide information, assuming the evidence is available, reasonable for the taxpayer to have and relevant for clarification purposes. Another tax provision was added in 2015, which extended a taxpayer's duty of cooperation to transactions between associated enterprises, although no specific transfer pricing documentation requirements are detailed therein. While this provision is merely there for clarification purposes, it confirms that the Luxembourg authorities are relying more heavily on transfer pricing documentation. Despite these developments being mainly driven by Organisation for Economic Co-operation and Development (OECD) principles, it is clearly not an exact science, which is thus open to interpretation. Having sound transfer pricing documentation in place when a given transaction is executed, rather than after the fact, is no longer a 'nice to have'; it is a must have. Every

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time a filing position is taken in a tax return, the taxpayer must be able to evidence how it reached that filing position.

Q. What steps can companies take to ensure they maintain robust tax compliance processes while maximising tax efficient structures?

TIFFON: The level of compliance has massively increased over the past few years. As before, companies must file tax returns on an annual basis. Leaving aside other tax legislation, DAC6 has added another layer of compliance which has slightly drifted into investor relations and other collateral concerns. In the alternative investment fund space, we notice limited partners (LPs) being warier of DAC6 monitoring and disclosure. This is legitimate in that if a taxpayer discloses an arrangement based on a hallmark that requires the main benefit test to be met, it acknowledges that tax was the main, or one of the main, drivers for setting up the arrangement, which makes it even more complicated to argue that it should be treaty eligible having passed the principal purpose test. Good governance practice is that any transaction should be presented to the board with a DAC6 analysis. ■

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ATOZ Tax Advisers, founded in 2004, is a high-end independent advisory firm based in Luxembourg offering a comprehensive and integrated range of tax, asset management and corporate services. The firm advises on, and delivers solutions for, sophisticated local and global professional clients. With over 150 highly skilled professionals, the team has in-depth experience of serving very demanding businesses and institutional clients in need of tailor-made advice. ATOZ is the Luxembourg member of the Taxand network which provides high quality, integrated tax advice worldwide.