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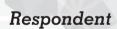
# TRANSFER PRICING

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











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A tax professional since 2003, Oliver R. Hoor has experience in Luxembourg and international taxation with a focus on alternative investments, including private equity, private debt, real estate, infrastructure, M&A 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 300 articles and books on Luxembourg and international taxation, including transfer pricing and related documentation requirements. He is a regular speaker at conferences and a lecturer with Legitech and ILA.

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?

A. A large part of the controlled transactions involving Luxembourg companies are financial transactions. Therefore, the single most important development impacting transfer pricing (TP) over the last 12 to 18 months was the interest rate policy of central banks in the Western world. Numerous interest rate hikes adopted since 2022 completely changed the interest rate environment at a record speed. Arm's length interest rates are significantly higher today than they were at the end of 2021. However, interest rates are generally determined when a debt instrument is granted and should not be updated throughout the term of the financing instrument unless the contract provides for a specific interest rate adjustment clause. Hence, the changed conditions may generally not be reflected in debt instruments that have been granted in the past but must be considered

with respect to new instruments. Depending on expectations regarding the future development of interest rates, associated enterprises may consider the implementation of variable interest rates or fixed interest rates. While according to the official narrative interest rates should remain high in order to counterbalance inflationary tendencies, the question arises whether such high interest rates can be reasonably upheld for an extended period of time. Considering contemporary debt levels of countries and the issues the current interest rate policy presents for the banking and other sectors – putting the valuation of bonds under massive pressure – this seems more than questionable. The current inverse interest rate curve also suggests lower interest rates in the notso-distant future. Moreover, a recent draft bill provides for certain TP documentation requirements for multinational enterprise groups that are subject to country-bycountry reporting (CbCR). In general, Luxembourg tax law does not provide for explicit TP documentation requirements. The draft bill further aims to introduce the possibility of concluding bilateral and multilateral advance pricing agreements (APAs).



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?

**A.** Over the last few years, tax audits are now performed more systematically by the Luxembourg tax authorities since the creation of a new tax audit division. 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 TP is frequently put under the microscope during tax audits. Tax authorities can more easily challenge TP when no TP documentation has been prepared: how can taxpayers make informed decisions if no TP analysis was performed before the pricing of intragroup transactions was determined? Therefore. TP should be considered before agreements are concluded.

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?

A. Opportunities to maximise tax efficiencies have decreased considerably over the last few years, with more severe tax rules and anti-abuse legislation being implemented in domestic tax laws and bilateral tax treaties. However, for optimal achievement in this new environment, TP is key and must be considered an integral part of each and every tax analysis. As such, TP and related documentation can be an important factor to unlock planning opportunities and mitigate tax risks.

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?

**A.** Luxembourg is a prime fund location and the jurisdiction of choice for many multinational groups when implementing a regional investment platform. As such, TP is often focused on financial transactions such as intragroup debt funding, financing activities and guarantees where arm's



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length interest rates, finance margins and guarantee fees have to be determined. Moreover, intragroup services such as administrative services and, in a fund context, fund management services are of great importance. With regard to the transfer of assets, the fair market value of participations, debt instruments and intangibles are essential in Luxembourg TP. Luxembourg taxpayers are under a duty to cooperate with the Luxembourg tax authorities and are required to evidence facts and provide information in regard to statements made in the tax returns. As a matter of principle, the arm's length pricing of material intragroup transactions should always be substantiated in sound TP documentation.

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

A. With the increased focus on TP, disputes between companies and the tax authorities are becoming more common. Nevertheless, TP disputes are most likely to occur in situations where companies did not prepare appropriate TP documentation with regard to material



intragroup transactions. Conversely, the preparation of robust TP documentation is generally an efficient protection against challenges by Luxembourg tax authorities. TP inevitably compels taxpayers to find a balance between a comfortable level of security and the costs of preparing relevant documentation. In practice, Luxembourg companies should screen major intragroup transactions in order 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 costbenefit analysis and weigh the costs of TP 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?

**A.** Taxpayers should ideally adopt a proactive attitude toward TP and prepare documentation, where appropriate, at the time they enter into a controlled transaction rather than waiting until a transaction is picked up during a tax audit. While TP documentation may also be prepared at the moment of a tax

audit, the level of scrutiny regarding the assumptions, the TP approach and the benchmarking that may be expected is unequally higher. After all, it might be considered as a coincidence if the TP analysis confirms the pricing of the intragroup transaction. When Luxembourg tax authorities can reasonably evidence that the TP of an intragroup transaction does not adhere to the arm's length principle, it is the responsibility of the taxpayer to disprove this rebuttable presumption. However, in the absence of appropriate TP documentation, it is difficult to substantiate the arm's length character of intragroup pricing. When TP 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?

**A.** Taxpayers should not consider the preparation of TP documentation as a

mere 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 to integrate the documentation of transfer prices in their wider tax strategy, using it as a means to reflect the business rationale behind their investment structures and intragroup transactions. It is also important that TP policies are not disregarded after their implementation. As a matter of best practice, taxpayers should review their TP documentation at least once a year in order to assess whether the fact pattern is still consistent with reality and to determine whether an update is necessary.

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