



■ **ANNUAL REVIEW** Reprint October 2020

Transfer pricing

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





Luxembourg ■

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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, the Organisation of Economic Co-operation and Development (OECD) Model Tax Convention and Base Erosion and Profit Shifting (BEPS) Project, the EU Anti-Tax Avoidance Directives and the mandatory disclosure regime (DAC 6).

■ **Q. What do you consider to be the most significant transfer pricing changes or developments to have taken place in Luxembourg over the past 12 months or so?**

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 Organisation for Economic Co-operation and Development (OECD) guidance on transfer pricing aspects of financial transactions is of particular importance from a Luxembourg transfer pricing perspective. The economic turmoil resulting from the measures taken by governments around the globe to manage the COVID-19 pandemic may have a significant impact on the economic parameters that are relevant for the transfer pricing analysis. Thus, it should be verified whether existing transfer pricing studies need to be updated in order to reflect these changes. Furthermore, given the dramatic impact of the global economic downturn on Luxembourg's state finances, it can be expected that transfer pricing will be subject to even greater scrutiny in the tax assessment process in the future.

■ **Q. In your opinion, do companies pay enough attention to the challenges and complexities of maintaining compliant transfer pricing policies?**

HOOR: Over the last few years, transfer pricing and related documentation has been the hot topic in Luxembourg taxation in an evolving environment that is relying increasingly less on tax rulings, including advance pricing agreements. In the past, taxpayers have viewed tax rulings as a way to obtain legal certainty and to mitigate tax risks relating to investments and the pricing of intragroup transactions. However, for several reasons this is no longer the case. Instead, transfer pricing documentation is the means of choice to substantiate arm's length pricing. This trend has been accompanied by the introduction of new transfer pricing legislation, a new circular on the tax treatment of finance companies and new reporting obligations regarding intragroup transactions which place more emphasis on transfer pricing. As a result of all these developments, Luxembourg companies are paying more attention to transfer pricing.

■ **Q. To what extent have the tax authorities in Luxembourg placed greater importance on the issue of transfer pricing in recent years, and 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 the country's 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 intragroup transactions was determined? Therefore, transfer pricing should always be considered before agreements are concluded.



■ **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 also 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 intragroup transactions. Conversely, the preparation of robust transfer pricing documentation is generally an efficient 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 costs for the preparation of 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 cost-benefit analysis and weigh the costs of transfer pricing documentation against the amount of potential tax risks.

■ **Q. How should companies respond if they become the subject of a tax audit or investigation? What documentation needs to be made available in this event?**

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 unequally higher. After all, it might be considered a coincidence if the transfer pricing analysis confirms the pricing of the intragroup transaction. When the Luxembourg tax authorities can reasonably prove that the transfer pricing of an intragroup transaction does not adhere to the arm's length principle, it is the responsibility of the taxpayer to disprove this presumption. However, in the absence of appropriate transfer pricing documentation, it is difficult to substantiate the arm's length character of intragroup 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 all the relevant information and comparables data.

■ **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 intragroup debt funding, financing activities and guarantees where arm's 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. 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

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Luxembourg tax authorities and are required to provide evidence confirming the 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 transfer pricing documentation.

■ **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 transfer pricing documentation into their wider tax strategies, using it as a means to reflect the business rationale behind their investment structures and intragroup transactions. However, 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 its impact on economic parameters must be considered. ■

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