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Oliver Hoor has experience in Luxembourg and international taxation with a focus on alternative investments, including private equity, real estate, infrastructure and hedge funds, M&A and multinational groups. He advises clients on all direct tax aspects regarding deal structuring, maintenance, reorganisations and exit planning. He has written over 250 articles and books on Luxembourg and international taxation including transfer pricing, the OECD Base Erosion and Profit Shifting project and the EU Anti-Tax Avoidance Directives, reporting obligations of tax intermediaries, the OECD Model Tax Convention and Tax Treaties, EU Law and the state aid investigations of the EU Commission.

Luxembourg

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 become a hot topic in Luxembourg taxation. 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 intra-group transactions. However, for several reasons this is no longer the case. Instead, transfer pricing documentation is the means of choice to substantiate the 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 intra-group transactions, which place more emphasis on transfer pricing. As a result of all these developments, Luxembourg companies are paying increasingly 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 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? Therefore, transfer pricing should always be considered before agreements are concluded.

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 into a controlled transaction, rather than waiting until a transaction is picked up during a tax audit. While transfer pricing documentation may also be prepared at the same time as 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 a coincidence if the transfer pricing analysis confirms the pricing of intra-group transactions. When the Luxembourg tax authorities can reasonably evidence 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 rebuttable presumption. 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. 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 tax returns. As a matter of principle, 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 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, 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 intra-group 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 potential tax risks.

Q. Could you outline the role and influence of the Organisation for Economic Co-operation and Development (OECD) on transfer pricing regulation in Luxembourg, including the latest developments on base erosion and profit shifting (BEPS)?

HOOR: The Luxembourg tax authorities have always followed the guidance provided in the OECD's transfer pricing guidelines as the international consensus toward the application of the arm's length principle. This did not change throughout the OECD BEPS project. Instead, Luxembourg was an early adopter of post-BEPS transfer pricing standards when releasing a new transfer pricing circular on 28 December 2016 regarding the tax treatment of Luxembourg finance companies. Here, new concepts such as control over risks and financial capacity to bear risks have been included.

"Taxpayers should review their transfer pricing 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 might be necessary."

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 into their wider tax strategy, using it as a means to reflect the business rationale behind their investment structures and intra-group 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 in order to assess whether the fact pattern is still consistent with reality and to determine whether an update might be necessary.

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