Transfer pricing audits in Luxembourg: thoughts on current practice and future developments

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Balazs Majoros and Adam Wojewoda of Deloitte Luxembourg offer practical tips for businesses facing audits in Luxembourg and anticipate some significant upcoming tax law changes.

Transfer pricing (TP) tax audits in Luxembourg are a growing discipline. Past practice mostly relied on advance pricing agreements (APAs), but over the last five years, the number of APAs has fallen while the number of tax audits has increased to become a regular procedure. The Luxembourg tax authorities (LTAs) are focusing on financial transactions, especially on the terms of lending transactions and the Luxembourg entity's ability to operate these lending activities (often called "substance" among international tax practitioners).

A Luxembourg TP audit requires the taxpayer to submit extensive information to allow the LTAs to thoroughly investigate the entity's tax position. Although taxpayers should already have the relevant TP documentation to hand, the details requested often go beyond TP reports to include general ledger extracts, copies of contract agreements, board meeting minutes, and more. This is because these audits also focus on the level of management of financing operations and control over the risks of such operations. Taxpayers would be advised to keep supporting corporate and internal documents readily available.

This part of the process also aims to test taxpayers' attitudes and readiness. However, as the regulations do not specify a clear deadline, Deloitte Luxembourg is seeing differences in the deadlines the LTAs grant —ranging from several weeks for some audits to just a few days for other similar cases.

In comparison, the authorities are not bound by a specific deadline to complete their investigation, except for the five-year statutory limitation to issue a tax assessment for a given year. The taxpayer may not receive a response for some months after providing the requested information; a timeframe that does not compare favourably with other European jurisdictions.

The LTA will always seek direct contact with the taxpayer's representatives during an audit, and a company should not shy away from inviting tax specialists to any meetings, such as the group's tax director or an external service provider. The management may not have the relevant tax expertise to address the LTA's various technical questions about the documentation submitted. Having tax specialists present would not be viewed as a lack of internal capabilities or substance, but rather a sign that the taxpayer is willing to address these questions.

If a tax reassessment is issued on completion of the audit, a taxpayer has only two options when an additional amount of tax is due: to agree or disagree with the reassessment. A taxpayer who disagrees must first send a written claim to the head of the LTA, known as a hierarchical appeal. Current Luxembourg tax law does not provide for a mandatory discussion between the taxpayer and the LTA to reach a potential outcome that would satisfy both parties and avoid the litigation phase.

The head of the LTA may then only affirm or cancel the tax reassessment. Hierarchical appeals often are rejected, meaning that taxpayers must either accept the tax reassessment or appeal through court litigation. If taxpayers choose to contest the reassessment, they must first pay the tax charged. Luxembourg tax law and legal precedents often reject parent company guarantees in favour of cash deposited on an escrow account. Since it is not always easy for taxpayers to deposit large amounts of cash, this may discourage them from challenging the LTA's position.

We would welcome changes to current legislation, especially regarding deadlines and the possibility of settling disputes before going to court. Practitioners will be familiar with concept of TP as an art and not an exact science, and there is always room for discussion on any TP position reached by the taxpayer. This discussion should be settled in a timely manner and preferably without involving the courts, considering that litigation is becoming a lengthy process in Luxembourg, often taking years to reach a final verdict.

Just as we were finishing this article, a draft law addressing some of the procedural elements of the tax code was released. This is a welcome first step in introducing the required changes to Luxembourg's tax procedure law to streamline the TP audit and appeals process.

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