Transfer Pricing and Substance

General and Luxembourg points of interest

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The British Chamber of Commerce for Luxembourg

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- 60% of international trade made between different legal entities within the same corporate group.

- Intra-group international transactions: potential opportunity to shift profits from a high to low taxing jurisdiction.

- The arm's length price can bring an array of tax opportunities to multinationals.

- Application of the arm's length price is made following a comparability analysis:

  - Identifying an uncontrolled transaction (or transactions) comparable to the transaction under consideration;
  - Applying pricing or margin information from the uncontrolled transactions to set or test the pricing or margin in place for the controlled transaction.

- The comparability analysis based on five factors: (i) characteristics of property or service, (ii) functional analysis, (iii) contractual terms, (iv) economic circumstances, (v) business strategies.

- Two circulars issued by the Luxembourg direct tax authorities regarding intra-group financing activities.
- Application to entities mainly engaged in intra-group financing activities.
- Framework under which the tax authorities will issue confirmations having binding effects:
  - Substance;
  - Capital at risk;
  - Transfer pricing study.

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- Domestic law principles: company resident in Luxembourg if:
  - Registered office; or
  - Central administration in Luxembourg

- International context
  - Effective level of substance jurisdiction-specific: possibility for foreign tax authorities to analyse the tax residency differently.
  - Risks:
    - attract residency of Luxembourg entity in their own jurisdiction; or
    - deny the benefit of DTT concluded with Luxembourg.

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