

Name of Country: LUXEMBOURG **Date of profile:** Oct 2012

1. Reference to the Arm's Length Principle

The arm's length principle is embedded in Section II Article 164 paragraph 3 of the income tax law (loi modifiée du 4.12.1967 concernant l'impôt sur le revenu).

Art. 164, § 3: Taxable income comprises hidden profit distributions. A hidden profit distribution arises in particular when a shareholder, a stockholder or an interested party receives either directly or indirectly benefits from a company or an association which he normally would not have received if he had not been a shareholder, a stockholder or an interested party.

2. Reference to the OECD Transfer Pricing Guidelines (if any)

National legislation doesn't contain a reference to the OECD Transfer Pricing Guidelines. All double tax treaties concluded by Luxembourg contain a provision corresponding to the provision of article 9 of the OECD Model Tax Convention.

3. Definition of related parties

National legislation doesn't provide for a definition of related parties. However, under article 164, paragraph 3 it suffices that the tax administration demonstrates that a shareholder, a stockholder or an interested party received an advantage from a company solely because of his quality as a shareholder, a stockholder or an interested party be it directly or indirectly.

4. Transfer pricing methods

National legislation doesn't prescribe the use of any specific transfer pricing method.

5. Transfer pricing documentation requirements

EU Transfer Pricing Documentation.

No national requirements apart from documentation obligations imposed by accounting and company law.

6. Specific transfer pricing audit procedures and / or specific transfer pricing penalties

Neither specific audit procedures nor specific transfer pricing penalties.

7. Relevant regulations on Advance Pricing Arrangements

Article 25 of relevant double tax treaty and EU Arbitration Convention.

Circular L.I.R. 164/2 dated 28 January 2010. Available at <http://www.impotsdirects.public.lu/legislation/legi11/index.html#circulaires>. For a courtesy translation of circular L.I.R. n° 164/2, see Annex 1.

8. Link to relevant Government Internet sites

Tax administration: <http://www.impotsdirects.public.lu>

9. Other relevant information

N/A

Note

1. Relevant provisions of domestic legislation referring to the Arm's Length Principle.
2. Reference if any to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations in domestic legislation or regulations.
3. Relevant legislation or regulations containing a definition of related parties or associated enterprises.
4. Relevant legislation or regulations containing guidance on transfer pricing methods including hierarchy among them if any.
5. Relevant regulations if any in relation to transfer pricing documentation requirements.
6. Relevant regulations if any on specific transfer pricing audit procedures and / or specific transfer pricing penalties.
7. Relevant regulations if any on Advance Pricing Arrangements.
8. Addresses of the Internet sites of the relevant authorities in charge of transfer pricing policy, its administration and Advance Pricing Arrangements.
9. Other relevant information, for instance having gone through a peer review, or having new transfer pricing regulations in preparation.

Annex 1

Circular issued by the Luxembourg direct tax authorities Luxembourg Income Tax Law (LITL) no. 164/2 dated 28 January 2010

Courtesy translation of circular LIR n° 164/2

Subject: Tax treatment of companies carrying out intra-group financing transactions

1. Definitions

Companies carrying out group financing transactions (hereafter: "group financing companies") should be taken to refer to entities which mainly conduct intra-group financing transactions. For the purpose of the previous sentence, activities related to the holding of participations are not taken into consideration.

The term "intra-group financing transaction" refers to any activity consisting of the granting of loans or advancing money to associated enterprises, refinanced by funds and financial instruments such as public offerings, private loans, advanced money or bank loans.

Two enterprises are associated enterprises where one enterprise participates directly or indirectly in the management, control or capital of the other or if the same persons participate directly or indirectly in the management, control or capital of both enterprises.

2. General Information

The arm's length principle as set forth in Article 9 of the OECD Model Tax Convention on Income and on Capital, is the international standard adopted by the OECD Member countries that must be used for the determination of transfer prices between associated enterprises conducting cross-border transactions. To ensure the application of this principle, the OECD has developed guidelines on the use of the arm's length principle that are updated on a regular basis and intended to be observed by multinational enterprises, and by tax authorities for the determination of transfer prices between associated enterprises carrying out cross-border transactions.

Under article 164 (3) Luxembourg Income Tax Law (LITL), a hidden profit distribution arises in particular when a shareholder, a stockholder or an interested party receives, either directly or indirectly, benefits from a company or an association which he normally would not have received if he had not been a shareholder, a stockholder or an interested party. The said article provides that such profit distribution is to be included in the taxable base of the company or association and establishes the arm's length principle in domestic law.

An intra-group service (including an intra-group financing transaction) has been rendered if, in comparable circumstances, an independent enterprise had been willing to pay another independent enterprise to carry out that activity, or if it had carried out that activity itself. Where an intra-group service has been rendered, as with other types of intra-group transfers, one should ascertain whether an arm's length price is charged for such service, i.e. a price corresponding to the price which would have been charged and agreed to by independent enterprises in comparable circumstances.

To determine whether transactions between independent enterprises are comparable to transactions between associated enterprises, a comparability analysis must be conducted. Characteristics or

"comparability factors" which might be important for the evaluation of the degree of comparability include the characteristics of the goods or services being transferred, the functions performed by the parties involved, the terms and conditions of the contract, the economic circumstances of the parties and the business strategies pursued by those parties.

In general, the remuneration of each enterprise which is party to a given transaction corresponds to the functions it performs (taking into account assets used and risks assumed). Thus, it is important to identify and compare economically significant activities and responsibilities as well as the assets used and risks assumed by the parties to the transaction(s). Therefore it is often useful to understand the structure and organisation of the group to which the associated enterprises belong.

In accordance with paragraph 171 of the General Tax Code taxpayers must be in a position to support data presented in their tax returns, including the transfer pricing of controlled transactions, i.e. transactions between associated enterprises.

3. Determination of the arm's length price for intra-group financing companies

As regards intra-group financing companies, the functions they perform when they grant loans to group entities are, in substance, comparable to the functions performed by independent financial institutions subject to the supervision of the "Commission de Surveillance du Secteur Financier" (CSSF). In this case, the arm's length price for the functions performed (taking into account assets used and risks assumed) should be based on the remuneration requested by those financial institutions for comparable credit transactions.

Before granting a loan or advancing money, financial institutions perform an analysis of the risks incurred. As part of their analysis, they review the financial statements of the borrower in order to evaluate the financial risk related to the transaction. They verify the existence of guarantees and examine the purpose of the loan, as well as its term, in order to evaluate borrower risk. An analysis of the industry sector in which the borrower operates enables the lender to evaluate business risk. Finally, structural risk is calculated based on ratings provided by independent rating agencies.

Independent financial service providers determine the expenses relating to granting loans by applying additional charges to the financing cost base. Such additional costs take into account, among other things, additional expenses generated by solvency requirements, additional expenses related to credit risk, processing fees or additional expenses related to foreign exchange risk.

Credit risk is to be determined based on the terms and conditions of the loan agreement and based on the outcome of the risk analysis. The terms of the credit agreement may have an impact on the degree of foreign exchange risk. In general, independent financial service providers set their remuneration based either on the loan amount or on the actual market value of the assets under management.

An additional fee related to solvency requirements may be based on the lender's solvency or on the solvency of another group entity which acts as guarantor as, in the latter case, the guarantor's equity is exposed to risk. In the former case, the additional cost is the arm's length remuneration for the equity that the lender must retain to be able to carry out the transaction. In the latter case, the enterprise which acts as guarantor would, in principle, receive remuneration for putting its equity at risk. The additional fee charged by the lender should at least correspond to the costs of the guarantee.

Following the example of independent service providers, group financing companies carrying out intra-group lending transactions should perform a risk analysis before granting a loan to an associated enterprise. They should also take into consideration any other factor which may influence the determination of their transfer prices.

In this respect, it is clear that a group financing company must have sufficient equity in order to assume the risks connected with its business and must assume those risks if they were to materialise. Based on the facts and circumstances of each individual case, it should therefore be assessed which are the risks assumed (nature, extent) and whether the group financing company has the appropriate level of equity to assume these risks.

4. Information which is binding on the direct tax authorities

4.1. Principles

Apart from article 27 of the grand-ducal regulation dated 27 December 1974 (as amended) addressing the procedure for withholding taxes on wages and pensions, offices of the direct tax authorities are not required to provide taxpayers or their agents with any information regarding specific cases which would be binding for taxation for one or more tax years.

As regards group financing companies, information which is binding on the direct tax authorities will only be provided if the company concerned has real substance in Luxembourg and if it assumes the risks connected with the granting of loans.

A group financing company has real substance in Luxembourg if it satisfies in particular all of the following requirements.

- The majority of the members of the board of directors, directors or managers, who have the authority to bind the group financing company are either Luxembourg residents, or non-residents who carry on a professional activity in Luxembourg falling under the scope of article 10 (1 to 4) LITL ¹and who are liable to tax in Luxembourg on at least 50 percent of total income from such activities. Where a corporate entity is a member of the board of directors, its registered office and its central administration must be located in Luxembourg.
- Members of the board, directors and managers, who live in Luxembourg or who derive at least 50 percent of total income referred to above in Luxembourg (for individuals) or have their registered office and central administration in Luxembourg (for corporate entities), must have the professional knowledge required to exercise their functions. Furthermore, they must have at least the authority to bind the company and ensure that all transactions are properly executed. The group financing company must have qualified personnel capable of executing and recording all transactions (the qualified personnel may be the company's own employees or foreign personnel to the company). The company must be capable of supervising the work performed by said personnel.
- Key decisions concerning the company's management must be taken in Luxembourg. In addition, companies for which Company Law requires the holding of general shareholders' meetings must hold in principle at least one general meeting per year at the place specified in the articles of association.
- The group financing company must have at least one bank account in its own name either at a credit institution established in Luxembourg or at a Luxembourg branch of a credit institution established outside Luxembourg.

¹ Art. 10 LITL

The following shall only be taken into consideration for the determination of total net income within the meaning of article 7 (2) :

1. trade and business income;
2. agriculture and forestry income;
3. income from independent professional services;
4. net income from employment;
5.

- At the time of submission of a request for information which is binding on the tax authorities, the company must have met all its filing requirements. This applies to returns relating to taxes assessed and collected by the direct tax authorities.
- The company should not be considered a tax resident of another country.
- The company should maintain an adequate level of equity with regard to the functions performed (taking into account assets used and risks assumed).

In general, a group financing company is considered to assume the risks related to granting loans if its equity is at least equal to 1 percent of the nominal value of the loan(s) granted or EUR 2 million. In this case, it is admitted that a group financing company assumes the risks related to its lending activity if it is able to demonstrate that it is effectively required to use its equity if the risks associated with the transactions materialise.

4.2. Contents of a request for information which is binding on the direct tax authorities in terms of transfer pricing for group financing companies

Depending on the facts and circumstances of each individual case any request for information should include at least the following information and documents:

1. the precise designation of the applicant (name, domicile, file number, if available) and the entities or branches which are parties to the transactions or arrangements referred to in the request;
2. a detailed description of the transactions, arrangements or legal acts referred to in the request, including a detailed statement of the legal position taken by the applicant;
3. any other country or countries affected by the transactions or arrangements;
4. a presentation of the group's legal structure, including information concerning the beneficial owner(s) of the applicant's equity;
5. tax years to be covered by the request;
6. a transfer pricing report in line with the transfer pricing guidelines issued by the OECD and including a comprehensive description of the proposed methodology, as well as detailed information and analysis in support of this methodology, for instance the identification of comparables and the expected range of results;
7. a general description of market conditions;
8. a review of any pertinent ancillary tax issues raised by the proposed methodology;
9. the assertion that the information needed to assess the facts is complete and truthful.

4.3. Validity period

Where the direct tax authorities respond to a request for information on transfer pricing from group financing companies, the validity of the decision depends on the facts and circumstances of each individual case. However, the decision by the competent tax office shall not be binding upon the direct tax authorities for a period covering more than five tax years. Once this period has passed, the competent tax office will examine, upon reasoned request of the company, whether a new decision can be rendered under the same

conditions. Likewise that new decision can not be binding upon the direct tax authorities for a period covering more than five tax years.

Based on the rule of good faith, the decision referred to above shall be binding on the direct tax authorities for the agreed period except where it is established that:

- the situation or the transactions described were incomplete or inaccurate,
- key elements of the actual transactions differ from the description provided in the request for information,
- the decision is not in line with the provisions of international law.

The decision will no longer be enforceable if the legal provisions (domestic or international) on which it was based are modified or if one of the key characteristics of a transaction is altered.

Luxembourg, 28 January 2011
Le Directeur des Contributions