

Transfer Pricing

Luxembourg

What is your strategy to deal with the Luxembourg Circulars on intra-group financing activities ?

Two Circulars were issued by the Luxembourg tax authorities

Earlier on this year, the Luxembourg tax authorities issued two administrative circulars. Circular LIR n°164/2 (hereafter "the January Circular") was issued on 28 January 2011 and is intended to provide guidance on transfer pricing considerations applicable to intra-group financing transactions entered into by companies who predominantly perform intra-group financing activities.

The January Circular basically defines as intra-group financing transactions all activities consisting in the granting of loans or advances to associated enterprises and re-financed for instance via the issuance of public or private loans, advances or bank loans.

The main points addressed by the Circular can be summarized as follows:

- ▶ Guidance to determine an arm's length remuneration to be realized by an intra-group financing company
- ▶ Binding clearance from the Luxembourg tax authorities on the annual remuneration realized on intra-group financing transactions

may be obtained to the extent the company meets certain substance criteria in Luxembourg and effectively bears the risks related to the financing transactions

- ▶ Guidance regarding the information which should be provided with the application for an Advance Pricing Agreement (APA)
- ▶ 5-year validity of APAs

Furthermore, the Luxembourg tax authorities have issued on 8 April 2011 an administrative Circular (LIR n°164/2bis) aiming to provide additional guidance and clarification. The latter provides for a grand-fathering period until the 31 December 2011, for existing companies to comply with the organizational and economical substance requirements, as well as with the transfer pricing documentation and other requirements of the January Circular. As from 1 January 2012 clearance of the remuneration for financing activities obtained prior to 28 January 2011 will no longer be binding. Companies that comply with the conditions of the January Circular may file an APA on the remuneration derived from their intra-group financing activities.




What you should do to be compliant with the Circulars ?

The actions needed to make your financing company compliant with the Circulars will depend on the facts and circumstances applicable to your financing company. In order to assess your needs in terms of tax and transfer pricing management, you should consider the following key questions :

- ▶ Does your financing company grant interest-bearing loans/advances to associated companies?
- ▶ Will the existing financing activity still be in place beyond 1 January 2012?
- ▶ Are these interest-bearing loans/fund advances financed by debt?
- ▶ Are the financing activities predominant compared to the other activities carried out by the financing company?
- ▶ What is the level of risk borne by the financing company and is the existing amount of equity sufficient in light of these risks?
- ▶ Has the annual remuneration realised by the financing company been validated in a Transfer Pricing study?

- ▶ Are there aspects other than the remuneration for financing activities that are covered in your existing tax clearance?
- ▶ Are there advantages in confirming the level of remuneration for financing activities in an APA?
- ▶ Is the level of organizational substance currently existing in Luxembourg in line with the requirements of the Circulars?
- ▶ Is the corporate governance of your Luxembourg entity in line with the administrative circulars?
- ▶ Do the existing advance tax confirmations of your Luxembourg entity still remain fully valid?
- ▶ Is there a need to review and adapt your Luxembourg substance?

As existing tax clearances may expire at the end of the year, it may be of utmost importance to take immediate actions.



How Ernst & Young Luxembourg can assist you to be compliant with the new Circulars

Your company can benefit from Ernst & Young's strong network of transfer pricing, tax and legal experts that will be able to provide you with a seamless coordinated service as part of a strong global network to address your international tax needs.

Our service offering includes the following:

- ▶ Assessment of impact of the Circulars on the existing structure and tax clearances
 - ▶ Analysis whether your current activities fall within the scope of the Circulars
 - ▶ Evaluation of the functions performed and risks borne by the intra-group financing company
 - ▶ Review of the existing substance of the financing company
 - ▶ Analysis of possible options including concrete and pragmatic recommendations

This analysis includes the review of the existing loan agreements and transfer pricing documentation in light of the requirements set by the Luxembourg tax authorities.

- ▶ Assistance in the implementation of remediate actions
 - ▶ Clear guidance relating to the organizational and economic substance required to secure your existing tax position
 - ▶ Preparation of an OECD compliant transfer pricing study on the remuneration for financing activities
 - ▶ Drafting of legal documentation to amend existing legal documentation or conclude new agreements
 - ▶ Assistance in the legal implementation of any changes required as a result of the substance conditions contained in the January Circular
 - ▶ Obtaining confirmation from the Luxembourg tax authorities on the continued validity of elements in existing tax clearance that are not related to the remuneration from financing activities
 - ▶ Obtaining of an APA from the Luxembourg tax authorities on the remuneration from financing activities

Other Transfer Pricing Services proposed by Ernst & Young Luxembourg

Ernst & Young Luxembourg proposes a wide range of Transfer Pricing services, including:

- ▶ Verification of the arms' length basis of interest rates for loans and financing instruments
- ▶ Verification of the arms' length basis of royalty rates for licensing activities
- ▶ Justification of intra-group management fees
- ▶ Documentation of cost plus spread for the provision of administrative services to group companies
- ▶ Justification of commissions in principal structures
- ▶ Documentation of fair market value of assets transferred in an intra-group sales transaction

Ernst & Young

Assurance | Tax | Transactions | Advisory

About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 141,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit www.ey.com

About Ernst & Young's International Tax services

In the current challenging environment, executives are looking to align their global tax position with their overall business strategy to maintain competitive advantage and provide value to shareholders. We help you manage your tax requirements by leveraging our integrated global network of dedicated international tax professionals – working together to uncover opportunities, manage global tax risks, meet cross-border reporting obligations and deal with transfer pricing issues.

Multidisciplinary teams help you assess your tax strategies and exposures, assisting with international tax issues, from forward planning, through reporting, to maintaining effective relationships with the tax authorities. Our talented people draw on their global insights and perspectives to help you build proactive and integrated global tax strategies that address the tax risks of today's businesses and achieve sustainable growth. It's how Ernst & Young makes a difference.

© 2011 EYGM Limited
All Rights Reserved.

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

www.ey.com/luxembourg

Contacts

Nicolas Gillet

Partner

+352 42 124 7524

nicolas.gillet@lu.ey.com

Paul Leyder

Partner

+352 42 124 7240

paul.leyder@lu.ey.com