LTPA

Luxembourg Transfer Pricing Association

FAQ on Transfer Pricing documentation in Luxembourg

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Purpose of this FAQ

Transfer pricing and related documentation have become increasingly important in Luxembourg over the past decade, ever since the first Transfer Pricing Circular (L.I.R. No. 164/2) was published in 2011. New tax provisions codifying the arm's length principle and reinforcing cooperation duties relating to transactions between associated enterprises were introduced in 2015 and 2017, thus completing the transfer pricing landscape in the Grand Duchy.

Transfer pricing documentation is now an essential tool for mitigating tax risks in Luxembourg and abroad, given that transfer pricing is frequently scrutinised during tax audits. Therefore, taxpayers must have a good understanding of when and why transfer pricing documentation is necessary to ensure compliance and build a robust defence.

Furthermore, taxpayers should not view the preparation of transfer pricing documentation merely as a compliance exercise. In the current international tax environment of heightened transparency and scrutiny, it would be prudent for Luxembourg companies to adopt a more comprehensive approach and integrate transfer pricing documentation into their overall tax strategy. This would enable them to clearly demonstrate the economic rationale behind their investment structures and intra-group transactions.

It is also important that transfer pricing policies are not disregarded after implementation. As a matter of best practice, taxpayers should regularly review their transfer pricing documentation to ensure it remains consistent with business reality, and determine whether an update is necessary.

This FAQ addresses the most pressing questions faced by professionals and practitioners responsible for managing transfer pricing documentation in Luxembourg. Designed to serve as a practical guide, it will be updated periodically to reflect the evolving Luxembourg and international transfer pricing landscape.

Luxembourg, 10 June 2026

Luxembourg Transfer Pricing Association (LTPA)

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I. Legal basis for Transfer Pricing in Luxembourg

1. What is the legal basis for transfer pricing in Luxembourg?

Luxembourg's tax law firmly embeds the arm's length principle, bringing the Grand Duchy into line with the international standards set by the OECD. The most important tax provisions and concepts are outlined below.

Article 56 of the LITL

This article formalises the application of the arm's length principle under Luxembourg tax law, in accordance with Article 9 of the OECD Model Tax Convention. It provides a legal basis for transfer pricing adjustments (both upward and downward) when associated enterprises deviate from the arm's length principle.

Article 56bis of the LITL

This article complements Article 56 of the LITL by providing definitions of several key terms relevant in a transfer pricing context, such as "arm's length principle" and "controlled transaction". It also sets out guiding principles for applying the arm's length principle that closely follow key paragraphs of Chapter I of the OECD Transfer Pricing Guidelines ("**OECD TP Guidelines**"). Consequently, Article 56bis of the LITL explicitly emphasises the importance of the OECD TP Guidelines within the framework of Luxembourg tax law.

Furthermore, it introduces the concept of comparability analysis by replicating guidance found in the OECD TP Guidelines. It clarifies that the arm's length principle must be satisfied whenever a Luxembourg company enters into a transaction with an affiliate. This requires calculation of the taxable income that could reasonably be expected if the parties had dealt at arm's length, effectively contrasting the taxpayer's choices and outcomes with those that would have resulted from market forces.

The concepts of hidden dividend distribution and hidden capital contribution

Hidden dividend distributions (Article 164 (3) of the LITL) and hidden capital contributions (Article 18 (1) of the LITL) also play an important role in ensuring that Luxembourg companies adhere to the arm's length principle.

According to Article 164(3) of the LITL, a hidden dividend distribution occurs when a shareholder (or a related party of the shareholders) receives benefits, either directly or indirectly, from a company that a third party would not have received. These profit distributions must be included in the company's taxable income and are therefore not deductible for tax purposes. They may also be subject to withholding tax if no exemption applies.

A hidden capital contribution, by contrast, refers to an advantage transferred by a shareholder to a company. While the concept is not explicitly defined in Luxembourg tax law, relevant case law has established the following characteristics:

- a shareholder or a related party of the shareholder;
- grants motivated by the shareholding relationship;
- an advantage to a company that may be reflected in the balance sheet, i.e. either an increase in assets or a decrease in liabilities (provided the shareholder does not receive arm's length compensation); and
- the contribution must not be a regular contribution under Luxembourg commercial law.

In principle, contributions increase the net equity in the receiving company's balance sheet. Therefore, hidden capital contributions should directly relate to balance sheet items, i.e. an increase in assets or a decrease in liabilities. In contrast, any advantage (including free services and interest-free loans) transferred by the company to its shareholder(s) should be classified as a hidden dividend distribution. Consequently, the scope of hidden capital contributions and that of hidden dividend distributions do not mirror each other, though both concepts share the same objective: separating the company from its shareholders.

Article 56 of the LITL and the concepts of hidden dividend distributions and hidden capital contributions operate independently of one another and may apply concurrently. However, in the event of an overlap, the concepts of hidden dividend distributions and hidden capital contributions generally take precedence over Article 56 of the LITL. This is because Article 56 solely results in an adjustment to the company's taxable income in order to restore arm's length conditions. In contrast, the concepts of hidden distributions and contributions may trigger additional tax consequences at both the company and shareholder level (e.g. withholding tax implications or adjustments to acquisition costs).

Other provisions under Luxembourg tax law

Several other provisions of Luxembourg tax law require the fair market value to be recognised. For instance, Article 22 (5) of the LITL provides that, in the event of an asset exchange, the fair market value of the transferred asset must be taken into account.

Furthermore, Article 169 of the LITL relates to the liquidation of Luxembourg companies and stipulates that assets and liabilities must be recognised at their fair market value.

Together with Articles 56 and 56bis of the LITL and the concepts of hidden dividend distribution and hidden capital contribution these provisions form a legal framework that ensures related-party transactions adhere to the arm’s length standard.

2. Is transfer pricing documentation legally required to be prepared in Luxembourg?

Paragraph 171 (3) of the General Tax Law (*Abgabenordnung*) explicitly extends the general duty of cooperation set out for taxpayers in paragraph 1 to transactions between associated enterprises. While this provision is, in a sense, a clarification (i.e., associated enterprises are, as taxpayers, already bound by Paragraph 171 (1) of the General Tax Law), its inclusion in

the law underscores the growing significance of transfer pricing and the expectation of the tax authorities that intra-group transactions are properly substantiated.

However, it is important to note that Paragraph 171(3) of the General Tax Law does not require the preparation of any specific transfer pricing documentation. Luxembourg tax law does not set out any statutory list of mandatory documents or prescribed content.

3. Are there specific requirements for Luxembourg companies that perform financing activities?

The Luxembourg tax authorities Circular dated 27 December 2016 provides guidance on applying the arm's length principle to intra-group financing activities.

It applies to Luxembourg companies that finance associated enterprises through debt instruments, whether financed by internal or external debt. It covers both Luxembourg-only and cross-border transactions.

The Circular sets out a number of substance requirements that Luxembourg finance companies must meet.[1] It also outlines specific formal requirements for companies requesting an Advance Pricing Agreement (APA).

4. How do the rules around burden of proof pressure taxpayers to prepare Transfer Pricing documentation?

Under Luxembourg tax law, the burden of proof is generally shared between the taxpayer and the Luxembourg tax authorities.

The key distinction lies in the direction of the proposed adjustment: the onus for facts and circumstances that would increase taxable income lies with the tax authorities, while the onus for facts and circumstances that would decrease it lies with the taxpayer.[2]

This allocation has significant implications for transfer pricing, where both upward and downward adjustments are possible.

The burden of proof in the event of an upward adjustment

In the context of an upward adjustment, the onus is generally on the Luxembourg tax authorities to prove that transactions are not at arm's length. It is the tax authorities' role to

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[1] In particular, Luxembourg finance companies should comply with the following substance requirements:
- The board of directors should comprise at least 50% of directors who are (professional) residents of Luxembourg.
- Board members must be qualified.
- The board of directors must have the capacity to act on behalf of the company.
- Key decisions regarding the management of the company must be taken during board meetings held in Luxembourg.
- The entity must not be considered a tax resident of another jurisdiction.

[2] Article 59 of the Law of 21 June 1999; BFH, Decision of 24.6.1976, IV R 101/75, BStBl II 1976, p. 562; BFH, Decision of 11.4.1984, I R 175/79, BStBl II 1984, p. 535.

verify that the transfer prices of transactions between group companies comply with the arm's length principle.

If the Luxembourg tax authorities can demonstrate that a transfer price falls outside the arm's length range, a rebuttable presumption arises that the transaction is not at arm's length.[3] Importantly, the threshold for the tax authorities to make this initial showing is relatively low: they may rely on benchmarks or highlight inconsistencies in the taxpayer's records.[4]

However, the taxpayer is not a passive observer in this process. Although the legal burden rests with the authorities, they can reasonably require the Luxembourg company to provide coherent arguments and supporting evidence for its transfer pricing.[5] In this regard, voluntarily producing robust documentation can significantly strengthen the company's position. A well-prepared transfer pricing documentation demonstrates good faith and can often prevent challenges from gaining momentum.[6]

Conversely, if a taxpayer cannot justify the arm's length nature of its intra-group transactions when requested to do so, whether during a routine review of corporate tax returns or a full audit, the company will be in a weak position.

In such cases, the tax authorities may invoke the concept of hidden dividend distributions or Article 56 LITL to make upward adjustments.[7]

The burden of proof in the case of downward adjustments

The dynamics shift in the case of downward adjustments. Where a taxpayer seeks to benefit from a hidden capital contribution or a downward adjustment under Article 56 LITL, the taxpayer must prove the facts and circumstances underlying the advantage shifted to the Luxembourg company.[8]

In these situations, the Luxembourg tax authorities may reasonably require the value of a hidden capital contribution, or the advantage giving rise to a downward adjustment under Article 56 LITL, to be substantiated through a formal transfer pricing documentation. Without such evidence, the claimed reduction in taxable income is unlikely to withstand scrutiny.

[3] The Luxembourg tax authorities may use public databases and data from comparable transactions in other cases (under certain conditions).

[4] According to Luxembourg case law, in order to reverse the burden of proof, the tax authorities need only show that it is probable that an advantage has been shifted by the company (without having to establish a precise breach of the arm's length principle); Tribunal Administratif, Decision of 27.11.2006, No. 21033 (ID 675); Tribunal Administratif, Decision of 31.12.2007, No. 22777 (ID 6149); Tribunal Administratif, Decision of 9.6.2008, No. 23324 (ID 7946); Cour Administrative, Decision of 12.2.2009, No. 24642C (ID 9626); Tribunal Administratif, Decision of 16.2.2009, No. 24105 (ID 9414).

[5] The taxpayer must provide consistent arguments that the arm's length character of the transfer price is at least a probable possibility; RFH, Decision of 21.12.1938, RStBl 1939, p. 307; BFH, Decision of 7.4.1959, I 2/58 S, BStBl III 1959, p. 233.

[6] If the arm's length character of transfer pricing is established in a transfer pricing study, the burden of proof for the non-arm's length character of intra-group transactions should be significantly higher; see Oliver R. Hoor, Philippe Neefs, "TP Documentation in Luxembourg: What the Luxembourg tax authorities may expect", Tax Planning International Transfer Pricing, BNA, December 2009, p. 26.

[7] § 217 (1) AO.

[8] At the level of the shareholder, the hidden capital contribution should result in an increase in taxable income (for example, if assets are sold to the company at a sales price below market value). Thus, in the case of Luxembourg shareholders, the burden of proof that the terms of a transaction do not comply with the arm's length principle should lie with the Luxembourg tax authorities.

Practical takeaway

The burden of proof rules provide a strong incentive for proactive documentation. Although the Luxembourg tax authorities carry the legal burden for upward adjustments, a taxpayer with comprehensive, contemporaneous documentation can effectively shift the practical burden back onto the authorities, compelling them to engage with the evidence rather than relying on presumptions. In contrast, taxpayer that did not prepare appropriate transfer pricing documentation may struggle, regardless of where the legal burden technically lies.

II. OECD guidance regarding TP documentation

1. What do the OECD TP Guidelines suggest for Multinational Enterprises regarding Transfer Pricing documentation?

Chapter V of the OECD TP Guidelines provides guidance on transfer pricing documentation. In the 2017 revision, this chapter was replaced with new guidance on transfer pricing documentation, which was developed by the OECD in relation to Action 13 of the Base Erosion and Profit Shifting ("**BEPS**") project.

This guidance sets out a three-tiered approach comprising a master file (containing standardised information relevant to all Multinational Enterprises ("**MNE**") group members), a local file (referring specifically to the local taxpayer's material transactions) and a Country-by-Country report (containing information on the global allocation of income and taxes paid by the MNE group, together with indicators of the location of economic activity within the group).[9] Collectively, these three reports are referred to as the Country-by-Country Reporting Package.

As an OECD member, Luxembourg takes the organisation's TP Guidelines into account. Therefore, transfer pricing documentation that complies with these guidelines should be accepted by the Luxembourg tax authorities.

This approach is intended to provide tax administrations with relevant, reliable information to enable them to perform an appropriate risk assessment. It will also encourage MNEs to consider and document their compliance with the arm's length principle for their material intra-group transactions.[10]

2. What should be the content of the master file?

In order to assist tax administrations in assessing the existence of significant transfer pricing risks, the master file should provide a high-level overview of the MNE group's business, including the nature of its global business operations, its overall transfer pricing policy, and its global allocation of income and economic activity. It should also include lists of significant agreements, intangibles and transactions. Taxpayers should use their best judgement to determine the appropriate level of detail for the information provided. These requirements could be met through specific cross-references to other existing documents.[11]

[9] See Paragraph 16 in Chapter V of the OECD TP Guidelines.
[10] See Paragraph 17 in Chapter V of the OECD TP Guidelines.
[11] See Paragraph 18 in Chapter V of the OECD TP Guidelines.

The information in the master file should provide a 'blueprint' of the MNE group. This information can be grouped into the following five categories:

(i) organisational structure;
(ii) description of the MNE business;
(iii) intangibles;
(iv) intercompany financial activities; and
(v) the MNE's financial and tax position.[12]

The information to be provided in the master file is set out in Annex I to Chapter V of the OECD TP Guidelines, including:

Organisational structure: A chart illustrating the MNE's legal and ownership structure, as well as the geographic locations of its operating entities.

A description of the MNE's business(es): A general written description of the MNE's business, including:

- Important drivers of business profit;
- A description of the supply chain for the group's five largest products and/or service offerings by turnover, plus any other products and/or services amounting to more than 5% of group turnover. This could be presented as a chart or diagram.
- A list and brief description of important service arrangements between members of the MNE group other than research and development (R&D) services. This should include a description of the capabilities of the main locations providing these services and the transfer pricing policies used to allocate service costs and determine prices for intra-group services.
- A description of the main geographic markets for the group's products and services referred to in the second item above.
- A brief functional analysis of the main contributions to value creation by individual entities within the group. This should include the key functions performed, significant risks assumed and key assets used.
- A description of any important business restructuring, acquisitions or divestitures occurring during the fiscal year.

The MNE's intangibles (as defined in Chapter VI of the updated OECD TP Guidelines):

- A general description of the MNE's overall strategy for developing, owning and exploiting intangibles, including the location of the main R&D facilities and R&D management;
- A list of the MNE group's significant intangibles for transfer pricing purposes, and the entities that legally own them;
- A list of important agreements among the identified associated enterprises relating to intangibles, including cost contribution arrangements, main research service agreements and licence agreements;
- A general description of the group's transfer pricing policies relating to R&D and intangibles;

[12] See Paragraph 19 in Chapter V of the OECD TP Guidelines.

- A general description of any significant transfers of interests in intangibles among the associated enterprises during the relevant fiscal year, including the entities, countries and compensation involved.

The MNE's intercompany financial activities:

- A general description of how the group is financed, including important financing arrangements with unrelated lenders;
- Identification of any members of the MNE group that provide a central financing function for the group, including the country in which the entity is organised and where it is effectively managed;
- A general description of the MNE's transfer pricing policies relating to financing arrangements between associated enterprises.

The MNE's financial and tax positions:

- The MNE's annual consolidated financial statement for the relevant fiscal year, if prepared for financial reporting, regulatory, internal management, tax or other purposes;
- A list and brief description of the MNE group's existing unilateral advance pricing agreements (APAs) and other tax rulings relating to the allocation of income among countries.

3. What should be the content of the local file?

Unlike the master file, which provides a high-level overview, the local file offers more detailed information on significant intercompany transactions involving the local subsidiary and associated enterprises in other countries. This information includes relevant financial data on these transactions, a comparability analysis, and details of the most appropriate transfer pricing method selected.[13]

The information to be included in the local file is set out in Annex II to Chapter V of the OECD TP Guidelines, as follows:

Management structure and strategy:

- A description of the management structure of the local entity;
- A local organisation chart;
- A description of the individuals to whom local management reports, and the country(ies) in which such individuals maintain their principal offices;
- A detailed description of the business and business strategy pursued by the local entity, including an indication as to whether the local entity has been involved in, or affected by, business restructurings or transfers of intangibles in the present or immediately past year as well as an explanation of those aspects of such transactions affecting the local entity; and
- Key competitors.

Controlled transactions: For each material category of controlled transactions in which the entity is involved, provide the following information:

[13] See Paragraph 22 in Chapter V of the OECD TP Guidelines.

- A description of the material controlled transactions (e.g. procurement of manufacturing services, purchase of goods, provision of services, loans, financial and performance guarantees, licences of intangibles), and the context in which such transactions take place;
- The amount of intra-group payments and receipts for each category of controlled transactions involving the local entity (e.g. payments and receipts for products, services, royalties, interest), broken down by the tax jurisdiction of the foreign payer or recipient;
- An identification of associated enterprises involved in each category of controlled transactions, and the relationships between them;
- Copies of all material intercompany agreements concluded by the local entity;
- A detailed comparability and functional analysis of the taxpayer and relevant associated enterprises with respect to each documented category of controlled transactions, including any changes compared to prior years;
- An identification of the most appropriate transfer pricing method, considering the category of the transaction, and the reasons for selecting that method;
- An indication of the selected associated enterprise as the tested party, if applicable, and the reasons for this selection;
- A summary of the important assumptions made when applying the transfer pricing methodology;
- If relevant, an explanation of the reasons for performing a multi-year analysis;
- A list and description of the selected comparable uncontrolled transactions (internal and external), if any, along with information on the relevant financial indicators for independent enterprises used in the transfer pricing analysis. This should include a description of the comparable search methodology and the source of such information;
- A description of any comparability adjustments performed, and an indication of whether adjustments have been made to the tested party's results, the comparable uncontrolled transactions' results, or both;
- A description of the reasons for concluding that relevant transactions were priced on an arm's length basis made on the application of the selected transfer pricing method;
- A summary of the financial information used when applying the transfer pricing methodology; and
- A copy of any existing unilateral, bilateral and multilateral APAs, as well as other tax rulings, to which the local tax jurisdiction is not a party, and which relate to the controlled transactions described above.

Financial information:

- Annual local entity financial accounts for the fiscal year in question. If audited statements exist, these must be supplied. If not, existing unaudited statements are to be supplied;
- Information and allocation schedules showing how the financial data used in applying the transfer pricing method is tied to the annual financial statements; and
- Summary schedules of relevant financial data for comparables used in the analysis, along with the sources from which these data were obtained.

4. What is the scope of Country-by-Country Reporting?

The OECD TP Guidelines state that MNE groups should be required to submit a country-by-country report (CbCR), which should be made available to the tax administrations of the countries in which they operate. Annex III to Chapter V sets out a model template for the CbCR, together with accompanying instructions.
The CbCR requires MNEs to report their income and taxes paid, as well as certain indicators of economic activity location (e.g. employment, capital and tangible assets) across the tax jurisdictions in which the MNE group operates.[14] The purpose of the CbCR is to provide the tax authorities involved with data for a high-level transfer pricing risk assessment.[15]

The OECD TP Guidelines explicitly state that the CbCR should not replace a detailed transfer pricing analysis of individual transactions and prices, based on full functional and comparability analyses. Furthermore, the OECD TP Guidelines emphasise that:

(i) the information in the CbCR does not, in itself, constitute conclusive evidence as to whether transfer prices are appropriate or not; and

(ii) the CbCR should not be used by tax administrations to propose transfer pricing adjustments based on global formulary apportionment of income.[16]

These statements address businesses' concerns that tax administrations may use the information to selectively apply formulary apportionment where it appears to be more advantageous from a tax revenue perspective. The simultaneous application of the arm's length principle and formulary apportionment is likely to result in double taxation and long-lasting disputes with the relevant tax administrations.[17]

In view of the substantial compliance burden and costs imposed on companies by CbCR, the OECD TP Guidelines stipulate an exemption for MNE groups with annual consolidated group revenues of less than EUR 750 million in the preceding financial year.[18] It is estimated that this threshold will exempt 85 – 90% of MNE groups from the CbCR requirement.[19]

5. Can MNEs rely on the guidance provided in the OECD TP Guidelines regarding the master file and local file?

As an OECD member, Luxembourg's tax authorities generally adhere to the guidance set out in the organisation's TP Guidelines for Multinational Enterprises and Tax Administrations.

Therefore, it should generally be acceptable for Luxembourg taxpayers to rely on the guidance in Chapter V of the OECD TP Guidelines, even though it requires more comprehensive transfer pricing documentation than is required under Luxembourg tax law.

[14] See Paragraph 24 in Chapter V of the OECD TP Guidelines.
[15] See Paragraph 25 in Chapter V of the OECD TP Guidelines.
[16] See Paragraph 25 in Chapter V of the OECD TP Guidelines.
[17] However, despite the strong statement by OECD member countries that the arm's length principle should be the sole standard for pricing intra-group transactions, it cannot be ruled out that the tax authorities of some countries may base transfer pricing adjustments on the information provided in the CbCR.
[18] See Paragraph 52 in Chapter V of the OECD TP Guidelines.
[19] See Paragraph 53 in Chapter V of the OECD TP Guidelines.

6. Are Luxembourg taxpayers obliged to follow the guidance provided in Chapter V (Transfer pricing documentation) of the OECD TP Guidelines?

No, the guidance set out in Chapter V of the OECD TP Guidelines is not legally binding on Luxembourg taxpayers with regard to the master file, local file and CbCR format.

However, under the law of 23 December 2016, Luxembourg transposed the provisions of EU Directive 2016/881 of 25 May 2016 into its tax law. This extends administrative cooperation in tax matters to include Country-by-Country Reporting. This law requires MNE groups with a consolidated turnover exceeding EUR 750 million to prepare a CbCR. Luxembourg entities that are members of an MNE group must notify the Luxembourg tax authorities of the identity and tax residence of the reporting entity (whether this is the Luxembourg entity itself or another group entity) by the last day of the MNE group's reporting fiscal year.

In 2023, the Luxembourg legislator published a draft regulation which would require multinational enterprises with an external turnover of at least EUR 750 million to prepare transfer pricing documentation in accordance with the master file and local file approach set out in Chapter V of the OECD TP Guidelines. The content requirements for the master and local files were found to be consistent with those in Chapter V of the OECD TP Guidelines (see answers to questions 2 and 3). However, the draft regulation has not yet been adopted, and it is unclear whether it will be in the future.

III. Preparation of Transfer Pricing documentation

1. How should taxpayers determine when Transfer Pricing documentation is necessary?

Transfer pricing requires taxpayers to strike a balance between achieving a satisfactory level of certainty and the cost of preparing the necessary documentation. While all intra-group transactions must adhere to the arm's length principle in theory, the practical question for Luxembourg companies is whether transactions justify the investment in documentation, and if so, what constitutes appropriate documentation.

To this end, companies should review their intra-group transactions to identify issues that might raise questions among the tax authorities and assess the level of tax risk involved. Taxpayers can then conduct a cost-benefit analysis, weighing the cost of transfer pricing documentation against the potential tax risks (i.e. transfer pricing adjustments). This decision requires careful judgement on a case-by-case basis and the reasoning behind it should be documented where possible.

The evidentiary value of documentation

If the Luxembourg tax authorities can reasonably demonstrate that the transfer pricing of a controlled transaction is not at arm's length, this creates a rebuttable presumption in their favour. The burden then shifts to the taxpayer to provide countervailing evidence. In these circumstances, contemporaneous transfer pricing documentation is not just helpful – it is often

the only credible means of rebuttal. Given that the tax authorities' initial burden of proof is relatively low, an undocumented taxpayer faces an uphill struggle from the outset.

Sound transfer pricing documentation may also be necessary to substantiate the value of a hidden capital contribution or to support a downward adjustment under Article 56 of the LITL. Without robust evidence, such claims are unlikely to survive scrutiny.

The foreign dimension: Documentation requirements beyond Luxembourg

Crucially, the decision to prepare documentation cannot be made solely by reference to Luxembourg's domestic rules. Several countries in Europe and around the world have introduced mandatory obligations to prepare a master file and local file in accordance with Chapter V of the OECD TP Guidelines.

Furthermore, some jurisdictions have implemented specific requirements, such as the need to follow a particular format for transfer pricing documentation purposes, and to meet filing deadlines.

Practical takeaway

The decision to prepare transfer pricing documentation should be based on a realistic assessment of risk, the need to preserve evidentiary information on intra-group transactions and the documentation requirements of the other jurisdictions in which the group operates.

Taking a proactive approach and documenting material transactions before controversy arises is almost always more cost-effective than defending position without appropriate Transfer Pricing documentation afterwards.

2. What types of controlled transactions are generally expected to be supported by transfer pricing documentation in Luxembourg?

Luxembourg companies may be involved in a wide range of controlled transactions. While documentation is generally recommended for all material related-party dealings, the following types of transactions most frequently trigger the need for a formal transfer pricing analysis:

- **Financing and Treasury:**
    - Interest rates on various debt instruments (e.g., shareholder loans, bonds, or where a Luxembourg company finances a subsidiary to ensure interest deductibility in the investment jurisdiction)
    - Financing activities
    - Financial intermediation
    - Cash pooling and other treasury activities
- **Intra-group Services:**
    - Management, administrative, and support services
    - Fund management services (a key area for Luxembourg)
    - Sales and marketing support

- **Intangibles:**
    - Royalties for the use of intellectual property
    - Sale of intangible assets between related parties

- **Manufacturing:**
    - Full-fledged manufacturer
    - Limited risk manufacturer
    - Toll manufacturer

- **Distribution:**
    - Full-fledged distributor
    - Limited risk distributor
    - Commission agent

- **Other Commercial Transactions:**
    - Sale of tangible assets between related parties
    - Engineering, technology and R&D
    - Insurance and reinsurance activities.

3. Is it always necessary to prepare full-fledged transfer pricing reports or is there a materiality threshold?

There is no one-size-fits-all approach to transfer pricing documentation. Taxpayers would be wise to adopt a risk-based approach, balancing the level of tax risk inherent in a transaction against the cost of preparing the necessary documentation. In practice, this means that the form of the documentation can vary depending on the significance of the transaction.

Tier 1: Full documentation for significant transactions

As a general rule, all significant intra-group transactions that give rise to material tax risks should be supported by comprehensive transfer pricing documentation.

This typically includes a full functional analysis, a detailed justification of the selected transfer pricing method and an economic analysis, including a benchmarking study.

The objective is to reduce tax risk to an acceptable level by providing the tax authorities with robust, defensible records that leave little room for challenge.

Tier 2: A lighter touch for moderately sized transactions

For intra-group transactions that are reasonably small or have a relatively low risk profile, a full transfer pricing report may be disproportionate. In such cases, it is sensible to prepare a transfer pricing study that focuses on the economic analysis rather than a full report.

The exact definition of this category depends to some extent on the taxpayer's understanding of materiality and their risk preferences.

This analysis should, at a minimum, cover the following:

- Outline the transfer pricing methodology used, including the selection and application of the most appropriate method to the specific transaction.
- Include screenshots or records of the database searches supporting the benchmarking;
- Document the key assumptions and conclusions.

This approach preserves the evidentiary value of contemporaneous documentation while avoiding the cost and complexity of a full report. If the Luxembourg tax authorities were to question the analysis at any point, the taxpayer would be well-placed to compile a more detailed report consistent with the economic analysis prepared at the time of the transaction. Crucially, this prevents the authorities from alleging that the documentation was crafted after the event to fit the outcome.

Tier 3: Reasonable assumptions for immaterial transactions

For transactions that are truly immaterial[20] – those with negligible value or risk – even a standalone economic analysis may be excessive. In these cases, transfer pricing may be based on reasonable, well-documented assumptions.

For example, a taxpayer could apply a standard cost-plus mark-up of 5% to low-value intra-group services, in line with the simplified approach set out in Chapter VII of the OECD TP Guidelines for what are termed “low-value intra-group services”. The important thing is that the assumption is documented, even if a full benchmarking study is not performed.

4. Are there materiality thresholds below which transfer pricing documentation is not expected in Luxembourg?

No, Luxembourg tax law does not set out materiality thresholds below which transfer pricing documentation is not required.

However, the magnitude of intra-group transactions, the related tax risks and the burden of proof rules do effectively create a materiality threshold of sorts (see answer to question 3 above). In other words, appropriate transfer pricing documentation should be used to mitigate (significant) tax risks.

[20] The term 'immaterial' cannot be defined in general. Instead, it is up to the individual taxpayer to judge whether a transaction and the related tax risks are immaterial. This also involves weighing up the potential tax risk against the cost of transfer pricing documentation in a cost-benefit analysis.

5. At what point in time should TP documentation be prepared?

For Luxembourg tax purposes, transfer prices must be consistent with the arm's length principle, taking into account the information that was reasonably available when the transaction was entered into. The contemporaneous assessment principle means that taxpayers should normally consider whether their transfer prices are appropriate for tax purposes before setting them, rather than years later when questions arise.

However, this does not mean that every transaction, regardless of size or risk, requires a full transfer pricing study at inception. Whether to prepare formal documentation should be guided by the earlier discussed cost-benefit analysis – taking into account the materiality of the transaction and the level of tax risk involved. However, the key point is that the thought process, underlying assumptions and supporting data should be in place when the pricing decision is made.

The risks of delay

The Luxembourg tax authorities may review transfer pricing several years after a transaction has taken place. From a practical standpoint, this presents significant challenges for taxpayers who did not produce transfer pricing documentation.

- **Fading evidence**: The individuals who negotiated and implemented the transaction may no longer be available.
- **Lost context**: The commercial rationale, market conditions and strategic considerations that informed the pricing become harder to reconstruct.
- **Shifting benchmarks**: Data from comparable transactions in the same year may no longer be readily accessible, making retrospective benchmarking difficult or unreliable.

These difficulties are not merely administrative; they directly affect the taxpayer's ability to defend their position. Contemporaneous documentation captures the facts and circumstances as they existed at the time, preserving evidence that would otherwise degrade over time.

The problem with "*post hoc*" documentation

Experience shows that transfer pricing documentation prepared after a challenge has been raised is significantly less valuable and far more vulnerable to attack. This is because tax authorities may view such documentation with inherent suspicion.

For example, if a taxpayer produces a transfer pricing analysis years after the event that conveniently confirms the original prices, the authorities may reasonably question whether the analysis was designed to reach a predetermined conclusion. A study prepared without contemporaneous records may lack credibility as it cannot reliably demonstrate what the taxpayer knew, considered or intended when the pricing decision was made. To an auditor, it may look less like evidence and more like *ex post facto* justification.

The specific context of multinational groups

Multinational groups often use one-sided transfer pricing methods, particularly the transactional net margin method (TNMM), to benchmark routine intercompany transactions. These methods essentially test whether the tested party's actual financial outcome for a given fiscal year is consistent with arm's length conditions. Consequently, a reliable TNMM analysis must rely on the financial results of the tested party for the closed year, as well as on benchmark data for independent comparables, which only becomes available after the end of the relevant financial year.

Consequently, it is not possible to have a complete and defensible set of transfer pricing documentation at the time the transaction takes place. At this point, neither the tested party's final results nor reliable comparable data are available.

This practical limitation is inherent to one-sided methods. While it does not relieve taxpayers of the obligation to have an *ex-ante* pricing framework in place (functional characterisation, risk allocation and pricing mechanism applied during the year), it does mean that the full transfer pricing documentation can only be prepared ex post, once the necessary data exists.

Practical takeaway

The best time to prepare transfer pricing documentation is during or before the transaction, rather than afterwards.

Although the level of detail in the documentation may vary based on risk, contemporaneous analysis serves two critical functions: it ensures that pricing decisions are grounded in economic reality and it creates a lasting record that can withstand scrutiny years later.

However, when multinational groups use methods such as the TNMM, complete transfer pricing documentation can only be finalised once the financial statements have been prepared, in order to use contemporaneous comparable data and apply price adjustment clauses.

6. Is there a prescribed format or structure for transfer pricing documentation in Luxembourg?

No, Luxembourg tax law does not prescribe a specific format or structure for transfer pricing documentation. This flexibility is intentional, as it enables taxpayers to adapt their documentation to their business's unique circumstances, rather than forcing them to adhere to a rigid template that may not align with their operations.

This approach is consistent with the OECD TP Guidelines, which emphasise that documentation should provide 'relevant and reliable information' without mandating a particular form.

While there is no legal requirement to adopt a specific format, prudent taxpayers will organise their documentation in a logical and coherent manner that anticipates the questions that the tax authorities are likely to ask.

In practice, transfer pricing reports prepared for Luxembourg entities typically follow a structure along these lines:

- **Background and group overview**: A description of the group's structure, business activities, and the role of the Luxembourg entity within it.
- **Functional analysis**: A detailed examination of the functions performed, assets used and risks assumed by each party to the controlled transactions (the 'FAR analysis').
- **Economic analysis**: Selection and application of the most appropriate transfer pricing method, including benchmarking studies and comparability analysis.
- **Conclusion and appendices**: A summary of the findings, together with supporting documents such as intercompany agreements, organisational charts and financial data.

Although this structure is not mandatory, reports that follow this logic should be easy to understand.

7. In which language should transfer pricing documentation be prepared or made available in Luxembourg?

Although Luxembourg has three official languages (Luxembourgish, German, and French), it is common practice to prepare transfer pricing documentation in English.

8. Is there a statutory deadline for the preparation of transfer pricing documentation in Luxembourg?

No, Luxembourg tax law does not stipulate a specific deadline for preparing transfer pricing documentation.

However, transfer pricing documentation should generally be prepared at the same time as a transaction is implemented, regardless of any legal requirements regarding timing (see section III, question 5).

9. Is transfer pricing documentation required to be filed automatically with the tax return, or only upon request by the tax authorities?

No, there is no automatic filing requirement. Transfer pricing documentation does not need to be submitted with the corporate tax return.

However, taxpayers are free to submit it proactively (with the corporate tax returns).

IV. Review and update of transfer pricing documentation

1. When and how often should transfer pricing documentation generally be reviewed?

It is important that transfer pricing policies are not neglected once implemented. This means that transfer pricing documentation should be reviewed regularly and updated as necessary to reflect the current situation.

As a best practice, transfer pricing documentation should be reviewed annually to ensure that it continues to reflect the correct facts, circumstances, and conduct of the parties involved in the controlled transactions. This task can be carried out either internally, for example by the staff or directors of the Luxembourg company, or externally, by qualified service providers.

From a practical perspective, these reviews could be conducted at the beginning of the financial year, allowing time for any necessary amendments to be made to the transfer pricing documentation and arrangements at the start of the year.

Ideally, the review of transfer pricing documentation, along with the related assessment of whether the documentation is still contemporary or requires an update, should be considered during a board meeting. This should be mentioned in the minutes of the meeting.

2. Apart from regular reviews, what could be triggers for a review of transfer pricing documentation?

While annual reviews provide a healthy rhythm, an immediate review is sometimes advisable.

Without attempting to provide an exhaustive list, transfer pricing documentation should be reviewed in the following cases:

- in the event of **transactional changes**, for example, a material increase or decrease in financing volume for financing activities or external revenue in case of sales transactions;
- in the event of **economic and market shifts** (e.g. significant downturns or crises affecting profitability);
- in the event of **regulatory or legal developments** (e.g. new transfer pricing legislation or guidance in Luxembourg or the counterparty jurisdiction).

Therefore, any significant change in facts, laws or financial performance may prompt an immediate review.

3. What is the benefit of regular reviews of the transfer pricing documentation?

Regular reviews ensure that transfer pricing documentation remains accurate and reflects current business realities, thereby preserving its value as a defence tool against challenges from the Luxembourg tax authorities and those of other countries.

The key benefits of regularly reviewing transfer pricing documentation include identifying changes early, maintaining credibility (i.e. demonstrating good faith by ensuring that the documentation aligns with reality) and ensuring consistency between the Luxembourg company's profile and its documented position.

Furthermore, regular reviews are indicative of good governance, reflecting a proactive approach to risk management and reducing the risk of successful challenges by Luxembourg and foreign tax authorities. Ideally, these reviews should be discussed at a board meeting and included in the minutes, which can serve as evidence in case of any questions.

4. When should transfer pricing documentation be updated?

Whether transfer pricing documentation needs updating depends on the nature of the transaction and the specific circumstances. As a general rule, the documentation should be reviewed and (if necessary) updated regularly, as well as whenever there is a significant change in the facts and circumstances that could affect the arm's length nature of the pricing.

For example:

- For a **long-term intra-group loan**, the arm's length interest rate is usually set when the loan is issued. The transfer pricing analysis generally does not require updating unless the agreement contains an adjustment clause, the principal amount increases significantly (if the loan is a facility agreement this should generally not be a trigger for an update) or the term is extended.
- For ongoing transactions or **long-term arrangements** (such as certain service or financing activities), the OECD TP Guidelines recommend periodically reviewing the functional and benchmarking analyses. In practice, a review every three years is commonly accepted, provided there have been no significant changes to the underlying functions, risks or market conditions. If a review confirms that the analysis remains valid, no immediate update is required.[21]

Ultimately, the key trigger for updating documentation is a change in facts and circumstances, not simply the passage of time.

V. Managing tax risks

1. In what ways can transfer pricing documentation help to mitigate tax risks?

Transfer pricing documentation is not merely a compliance exercise. Rather, it is a risk management tool that serves three critical functions:

- Firstly, contemporaneous transfer pricing documentation captures facts, commercial rationale and market conditions at the time of the transaction.
- Secondly, while the burden of proof for upward adjustments rests with the Luxembourg tax authorities, taxpayers without documentation are unable to defend themselves when challenges arise. Robust transfer pricing documentation provides credible

[21] See Paragraph 5.38 in Chapter V of the OECD TP Guidelines.

evidence to rebut presumptions, forcing the authorities to engage with the transfer pricing analysis rather than imposing their own.

- Thirdly, the documentation provides a detailed account of the functions performed, the assets used and the risks assumed. When the transfer pricing study reflects reality, it demonstrates that the Luxembourg company has the necessary substance to justify its profit allocation.

Tax authorities allocate audit resources where risk appears highest. Well-documented taxpayers appear lower-risk, reducing the likelihood of an audit. If audited, the documentation provides a basis for defending positions and avoiding adjustments, penalties and interest.

While contemporaneous transfer pricing documentation does not eliminate risk, it does put taxpayers in a strong, defensible position.

2. What is the relationship between transfer pricing documentation and substance?

The arm's length principle requires intra-group prices to reflect those that independent parties would have agreed upon. This inevitably raises questions of substance: Which functions are being performed? What assets are used? What risks are assumed? A functional analysis seeks to answer precisely these questions.

In a transfer pricing context, substance is relevant in several key ways. For example:

- Risk allocation requires the entity assuming the risk to exercise control over it and have the financial capacity to bear it — both of which are substance tests.
- Profit attribution to permanent establishments hinges on 'significant people functions'.

In short, substance directly impacts profit allocation. A company cannot credibly claim a return for bearing risk or performing complex functions if these activities are carried out elsewhere.

This is where transfer pricing documentation plays a crucial role. It provides a written record of the company's activities, demonstrating to tax authorities what it does, what it controls and what risks it bears.

Importantly, preparing, reviewing and updating this documentation is a function performed by the Luxembourg company itself. In this sense, transfer pricing documentation is an expression of substance, not merely evidence of it.

3. May advance pricing agreements (APA) be an option to manage tax risks?

Yes, Luxembourg companies can apply to the Luxembourg tax authorities for an advance pricing agreement (APA), which confirms that their transfer pricing for a specific transaction or arrangement complies with the arm's length principle. An APA must be accompanied by a comprehensive transfer pricing report.

Provided the underlying facts and circumstances do not change, an APA is typically valid for up to five years.

However, where transfer pricing has been analysed and documented properly in line with OECD and Luxembourg standards, such contemporaneous documentation should generally mitigate the risk of challenge by the Luxembourg tax authorities and an APA may offer limited additional reassurance.