CLIFFORD CHANCE

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Clarifications regarding transfer pricing rules for intra-group financing transactions

On 8 April 2011 the Luxembourg direct tax authorities issued Circular L.I.R. 164/2 bis (Circular Bis), which clarifies the conditions for application of their previous circular dated 28 January 2011 (the Initial Circular) relating to the tax treatment of intra-group financing transactions (see Client briefing January 2011). This development can be seen in the light of the desire of the Luxembourg tax authorities to reiterate the alignment of their APA practice with OECD transfer pricing principles.

The Initial Circular was confirmed the application of the OECD transfer pricing guidelines to intra-group financing and formalised the application procedure for an Advance Pricing Agreement (APA). Although the Initial Circular gave no date for its entry into force, it was the common understanding of most market players that the rules laid down in the Initial Circular only applied as from January 2011. Circular Bis now provides some clarification in this respect. It states that from 1 January 2012, the tax authorities will no longer be bound by APAs obtained before 28 January 2011 in relation to intra-group financing transactions which would otherwise fall within the scope of the Initial Circular.

For each individual intra-group financing transaction, the practical impact of Circular Bis will depend on the facts. In cases where the essential characteristics of a financing transaction have not been modified since the initial APA was issued, the (implicit or explicit) transfer pricing analysis performed at the time when it was implemented, and therefore its arm's length character, will not be altered by the fact that the transaction is no longer covered by an APA. Consequently, the tax authorities are unlikely to deviate from the remuneration confirmed in the initial APA once it has ended. Taxpayers benefiting from an APA which under Circular Bis would expire as from 1 January 2012 may therefore simply wish to check whether the remuneration confirmed in this initial APA is satisfactorily substantiated. This will generally be the case when a transfer pricing analysis was available with the original APA. If this is not the case, a transfer pricing study could be carried out on the basis of data available on the date of the transaction. With satisfactory transfer pricing documentation, even in the absence of a new APA, taxpayers may expect to continue to be assessed on the same basis after 2011.

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Equally, taxpayers who wish to continue benefiting from an APA for an existing structure may prefer to submit a new request and comply with the conditions set forth in the Initial Circular, most notably, having the minimum required equity at risk (the lower of 1% of the financing volume and EUR 2 million), a majority of local directors and a transfer pricing report substantiating the arm's length remuneration.