Luxembourg budget for 2017: bill presented to parliament

On 12 October 2016, the Luxembourg government presented a draft law for the 2017 budget. The draft law includes some new tax measures applicable from 2017 which are summarised below.

These tax measures complement the ones already included in the bill released this summer for the Luxembourg tax reform 2017 (see our Tax Alert here).

Further guidance for applying the arm's length principle

Despite the fact that the work on Actions 8-10 of the OECD/G20 BEPS Project 'Aligning Transfer Pricing Outcomes with Value Creation' is not yet finalised, the Luxembourg government has already put forward a draft law transposing certain parts thereof into Luxembourg law. This will provide Luxembourg taxpayers with further guidance for applying the arm's length principle from 2017 onwards—following the 2011 transfer pricing circular for intra-group financing and the 2015 legal framework for transfer pricing adjustments and documentation.

Thus, Article 56bis shall be introduced into Luxembourg Income Tax Law (LITL). This new article outlines the legal framework for a comparability analysis. The draft law takes into account the revisions to section D of Chapter I of the OECD Transfer Pricing Guidelines as laid down in the 2015 final report on Actions 8-10 of the OECD/G20 BEPS Project.

With this new Article 56bis LITL, Luxembourg emphasises that the arm's length principle must also be applied in the context of a wider value chain analysis. KPMG Luxembourg welcomes this addition to the existing Article 56 LITL, as it will give taxpayers and tax authorities more guidance on how to apply the arm's length principle.

The draft law requires that a transfer pricing analysis be carried out by taxpayers for each and every controlled transaction. However, if it turns out during the comparability analysis that the same transaction cannot be seen between independent parties, this mere fact does not necessarily mean that this controlled transaction does not have the characteristics of an arm's length arrangement.

The draft law states that a transfer pricing analysis should be based on a comparison of the conditions in a controlled transaction with the conditions that would have been made had the parties been independent and undertaking a comparable transaction under comparable circumstances.

The new Article 56bis LITL thus recognises two key aspects for the comparability analysis:

1. to identify the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations so that the controlled transaction is accurately delineated; and
2. to compare the conditions and the economically relevant circumstances of the controlled transaction as accurately delineated with the conditions and the economically relevant circumstances of comparable transactions between independent parties.

According to the draft law, the comparability factors that need to be identified can be broadly categorised as follows:

a. the contractual terms of the transaction;
b. the functions performed by each of the parties to the transaction, taking into account assets used and risks assumed and managed;
c. the characteristics of the property transferred, the services provided or the agreement concluded;
d. the economic circumstances of the parties and of the market in which the parties operate;
e. the business strategies pursued by the parties.

The transfer pricing methods should take into account the identified comparability factors and should be consistent with the actual nature of the accurately delineated transaction. The draft law imposes the obligation on the taxpayer to determine the most appropriate transfer pricing method that allows for the closest approximation to an arm's length price.

Accurately delineated transactions between the parties can be disregarded for transfer pricing purposes, if [part of] the transaction does not possess the commercial rationality of arrangements that would be agreed between independent parties under comparable economic circumstances (non-recognition).

Increase of the VAT threshold for small enterprises

The threshold to qualify as a small enterprise shall be increased from the current €25,000 to €30,000. Consequently, from 1 January 2017, the supply of goods and services made by enterprises with an annual turnover below €30,000 would be exempt from VAT. Small enterprises are therefore excluded from entitlement to VAT deduction and cannot list VAT on their invoices.

Abolishment of tax guarantee for new taxpayers

Until now, direct tax authorities were allowed to request a guarantee (for the recovery of taxes due) from new taxpayers that moved to Luxembourg from an EU/EEA country without owning Luxembourg real estate. This provision shall be abolished from 2017 to bring the Luxembourg tax laws in line with EU law.

Increase of family allowances

In favour of families and single-parent households with children, the budget for family allowances, for parental leave, for child care and for multilingual education shall be increased significantly.

Real estate tax exemption available for non-resident charities

Luxembourg entities that pursue charitable purposes exclusively and directly are exempt from real estate tax on their Luxembourg real estate assets. This exemption shall be extended to non-resident charitable entities for their use of Luxembourg real estate, thus making Luxembourg's tax laws compliant with EU law.
