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Tax Controversy 2024

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Luxembourg: Law & Practice

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GSK Stockmann

LUXEMBOURG

Law and Practice

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1. Tax Controversies

1.1 Tax Controversies in This Jurisdiction

Most tax controversies arise as a result of tax assessments or reassessments.

Besides the traditional issues resulting from taxpayers challenging tax assessment notices, tax litigation in Luxembourg recently saw an increase in cases arising from exchange of information queries from foreign tax administrations. Since the Berlioz case (C 682-15) and the subsequent change of the Luxembourg tax law, the Luxembourg tax administration (LTA) has to verify the purpose and relevance of the inquiry (eg, no fishing expedition). As a result, cases are regularly brought before the courts to assess the relevance of the exchange of information requests (eg, decisions of the Administrative Court of 24 May 2022 and the Administrative Tribunal of 18 May 2022).

After the aforementioned cases, the most common cases on direct taxes refer to the application of Luxembourg anti-abuse provisions (*abus de droit*), which are more frequently used by the LTA to challenge a taxpayer's position. In this field, topics such as hidden dividend distributions and managers' or directors' joint and several liability for the payment of taxes constitute the main areas of tax disputes.

Other common issues are requests for an exceptional remission of tax debt, domestic participation exemptions, fiscal unity, treaty benefits or interpretations and ex officio taxation.

1.2 Causes of Tax Controversies

Luxembourg tax disputes mostly involve personal income taxes (generally regarding deduction of expenses/costs and requests for exceptional remittance), dividend withholding tax and corporate income taxes.

1.3 Avoidance of Tax Controversies

Tax disputes may be mitigated by entering into advance tax agreements (ATAs) or advance pricing agreements (APAs) with the Luxembourg direct tax authorities (contrary to other European countries, the Luxembourg VAT authorities do not issue ATAs). ATAs or APAs may provide for legal certainty by determining the future tax liability of taxpayers.

In 2015, Luxembourg introduced a legislative framework for the tax ruling procedure. Each request for a tax ruling is processed by a committee composed of between four to six tax civil servants. The committee provides a final binding

answer within a timeframe of generally two to three months after the payment of an administrative fee ranging between EUR3,000 and EUR10,000 (depending on the complexity of the file). Rulings are binding for a period of five years.

On 28 March 2023, the Luxembourg government released the bill of Law n° 8186 (New Procedure Bill). The bill introduces the possibility of requesting bilateral or multilateral APAs. The bilateral or multilateral APAs will be entered into between the competent tax authorities of the involved jurisdictions. The administrative fee will range between EUR10,000 and EUR20,000 depending on the complexity of the request and the volume of work. The bill has not yet been approved.

After the decrease in the number of filed rulings in previous years following the LuxLeaks and the Panama Papers, 2023 saw a significant decrease to 36 APAs/ATAs filed. Out of these requests, 31 APAs/ATAs were approved in 2023.

1.4 Efforts to Combat Tax Avoidance

There has been a steady increase in tax litigation over the last ten years (up almost 57% between 2014 and 2023 according to the LTA in its 2023 annual report). This trend looks to continue with the new provisions and tools available to the administration to combat harmful tax practices and tax avoidance schemes, and a potential increase in reassessments following an audit. Further, the drop in the filing of ATAs/APAs provides for less fiscal certainty and will de facto lead to increased tax controversies.

Regarding the BEPS recommendations to combat tax avoidance, it should be noted that Luxembourg implemented several EU directives which will have a direct impact on the amount of tax disputes.

Anti-Tax Avoidance Directive

From the authors' point of view, the implementation of the Anti-Tax Avoidance Directive (EU) 2016/1164 (ATAD 1), introducing, inter alia, interest limitation and general anti-abuse rules as of 1 January 2019, and the Anti-Tax Avoidance Directive (EU) 2017/952 (ATAD 2), as regards hybrid mismatches with third countries as of 1 January 2020, should lead to an increase in the number of tax disputes in Luxembourg. In particular, although covered by circulars issued by the LTA, new topics such as the interest deduction limitation rule or CFC rules will most certainly lead to deviating interpretations between the LTA and the taxpayers.

DAC6

The implementation of Council Directive (EU) 2018/822 on mandatory disclosure rules (DAC6) into Luxembourg law, as of 25 March 2020, created great uncertainty among practitioners and taxpayers due to its broad, though vague, scope (especially as to the interpretation of the hallmarks). Until 4 May 2022, the LTA had issued very limited guidance on the interpretation of the hallmarks, which de facto would have led to an increase in tax litigation. However, with the FAQs updated on 30 June 2023, taxpayers have been provided with a clearer explanation of key definitions, leading to a more foreseeable interpretation of the rules.

ATAD 3/Pillar One/Pillar Two

The Luxembourg market was awaiting the implementation of the proposal for a Council Directive laying down rules to prevent the misuse of shell entities (ATAD 3 proposal) into domestic law. On 17 January 2023, the European Parliament approved the ATAD 3 proposal taking into con-

sideration the amendments suggested by the ECON on 9 December 2022. However, at present, no agreement for the approval of the proposal has been found at the level of the Council of the European Union. As a result, it is unclear if and when the current version of the ATAD 3 Proposal will be agreed on.

In addition, it is to be expected that the (i) contemplated implementation of the "Pillar One" proposal foreseeing taxing rights on profits realised by MNE groups in so-called market jurisdictions and (ii) the entering into force of the "Pillar Two" rules (applicable from the fiscal years starting on or after 31 December 2023) providing for a global minimum corporate income tax at the rate of 15% will lead to more heated debates between the tax administrations and their relevant taxpayers.

1.5 Additional Tax Assessments

Before 1 January 2023, the official deadline for Luxembourg companies to file their annual tax returns was 31 March of each following year. Since the Budget law for 2023, the filing deadline has been pushed to 31 December of the following year (applicable to tax returns from the fiscal year 2022).

The late filing of tax returns can be subject to a penalty of 10% of the tax due and a fine of up to EUR25,000. In practice, for the first offence, the fine is usually EUR800 for individuals and EUR1,200 for companies, respectively.

However, the head of the LTA recently announced that, since the entry into force of this new law, the LTA would not wait long before issuing fines to entities that did not file their tax returns by 31 December of each relevant year.

In the event of a challenge of a tax assessment issued by the LTA, the lodging of a claim does not suspend the obligation to pay the taxes due. Also, the late payment of taxes triggers an automatic default interest of 0.6% per month, so it is usually recommended (when possible) to pay the taxes due upfront, even where the tax assessment is challenged.

Luxembourg law does not, however, impose a preliminary payment or guarantee as a prerequisite to filing a claim.

2. Tax Audits

2.1 Main Rules Determining Tax Audits

Luxembourg companies are audited on a discretionary basis. However, in recent years, tax audits have been initiated by the Luxembourg tax authorities due to the exchange of information procedure implemented by the respective Directives on Administrative Cooperation (DAC). Also, companies held by individual tax residents are usually under scrutiny by the LTA.

2.2 Initiation and Duration of a Tax Audit

Tax audits may be (i) initiated in the context of an investigation linked to tax returns filed for one or several tax years or (ii) freely initiated by the LTA for tax surveillance purposes. For companies, tax audits often arise, in practice, from the absence, delay or wrongful preparation of account books or tax returns. Once initiated, Luxembourg law does not provide for any specific deadline with regard to the duration of a tax audit.

In the case of direct taxes, the limitation period of the tax audit is five years, starting from the end of the fiscal year in which the tax claim arose.

In the case of concealment, with or without fraudulent intent, the limitation period is extended to ten years.

2.3 Location and Procedure of Tax Audits

The powers of the LTA are broad when it comes to tax audits. In practice, the LTA will monitor whether taxpayers comply with their bookkeeping obligations such as the regular and correct preparation of annual accounts, record keeping of supporting documents or the use of accurate values. The LTA has the right and obligation to request information from taxpayers directly.

Tax audits may be performed remotely by requesting specific documents from taxpayers or "on-site" (which is the preferred route). Luxembourg taxpayers have to provide the requested information in a timely manner. If they do not, the LTA may make its request to any third parties which are likely to hold the relevant information.

The LTA may also proceed to "on-site" inspections of taxpayers' premises. As a general principle, such "on-site" inspections should occur every three years for large companies. Alongside these "scheduled" inspections, the LTA may perform special "on-site" inspections for taxpayers which are considered "high risk".

Documents requested by the tax authorities may be given in person or sent by mail.

2.4 Areas of Special Attention in Tax Audits

In principle, the general tax position of a taxpayer is being scrutinised.

Furthermore, with Luxembourg being a global hub for international investments, most transactions have a cross-border element. As such, some of the main areas for civil servants include the potential existence of permanent establishments, potential hidden dividend distributions and the deductibility of operating costs. Given the high number of intra-group financings conducted via Luxembourg companies, compliance with the transfer pricing rules is another key area that attracts the attention of the Luxembourg tax authorities.

Since the court ruling from the European Court of Justice in relation to the Danish UBO cases, a focus has been placed on the substance requirements of Luxembourg companies acting as "conduits" within international structures.

2.5 Impact of Rules Concerning Cross-Border Exchanges of Information and Mutual Assistance Between Tax Authorities on Tax Audits

Within the framework of the DACs, Luxembourg has exchanged an average of 450,000 files with foreign tax administrations over the last few years, and received approximately 100,000 foreign reports in return.

The automatic exchange of tax information, and in particular the Common Reporting Standard (CRS), led to an increase in tax audits initiated by the LTA.

2.6 Strategic Points for Consideration During Tax Audits

In the course of a tax audit, it is important to assess the background and purpose of the audit. This preliminary assessment phase is relevant in order to provide the appropriate and correct information to the tax authorities.

Although not mandatory, it is recommended that a tax adviser assists in order to streamline the communication with the LTA. The tax adviser

may schedule a meeting with the civil servant in charge of the tax audit and negotiate a settlement.

3. Administrative Litigation

3.1 Administrative Claim Phase

Although direct taxes and indirect taxes are supervised by two segregated tax administrations, the administrative claim phase is now harmonised between the two public bodies.

Direct Taxes

Pursuant to paragraph 228 of the Luxembourg General Tax Law (LGTL), Luxembourg taxpayers may file an administrative claim against their tax assessments issued by the LTA within three months from the notification of the tax assessment. The receipt of the notification is assumed to have occurred three business days after its issuance by the LTA. Such a claim is to be directly addressed to the director (*préposé*) of the competent tax office and be motivated by sound reasons. The New Procedure Bill specifies which information should be provided in the administrative claim (eg, identification of the assessment, object of the claim). In the event that the mandatory information is not provided, the claim would not be accepted.

Taxpayers may also address a claim to the direct tax authorities, per paragraph 94 of the LGTL, regarding a specific matter. The filing of an administrative claim on the basis of paragraph 94 of the LGTL does not, contrary to the filing on the grounds of paragraph 228 of the LGTL, grant the taxpayer the right to initiate judicial litigation in the absence of a response from the director of the competent tax office.

If the director of the competent tax office rejects the administrative claim, the taxpayer may file a judicial claim within three months from the notification of the rejection.

Indirect Taxes

Article 76 (3) of the Luxembourg VAT law provides for the right to file a claim also within three months from receipt of the VAT assessment notice. If the VAT office rejects the administrative claim, the claim is automatically redirected to the director of the indirect tax authority.

If the administrative claim is rejected by the director of the VAT administration, the taxpayer may file a judicial claim before the civil courts, also within three months from the notification of the rejection.

3.2 Deadline for Administrative Claims

In Luxembourg, claims regarding direct taxes or indirect taxes are not lodged before the same jurisdictions. In both cases, however, the director of the relevant tax administration is not compelled by law to respond within a specific maximum timeframe.

Direct Taxes

If the director of the direct tax administration does not respond within six months from the filing of the administrative claim, the taxpayer is entitled to assume that the absence of an answer is equivalent to a negative decision. The taxpayer may then initiate a judicial claim before the Luxembourg Administrative Tribunal. There is no specific deadline for the filing of the judicial claim if the administrative claim remains unanswered.

The New Procedure Bill proposes to introduce a 12-month period for the taxpayer to initiate judi-

cial litigation if the claim has not been answered within six months from its filing.

Indirect Taxes

If the administrative claim remains unanswered six months after the filing of such a claim, the taxpayer may file a judicial claim before the District Court. No specific deadline applies.

4. Judicial Litigation: First Instance

4.1 Initiation of Judicial Tax Litigation

For Luxembourg tax purposes, the judicial phase is considered a second level of jurisdiction. Indeed, in order to be able to initiate the judicial phase, the taxpayer must first have had a claim rejected in the administrative phase, by the relevant tax authorities.

Direct Taxes

For direct tax purposes only, judicial claims must be filed with the Administrative Tribunal. As a general rule, litigation procedures before the administrative courts must, in principle, be initiated by a Luxembourg lawyer.

However, for procedures relating to direct taxes, no specific formalities are required with regard to the representation of the litigants or the filing of the initiation of the litigation procedure. In other words, the taxpayer can represent itself or be represented by a tax adviser, who does not need to be a qualified lawyer.

Indirect Taxes

Luxembourg civil courts have jurisdiction over judicial litigation in relation to VAT and other indirect taxes. Unlike direct tax procedures before Luxembourg administrative courts, indirect tax procedures brought before civil courts must be initiated by the filing of a writ of summons by a Luxembourg lawyer. The writ of summons must be notified to the counterparty by a bailiff in a timely manner.

4.2 Procedure for Judicial Tax Litigation

Direct Taxes

After the filing of the judicial claim, the registry of the Administrative Court shall forward the judicial claim to the competent tax office.

The procedure before the Administrative Court begins with an exchange of arguments between the parties, which occurs in a limited number of briefs. The first brief occurs within a period of three months, and every subsequent brief occurs within a period of one month. After the exchange of the final subsequent briefs by each party, the Administrative Tribunal fixes oral hearings.

The decision of the Administrative Tribunal should occur approximately one year following the initiation of the judicial tax litigation.

Indirect Taxes

In indirect tax court proceedings, the dates for the exchange of briefs and the oral hearing(s) are set by the District Court. The decision of the District Court should occur approximately two years after the filing of the claim.

4.3 Relevance of Evidence in Judicial Tax Litigation

As the Luxembourg judicial tax procedure is written and based on the adversarial principle, the provision and use of written evidence is essential.

Although uncommon, taxpayers and the tax administration may request witness evidence from a third party to consolidate their case. Where the tax administration requires a third

party to act as a witness during the procedure, a party may only refuse under specific conditions (eg, family member or professional secrecy obligations).

Pursuant to the LGTL, witnesses may only provide the relevant information in writing. In cases where written evidence would not suffice in the making of a decision, the court may request an expert witness in order to verify certain open points (eg, valuation of a real estate asset).

4.4 Burden of Proof in Judicial Tax Litigation

Under Luxembourg law, as a general principle, the burden of proof lies with the party who claims for the execution of an obligation.

For tax purposes, the burden of proof remains with the taxpayer who claims a reduction of their taxable income. If the LTA's assessment results in an increase in the taxpayer's taxable income, the burden of proof lies with the LTA.

However, within judicial procedures relating to direct tax matters, the burden of proof is borne by the direct tax authorities.

4.5 Strategic Options in Judicial Tax Litigation

The strategic options which are to be considered in the course of judicial tax litigations should be determined and monitored on a case-by-case basis.

4.6 Relevance of Jurisprudence and Guidelines to Judicial Tax Litigation

Although not a source of law, Luxembourg tax case law has considerable authority. Furthermore, since most of the Luxembourg legal texts are of foreign origin, practitioners attach great importance to the study of foreign case law. More specifically, Luxembourg tax law has been strongly influenced by German tax law as a result of the German occupation during WWII. As a result, Luxembourg case law often refers to German court decisions in tax matters and follows the same views.

With regard to transfer pricing rules, the Luxembourg Income Tax Law (LITL) expressly refers to the OECD transfer pricing guidelines as an official source of interpretation. Similarly, the LITL also refers to the EU directives and OECD BEPS reports when it comes to the interpretation of hybrid mismatches or CFC rules.

Last but not least, ECJ decisions are also used as an official source of interpretation for domestic courts.

5. Judicial Litigation: Appeals

5.1 System for Appealing Judicial Tax Litigation

Following the decision of the Administrative Tribunal or the District Court, taxpayers may file an appeal within a period of 40 days following the notification of the decision of the lower courts. While the decisions of the Administrative Tribunal may be challenged before the Administrative Court, appeals against the decisions of the District Court may be filed before the Court of Appeal with the necessary intervention of a bailiff.

Based on unofficial sources (annual MEETINCS conferences, speaker Mr Georges Simon), taxpayers have a higher chance of success (even if only partially) before higher courts in contrast to proceedings held before lower courts.

From the perspective of the LTA, except in "cases of principle", it generally accepts the decisions rendered by the lower courts.

Decisions of the Administrative Court of Appeal are not subject to a *pourvoi en cassation*. However, taxpayers may submit a *pourvoi en cassation* before the Court of Cassation against decisions of the Civil Court of Appeal.

5.2 Stages in the Tax Appeal Procedure

For direct tax matters, the tax appeal procedure is identical to the procedure before the Administrative Tribunal. There is a wide range of arguments that can be raised during the tax appeal procedure.

The brief of the defendant must be filed with the registry of the Administrative Court of Appeal, which shall communicate the claim to the parties within one month. The claimant may reply to the first brief within a month. The same deadline applies to the defendant following the notification of the first brief of the claimant.

The stages of the indirect tax appeal procedure before the Civil Court of Appeal are identical to the procedure applicable before the District Courts.

5.3 Judges and Decisions in Tax Appeals

The Administrative Court of Appeal is composed of five judges and contains one unique panel of three judges.

The Civil Court of Appeal has a specific chamber for tax-related matters composed of three professional magistrates, namely a president and two counsels.

The Court of Cassation is composed of one president and four permanent counsels. When the Court of Cassation overturns the decision of the Civil Court of Appeal, the case is sent back before the same Court of Appeal that ruled in the first case.

6. Alternative Dispute Resolution (ADR) Mechanisms

6.1 Mechanisms for Tax-Related ADR in This Jurisdiction

Luxembourg implemented the EU Directive on tax dispute resolution mechanisms on 20 December 2019. The mutual agreement procedure applies to any disputes relating to Luxembourg income tax, withholding tax, municipal business tax and wealth tax for all financial years following 2018.

EU-resident taxpayers can file claims to the competent authority (direct tax authorities in Luxembourg) relating to the EU Arbitration Convention and double tax treaties entered into between member states.

6.2 Settlement of Tax Disputes by Means of ADR

Taxpayers may file a claim with the competent tax authority within three years from the notification of the tax assessment.

Upon the filing of a claim, if the competent tax authority does not answer the case within six months from the filing, the claim may be resolved via the mutual agreement procedure within two years from the filing. The dispute is resolved by a commission composed of a judge assisted by independent persons and, on the other side, competent tax officials. The commission shall provide a resolution within a fixed period of six months. The resolution of the commission is binding for the tax authorities.

The mutual agreement procedure may be initiated in parallel to the traditional judicial procedures.

6.3 Agreements to Reduce Tax Assessments, Interest or Penalties

Ombudsman

Since 2003, it has been possible for any private person or company to reach out to the Luxembourg Ombudsman (either by written request or even orally) to file a claim against the LTA. This is especially the case when the taxpayer considers itself unfairly treated by the LTAs or when the administration acted in breach of its public mission.

In 2022, the Ombudsman intervened in approximately 27 cases relating to direct tax matters.

Remittance of Taxes

The director of direct taxes is empowered to grant a total or partial remission of taxes whose collection would be unfair, considering the particularity of the situation in which the taxpayer finds itself (objective or subjective severity). Situations must be assessed on a case-by-case basis.

There are two kinds of fairness:

- objective fairness, which is intended to correct the rule that proves to be unjust in a particular case, because it leads to taxation contrary to the legislator's intent; and
- subjective fairness in the person of the taxpayer, where the payment of the tax compromises economic existence and deprives indispensable means of substance.

The application for a remission of taxes does not challenge the legality of the tax assessment, but merely invokes considerations of equity. A challenge to the content of the tax assessment itself falls under litigation proceedings.

See **1.3 Avoidance of Tax Controversies**.

6.4 Avoiding Disputes by Means of Binding Advance Information and Ruling Requests

See **1.3 Avoidance of Tax Controversies**.

6.5 Further Particulars Concerning Tax ADR Mechanisms

See **6.2 Settlement of Tax Disputes by Means of ADR**.

6.6 Use of ADR in Transfer Pricing and Cases of Indirect Determination of Tax

See **6.2 Settlement of Tax Disputes by Means of ADR**.

7. Administrative and Criminal Tax Offences

7.1 Interaction of Tax Assessments With Tax Infringements

Administrative Tax Offences

The LTA may issue additional tax assessments in cases where the taxpayer did not comply with the applicable legal obligations (eg, absence or late filing of tax returns). In such cases, the LTA may impose either lump sum fines or apply interest on the due amount. The LTA may also impose administrative fines for non-criminal infringements of the tax law.

In the context of the taxation process, the LTA may impose individual fines of up to EUR25,000. Where the law allows the granting of tax benefits or reliefs, specific conditions may be imposed on taxpayers. The infringement of these conditions may be subject to a fine of up to EUR2,500, even

if the taxpayer did not trigger any benefit from such infringement.

In addition, per the circular LG — A n° 67 issued on 28 July 2021 by the Luxembourg tax authorities (Circular n° 67), taxpayers may be subject to fines for the following infringements:

- intentional inaccuracies in the filed tax returns are subject to a fine ranging between 5% and 25% of the evaded taxes;
- simple tax fraud (ie, a tax advantage unduly obtained by fraud or an intended reduction of the taxable income) is subject to a fine ranging between 10% and 50% of the evaded taxes or unduly reimbursed amounts;
- unintended tax fraud (ie, tax advantage unduly obtained by negligence or unintended reduction of the taxable income) is subject to a fine ranging between 5% and 25% of the underpaid taxes or unduly reimbursed amounts.

It is important to note that the fine issued by the LTA must be proportional to the infringement committed by the taxpayer.

Criminal Tax Offences

Since 2017, tax fraud and aggravated tax fraud have been considered primary offences for anti-money laundering purposes.

Per Circular n° 67, taxpayers may be punished for the following tax-related criminal offences.

- aggravated tax fraud, which is committed if the evaded taxes/unduly reimbursed amounts (i) exceed 25% of the due taxes for the given year without being lower than EUR10,000, or (ii) exceed EUR200,000; aggravated tax fraud is punishable by imprisonment of one month to three years and a fine ranging between EUR25,000 and six times the evaded taxes or the unduly reimbursed amounts; and
- tax fraud, which is committed if (i) the amount of evaded taxes constitutes a significant amount with regard to either the total amount due or the taxes due for the given year or the unduly reimbursed amounts, and (ii) results from the systematic use of fraudulent practices having the purpose of concealing facts; tax fraud is punishable by imprisonment of one month to five years and a fine ranging between EUR25,000 and ten times the evaded taxes or the unduly reimbursed amounts.

7.2 Relationship Between Administrative and Criminal Processes

In criminal proceedings, a taxpayer may only be sentenced for tax fraud if it has been proved that the taxes evaded were effectively due. The relationship between the administrative and criminal procedure is marked by the necessity to determine whether the taxpayer was subject to fiscal obligations. A criminal judge within a tax offence procedure must first wait for the decision of the administrative judge determining whether the defrauded taxes were due or not.

7.3 Initiation of Administrative Processes and Criminal Cases

If the LTA suspects that a taxpayer has committed a tax-related offence, it may initiate a criminal tax procedure by transmitting the file to the public prosecutor. After the transmission, the public prosecutor conducts an investigation.

7.4 Stages of Administrative Processes and Criminal Cases

See **4.2 Procedure for Judicial Tax Litigation**.

7.5 Possibility of Fine Reductions

Under the LITL, there is no reduction of potential fines if the taxpayer proceeds with an upfront

payment of the additional tax assessment. Late payment of taxes due is subject to a late payment interest of 0.6% per month.

On a case-by-case basis, and upon substantiated requests only, the director of the relevant tax administrations may decide to increase or reduce a fine.

7.6 Possibility of Agreements to Prevent Trial

Under Luxembourg law, taxpayers involved in a criminal tax trial may not benefit from any plea bargain by entering into an agreement with the public prosecutor in order to stop or prevent such a trial.

7.7 Appeals Against Criminal Tax Decisions

Either the taxpayer or the public prosecutor may file an appeal before the Court of Appeal against a decision of the Criminal Court related to a criminal tax offence. The deadline for the filing of the appeal ends 40 days following the notification of the decision of the Criminal Court.

7.8 Rules Challenging Transactions and Operations in This Jurisdiction

As a result of an audit or a reassessment notice, the LTA may transfer the case to another authority (judicial authority, public prosecutor, etc). In 2022, the direct tax administration transferred 45 cases to the relevant public bodies in the framework of inter-administrative and judicial co-operation.

Regarding tax litigations, there has been an increase in case law referring to artificial cross-border transactions challenged by the LTA under the general anti-abuse rule (GAAR). However, the Luxembourg tax courts have set boundaries and more detailed rules for determining whether a transaction is artificial.

Recently, the Administrative Tribunal issued a decision in relation to an exchange of information request of the Belgian tax authorities, which was motivated by the infringement of the GAAR by a cross-border structure using a Luxembourg "conduit" company. It is to be expected that the GAAR will give rise to additional administrative litigation (though rarely to criminal offences).

8. Cross-Border Tax Disputes

8.1 Mechanisms to Deal With Double Taxation

Where a tax assessment or tax adjustment triggers a double taxation situation, it is common to initiate a domestic litigation procedure and the mutual agreement procedure mechanism under the applicable double tax treaty.

8.2 Application of GAAR/SAAR to Cross-Border Situations

Since the amendment of the domestic GAAR through the implementation of ATAD 1, Luxembourg tax authorities should not ignore any misuse of forms and institutions of law (ie, an arrangement) which has been carried out primarily for achieving a tax advantage and which is not commercially genuine. An arrangement is considered "not genuine" if it has not been put into place for valid commercial reasons which reflect economic reality. The GAAR may apply to cross-border situations covered by double tax treaties.

The rationale behind the principal purpose test (PPT) lies in denying the benefit of a double tax treaty to a taxpayer if such a benefit was one of the main motivations for entering into an arrangement. Luxembourg opted for the discretionary

relief clause enabling taxpayers to request that the LTA grant a treaty benefit if such a benefit would have been granted to the taxpayer in the absence of the concerned arrangement.

The denial of a treaty benefit on the grounds of the PPT should be analysed by the LTA on a case-by-case basis. It should be noted that the PPT applies in parallel to the GAAR and, hence, adds an additional layer of complexity with regard to the application of anti-abuse rules.

It is expected that the interpretation of the PPT will trigger additional litigation matters in Luxembourg.

8.3 Challenges to International Transfer Pricing Adjustments

Luxembourg embedded the arm's length principle, deriving from Article 9 of the OECD Model Convention, in Articles 56 and 56 bis of the LITL. Moreover, the mentioned articles reflect the spirit set out in BEPS Actions 8–10, such as the concept of comparability analysis and a general anti-abuse rule that allows the LTA to disregard a transaction that has been made without any valid commercial or business justification.

The LTA issued Circular No 56/1-56 bis/1 on 27 December 2016, which provides further guidance with regard to substance and transfer pricing requirements in line with the OECD guidelines. As a result, international transfer pricing adjustments can, from a Luxembourg standpoint, be challenged before domestic tax courts if not compliant with the OECD transfer pricing guidelines.

8.4 Unilateral/Bilateral Advance Pricing Agreements

While APAs traditionally constituted a good mechanism for mitigating transfer pricing matters, since the LuxLeaks affair, the committee in charge of the advance pricing agreements procedure, as mentioned in **1.3 Avoidance of Tax Controversies**, has adopted more restrictive conditions for granting APAs to taxpayers. It is estimated that only one in four APA requests is agreed on by the ruling committee.

The New Procedure Bill proposes to introduce bilateral and multilateral APAs.

8.5 Litigation Relating to Cross-Border Situations

Given that Luxembourg companies are often used for international tax structuring purposes, cross-border dividend and interest payments between associated enterprises are a focus of the LTA.

In view of the recent amendments to Luxembourg domestic law made in order to comply with the latest OECD BEPS guidelines (eg, GAAR and PPT), both withholding tax and transfer pricing issues trigger, or will trigger in the near future, additional litigation in Luxembourg.

Further, given that Luxembourg shares its borders with four countries and has a large number of cross-border workers from France, Germany and Belgium, arbitration for the taxation of teleworkers applies frequently with these respective countries. This topic was heavily discussed and negotiated with the foreign tax administrations and relevant ministries at the beginning of the COVID-19 pandemic due to multiple lockdowns and official work-from-home recommendations for cross-border commuters.

9. State Aid Disputes

9.1 State Aid Disputes Involving Taxes

There have been several state aid disputes involving tax rulings granted by the LTA in favour of Luxembourg companies.

On 12 May 2021, the General Court of the European Union ruled on the Engie case (cases T-516/18 and T-525/18) which follows the decision of the European (EU) Commission of 20 June 2018 claiming that the State of Luxembourg granted a selective advantage to an entity. In a nutshell, the EU Commission claimed that the LTA had granted state aid by issuing several tax rulings in relation to intra-group financing between Luxembourg entities of the Engie group. The rulings of the LTA confirmed that accrued but unpaid expenses under a convertible loan were deductible without being included in the taxable income of the holder of the loan. The EU Commission argued the following.

- Luxembourg law did not allow the deduction of expenses at the level of the payer if the related income is not included in the taxable basis of the payee (so-called deduction without inclusion situation).
- Luxembourg granted an advantage to the Engie group which was financed out of the resources of the Luxembourg state due to the loss of tax revenue.
- Additionally, Luxembourg did not apply the anti-abuse rules. In its decision, the CJEU confirmed that the EU Commission has the power to challenge tax rulings for state aid purposes and upheld the claims of the EU Commission. Luxembourg appealed against this judgment on 21 July 2021. The appeal was published on 29 November 2021.

On 5 December 2023, the Court of Justice set aside the General Court's judgment of 12 May 2021 and annulled the decision of the Commission in the joined cases C-451/21 P and C-451/21 P on the grounds that the Commission had not demonstrated that these arrangements resulted in a tax advantage for the Engie group. On 12 May 2021, the General Court of the European Union also ruled on the Amazon case (cases T 816/17 and T 318/18). This case involves a Luxembourg partnership (the SCS) being fully held by US companies of the Amazon group and its subsidiary, a Luxembourg operating company (the OpCo). The SCS granted the use of certain IP rights to the OpCo which in return paid royalties to the SCS. The LTA had confirmed in its ruling the arm's length nature of such royalty payments and its determination via the transactional net margin method (TNMM). In its decision dated 4 October 2017, the EU Commission claimed that the use of the TNMM method resulted in excessive royalty payments and that the taxable basis of OpCo was hence "artificially reduced". The EU Commission based its arguments on the fact that the following errors resulted in a false calculation:

- the use of the TNMM method;
- the false "testing party";
- the choice of the profit level indicator; and
- the inclusion of a ceiling mechanism.

The General Court stated in its judgment of 12 May 2021 that the EU Commission had failed to demonstrate the existence of methodological errors and the granting of a selective advantage. The EU Commission prepared an appeal against the judgment dated 12 May 2021.

On 14 December 2023, the Court of Justice confirmed the judgment of the General Court (although for different reasons) and stated that

the EU Commission had not demonstrated the existence of an advantage to the Amazon group.

Further, the Huhtamäki case involving a Luxembourg company is still being investigated by the EU Commission. In that case, the EU Commission claims that the LTA issued tax rulings which confirmed that the Luxembourg company of the group would be making an arm's length profit margin on its financing activities and could deduct fictitious interest payments made under interest-free loans.

On 3 October 2019, the Luxembourg company requested the EU Commission to provide non-confidential versions of the tax rulings and the list of the recipients of the tax rulings communicated by Luxembourg. The EU Commission rejected this request in Decision C(2019) 9417 final dated 18 December 2019 on the grounds that the documents fell under the general presumption of confidentiality. On 2 March 2022, the CJEU issued a judgment which annulled the Decision C(2019) 9417 final on the basis that the arguments of the decision of the CJEU were not valid.

Further, the Court of Justice also ruled on the Fiat case. On 21 October 2015, the EU Commission claimed that the LTA had granted a selective advantage to Fiat Chrysler Finance Europe S.à r.l. (FCF) via a tax ruling.

FCF carried out (i) financing and treasury activities for the benefit of other European entities of the Fiat group and (ii) shareholding activities. FCF's remuneration for its financing activities had been determined on the basis of a transfer pricing report by using the TNMM. The remuneration consisted in:

- "risk remuneration" calculated by multiplying FCF's hypothetical regulatory capital of the entity by a "pre-tax expected return" rate; and
- "functions remuneration" calculated by multiplying FCF's capital used in order to carry out its functions by the market interest rate applied to short-term deposits.

Accordingly, the equity of FCF had been segmented and different rates were applied in order to calculate the return on capital. In addition, the equity used for its shareholding activities had not been considered for the calculation of the return on capital. The above-mentioned remuneration was endorsed by a tax ruling issued by the Luxembourg tax authorities.

The EU Commission argued that the terms of the application of the TNMM were incorrect as the entirety of FCF's capital should have been multiplied by a unique interest rate (ie, the capital should not have been segmented) in order for the remuneration to be at arm's length. FCF and Luxembourg contested the decision of the EU Commission.

On 24 September 2019, the General Court of the European Union dismissed the actions of FCF and Luxembourg in the joined cases T-755/15 and T-759/15 and agreed with the decision of the EU Commission by stating that the entirety of FCF's capital should be considered for the calculation of the arm's length remuneration. FCF and Ireland lodged an appeal against the judgment of the EU General Court.

On 8 November 2022, the Court of Justice annulled the judgment of the EU General Court in the joined cases (C-885/19 P and C-898/19 P) on the grounds that a selective advantage may only be determined if compared with the "tax system normally applicable in the Member State

concerned" and not assessed on a "hypothetical tax system". As the remuneration is deemed to be at arm's length under the Luxembourg transfer pricing rules, no selective advantage was granted.

9.2 Procedures Used to Recover Unlawful/Incompatible Fiscal State Aid

State aid disputes involving Luxembourg companies often originate from the initiation of a formal investigation procedure by the EU Commission pursuant to Article 108(2) TFEU which requests information from the Luxembourg state. In the cases mentioned under **9.1 State Aid Disputes Involving Taxes**, the Luxembourg state brought an action requesting the annulment of the decisions of the EU Commission.

9.3 Challenges by Taxpayers

In the cases mentioned in **9.1 State Aid Disputes Involving Taxes**, both Engie and Amazon brought an action requesting the annulment of the respective decisions of the EU Commission and assumed the role of applicant in the judicial procedures.

9.4 Refunds Invoking Extra-Contractual Civil Liability

In the context of state aid disputes involving Luxembourg structures, there are rarely, if any, litigation procedures brought against the Luxembourg state invoking extra-contractual civil liability.

10. International Tax Arbitration Options and Procedures

10.1 Application of Part VI of the Multilateral Instrument (MLI) to Covered Tax Agreements (CTAs)

Within the framework of the introduction of the MLI on 1 August 2019 in domestic law, Luxembourg has been guided in its choices by a policy of prudence, opting, on the one hand, for provisions that are in line with its current treaty policy and, on the other hand, for provisions introducing minimum standards that are mandatory but can be adopted in a flexible manner.

As for the mandatory provisions, Luxembourg has chosen the options that best suit its contractual policy.

For arbitration matters, Luxembourg opted for the mandatory binding arbitration rule in Article 19 of the Luxembourg MLI law.

This mandatory binding arbitration rule states that in cases of arbitration procedure initiated on the basis of the mutual agreement procedure provided for by the respective double tax treaties, if the taxpayer considers that the decision resulting from such a procedure may not be in line with the applicable laws, or the case has not been resolved within a period of two years, the case should be deferred to an impartial arbitration panel upon the request of the relevant taxpayer.

10.2 Types of Matters That Can Be Submitted to Arbitration

There are currently no provisions under DTTs or the MLI law which limit or restrict the access to arbitration for tax disputes.

10.3 Application of the Baseball Arbitration or the Independent Opinion Procedure

Pursuant to Article 23 (1) of the MLI law, Luxembourg opted for the baseball arbitration procedure.

Although the reason behind choosing the baseball procedure was not explicitly mentioned in the draft bill, it can be assumed that this choice was motivated by the desire to promote quick outcomes for arbitration cases by reducing time and costs compared to the independent opinion procedure. The baseball procedure is consistent with the existing options under DTTs and the Arbitration Convention.

10.4 Implementation of the EU Directive on Arbitration and/or the MLI

Luxembourg, being an EU member state, followed the trends in international tax arbitration made by the OECD by introducing in its domestic law on 20 December 2019 Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms.

10.5 Existing Use of Recent International and EU Legal Instruments

At present, there is no publicly available information regarding the use of the recent legal instruments for tax dispute resolutions.

10.6 New Procedures for New Developments Under Pillars One and Two

On 1 July 2021, the OECD released a statement addressing the two elements of the BEPS 2.0 project, being (i) Pillar One providing for the re-allocation of taxation rights on profits of multinational groups (MNEs) to market jurisdictions and (ii) Pillar Two establishing a minimum tax rate for MNEs.

On 22 December 2021, the EU Commission issued a proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union in order to implement the OECD Pillar Two in the EU. On 16 December 2022 the EU Council adopted the Pillar Two Directive. Luxembourg implemented the Pillar Two Directive into domestic law and the rules apply from the fiscal years starting on or after 31 December 2023. At the current stage, the EU Commission has not issued a draft directive for the implementation of Pillar One.

As MNEs often use Luxembourg holding or financing companies as gateways to European market jurisdictions, the implementation of Pillar One and Two should be monitored in order to avoid any adverse consequences on the MNE structures.

Given the complexity of the taxation mechanisms under OECD Pillar One and Two, their implementation may result in uncertainty for states and taxpayers. In particular, there is a risk that taxpayers are unduly subject to multiple taxation in several states and that jurisdictions wrongly apply the taxation rules. As a result, it is to be expected that the implementation of these mechanisms will lead to an increase in tax disputes.

Pillar One

As mentioned above, Pillar One provides for a re-allocation of the taxing rights to market jurisdictions. For this purpose, two categories of profits shall be allocated to market jurisdictions:

- Amount A corresponding to the share of residual profit which is allocated to market jurisdictions regardless of whether the MNE has a physical presence in those jurisdictions; and

- Amount B corresponding to a fixed remuneration for baseline marketing and distribution activities occurring in market jurisdictions.

The Blueprint on Pillar One dated 14 October 2020 intends to provide for tax certainty by effective dispute prevention and resolution mechanisms. As the determination of Amount A should be the main source of disputes, the provisions of Pillar One foresee the following dispute resolution procedure.

- Establishing and filing of a standardised self-assessment return for Amount A by the co-ordinating entity with the lead tax administration. Alternatively, the MNE may request early tax certainty with the lead tax administration.
- The lead tax administration circulates the self-assessment to other tax administrations of jurisdictions in which the MNE has constituent entities and validates the self-assessment return or the early tax certainty. As an option, the lead tax administration shall perform an initial review and determine whether a panel review is necessary.
- If required, a review panel will be constituted which is formed by the concerned tax administrations and has the purpose of pursuing an amicable settlement via consensus.
- If the review panel cannot agree on an outcome, a determination panel shall be constituted which is formed by individual panellists.
- The outcome is presented to the MNE. The MNE may (i) accept the outcome which is binding for all involved jurisdictions and the MNE and resolve the dispute, or (ii) deny the outcome, withdraw the early certainty request and use domestic dispute resolution procedures.

As mentioned above, MNEs should benefit from dispute prevention and resolution mechanisms which ensure tax certainty under Pillar One. However, given the current climate with regard to ATAs/APAs as mentioned in **1.3 Avoidance of Tax Controversies**, it should be clarified to what extent the LTA will grant early tax certainty to MNEs. The directive implementing Pillar One should provide further clarification in this regard.

Pillar Two

The Blueprint for Pillar Two and the directive implementing Pillar Two do not provide for tax dispute resolution mechanisms. However, the Blueprint foresees that taxpayers may rely on the dispute resolution mechanisms provided by tax treaties.

10.7 Publication of Decisions

Per Article 18 (2) of the MLI, the LTA may publish, via the European Commission, an anonymised summary of its decisions mentioning the legal issue, the facts, the date, the relevant fiscal years, the legal basis, the business sector and the final decision.

However, the LTA and, if applicable, the foreign tax authorities may publish the entire decision with the consent of the relevant taxpayer. Before the publication of the decision, the LTA must notify the relevant taxpayer. Upon receipt of the notification, the taxpayer then has 60 days to request that the LTA not publish any information relating to a commercial, industrial or professional secret, or a commercial procedure, or which would be contrary to the public order.

Under the MLI law, there are no obligations to publish the decisions taken by the Arbitration Commission.

10.8 Most Common Legal Instruments to Settle Tax Disputes

While the tax dispute resolution mechanism under the MAP Directive applies exclusively to tax disputes deriving from the application of DTTs entered into between EU member states, the mechanism under the MLI applies to issues arising from the application or interpretation of DTTs entered into by states that opted for the same options under the MLI. Thus, the choice of the mechanism is determined on a case-by-case basis.

Regarding double tax disputes involving the EU member states that implemented the MLI, taxpayers may choose between a procedure under the MLI or the MAP.

10.9 Involvements of Lawyers, Barristers and Practitioners in International Tax Arbitration to Settle Tax Disputes

Given that tax disputes arising in Luxembourg usually involve foreign investors or shareholders, corporate taxpayers generally involve their local tax adviser in order to initiate and co-ordinate the international tax arbitration procedure.

11. Costs/Fees

11.1 Costs/Fees Relating to Administrative Litigation

In administrative litigation proceedings relating to direct tax claims, taxpayers are not obliged to act through a bailiff in order to file a claim or an appeal before the Administrative Tribunal or the Administrative Court of Appeal. Accordingly, the costs arising from such administrative direct tax procedures remain low.

11.2 Judicial Court Fees

Unlike administrative tax procedures, judicial claims relating to indirect taxes must be initiated by means of a writ of summons filed by a Luxembourg lawyer and notified to the counterparty by a bailiff. Taxpayers must be represented by a Luxembourg lawyer before the judicial court, which triggers further fees. Payable amounts imposed by the courts are due upon the notification of their decision. The courts may require that one of the parties pays a guarantee in advance of the decision.

The Luxembourg civil procedure law provides that certain costs arising from the judicial procedure may be allocated to one of the parties to the procedure. In practice, the procedure costs are borne by the party that loses the case. Legal costs arising from the mandate of a lawyer may only be partially allocated to the unsuccessful party.

11.3 Indemnities

Luxembourg law does not provide for any indemnities in the event that the court decides that the initial additional tax assessment issued by the LTA is null and void.

11.4 Costs of ADR

Under Luxembourg law, no court fees are due if a taxpayer opts to use any alternative dispute resolution mechanisms.

12. Statistics

12.1 Pending Tax Court Cases

There are no official statistics regarding the number of pending tax court cases in Luxembourg.

12.2 Cases Relating to Different Taxes

Direct Taxes

Based on the annual reports from the direct tax administration, during 2019, the direct tax administration registered 1,635 claims filed by taxpayers against tax assessments. Approximately 251 direct tax claims resulted in the introduction of an administrative claim before the Administrative Tribunal. In 2020, the number of claims lodged dropped to 193, which is only due to the suspension of the deadlines as an extraordinary measure against the COVID-19 pandemic. Surprisingly, 177 claims have been introduced before the Administrative Tribunal in 2021. In 2022, 206 direct tax claims were introduced before the Administrative Tribunal and 69 before the Administrative Court. During 2023, 197 direct tax claims were introduced before the Administrative Tribunal and 49 before the Administrative Court.

The tax administration stresses that the cases are increasingly complex and involve various issues relating to domestic and European topics, tax assessments, joint payment of taxes and exchange of information.

Indirect Taxes

With regard to indirect taxes, the VAT administration registered 268 claims against VAT assessments and 912 claims against additional VAT assessments during 2019. During the same year, taxpayers initiated proceedings against the VAT administration in 25 cases before civil courts. According to the VAT administration's statistics, in the vast majority of disputes between the taxpayer and the VAT administration, the courts essentially confirmed the VAT administration's position.

In 2020, the VAT administration registered 998 claims, where 304 related to claims against a VAT assessment and 694 were claims against administrative penalties. Within the same year, 41 claims were lodged before the civil courts against decisions of the VAT administration.

In 2021, the VAT administration registered 1,583 claims, of which 310 were filed against VAT assessment notices and 1,273 against administrative penalties.

In 2022, the VAT administration registered 1,660 claims, of which 340 were filed against VAT assessment notices and 1,320 against administrative penalties. Taxpayers initiated proceedings against the VAT administration in 27 cases before civil courts.

In 2023, the VAT administration registered 2,195 claims, of which 334 were filed against VAT assessment notices and 1,524 against administrative penalties. Taxpayers initiated proceedings against the VAT administration in 40 cases before civil courts.

12.3 Parties Succeeding in Litigation

Statistics regarding the outcome of litigation procedures are not published in Luxembourg.

Based on unofficial sources (annual MEETINCS conference, speaker Mr Georges Simon), for 2021, 29% of the Administrative Tribunal's decisions were in favour of the taxpayer (either fully for 23% or partially for 6%), while 49% of the decisions were unfavourable to the taxpayer.

Regarding the higher courts, a total of 54% of the Administrative Court's decisions were in favour of the taxpayer (with 28% fully and 26% partially), while 46% of the decisions were unfavourable to the taxpayer.

13. Strategies

13.1 Strategic Guidelines in Tax Controversies

When it comes to procedural matters, meeting the deadlines provided by the law remains one of the main considerations. With Luxembourg being a global hub for international investments, investors are usually residing in foreign jurisdictions.

Given that the claims and the writs of summons must be sent via registered mail or bailiff to the respective courts or counterparties, postal delays should be taken into consideration for the meeting of deadlines. However, litigants residing in foreign jurisdictions may appoint local legal counsel in order to co-ordinate the litigation procedure.

Further, given the large number of international groups using Luxembourg companies as a gateway to Europe, tax litigation procedures usually involve cross-border cash flows between linked entities residing in different jurisdictions. Such cases result in international tax issues which require close monitoring and co-ordination between the involved entities and their respective legal counsels.

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