

## New Circular L.I.R. n° 164/1 of 29 January 2025 on arm's length interest rates applicable to shareholders' current accounts

On 29 January 2025, Luxembourg Tax Administration ("LTA") issued a new Circular L.I.R. 164/1 ("Circular"), which replaces Circular L.I.R. of 23 March 1998.

The Circular brings clarifications on the application of the arm's length principle to determine interest rates applicable on current accounts of partners or shareholders of a Luxembourg company subject to corporate income tax, in two situations:

### 1. THE SHAREHOLDER OR PARTNER IS AN INDIVIDUAL

The Circular indicates that in this situation, the arm's length interest rates on the debit balance should be determined based on the conditions which would be agreed on the free market between third parties. Reference is made to the arm's length principle as per article 164, paragraph 3 of the Luxembourg Income Tax Law ("LITL").

As a simplification measure, LTA indicates that, in order to establish the interest rates on the shareholder current accounts debit positions, it is acceptable to use as a reference the annual interest rate applicable to consumer loans.

For this purpose, the monthly average rates for the respective entity's financial year should be considered. Such rates and statistics are published monthly by the Luxembourg Central Bank.

The interest should be recorded at the end of the financial year, and its calculation depends on whether the current account remains consistently in a debit position during the respective financial year or if it fluctuates.

The Circular further mentions that the provisions of the memo LITL 164/1 of 9 June 1993 remain valid, especially in relation to the criteria for a reimbursable current account debit.

The main difference observed, compared to the Circular of 1998, is the abolishment of the 5% safe harbour rate and the requirement to apply instead a market interest rate.

## 2. THE SHAREHOLDER OR PARTNER IS A RELATED PARTY ENTERPRISE

In line with the previous circular, for debt positions between related party companies, the Circular emphasizes the importance of determining interest rates on a case-by-case basis according to the arm's length principle, as outlined in Articles 56 and 56bis of the LITL.

It further specifies that, in determining interest rates, factors such as the loan's currency, currency risk, credit risk, refinancing considerations, maturity, and other relevant aspects must be taken into account.

### WHAT ARE THE RISKS AND WHAT SHOULD YOU DO NEXT?

With the new Circular, the LTA reiterates the importance of respecting transfer pricing principles when setting interest rates on related party transactions. It also emphasizes the need to support the interest rates charged between related parties companies with appropriate transfer pricing documentation.

Failure to comply with the arm's length principle may lead to challenges and adjustments by the LTA to the amounts reported in the corporate income tax return of Luxembourg entities. This could result in significant additional taxes, cash flow constraints, and penalties for late payments.

Given the recent substantial increase in TP audits, requests for additional information from the LTA, and TP-related case law in Luxembourg, it is advisable to:

- ▶ Assess the materiality of debit amounts recorded in shareholders' accounts, as well as the duration these amounts were outstanding.
- ▶ Review the interest rates applied to shareholders' current accounts to ensure compliance with the new provisions of the Circular.
- ▶ Prepare adequate justifications for debit positions with individual shareholders and maintain comprehensive transfer pricing documentation for intercompany debt positions.

### HOW BDO CAN HELP?

BDO's Transfer Pricing team is here to support you with ensuring compliance with the requirements of the new Circular.

Our team of experts can assist you in assessing potential risks, reviewing your existing intercompany financing arrangements, and optimizing your transfer pricing policies to align with the latest regulatory standards.



## INTERESTED?

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