

# Tax Controversy

*Contributing editor*  
**Jean A Pawlow**



2016

GETTING THE  
DEAL THROUGH 

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# Tax Controversy 2016

*Contributing editor*

**Jean A Pawlow**

**McDermott Will & Emery LLP**

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# Luxembourg

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## Overview

### 1 What is the relevant legislation and who enforces it?

The relevant legislation is the Luxembourg Tax Law (LTL), which is compiled in seven volumes and provides common rules for determining the taxable basis and the applicable procedural regulations.

The rules governing tax compliance procedures, tax recovery and tax controversies are not compiled in one single volume. Tax compliance related to direct tax matters is governed by provisions of German inspiration, whereas indirect taxes, namely registration duties as well as value added tax, have their own tax proceedings.

The LTL is enacted by Parliament and is enforced by the Luxembourg Tax Authorities (LTA) and the Luxembourg courts.

### 2 Other than legislation, are there other binding rules for taxpayers and the tax authority?

The LTA must apply the LTL in accordance with the provisions of other binding rules deriving from:

- the Constitution;
- double tax treaties signed by Luxembourg that are currently in force;
- EU directives that have been duly implemented into Luxembourg legislation;
- the European Convention on Human Rights; and
- the Treaty on the Functioning of the European Union.

Additionally, the LTA generally issue circulars and administrative notes that ensure a uniform interpretation of the LTL. Such circulars and guidelines are published on the LTA website and also have a legally binding effect for the LTA and taxpayers.

Moreover, taxpayers may apply for advance tax clearances on the application of certain provisions of the tax law to their personal situation. Such rulings, which must be duly justified and addressed in writing to the competent tax service, are binding for the LTA if approved. In practice, a summary of the request will be published on an anonymous basis in the annual report of the LTA.

Finally, the LTA and tax courts generally and extensively refer to German case law.

### 3 How is the tax authority organised?

The LTA are headed by the Ministry of Finance and are divided into three main parts:

- the directorate, which is mainly in charge of legislation, claims, international relations and tax audits;
- several tax offices, which review the declarations and calculate the taxes due; and
- the tax collection services.

## Enforcement

### 4 How does the tax authority verify compliance with the tax laws? What is the typical procedure for the tax authority to review a tax return and how long does the review last?

The LTA have the power to perform tax audits on the basis of documents and on the spot over all taxpayers.

In practice and particularly in the case of audits of corporate income tax returns, the LTA will generally issue provisional tax assessments that

are solely based on the filed tax returns, without carrying out any prior review of the latter. At a later stage and within the legal statute of limitations, the LTA may review the provisional tax assessments further to the tax return's verification.

Tax returns related to personal income tax or to indirect tax are directly subject to a final tax assessment after the competent tax inspector has verified the tax return. Such tax assessment must be issued within the legal statute of limitations.

The tax inspector must follow a certain order when conducting his or her investigations: first, he or she must request additional information on the facts and numbers reported in the tax returns. Second, if the requested information is deemed insufficient, he or she may require copies of the related legal documents. Last, he or she may require from the taxpayer an explanation as to why a certain tax treatment is applied in the tax return.

The tax inspector will only be allowed to require additional information from third parties if the information obtained from the above steps is deemed insufficient and the taxpayer does not provide useful explanations. Upon request from the tax inspector, the taxpayer (or the third party) is legally obliged to provide all clarifications and documents required as long as such information is relevant to review the tax return.

Exceptionally, if the off-site check is inconclusive, the inspector may conduct an on-site tax audit, which generally takes place at the residence or professional address of the taxpayer. Based on the 2014 annual report of the LTA, 45 on-site tax return reviews were performed leading to an additional collection of taxes amounting to €6,510,023.86.

The duration of the review varies and can take up to several months depending on several elements (eg, the level of detail provided in the tax return, the size of the business, the reactivity of the taxpayer in providing the required information, etc).

### 5 Are different types of taxpayers subjected to different reporting requirements? Can they be subjected to different types of review?

Taxpayers are either business entities or individuals. The rules that apply to the review of their tax returns are generally similar; however, some differences exist and are mainly related to the determination of their taxable basis and the applicable tax rate, as described below.

Contrary to the tax rate applicable to businesses, which is fixed and the same for all types of business taxpayers, the tax rates applicable to individuals are progressive and take into account the taxpayer's personal situation such as marital status, the minimum essential income, etc.

The official deadlines for filing personal income tax returns, corporate income tax returns and VAT returns are set on different dates.

Personal income tax returns can be electronically filed. VAT returns must be electronically filed. Other tax returns are filed via mail.

The taxable basis of business taxpayers of a certain size, who are required to prepare annual financial statements, is based on their accounting results after adjustments for tax purposes. Duly approved financial statements are part of the tax return and must be enclosed therein. Individuals are taxed on their income after deduction of certain expenses specifically determined by the LTL.

In practice, tax audits on individuals are generally shorter and less complicated unless the individual carries out an undisclosed activity or is suspected of tax fraud.

## 6 What types of information may the tax authority request from taxpayers? Can the tax authority interview the taxpayer or the taxpayer's employees? If so, are there any restrictions?

The LTA are entitled to request any information that is deemed necessary to review the tax return.

The information requested includes copies of the contracts, copies of legal document supporting the entries included in the financial statements, copies of the transfer pricing report supporting a remuneration earned by the taxpayer, general ledger, invoices, bank statements, receipts, copies of tax returns filed abroad by a foreign subsidiary or by a foreign branch held by the taxpayer, copies of residence certificates confirming the fiscal residency of a related party, etc.

Tax returns are mainly reviewed by referring to the required documentation; however, the LTA may interview a taxpayer (individual) or the representative of a business taxpayer. Both are allowed to be assisted by their counsel.

If the LTA do not receive adequate answers from the taxpayer, they may request information from third parties at the taxpayer's cost.

## 7 What actions may the agencies take if the taxpayer does not provide the required information?

The LTA may force the taxpayer to cooperate by imposing a penalty. They may also issue an estimated tax assessment as a last resort.

## 8 How may taxpayers protect commercial information, including business secrets, from disclosure?

As taxpayers are obliged to cooperate with the LTA and to provide them with all relevant information related to their tax affairs (including information that is related to third parties), the LTA are legally subject to professional secrecy, ie, they are not allowed to disclose any information received, including commercial and business secrets. Breach of professional secrecy by a tax inspector may entail criminal charges against the LTA.

However, the LTA may be obliged to inform other public authorities or criminal prosecutors (eg, within the context of a criminal proceeding).

## 9 What limitation period applies to the review of tax returns?

The statute of limitations expires on 31 December of the fifth year following the fiscal year concerned (eg, the prescription period for taxes of the 2010 fiscal year ends on 31 December 2015).

The limitation does not apply when it comes to confirming the amount of tax losses carried forward, ie, the tax inspector can review these tax losses at any time, when they are needed to effectively offset taxable income.

In some cases, the statute of limitations can either be interrupted (eg, upon renunciation by the taxpayer) or be extended from five years to 10 years (eg, if the tax returns are not filed or are incomplete).

## 10 Describe any alternative dispute resolution (ADR) or settlement options available.

In order to avoid having the LTA challenge the filing of a tax return, taxpayers may either file a ruling with the LTA to agree upfront on the tax treatment applicable to their specific case or file an advance pricing agreement with the LTA to agree on the applicable arm's-length margin for transfer pricing purposes.

Upon agreement, the ruling or the advance pricing agreement is not transferable ipso facto to other cases and is binding for the LTA for five fiscal years (unless one of the key characteristics of the transaction is modified in the meantime). However, the decision of the LTA will no longer be enforceable if the legal provision or the administrative practice on which it was based is modified.

An appeal mechanism is also available within the tax administration (see question 26).

## 11 How may the tax authority collect overdue tax payments following a tax review?

Following a tax review, the tax inspector will issue a tax assessment confirming the amount of tax due. Such amount is payable within one month as from the date of notification to the taxpayer.

Under certain conditions, the taxpayer may apply for a payment in instalments or for the postponement of payment.

If the taxpayer does not pay within one month and has not concluded any payment arrangement with the LTA, the latter will initially issue an order to pay within five business days followed by a second order sent

via a bailiff if the first order does not produce the expected results. In the absence of payment further to the two orders, the LTA will issue a summons to pay within a certain period by which they will inform the taxpayer of their intention to pursue the payment of the outstanding tax (and related interest) by any legal means. Such legal means include seizure and realisation of a taxpayer's moveable assets, receivables, immoveable assets and seizure of amounts owed to the taxpayer by third parties (eg, an employer, a notary or banks).

For corporate taxpayers, the LTA may also request the court to declare a company bankrupt for default in payment. In this case, the bankruptcy trustee may realise the assets of the taxpayer in order to satisfy the payment obligations.

## 12 In what circumstances may the tax authority impose penalties?

The LTA may impose penalties if tax returns are not filed or not filed on time and if the tax is not paid on time.

## 13 How are penalties calculated?

The LTA may charge:

- additional tax (eg, 10 per cent of tax due);
- a fixed fine (which may range from €1,250 to €25,000); or
- a variable fine (ie, the fine's amount increases with respect to the period the tax return remains unfilled).

If the taxpayer refuses to file a tax return, the LTA may issue a tax assessment based on their estimate of the tax due.

## 14 What defences are available if penalties are imposed?

If the delay in filing a tax return is due to force majeure, the taxpayer can send a letter to the LTA to explain the objective reasons that prevented its timely filing. If the arguments of the taxpayer are accepted, the fine will be cancelled.

Moreover, where penalties are calculated on the amount of assessed tax, any reduction of such tax will result in cancellation of the excessive penalty.

## 15 In what circumstances may the tax authority collect interest and how is it calculated?

The LTA may charge interest for late payment of tax due. Interest for late payment is assessed at 0.6 per cent per month starting after the expiration of the month in which the relevant tax should have been paid.

## 16 Are there criminal consequences that can arise as a result of a tax review?

If as a result of a tax review, the LTA discover that substantial amounts were not declared on purpose by way of intentional false declarations or accounting misrepresentation (eg, if the accounts are falsified resulting in the omission of substantial taxable amounts or in deduction of substantial expenses, or if the supporting legal documents are missing or have been falsified), they may suspect and file a criminal case for tax fraud (or an attempt to commit tax fraud). The penalty related to the latter could be imprisonment and/or a monetary fine up to 10 times the amount of tax due.

## 17 What is the recent enforcement record of the authorities?

Based on the 2014 annual report of the LTA, the percentage of claims increased by 4 per cent in 2014, whereas the percentage of disputes solved through the administrative procedures increased by 18 per cent.

### Overview of the past six years

Year	Claims filed with the LTA	Claims solved upon decision of the LTA	Claims filed with the Administrative Tribunal	
			Without decision from the LTA	After decision of the LTA
2009	721	547	8	60
2010	778	596	13	106
2011	875	429	21	51

Year	Claims filed with the LTA	Claims solved upon decision of the LTA	Claims filed with the Administrative Tribunal	
			Without decision from the LTA	After decision of the LTA
2012	957	556	15	66
2013	1083	665	20	84
2014	1124	783	19	83

### Third parties and other authorities

#### 18 Are third parties involved in the authority's review of tax returns and what rights do taxpayers have with respect to their involvement?

The LTA are entitled to request information on a taxpayer from third parties, if the justifications provided by the taxpayer are insufficient to review the tax return. In principle, only documents and information which are relevant to review the tax return can be requested from third parties by the LTA. Additionally, the right of the LTA to request information may be limited by professional confidentiality applicable to certain third parties (eg, employees of the central service of statistics or STATEC).

As for banks, Luxembourg is entering a world of total fiscal transparency. Since 1 January 2015 banks have started to automatically communicate interest income received by non-residents of EU member states to the related tax authorities. As stated under OECD agreements, the main scope of the application of automatic exchange will be to extend it to other income. The exchange of information will include dividends and capital gains earned directly or indirectly in 2016, as well as bank account balances. In addition, the exchange will no longer be limited to EU countries but will apply internationally.

#### 19 Does the tax authority cooperate with other authorities within the country? Does the tax authority cooperate with the tax authorities in other countries?

Tax authorities can exchange information with any other local authority. Some information is automatically disclosed to the LTA (eg, income from employment as declared for social security).

Since 1 January 2015 Luxembourg has automatically exchanged information with EU member state tax authorities based on EU Directive 2003/48/CE as regards interest paid to individual residents in another EU country.

Luxembourg has transposed article 8 of EU Directive 2011/16/EU of 15 February 2011 on administrative cooperation in tax matters in its domestic law. Therefore, Luxembourg law has introduced a mandatory and automatic exchange of information on the following types of income: wages, pensions and directors' fees.

Luxembourg has also entered into a Foreign Account Tax Compliance Act agreement with the US according to which Luxembourg's financial institutions are required to provide the LTA with information regarding the accounts held by US citizens and US tax residents. The information will be forwarded to the US tax authorities.

Most double tax treaties are also a legal source of exchange of information between countries, based on the provisions of administrative assistance included therein.

Another source of exchange of information on VAT is EU Regulation No. 218/92 of 27 January 1992 modified by Regulation No. 1798/2003 of the EU Council of 7 October 2003.

### Special procedures

#### 20 Do any special procedures apply in cases of financial or other hardship, for example when a taxpayer is bankrupt?

In case of financial or other hardship, the LTA may authorise payment in instalments upon the taxpayer's request. Interest for late payment may in this case be adapted to the financial situation of the taxpayer.

The LTA may also postpone in full or in part the payment of tax if their immediate payment will irremediably compromise the financial situation of the taxpayer and provided that the financial difficulties are not due to the taxpayer's negligence. In this case, the LTA will generally require sufficient guarantees to protect their interest.

The LTA or the judge may also fully or partially waive the tax debt and related penalties if the collection of such amounts is unreasonably inequitable for the taxpayer.

Based on the 2014 annual report of the LTA, 335 requests were filed in this respect in 2014, of which 215 have received a decision from the head of the tax administration.

#### 21 Are there any voluntary disclosure or amnesty programmes?

In 2006 Luxembourg introduced a voluntary disclosure programme for individuals allowing them to repatriate money held in foreign bank accounts that they did not declare in exchange for absence of penalties and fines that would have otherwise been applicable.

No other voluntary disclosure or amnesty programmes have been introduced to date.

### Rights of taxpayers

#### 22 What rules are in place to protect taxpayers?

The LTL provides for certain rules in order to protect taxpayers.

For instance, the LTA are obliged to inform taxpayers that they intend to deviate from tax returns. Taxpayers must have the opportunity to defend the position taken in their tax returns before the issuance of the tax bulletin by the LTA.

Upon communication of the tax bulletin, the taxpayer can file a claim against such bulletin within three months as from the date of notification.

The LTA must apply the principles of objectivity and of proportionality when reviewing the tax returns.

#### 23 How can taxpayers obtain information from the tax authority? What information can taxpayers request?

The LTL provides that the taxpayer is entitled to receive from the LTA all information and documents that have led to the determination of their taxable basis, except for documents that may affect the tax situation of a third party, which must remain protected by fiscal secrecy. The information can either be automatically sent to the taxpayer or at the taxpayer's request.

#### 24 Is the tax authority subject to non-judicial oversight?

The Law of 22 August 2003 organises the tasks of a mediator who is placed under the supervision of Parliament. Any taxpayer (ie, an individual or a company via its legal representatives) who believes that, on the occasion of a personal conflict with the LTA, the latter did not act according to their mission as a public institution, or contravened conventions, laws or regulations, may bring the matter to the attention of the mediator either by way of a written or oral statement.

The mediator analyses the claims formulated by the taxpayer, investigates and proposes recommendations to the tax service concerned if the mediator concludes that the complaint is admissible.

Upon execution of the recommendations, the LTA must inform the mediator. If the LTA do not apply the recommendations, the mediator is entitled to publish the recommendations.

If a complaint is rejected, the mediator must inform the taxpayer by mail and justify his or her decision.

Based on the 2014 annual report of the LTA, 35 claims were filed via the mediator in 2014.

### Court actions

#### 25 Which courts have jurisdiction to hear tax disputes?

In principle, the courts that are competent for disputes related to direct tax (eg, personal tax, corporate income tax, municipal business tax, net wealth tax) are administrative courts.

Claims are initially heard by the Administrative Tribunal, which is therefore the tribunal of first instance.

An appeal against the decision of the Administrative Tribunal will be heard by the Administrative Court, which is the court of appeal. Such appeal may be based on an error in the application of the law or of a procedure.

Disputes related to indirect tax (eg, VAT, subscription tax) are heard by civil courts.



## 26 How can tax disputes be brought before the courts?

As regards direct taxes, there are two stages for filing a tax appeal. The taxpayer is obliged to file a formal claim with the LTA prior to filing a claim with the judge (ie, the claim to the court will not be valid in the absence of a prerequisite claim to the LTA).

The formal claim to the LTA must be filed within three months of the notification of the tax assessment; it must be sent to the head of the tax service that has issued the disputed tax bulletin. The inspector-in-chief will automatically review the overall tax position of the taxpayer (and not only the disputed points) and is expected to provide his or her decision within three months.

Based on the 2014 annual report of the LTA, 1,124 claims were filed in 2014, of which 983 have received a decision from the head of the LTA.

If the decision of the LTA is not (completely) satisfactory, the taxpayer can bring the dispute to the Administrative Tribunal within three months as from the notification of the decision of the LTA.

Six months after the filing of a formal claim, and if the LTA did not reply, the taxpayer is allowed to bring the dispute to the Administrative Tribunal at any time after the expiration of the above six months. Based on the 2014 annual report of the LTA, 103 claims were filed with the Administrative Tribunal in 2014, of which 19 did not receive a decision from the LTA.

As mentioned above, an appeal against the judgment of the Administrative Tribunal can be lodged with the Administrative Court.

With respect to indirect taxes, filing a formal claim with the LTA is not a prerequisite (ie, the taxpayer is allowed to file a claim with the court and another claim with the LTA simultaneously, alternatively or consecutively).

In both cases the filing of a claim with the LTA does not preclude the payment of the contested tax.

## 27 Must the taxpayer pay the amounts in dispute into court before bringing a claim? Can the costs of a dispute be recovered?

If the taxpayer does not agree with the tax determined by the LTA, he or she must nevertheless pay the amounts due within the established deadline and then file a claim with the LTA. If the decision of the LTA is not satisfactory, he or she may file a complaint with the Administrative Tribunal. However, the trial does not suspend the taxpayer's obligation to pay the disputed tax. The LTA may continue to pursue payment of tax even if the trial is pending.

Under certain circumstances, the payment of tax may be suspended upon the taxpayer's request provided that, based on the arguments presented by the taxpayer, the judge deems that the taxpayer's chances of winning the case against the LTA are significantly high and that it is possible to prove that the immediate payment of tax will result in the taxpayer's unreasonable and irremediable financial distress.

If at the closing of the trial, the decision of the judge is not favourable to the taxpayer, the tax and interest for late payment will be retroactively due (ie, including for the period when the payment of tax was suspended).

The costs of the legal procedure are generally borne by the party who has lost the case, ie, the judge will oblige the taxpayer to pay the costs for legal proceedings if the decision was favourable to the LTA and vice versa. The judge may allocate a portion of fees to each party if his or her decision is only partly favourable to each of them.

In principle, each party must pay the cost for hiring a representative (eg, a lawyer).

## 28 Who is the decision maker in the court? Is a jury trial available to hear tax disputes?

In general, the decisions of the fiscal courts are made by a panel of three judges. There are no jury trials to hear tax disputes.

## 29 What are the usual time frames for tax trials?

Tax trial decisions may take between six and 24 months to be delivered, depending on the complexity of the case. An appeal may take up to 24 additional months approximately.

## 30 Describe the discovery process for a tax trial.

Tax trials are generally based on factual elements and arguments described by each party in the briefs. Evidence to support their respective opinions are also generally directly provided by either the taxpayer or the LTA to the judge.

Other means (eg, testimony by an expert) may be used at the discretion of the judge. The judge will generally pronounce his or her judgment on the basis of facts, arguments and proof produced during the trial.

## 31 What testimony is permitted in a tax trial?

Any type of evidence is in principle acceptable including testimony by the taxpayer or by a court-appointed expert. The choice of the most appropriate means of evidence lies with the judge. In straightforward cases, only written evidence (eg, paperwork, accounts, invoices, contracts) is generally used.

## 32 Who can represent taxpayers in a tax trial? Who represents the tax authority?

In the proceedings before the tribunal of first instance taxpayers are allowed to either represent themselves or to appoint a representative provided that the latter performs a regulated profession (an attorney, a certified accountant or a certified auditor).

In proceedings before the court of appeal, taxpayers must be represented by an attorney.

The LTA are represented by the government's representative.

## 33 Are tax trial proceedings public?

In general tax trial proceedings are held in public. The parties or their representatives are allowed to orally present their arguments. The representative of the government must further give his or her conclusions, which are publicly read before the judges' deliberation. The deliberations are not held in public, although the final decision of the tribunal can be further read in a public hearing.

## 34 Who has the burden of proof in a tax trial?

The guiding principles governing the burden of proof in tax matters are not fundamentally different from those applicable in general: it belongs to each party to the trial to prove the facts being presented.

Indeed, the general rule is that the LTA have the burden of proving facts that trigger or that increase the taxable basis, whereas the taxpayer has the burden of proving facts that reduce or that cancel tax liability. In other words, the burden of proof of taxable income belongs to the LTA, while that relating to deductible expenses is to be made by the taxpayer.

However, the situation is different in the field of criminal tax law where the burden of proof remains in all cases in the hands of the LTA.

It should be noted that, within the context of a review of a tax return and if the LTA are doubtful about the accuracy of the facts and figures declared by the taxpayer, they are entitled to require additional information and the law provides that the taxpayer must mandatorily justify any points that seem doubtful to the LTA.

It is up to the LTA to prove that the procedure applied to the taxpayer has respected all the legal requirements (eg, the LTA must prove that they have diligently requested the tax return before issuing an ex officio tax assessment).

## 35 Describe the briefing process for a tax trial.

The taxpayer must file a duly justified written complaint with the Administrative Tribunal within three months following the notification of the decision of the LTA. The tribunal will immediately send a copy of the complaint to the LTA, which is thus deemed to be duly notified.

Upon receipt of a copy of the claim, the LTA will send a copy of the taxpayer's file to the Administrative Tribunal in order for the taxpayer to have access to all information contained in his or her tax file.

The representative of the LTA must lodge its defence in writing within three months.

After the tribunal has received the written defence of the defendant, a copy will be sent to the taxpayer, who may reply in writing to the defence within one month.

A copy of the plaintiff's brief will be sent to the representative of the defendant, who in turn has an opportunity to reply within one month.

Briefs that are produced after the expiry of the time limit required by the tribunal are generally not analysed by the judge.

In some cases, the judge can exceptionally extend the time limits for the above exchanges of briefs upon duly justified written request.

**36 Can a court decision be appealed?**

Any judgment of the Administrative Tribunal (in its capacity of tribunal of first instance) may be appealed to the Administrative Court. The appeal can be based either on the facts or on errors of law and of procedure.

The appeal must be filed within 40 days following the communication of the decision of the tribunal of first instance. Such delay cannot be extended. The taxpayer must be represented by a lawyer when appealing

against the judgment of the tribunal of first instance. The LTA must be represented either by a representative of the government or by a lawyer. The decision-making powers of the Administrative Court are similar to those of the Administrative Tribunal.

The decision of the Administrative Court is final (ie, it may not be challenged before a Court of Cassation).



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