Newsletter
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BONN STEICHEN & PARTNERS

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SUMMARY

BANKING & FINANCE

NEW RULES ON PAYMENT SERVICES

On July 24th 2013 the European Commission (the "Commission") presented its proposal for a new directive on payment services ("PSD2") and a proposal for a regulation on interchange fees for card-based payment transactions.

- The revised PSD2 will amend the previous payment services directive of 2007. The new directive aims to create higher levels of security and to improve consumers' protection to combat fraud and abuse. In addition, the proposal seeks to promote the introduction of new, innovative low-cost payment services, mainly internet-based services (without the use of a credit card). Consumers will be better protected against fraud, abuse and payment errors. Consumers may be required to face only very limited losses (up to maximum of 50 EUR – versus 150 EUR currently) in the case of an unauthorised credit card payment.

- Interchange fees are charged by card companies to retailers who in turn pass on the cost to the consumer. They are common in particular when purchasing airline tickets. Surcharges are additional charges imposed by some retailers when using certain payment cards. The Commission believes that capping the interchange fees will reduce costs for retailers and consumers and help to create an EU-wide payments' market. The regulation on interchange fees aims to introduce a cap on fees for cross-border transactions involving consumer debit and credit cards together with a ban on surcharges on these types of cards. After a transition period of 22 months, the caps will also apply to domestic transactions. The caps are set at 0.2% of the value of the transaction for debit cards and 0.3% for credit cards.

CAPITAL MARKET

RECENT DEVELOPMENTS IN EU LEGISLATION

Transparency Directive

The proposal for a directive amending Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC was adopted by Parliament in first-reading on June 12th 2013 and by the Council on June 21st 2013. The text has not yet been published in the Official Journal of the European Union but is provisionally agreed between the European Parliament and Council.

Some of the more interesting amendments include:

- The introduction of an obligation, across the EU, to disclose holdings of financial instruments that have the same economic effect as holdings of shares.
- The removal of the requirement to produce interim management statements or quarterly reports. The home Member State may make an issuer subject to requirements more stringent than those laid down in the directive, except they should not require issuers to publish periodic financial information on a more frequent basis than annual financial reports and half-yearly financial reports. Member States may nevertheless require issuers to publish additional periodic financial information if such requirement does not constitute a significant financial burden and if the additional information required is proportionate to what contributes to investment decisions. This is without prejudice to the ability of Member States to require the publication of additional periodic financial information by financial institutions.
- The introduction of a requirement for extractive and forestry logging companies to disclose payments to governments on a country by country and project specific basis.

As for timing, it is expected that these amendments will be implemented in the Member States in mid-2015.

Market Abuse Directive

On June 26th 2013, the Council approved a compromise with Parliament on a market abuse package, consisting of a regulation on the substantive rules aimed at attacking insider dealing and market manipulation on securities market and a directive containing criminal sanctions. While the text has yet to be consolidated and aligned to the new proposals for MIFID II, a final agreement is close.

The draft regulation extends the scope of the existing regulatory framework to financial instruments traded on more recently created venues such as multilateral trading facilities and organised trading facilities, as well as to OTC-traded financial instruments.

CORPORATE

CASE LAW UPDATE FROM THE "*COUR DE CASSATION*" OF 7th FEBRUARY 2013

The decision of the Supreme Court (*Cour de Cassation*) is informative and should be noted by legal and insolvency practitioners in Luxembourg. The Supreme Court was asked to rule on the duty of the liquidator to make adequate provisions for the liabilities of a company in liquidation.

The District Court (*Tribunal d'Arrondissement*) declared at the first instance unfounded the application for the grant of damages against the liquidator in respect of the completion of the liquidation of the company, a "*Société Anonyme*". In the case in question a ten-year warranty on construction (Articles 1792 & 2270 of the Civil Code) had not expired. It was held that the duty of the liquidator to make a provision for such liability had not been established.

The judgment was upheld on appeal. The Court of Appeal (*Cour d'Appel*) also stated that there is no legal provision that would prohibit the liquidation of a company before the expiry of the ten-year guarantee period and furthermore that there were no grounds for the suspension of the completion of the liquidation until the expiry of the guarantee period. In addition, the Court of Appeal also rejected the application for damages against the liquidator on the basis of Article 149 of the law of 10 August 1915 on commercial companies, as amended (the "LSC") because the existence of a dispute between the parties or of an unresolved liability of the company before the completion of the liquidation was not established.

The Supreme Court overturned the decision of the Court of Appeal and strongly criticised the decision of the Court of Appeal because article 149 of the LSC does not require the existence of a debt. The Supreme Court considered that the liquidator should have addressed the liability by the constitution of a provision or insurance to cover the obligation to repair the damage resulting from the occurrence of defects after completion of the liquidation for the remainder of the period of the guarantee.

Legal advisors and insolvency practitioners should be very vigilant in the future and advise the liquidator to make provisions in respect of contractual guarantees granted by the company in liquidation to third parties. If no period of guarantee is provided for under contract, the statute of limitations is 10 years in respect of claims arising pursuant to commercial matters.

INVESTMENT FUNDS

PRACTICAL GUIDANCE IN RESPECT OF THE ENTRY INTO FORCE OF THE EuVECA REGULATION AND THE EuSEF REGULATION – CSSF - PRESS RELEASE 13/36 OF AUGUST 2ND 2013

On July 22nd 2013, coinciding with the effective date of the Alternative Investment Fund Managers Directive (AIFMD), and following the Luxembourg implementation of the AIFMD (AIFM Law), Regulation No 345/2013 of April 17th 2013 on European venture capital funds (EuVECA) and Regulation No 346/2013 of April 17th 2013 on European social entrepreneurship funds (EuSEF) entered into force. Both the EuVECA and EuSEF regimes are only available to alternative investment fund managers (AIFMs) which are below the thresholds of article 3 (2) of the AIFMD (Light Regime).

As a reminder, the EuVECA and EuSEF Regulations are intended to provide AIFMs, which are subject to the Light Regime, the possibility to adopt the EuVECA or EuSEF designation. In addition to providing a brand name to such AIFMs, those designations enable Light Regime AIFMs to benefit from a marketing passport which would otherwise not be available to Light Regime AIFMs. Further information on the content of both regulations can be found in our Newsletter of September - January 2013, the Newsletter of April - June 2013 and our article "The new regime for European Venture Capital Funds" at http://www.bsp.lu/publications/articles-books/new-regime-european-venture-capital-funds.

In Luxembourg, the *Commision de Surveillance du Surveillance du Secteur Financier* (CSSF) is the competent authority for the issuance of the EuVECA or EuSEF designations. In relation thereto, the CSSF issued press release 13/36 in order to provide practical guidance to AIFMs wishing to adopt the EuVECA or EuSEF.

Interested AIFMs are therefore invited to provide the CSSF with the information required by article 14 of the EuVECA Regulation or article 15 of the EuSEF Regulation respectively to the following e-mail address: aifm@cssf.lu

Interested AIFMs also have to be registered as a Light Regime AIFM with the CSSF pursuant to article 3 of the AIFM Law. The CSSF already published practical guidance in this respect in its press release 13/32.

UPDATE UCITS V – EUROPEAN PARLIAMENT REJECTS REMUNERATION PROPOSALS

On July 3rd 2013 the European Parliament rejected proposals contained in the proposed directive amending Directive 2009/65/EC on undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (UCITS V Directive) regarding bonus caps and performance fees for managers of UCITS. The amendments adopted to the text provide for less strict curbs on UCITS fund managers pay.

In particular, the amended test:

- Retains the Commission's text where at least 50% of any variable remuneration must consist of units of the UCITS concerned or equivalent except in certain circumstances.
- Provides that at least 25% of the variable remuneration component must be deferred over a period which is appropriate.

The proposal has been referred back to the Committee on Economic and Monetary Affairs and will be subject to a later plenary vote of the Parliament.

For a full description of the UCITS V proposal please see our Newsletter of September 2012.

EMIR - UPDATE

Certain requirements under EU Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR) have recently or will soon enter into force.

CSSF Press release 13/26 of June 24th 2013

The Luxembourg financial services regulator (CSSF), through press release 13/26, drew the attention of financial counterparties (including undertakings for collective investment) to the fact that the following requirements under EMIR are applicable as from September 15th 2013:

1. Portfolio reconciliation: there shall be a written agreement between the FFIs which are party to an over the counter derivative contract (OTC Derivative Contract) on the arrangements under which portfolios shall be reconciled. Such agreement shall be reached before entering into the OTC Derivative Contract. Portfolio reconciliation may also be performed by an appointed third party. In any case, portfolio reconciliation shall be made on a regular basis depending on the number of OTC Derivative Contracts that have been entered into.
2. Portfolio compression: Only applicable when 500 or more OTC derivative Contracts are outstanding, in such case, the FFIs shall at least twice a year, analyse the possibility to conduct a portfolio compression exercise in order to reduce their counterparty credit risk and engage in such a portfolio compression exercise.
3. Dispute resolution: there shall be detailed procedures and processes in relation to (i) the identification, recording, and monitoring of disputes relating to the recognition or valuation of the contract and to the exchange of collateral between counterparties and (ii) the resolution of disputes which shall be done in a timely manner with a specific process for those disputes that are not resolved within five business days.

All three points above are part of the risk mitigation techniques for OTC Derivatives Contracts which are <u>not</u> cleared by a central counterparty.

In addition, according to the CSSF, as from September 23rd 2013 (<u>but</u> provided that a relevant trade repository (TR) is authorised by that date – see below), credit derivative and interest rate derivative contracts shall be reported to trade repositories.

ESMA - Trade Repository registration approval not expected before November 7th 2013, reporting to begin February 2014

The European Securities Market Authority (ESMA) published on September 13th 2013 an updated version of the timeline for the entry into force of EMIR. The main update of the timeline relates to the date of the expected first registration of a TR which was originally scheduled for September 24th 2013. The first TR

registration is now expected for November 7th 2013.

Furthermore, credit derivative and interest rate derivative contracts shall be reported as from February 2014 at the earliest, but still provided that a TR will have been authorised by that date (see above).

ESMA - Update of the Q&A Document on EMIR on August 5th 2013

On August 5th 2013, ESMA published its Questions and Answers Document on the Implementation of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (Q&A Document). As a reminder, the aim of the Q&A Document is, according to ESMA, to promote common supervisory approaches and practices in the application of EMIR. It provides responses to questions posed by the general public, market participants and competent authorities in relation to the practical application of EMIR.

ESMA - Draft implementing technical standards amending Commission Implementing Regulation (EU) No 1247/2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories under Regulation (EU) No 648/2012 (Draft RTS)

The draft RTS were issued by ESMA on August 6th 2013 in order to propose an amendment to article 5 of Commission Implementing Regulation (EU) N° 1247/2012. Such article provides for the format and frequency of reporting to TRs under EMIR. More particularly, it relates to the reporting of derivative contracts and proposes to postpone the deadline for the reporting of exchange traded derivatives by one additional year that is until January 1st 2015. In the opinion of ESMA, the postponing of the reporting requirement, which appear to be particularly complex, has proven essential in order for market participants to adapt to the new regulations and for ESMA to issue further guidelines on the topic.

INVESTMENT FUNDS - AIMFD

LUXEMBOURG PARLIAMENT ENACTED THE IMPLEMENTATION OF THE AIFMD ON JULY 12TH 2013

Implementation of the AIFMD is now accomplished

Directive 2011/61/EU of the European Parliament and of the Council of June 8th 2011 on alternative investment fund managers (AIFMD) has been implemented through the Luxembourg law of July 12th 2013 on alternative investment fund managers (AIFM Law).

It is the first time in Luxembourg that managers (AIFMs) of alternative funds (AIFs) are themselves regulated, considering the fact that the purpose of previous legislation was to provide regulation at the level of the AIFs.

As a result, the following entities are impacted by the AIFM Law, subject to exemptions:

1. Management companies under chapter 15 of the law of December 17th 2010 (UCI Law) relating to undertakings for collective investment (UCIs), when they manage investment funds other than undertakings for collective investment in transferable securities (UCITS);
2. Management companies under chapter 16 of the UCI Law;
3. Internally managed UCIs under part II of the UCI Law;
4. Internally managed specialised investment funds (SIFs);
5. Internally managed investment companies in risk capital (SICARs);
6. Unregulated entities which qualify as internally managed AIFs; and
7. Managers of unregulated externally managed entities which qualify as AIFs.

Requirements of the AIFM Law

All AIFMs are henceforth required to be either registered or authorised depending on the amount of assets that are under the AIFM's management. The Luxembourg supervisory authority, the *Commission de Surveillance du Secteur Financier* (CSSF), is responsible for the enforcement of both procedures.

The AIFMs are required to comply with new mandatory rules regarding, among others, conflicts of interest and risk management, organisation of the AIFM, transparency, remuneration, amount of capital, liquidity management, valuation, delegation arrangements and reporting.

In return for complying with those requirements, the AIFM Law offers new possibilities and opportunities to AIFMs. AIFMs shall now have the possibility to remotely manage AIFs in other countries and to market the shares of AIFs throughout the European Union.

Grand-fathering provisions

Pursuant to the grand-fathering rules of the AIFM Law, AIFMs are not required to be authorised under the AIFM Law if the AIF they manage is a closed-ended fund which either:

(a) is not making any investments after July 22nd 2013; or
(b) has a term which expires no later than July 22nd 2016 and whose subscription period closed before July 22nd 2011.

Transitional provisions

Any AIFM that falls within the scope of the AIFM Law shall have until July 22nd 2014 to comply with

the requirements as laid down in the AIFM Law and to apply for authorisation with the CSSF.

SUMMARY OF NEW AIFM DEVELOPMENTS

In the context of the implementation of Directive 2011/61/EU of the European Parliament and of the Council of June 8th 2011 on alternative investment fund managers (AIFMD), the European Securities Market Authority (ESMA) has issued in July and August 2013 the following guidelines, memoranda and opinions.

Guidelines on key concepts of the AIFMD

ESMA released on August 13th 2013 its final guidelines on key concepts of the AIFMD. The purpose of these guidelines is to ensure common, uniform and consistent application of the concepts that comprise the definition of "alternative investment funds (AIFs)" in Article 4(1) (a) of the AIFMD.

As a reminder, in order to know if a managing entity qualifies as alternative investment fund manager (AIFM) and thus is subject to the AIFMD, it must for such purpose assess whether the entity it manages qualifies as an AIF. An AIF is a collective investment undertaking, including investment compartments thereof, which:

1. raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and
2. does not require authorisation pursuant to Article 5 of Directive 2009/65/EC.

For that purpose, the guidelines define the terms (i) collective investment undertaking, (ii) raising capital, (iii) number of investors and (iv) defined investment policy.

Opinion on draft regulatory technical standards on types of AIFMs

On August 13th 2013, ESMA submitted its formal opinion to the European Commission, in response to the letter received on July 8th 2013, on draft regulatory technical standards (RTS) under Article 4(4) of the AIFMD (Opinion).

Previously in December 2012, in its consultation paper on the draft RTS, ESMA proposed to identify closed-ended and open-ended AIFs on the basis of the frequency of redemptions. If the possibility to redeem units/shares of the AIF is on a basis that is less frequent than annually, then, in ESMA's opinion, the AIF should be considered as closed-ended with all related legal results. However, the European Commission was of the opinion that all AIFs offering the possibility to their investors to redeem units/shares anytime prior to liquidation shall be considered as open-ended AIFs, regardless of the frequency of possible redemptions.

As a result of the foregoing debate between ESMA and the European Commission, ESMA in proposed new wording for the RTS provides that any possibility to redeem units/shares before the beginning of the AIF's liquidation shall henceforth qualify the AIF as open-ended. However it is also clarified that a decrease of the AIF's capital in connection with distributions cannot be considered as a redemption in this respect. In addition, whether an AIF's shares or units can be negotiated on the secondary market and are not repurchased or redeemed by the AIF shall not be taken into account for the purpose of determining whether or not the AIF is of the open-ended type.

Discussions are nevertheless still in progress between the European Commission and ESMA on that hot topic.

ESMA negotiations on memoranda of understanding

On July 18th 2013, ESMA finalised seven co-operation arrangements between EU securities regulators and their global counterparts.

Those foreign jurisdictions include:

- Commodity Futures Trading Commission, United States of America;
- Financial Services Agency of Japan;
- Ministry of Economy, Trade and Industry of Japan;
- Ministry of Agriculture, Forestry and Fisheries of Japan;
- Securities Commission, Malaysia;
- National Banking and Securities Commission of the United Mexican States; and
- Securities Commission of the Bahamas.

As from now, there are 38 agreements negotiated by ESMA on behalf of the 31 EU/EEA national competent authorities for securities markets supervision. Those agreements must be ratified by the relevant national authorities in order to be effective. In Luxembourg, the *Commission de Surveillance du Secteur Financier* (CSSF), has already ratified a significant number of co-operation agreements. The complete list of all agreements entered into by the CSSF can be found on the following web site: http://www.cssf.lu/en/about-the-cssf/international-relations/.

The purpose of such agreements is twofold. They cover third-country AIFMs that market AIFs in the EU and EU AIFMs that manage or market AIFs outside the EU. They also cover co-operation in the cross-border supervision of depositaries and AIFMs' delegates. As a result, third country AIFMs will be able to market their AIFs within the EU and to manage EU based AIFs.

Final guidelines on sound remuneration policies

The guidelines on sound remuneration policies (Remuneration Guidelines) under the AIFMD have been published in their final form by ESMA on July 3rd 2013. The Remuneration Guidelines are the most controversial topic in relation to the AIFMD. Among others, the long term (up to 5 years) deferral of remuneration paid to AIFMs has been criticised by the alternative investment fund industry.

In a reaction thereto, the British financial supervisory authority, the Financial Conduct Authority (FCA), states in its consultation paper CP13/9 dated of September 2013, that it contemplates to authorise AIFMs not to apply some requirements of the Remuneration Guidelines, including the deferral of remuneration, if the assets under management are under certain thresholds (less than £ 1.5 billion for leveraged portfolios and less than £ 6 billion unleveraged portfolios and which have no redemptions rights following the first 5 years of the initial launch of the relevant AIF).

If the FCA enforces its proposal, it is likely that Luxembourg and some other jurisdictions will follow in their footsteps.

CSSF - Frequently Asked Questions Document (FAQ) by the CSSF

On June 18th 2013, the CSSF published a FAQ document on the implementation of the AIFMD into Luxembourg law (AIFM Law). The aim of the FAQ document is to highlight some of the key aspects of the AIFMD from a Luxembourg perspective. More particularly, it stresses the impact of the AIFM Law on already existing Luxembourg entities falling under the scope of

the AIFMD. It further clarifies the application of the transitional provisions to Non-EU AIFMs marketing their AIFs in Luxembourg.

Please note that the European Commission has also published and updates on a regular basis its own questions & answers document, which can be found on the [European Commission web site](#).

ESMA's opinion on practical arrangements for the late transposition of the AIFMD

Following the end of the deadline for the implementation of the AIFMD into national law, ESMA published its opinion on August 1st 2013 on the arrangements to be adopted by AIFMs facing member states which have not transposed AIFMD yet, and which do not have the legislative framework in place to allow a proper implementation of the rights and obligations provided for in the AIFMD.

In particular, two potential issues have been identified by ESMA:

- The situation where an AIFM wishes to market shares in an EU country which has not transposed the AIFMD yet; and
- The situation where an AIFM wishes to manage an AIF located in an EU country which has not transposed the AIFMD yet.

In both situations, ESMA states that the competent authority in the EU country which has not transposed the AIFMD must accept the use of the marketing and the management passport by the AIFM authorised in its home member state.

LABOUR LAW

EUROPEAN COURT OF JUSTICE, JULY 18th 2013, C-426/11

In 2002, certain activities of a public entity were transferred to a private sector undertaking and the employees working in that department became part of the staff of such private sector undertaking. At the time of the transfer, the employees of the public entity had the benefit of a precise and explicit commitment to observe the terms and conditions arising from the collective bargaining process, both present and future (a so-called "dynamic clause", adopting the terms agreed in future agreements).

In 2004, a new retroactive agreement was reached by a local collective bargaining body. Given that the new terms and conditions were not binding on the private undertaking that was unable to participate in the collective bargaining body, it refused to abide by their terms.

According to the ECJ, the dynamic clause by which the employer may be indefinitely bound, in the event of a transfer of undertaking, by terms and conditions of employment to which it did not agree may undermine the fair balance between the interests of the transferee in its capacity as employer, on the one hand, and those of the employees, on the other. The transferee who is unable to participate in negotiations with the collective bargaining body can neither assert its interests effectively in a contractual process, nor negotiate the aspects determining changes in working conditions for its employees with a view to its future economic activity. Such limitation of the transferee's contractual freedom is liable to affect its freedom to conduct a business.

In the light of the foregoing, the ECJ found that the dynamic clauses referring to collective agreements negotiated and adopted after the date of transfer should not be enforceable against the transferee, where that transferee does not have the possibility of participating in the negotiation process of such collective agreements concluded after the date of the transfer.

EUROPEAN COURT OF JUSTICE, JULY 20TH 2013, C-7/12

A public administration employee took parental leave from November 2007 to May 2009. After her return to work, one post was abolished as a part of a structural reorganisation of the administration. In order to determine which official would be affected by the abolishment of that post, the performance and qualifications of four officials, including the plaintiff, were assessed. The concerned employee was assessed on the basis of the last annual performance appraisal conducted before she took parental leave. The other employees, who did not take parental leave, were assessed on the basis of a period from February 2008 to February 2009. As a consequence of a low overall mark, the employee was dismissed.

The employee brought an action before the competent courts arguing that under EU law; female workers taking parental leave have a right, at the end of that leave, to return to their post or an equivalent post. Moreover, according to the employee, the principle of non-discrimination was violated where the employees in active service and employees on parental leave could be assessed on the basis of different principles.

According to the ECJ, in order not to place employees who have taken parental leave at a disadvantage, the assessment must (i) encompass all employees liable to be concerned by the abolishment of the post, (ii) be based on criteria which are absolutely identical to those which apply to workers in active service, and (iii) not involve the physical presence of employees on parental leave.

Finally, the ECJ ruled that the national courts must verify whether it was possible for the employer who at the time of the transfer, was informed that the new post was due to be abolished, to allow a female worker who has been transferred to another post at the end of her parental leave to return to her former post or to a post where the work assigned to her was equivalent or similar and consistent with her employment contract.

TAX

LOWER ADMINISTRATIVE COURT – DECISION 30215: CLARIFICATION REGARDING THE IP TAX REGIME

The Lower Administrative Court of Luxembourg (*Tribunal administratif* - the “Court”) issued a decision on June 27th 2013 clarifying the conditions for the availability of the Luxembourg intellectual property regime (“IP Regime”) - which exempts 80% of the income deriving from qualifying intellectual property rights (“IP”) and particularly the condition with respect to the *date of creation* or acquisition of the IP which has to be after December 31st 2007.

In the case at hand, the Luxembourg company was selling, since its incorporation in 1994, products under its own trademark, but the registration of the trademark was only made in 2008. The Court hence had to rule on the date which is decisive for the availability of the IP Regime: (i) the date of registration of the trademark (2008, thus, after December 31st 2007) or (ii) the date as from which the company sold products under its own trademark (1994, thus, prior to December 31st 2007).
The tax authorities - on the basis of the circular issued by the head of the tax authorities on March 5th 2009 (“IP Circular”) - denied the application of the IP Regime on the grounds that the date of creation of the IP within the meaning of article 50*bis* LIR was not the date of registration of the trademark but the date as from which it was used.

Since article 50*bis* LIR does not give any definition of or guidance for the determination of the date of creation, the Court referred to the parliamentary documents and ruled that the date of creation in the sense of article 50bis (4) LIR is the date of registration of the trademark. The Court’s decision was hence favourable to the Luxembourg tax payer even if this was not in line with the IP Circular. In its ruling, the Court emphasised that the circulars issued by the head of the tax authorities are not statute provisions but internal administrative guidelines which may not impose additional or more stringent conditions than those expressly mentioned in the law.

An appeal has been introduced against this decision before the Higher Administrative Court.

CIRCULAR LIR N° 174/1 – CLARIFICATION OF THE MINIMUM CORPORATE INCOME TAX

On August 1st 2013, the Luxembourg Tax Authorities issued a Circular in relation to the Minimum Corporate Income Tax (“MCIT”). The MCIT regime existing since 2011 was amended and extended in 2013 to all Luxembourg tax-resident companies whether regulated or not. For financial companies (more than 90% of whose assets consist of financial assets, receivables against affiliated companies, transferrable securities and cash at bank) the MCIT amounts to EUR 3,000 and for the other companies the MCIT ranges from EUR 500 (for a total balance sheet of up to EUR 350,000) to EUR 20,000 (for a total balance above EUR 20M). We refer to our newsletter dated September – January 2013 for further details on the MCIT. The Circular specifies that, before determining whether the company is a financial company or not, the total balance has to be adjusted in order to exclude the income-generating assets, which are exclusively taxable in a third country by virtue of a double tax

convention (e.g. permanent establishments or real estate). This means for instance that companies holding exclusively real estate and cash will be subject to a MCIT liability of EUR 3,000.

The Circular also confirms and/or includes examples illustrating the following points:

- The MCIT will not be prorated in the year of incorporation or liquidation of a corporation.
- The MCIT does not impact the determination of the amount of losses that can be carried forward. If the losses carried forward exceed the taxable income of the relevant year, the balance will be carried forward and the MCIT applicable.
    - The MCIT is considered as an advance payment of corporate income tax that will not be reimbursed by the Luxembourg tax authorities but the amount paid can be offset against further corporate income tax liabilities with no time limit. The computation of the amount of the advance is illustrated by several examples.
    - The MCIT does not preclude the use of tax credits (investment tax credit, risk capital credit, credit for recruitment of unemployed people, etc.) which can be deducted from the Luxembourg income tax charge. However, such offsetting is limited (except for withholding tax credits), so that the corporate income tax liability of the company cannot go below the MCIT applicable for that company. Again, the Circular illustrates this concept with several examples.

DRAFT LAW INTRODUCING A NEW VEHICLE FOR WEALTH MANAGEMENT – THE PRIVATE FOUNDATION

On July 22nd 2013, the Luxembourg Government submitted to the Parliament a draft law introducing the private foundation into the Luxembourg law and providing for a step-up provision for individuals transferring their tax residence to Luxembourg.

Private Foundation

The private foundation ("Private Foundation") is an initiative to further develop the "private banking" in Luxembourg. It offers high net wealth individuals and private wealth management entities an interesting and tax efficient wealth and estate planning tool. Like the Anglo-Saxo Trust, it is an orphan structure but it differentiates itself by the fact that it has a legal personality. The Private Foundation may own any movable or immovable tangible or intangible assets. It may enter or be the beneficiary of insurance contracts but may not intervene in the management of the companies in which it holds a shareholding. The Private Foundation may issue registered certificates in relation with the assets held and representing the specific rights defined in the incorporation deed. It is managed by one or several directors and it therefore offers a solution in terms of governance: it allows to dissociate the economic rights attached to the assets held by the Private Foundation from the management of these assets.

From an income tax perspective, the Private Foundation is subject to the standard tax regime: it is subject to corporate income tax and municipal business tax. Income from capital as defined under article 97 of the Luxembourg Income Tax Law (i.e. interest and dividend income), capital gains from such investments, capital gains on the disposal of tangible assets 6 months after their acquisition and the capital and redemption value received pursuant to a life insurance are however tax exempt but is exempt from net wealth tax.

Distributions made by the private foundation to an individual beneficiary or its founder resident in Luxembourg are not subject to withholding tax and benefit from a 50% exemption. Payments made to non-residents beneficiaries are not subject to withholding taxes and should not be taxable in Luxembourg.

The transfer of assets by the private foundation to its beneficiaries or its founder is tax neutral. At the level of the private foundation, the transfer of the assets is done at book value and at the level of the acquirer, the acquisition price to be taken into account is the historical book value of the assets as they were accounted for by the private foundation. This means that the transfer of assets to the foundation and the subsequent transfer of these assets from the foundation to the beneficiaries is from a tax perspective similar to a direct transfer of the assets to the beneficiary.

Regarding registration duties, the draft law proposes to introduce a specific registration duty which would be due on the net asset of the foundation at the time of the decease of the founder. This registration duty would be limited to the real estate located in Luxembourg if the founder was not resident in Luxembourg.

Step-up

The draft law provides for a step-up in basis for individuals becoming Luxembourg residents. This regime will apply to substantial shareholdings (i.e. more than 10% held in the share capital of the company) and convertible loans issued by companies in which the individual holds a substantial shareholding. Once the draft law is voted, Luxembourg will definitely not taxed the latent capital gains on the substantial shareholding existing at the date of the transfer of tax residence since the acquisition price of the substantial shareholdings and convertible loans issued by companies in which they hold a substantial shareholding will be deemed to be equal to their estimated realisation value at this date.

ADMINISTRATIVE COURT OF APPEAL – AUGUST 7TH 2013 – 31981C

In the case at hand, the exemption of the liquidation proceeds provided for under article 166 of the Luxembourg Income Tax Law (“LITL”) was denied by the tax authorities on the grounds that the holding period condition was not met.

A Luxembourg company (“ParentCo”) was holding a participation in a French real estate partnership (the “SCI”). On August 24th 2006, SCI was migrated to Luxembourg and converted into a Luxembourg private limited company (*Société à responsabilité limitée*). On June 7th 2007, less than 12 months after the migration and conversion, the SCI was liquidated.

The Court considered that, although not expressly mentioned in article 166 LITL, the benefit from the participation exemption regime is available only “*if the parent company and the subsidiary fall within the personal scope of that article (article 166LIR) throughout the holding period*”. In the case at hand, the Court ruled that the exemption was not available because ParentCo has not held during 12 months a shareholding in a company meeting

the legal form test; the holding period starting only when the legal form test is met.

The Court also rejected the argument of discrimination between a holding company under the law of July 31st 1929 ("Holding 1929" – this regime is abolished) which is "converted" into a fully taxable company (and which benefited from the holding period which elapsed during the period it was an exempt company) and a foreign company which is migrated to Luxembourg. According to the Court, the difference in treatment is justified by the fact that a Holding 1929 had adopted a corporate form listed on article 166 LITL since its incorporation while the French company did not, before its migration to Luxembourg, have a legal form referred to in article 166 LITL; the fact that the Holding 1929 was a tax exempt entity during a certain period of time being not relevant.

DOUBLE TAX TREATIES AND PROTOCOLS WITH LUXEMBOURG

Income tax treaty with Saudi Arabia

On May 7th 2013, Luxembourg and Saudi Arabia signed for the first time an income tax treaty ("Treaty") based on the OECD model tax convention. A 5% withholding tax on dividends and royalties is provided by the Treaty (to the extent conditions are met). No withholding tax will apply on interest payments. With respect to permanent establishments ("PE"), a "service permanent establishment" clause is included in the Treaty. According to such clause, the provision of services (including consultancy services) by a company through employees or other personnel engaged by the company for such purpose for a period of at least six months within any twelve month period will give rise to a PE. A "real estate rich companies" clause is also included in the Treaty which authorises the source State to tax capital gains realised upon disposal of shares in a company investing primarily in immovable property located in the source State. Further to the protocol to the Treaty, undertakings for collective investments and pension funds will be considered resident for Treaty purposes and beneficial owners of the income they receive. The Treaty will enter into force further to the completion of the ratification process by Luxembourg and Saudi Arabia and its provisions will apply as from January 1st of the following year.

Protocols to the tax treaty with Russia ratified

The protocol to the treaty with Russia signed on November 21st 2011 was ratified by Luxembourg on July 4th 2013 and by Russia on December 30th 2012. This protocol will be effective as from January 1st 2014. The main changes are the reduction of the dividend withholding tax rate to 5%, the introduction of a "service permanent establishment", a "real estate rich company" provision and an anti-treaty shopping clause.

Treatment of Luxembourg Private Wealth Management Companies (*Société de gestion de patrimoine familial*) under the income tax treaty between Luxembourg and Japan

On July 19th 2013, Luxembourg and Japan confirmed that Luxembourg private wealth management companies (*Société de gestion de patrimoine familial* – SPFs) will not have access to the tax treaty benefits, that is, SPFs will not be entitled to benefit from reduced rates or exemptions under the treaty. This would, however, not prevent exchange of information concerning SPFs between Luxembourg and Japan. This amendment entered in force on August 18th 2013.

Exchange of information – Protocols to the double tax treaties with Belgium, Malta, Romania and Switzerland

Luxembourg signed protocols to the income tax treaties with Belgium, Romania and Malta according to which the international standard of exchange of information upon request is integrated in the relevant tax treaties thus ensuring that these treaties comply with OECD international standards on tax information exchange. The protocols will be effective as from January 1st 2014.

Whist the tax treaty with Switzerland complies with the OECD international standards on tax information exchange since 2010, the Swiss Protocol clarifies that exchange of information between Luxembourg and Switzerland should not be hindered by measures or practices of an administrative nature that preclude an effective exchange of information between the two States. The Swiss Protocol further clarifies that the identification of the taxpayer subject to the tax control can be established by the requesting State by means other than name or address. This protocol is effective as from January 1st 2011.

FATCA UPDATE

As mentioned in our previous newsletter, the Luxembourg tax authorities have announced that they have chosen the Model I IGA which will provide automatic exchange of information between the Luxembourg and US tax authorities on bank accounts held in Luxembourg by citizens and residents of the United States. The IGA between Luxembourg and the US has not yet been executed.

The relevant developments regarding FATCA are as follows:

- The IRS issued Notice 2013-43 (Notice) which amends the timeline for the entry into force of FATCA requirements (most of the deadlines have been extended for a period of six months):
    - FFI of jurisdictions under Model I IGA have time beyond July 1st 2014 to register and to obtain a global intermediary identification number (GIIN) in order to ensure that they are included on the IRS FFI list before January 1st 2015;
    - Withholding certificates and documentary evidence are valid until June 30th 2014;
    - All Qualified Intermediary (QI), Withholding Foreign Partnership (WP), and Withholding Foreign Trust (WT) Agreements within the meaning of FATCA will be automatically extended until June 30th 2014.
- The FATCA registration portal is opened since August 19th 2013. All FFIs are required to register under this web site. To ensure inclusion in the June 2014 IRS FFI List, registration must be finalised by April 25th 2014 at the latest. A "user guide" containing registration guidelines is available on the web site of the IRS.
- The IRS has also issued two set of FAQ. The first set focuses on registration issues. The second set concerns issues involving QI, IGA and other registration issues. Please refer to the web site of the IRS for further guidance.

- Recently, the finalised version of Form W-9 and the related instructions have been released.

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