NEWSLETTER

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COVID-19

PLEASE ALSO REFER TO OUR BSP COVID-19 DEDICATED NEWSLETTER FOR MORE INFO ON THE LATEST LUXEMBOURG LEGAL DEVELOPMENTS ARISING FROM THE COVID-19 EMERGENCY.

INVESTMENT FUNDS | ANNUAL ACCOUNT DEROGATIONS

BACKGROUND

On 26 March 2020, the Chamber of Deputies of the Grand-Duchy of Luxembourg issued a draft law No.7540 (the "**Draft Law**") for the purposes of introducing temporary derogations from accounting requirements for financial sector entities, including funds, in the context of the fight against the COVID-19 virus.

The temporary derogations concern only deadlines relating to a financial year closed on the date of the end of the state of crisis and for which the deadlines for filing and publication had not expired on 18 March 2020.

For investment funds, the proposed derogations included in the Draft Law are the following:

- First, by way of derogation from Article 23(2) of the amended Law of 15 June 2004 on investment companies in risk capital ("**SICAR**"), an extension period of 3 months is granted to make available to investors the annual report together with the auditor's certificate.
- Furthermore, by way of derogation from Article 52(2) of the amended Law of 13 February 2007 on specialised investment funds ("**FIS**") and from Article 38(2) of the amended Law of 23 July 2016 on reserved alternative investment funds ("**RAIF**"), an extension period of 3 months is granted to make available to investors the annual report.
- Finally, notwithstanding Article 150(2), subparagraph 2, of the amended Law of 17 December 2010 concerning undertakings for collective investment ("**UCITS**"), an extension period of 3 months is granted for the publication of the annual and semi-annual reports.

In addition the Draft Law allows the CSSF to postpone by three months the deadline for the filing of other periodic reports, not referred to in this Draft Law, required by any of the laws where it acts as supervisor.

There is also before the Parliament a draft law No.7541 which will allow commercial companies to benefit from an extension period of 3 months for filings and publications with the Luxembourg Register of Commerce and Companies.

COVID-19: WHAT IS THE IMPACT ON THE FREE MOVEMENT OF PERSONS?

The coronavirus has spread around the globe and the scale of the threat faced today underlines the imperative need for coordinated restriction measures on the free movement of people at the European level, in order to maximise the potential impact of measures taken at the national level to fight the pandemic.

However, while 14 Member States (Luxembourg excluded) have notified the European Commission of their decision to temporarily reintroduce border controls to limit the spread of the COVID-19, it remains imperative that certain categories of cross-border workers be able to travel to their workplace without constraint or delay.

It is in this context that the European Commission adopted on 16 March 2020 a communication calling for temporary travel restrictions applying to all non-essential travel from third-countries to the European Union

(the "**EU**"), including Member States of the European Economic Area and Switzerland (the "**Associated States**"). On 30 March 2020, the European Commission also published guidelines on how to implement these temporary travel restrictions (the "**Guidelines**").

Following the endorsement by EU leaders, all EU Member States are now applying these restrictions.

TEMPORARY RESTRICTIONS FOR NON-ESSENTIAL TRAVELS

Pursuant to the European Commission recommendations and guidelines, the temporary travel restrictions should apply to all **non-essential** travels from third-countries to the EU and the Associated States.

More particularly, the restrictions on non-essential travels shall concern **non-resident third-country nationals** where they present relevant symptoms or have been particularly exposed to risk of infection and are considered to be a **threat to public health**. In this respect, if a refusal decision is issued by a border guard, it must state the precise reasons for the refusal and be given by means of a standard form (available under Annex V Part B of the Schengen Borders Code). In addition, any refusal decision must be proportionate, non-discriminatory and implemented in a way that ensures full respect of the human dignity of the persons concerned.

EXEMPTION FOR EU CITIZENS AND RESIDENTS

EU citizens and third-country nationals legally residing in the EU shall however be exempted from these restrictions. Member States shall indeed always admit these individuals on their territory for the purpose of returning home. Member States can however take appropriate measures such as requiring non-nationals entering their territory to undergo self-isolation or similar measures upon return from an area affected by COVID-19, provided they impose the same requirements on their own nationals.

FREE MOVEMENT OF CERTAIN CATEGORIES OF WORKERS

As many of the cross-border and posted workers are crucial for their host Member State (e.g. in the health care system, provision of other essential services such as medical equipment or supply of goods), unhindered movement across borders is essential for them. Indeed, restrictions applied to these workers could lead to additional difficulties or even hinder efforts to fight the COVID-19 crisis.

Consequently, cross-border and posted workers (including workers using a Member State only as a transit country to reach another Member State) as well as seasonal workers shall benefit from continued and free mobility, and Member States should allow these workers to have unhindered access to their place of work if they exercise:

- one of the critical occupations listed in the Guidelines (non-exhaustive list); or
- other activities still allowed in the host Member State; or
- seasonal activities in particular in the agricultural sector.

To ensure free mobility of these workers, Member States (in particular those that have temporarily reintroduced border controls) should establish **burden-free and fast procedures** for border crossing points regularly used by these workers (such as dedicated lanes or specific stickers).

In addition, health screening, which can only be carried out before or after the border, should not necessitate the workers to leave their vehicles (e.g. by electronic body temperature measurement, which should not be carried out more than three times within the same day).

RELATED NATIONAL MEASURES IMPLEMENTED IN LUXEMBOURG

In light of the Commission recommendations, the Luxembourg Government adopted a grand-ducal regulation on 18 March 2020 introducing a series of measures in the context

of the fight against COVID-19 (the "**Regulation**").

The Regulation provides that third-country nationals may no longer enter the territory of Luxembourg from 18 March 2020 at 18.00 for a renewable period of one month. In this regard, in order to be in line with the European recommendations, the Luxembourg government could clarify the conditions under which a decision to refuse entry to the Luxembourg territory may be issued.

Citizens of the EU and the United Kingdom (who must be treated in the same way as citizens of the EU until the end of 2020), as well as their family members, are however excluded from these temporary travel restrictions for the purposes of returning home, in accordance with the European Guidelines.

Derogations are in addition provided, in particular, for:

- cross-border workers;
- third-country nationals who have long-term resident status, as well as any other person with a right of residence in accordance with European directives and national law in Luxembourg or one of the neighbouring countries;
- health professionals, health researchers and professionals involved in the care of the elderly;
- persons employed in the transport of goods and persons, including airline personnel;
- members of the diplomatic corps, personnel of international organisations, military personnel, personnel in the field of development cooperation and humanitarian aid, in the exercise of their respective functions;
- passengers in transit;
- passengers traveling for urgent and duly justified family reasons.

SITUATION OF THIRD-COUNTRY NATIONALS ALREADY IN LUXEMBOURG

The Regulation furthermore provides that, by way of derogation from the Law of 29 August 2008 on the free movement of persons and immigration, the validity of visas, temporary residence permits, residence cards and residence permits, due to expire after 1 March 2020, is automatically extended for the duration of the state of emergency (which has been extended for three months by a law of 24 March 2020).

Similarly, the stay of third-country nationals not subject to visa requirements whose stay has just exceeded 90 days will be considered legal for the duration of the state of emergency.

CAPITAL MARKETS

PROSPECTUS REGULATION | ESMA UPDATES

On 18 February 2020, ESMA updated its Q&As in relation to Regulation (EU) 2017/1129 of 14 June 2017 on the prospectus to be published when securities are offered to the pubic or admitted to trading on a regulated market (the "**Prospectus Regulation**") with two new Q&As clarifying the permitted length of summaries in prospectuses for multiple securities and multiple guarantors.

Pursuant to Article 7(3) of the Prospectus Regulation, the length of summary in a prospectus shall not exceed seven sides of A4-sized paper when printed.

Pursuant to Article 7(7), where a single summary covers several securities which differ only in some very limited details, such as the issue price or maturity date, the maximum length set out in paragraph 3 shall be extended by two additional sides of A4-sized paper only. ESMA has clarified in these updated Q&As that the extension of two additional pages is not per security. In total, the summary cannot exceed nine sides of A4-sized paper. On the other hand, the summary in a key information document (KID) can be extended by three pages for each additional security.

Pursuant to Article 7(7)(c), where there is a guarantee attached to the securities, specific information on that guarantee and the guarantor must be included in the section of the summary which provides key information on the securities. In such case, the maximum length of the summary shall be extended by one additional side of A4-sized paper per guarantor. ESMA stresses the need to keep summaries with multiple guarantors as short as possible and encourages that the additional pages only be used for information relating to the guarantors.

MIFID II & MIFIR | UPDATE OF ESMA Q&A

Since our last newsletter, ESMA updated its Q&A on the implementation of investor protection topics under the Market in Financial Instruments Directive 2014/65/EU of 15 May 2014 ("**MiFID II**") and on the Markets in Financial Instruments Regulation 600/2014 of 15 May 2014 ("**MiFIR**"): Q&A on MiFID II and MiFIR investor protection and intermediaries (the "**Q&A**").

This updated Q&A includes an entire new section on "MiFID practices for firms selling financial instruments subject to the Bank Recovery and Resolution Directive ("**BRRD**") regime".

Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms established a common approach within the EU for the recovery and resolution of banks and investment firms. Directive (EU) 2019/879 of 20 May 2019 (the "**BRRD 2**") amends the BRRD and will enter into force on 28 December 2020, but Member States may apply some derogations.

Article 44a of the BRRD 2 has introduced new requirements for the 'Selling of subordinated eligible liabilities (SELs) to retail clients'. The new section of the Q&A provides practical guidance on the application of Article 44a of the BRRD 2 and the relevant MiFID II requirements to which Article 44a cross-refers.

More specifically, the updated Q&A provides information on the following topics:

- Sales of subordinated eligible liabilities and the assessment of suitability;
- Whether Article 44a of BRRD 2 should be applied only if there is an active offering on the part of the firm;
- Information to be collected from clients in order to comply with Article 44a(1) and 44a(2) of BRRD 2;

- Calculation of 10% threshold referred to in Article 44a(2)(a) of BRRD 2;
- What happens if a transaction relating to subordinated eligible liabilities is deemed unsuitable by the firm, but the retail client wishes to proceed anyway;
- Monitoring of 10% threshold referred to in Article 44a(2)(a) of BRRD 2.

INVESTMENT MANAGEMENT

CSSF ML/FT RISK ANALYSIS ON THE COLLECTIVE INVESTMENT SECTOR

BACKGROUND

On 27 January 2020, the CSSF published its first ML/FT risk analysis on the collective investment sector (the "**Analysis**").

In 2019, in order to link the national risk assessment ("**NRA**") of money laundering and terrorist financing ("**ML/FT**") to the entity-level ML/FT risk assessments that the CSSF performs annually on investment fund managers operating in Luxembourg, the CSSF already began an analysis of ML/FT risks affecting the collective investment sector.

The Luxembourg's NRA concluded in its first publication back in December 2018 that the collective investment sector carries a high inherent ML/FT risk.

SUBSTANCE OF THE REPORT

The aim of the Analysis, apart from the establishment of a link between the NRA and the investment fund managers ML/FT risk assessments, is to develop a more granular and systematic perspective on the risks faced by the collective investment sector, to elaborate supervisory actions and identify specific sub-sectors, products and activities which present a higher risk of ML/TF.

The assessments made in the Analysis follow the general CSSF risk assessment approach defined in the CSSF's AML/CFT risk assessment policy and focuses on the collective investments sub-sector. In this respect, a separate entity-level risk assessment for each regulated undertaking for collective investment and a clustering for three main classes have been made, namely: UCITS ManCo, AIFM and self or internally-managed UCI.

The Analysis provides for a non-exhaustive list of threats and risk mitigating factors that should be taken into account by the actors of the collective investment sector.

The Analysis furthermore gives high level recommendations to enhance the regulatory and supervisory framework.

PURPOSE

The CSSF, through the explanations and examples given in the Analysis, expects supervised entities involved in the collective investment sector to reflect the findings and conclusions from this sub-sector risk assessment into their frameworks.

The Analysis should help actors of the collective investment sector to better identify the risks they are facing in matters of ML/FT and to take all measures appropriate to effectively mitigate those risks.

MONEY MARKET FUNDS | REPORTING AND STRESS TESTS – CSSF CIRCULARS

On 28 January 2020, the CSSF published the following three Circulars for the attention of all money market funds ("**MMF(s)**") under the supervision of the CSSF and Luxembourg managers of MMFs as well as of those that take part in the functioning and control of these undertakings:

CSSF CIRCULAR 20/734 ON NEW REPORTING OBLIGATIONS FOR MMF MANAGERS AND CSSF CIRCULAR 20/736 ON ESMA GUIDELINES ON THE REPORTING TO COMPETENT AUTHORITIES UNDER ARTICLE 37 OF THE MMF REGULATION

Article 37 of Regulation (EU) 2017/1131 of 14 June 2017 on money market funds ("**MMF Regulation**") requires that periodical information from the managers of MMFs be provided to competent authorities within a frequency depending on the assets under management.

Following the publication of (i) the template to be used by managers of MMFs when reporting to competent authorities under Article 37 of the MMF Regulation (found in the Annex to Regulation (EU) 2018/708), (ii) ESMA's "Money Market Fund reporting technical reporting instructions" - *Ref. ESMA/65-8-6480*, and (iii) ESMA's "Guidelines on the reporting obligations to competent authorities under Article 37 of the MMF Regulation" - *Ref. ESMA34-49-168,* Circular 20/734 provides additional Luxembourg specific technical details for managers of MMFs to fulfil their reporting obligations under Article 37 of the MMF Regulation.

ESMA's "Guidelines on the reporting obligations to competent authorities under Article 37 of the MMF Regulation" are implemented into the Luxembourg regulation by means of CSSF Circular 20/736.

The CSSF Circular 20/736 emphasises that the first reporting period starts from 01/01/2020 to 31/03/2020 for MMFs subject to a quarterly reporting obligation, respectively from 01/01/2020 to 31/12/2020 for MMFs subject to a yearly reporting obligation. For funds authorised as MMFs after 1 January 2020, the first reporting should cover the period from the authorisation date of the MMF (exact date) until the end of the reporting period. This also means that MMF managers will have to provide reports for MMFs that are authorised, but have not yet been launched.

Further to ESMA's statement on 31 March 2020, the CSSF announced that the submission of quarterly reporting for Q1 and Q2 to the CSSF as required per Article 37 of the MMF Regulation by managers of Luxembourg domiciled MMFs is postponed to September 2020. As a result, the previously applicable submission deadline stated in Circular CSSF 20/736 (end of April 2020) is postponed. An amended XML schema (version 1.1) together with revised reporting instructions will be published and the CSSF stated that the submission of the relevant reporting before the September deadline is encouraged.

CSSF CIRCULAR 20/735 ON ESMA GUIDELINES ON STRESS TEST SCENARIOS UNDER ARTICLE 28 OF THE MMF REGULATION

Article 28 of the MMF Regulation provides that ESMA shall develop guidelines with a view to establishing common reference parameters of the stress test scenarios to be included in the stress tests that MMFs or managers of MMFs are required to conduct. These guidelines will be updated at least every year taking into account the latest market developments.

The CSSF has implemented into the Luxembourg regulatory framework the first set of these guidelines (*Ref. ESMA34-49-115*) back in 2018 with the publication of the CSSF Circular 18/696. In light of the recent update to the guidelines, CSSF Circular 20/735 now adopts into national regulation ESMA's updated "Guidelines on stress tests scenarios under Article 28 of the MMF Regulation" - *Ref. ESMA/34-49-164*. In contrast with their previous version, these latest ESMA guidelines now include common reference stress test scenarios as well as common reference parameters for those scenarios.

BREXIT | CSSF PRESS RELEASE ON BREXIT NOTIFICATIONS

On 31 January 2020, the CSSF published press release 20/03 in the context of Brexit (the "**Press Release**"). It refers to the CSSF's press releases issued in 2019 on Brexit as well as the Luxembourg Laws of 8 April 2019 published in the context of the United Kingdom leaving the European Union without a withdrawal agreement (the "**Hard Brexit Laws**"). The purpose of the Hard Brexit Laws was to establish a transitional framework ensuring that the entities from the United Kingdom providing financial services in Luxembourg under the EU passport would be able to continue their activities for a limited period in the event of a hard Brexit.

Following a formal adoption of the withdrawal agreement relating to the withdrawal of the

United Kingdom from the European Union on 31 January 2020, EU Law will continue to apply in the United Kingdom until 31 December 2020. The assumption of a hard Brexit is therefore no longer relevant and the CSSF's Press Release provided that the individual decisions granting a 12-month transitional regime to the UK entities and all notifications made in that context through the eDesk portal were lapsing. Moreover, sections of the eDesk portal dedicated to Brexit notifications were closed effective immediately.

The Press Release also pointed out that notwithstanding the current political situation, impacted entities should continue to take all necessary steps to anticipate the end of the transition period on 31 December 2020. Preparations should include contingency planning as well as provision of adequate information to investors and customers.

AIFMD | ESMA CONSULTS ON GUIDELINES ON ARTICLE 25 (LEVERAGE)

On 27 March 2020, the European Securities and Markets Authority (ESMA) announced a public consultation on its draft guidelines (the "**Guidelines**") on article 25 of Directive 2011/61/EU on alternative investment fund managers (the "**AIFMD**") related to leverage risks in the alternative investment funds sector. The consultation is a part of the ESMA's response to the recommendations of the European Systemic Risk Board (ESRB) published in April 2018 on liquidity and leverage risk in investment funds.

The objective of the Guidelines is to establish consistent and effective supervisory practices within the European System of Financial Supervision and to ensure the common, uniform and consistent application of Article 25 of the AIFMD.

Article 25(1) of the AIFMD provides that Member States shall "*ensure that the competent authorities of the home Member State of the AIFM use the information to be gathered under Article 24 for the purposes of identifying the extent to which the use of leverage contributes to the build-up of systemic risk in the financial system, risks of disorderly markets or risks to the long-term growth of the economy*".

The Guidelines relate to the assessment of leverage-related systemic risk and aim at ensuring that the National Competent Authorities adopt a consistent approach when assessing whether the condition for imposing leverage-related measures are met. They set out a two-step approach that NCAs should adopt when carrying out their risk assessment: firstly identifying the level, source and different uses of leverage and secondly identifying leverage related systemic risk. The Guidelines suggest that NCAs carry out the assessment on a quarterly basis and use a range of qualitative and quantitative data.

ESMA invites comments on all matters referred to in the Guidelines and in particular on the specific questions summarised in Annex I. Comments should respond to the question stated, indicate the specific question to which the comment relates and describe any alternatives ESMA should consider (if any). All contributions should be submitted online at www.esma.europa.eu using the dedicated Response Form by 1 September 2020.

DIRECTIVE (EU) 2019/2162 ON COVERED BONDS | AMENDMENTS TO UCITS DIRECTIVE

On 18 December 2019, Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019 on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU (the "**Directive**") was published in the Official Journal of the European Union. The Directive aims to establish rules to protect investors in their transactions involving covered bonds. The Directive amends Directive 2009/65/EC of the

European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (the "**UCITS Directive**").

Article 52(4) of the UCITS Directive already allowed an exemption to the minimum percentage of assets that a UCITS is authorized to invest in transferable securities issued by the same issuer. In the case of covered bonds, Member States could raise the general 5% limit to allow a UCITS to invest up to 25% of its assets in covered bonds issued by the same issuer. The Directive amends article 52 (4) to provide that the 25% limit applies in the following circumstances:

i. Where bonds were issued before 8 July 2022 and met the requirements applicable to covered bonds on the date of their issue, or
ii. Where bonds fall under the definition of covered bonds in the Directive which means a debt obligation that is issued by a credit institution in accordance with the provisions of national law transposing the mandatory requirements of the Directive and that is secured by cover assets to which covered bond investors have direct recourse as preferred creditors.

In addition, the Directive reduces supervisory requirements by exempting Member States from reporting the list of covered bond categories and authorised issuers to ESMA and the EU Commission.

Those measures shall be applied at the latest from **8 July 2022**. Transitional measures foresee that covered bonds issued before 8 July 2022 that comply with the UCITS Directive as applicable on the date of their issue, are not subject to the requirements set out in the Directive (i.e. requirements on bankruptcy remoteness of covered bonds, eligible assets, coverage and liquidity requirements and permission for covered bond programmes requirement), and continue to be referred to as covered bonds in accordance with the Directive until their maturity.

UCITS | UPDATED CSSF FAQ

On 10 March 2020, CSSF issued updated Frequently Asked Questions concerning the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment. The update concerns disclosure of the performance fee, the investment manager's fee and the investment advisor's fee to investors of a UCITS.

1. The fee model for any performance fees payable by a UCITS should be disclosed in the prospectus, as well as the investment manager as the entity entitled to receive such fee, and, should there exist a sharing arrangement of the performance fee with any investment advisor(s) contractually linked to the UCITS, the prospectus shall also inform about this arrangement.
2. UCITS are obliged to have disclosure in the prospectus of all expenses and fees. This disclosure should distinguish between:
    - Fee to be paid by the unit-holders, and
    - Fee to be paid out of the assets of the UCITS.

Where a service fee is directly paid out of the assets of the UCITS to the investment manager(s), and possibly to any investment advisor(s) contractually linked to the UCITS, such a fee shall only pay for investment management, respectively investment advice and the method of calculation or the rate of the fee to each recipient must be disclosed in the prospectus.

When other expenses or fees for activities beyond the direct scope of investment management or advice are payable out of the assets of the UCITS to the investment manager(s) or investment advisor(s), such expenses or fees must be disclosed separately from the investment manager's fee or the investment advisor's fee, in a way that clearly informs investors about the nature of such expenses or fees. The CSSF clarified that as a general rule the investment advisor's fee is expected to be at a lower level than the investment manager's fee.

In cases where the option of an “all-in” fee is proposed, which implies that only one compensation amount is paid out of the assets of the UCITS to a recipient (commonly the management company) who will afterwards pay the other service providers to the UCITS, the prospectus must clearly state the scope and nature of such “all-in” fee. Ideally, each contractual recipient of this all-in fee should be specified. This provides clarity to investors concerning compensation, fees and expenses in order to allow comparison across UCITS and facilitate investment choice.

UPDATED REQUIREMENTS FOR LUXEMBOURG UCITS MARKETED IN HONG KONG

BACKGROUND

The Securities and Futures Commission of Hong Kong (the “**SFC**”) and *the Commission de Surveillance du Secteur Financier* (the “**CSSF**”) signed on 15 January 2019 a Memorandum of Understanding concerning Mutual Recognition of Covered Funds (“**MRF**”) between both countries.

In relation to MRF, the SFC issued on 28 February 2020 an updated circular, guidance notices, application forms, checklists and FAQs (notably regarding the application procedures for investment funds under the revamped authorization process).

MAIN CHANGES

The main changes that were made by the updates are the following:

- Key facts statements (“**KFS**”) templates have been updated. It is now required to include risks regarding renminbi shares and specific disclosures regarding the use of derivatives.
- It is no longer possible to follow the standard application process under the “revamped authorization process” for Luxembourg UCITS that invest more than 50% of their NAV in derivative instruments or funds that use guaranteed features. In this case, the non-standard application process has to be used in Hong Kong.
- If a previously authorized UCITS changes after its authorization and, as a result, no longer meets the eligibility criteria, the SFC must be informed as soon as possible.
- The SFC removed the possibility to prepare a long-form audit report. It is now mandatory to use the SFC specific report.

PERFORMANCE FEES | ESMA GUIDELINES FOR UCITS AND CERTAIN TYPES OF AIFS

On 3 April 2020, ESMA published its guidelines on performance fees in investment funds, which will be applicable to both UCITS and certain types of AIFs. The guidelines will be translated into the official EU languages. They will become applicable two months after the publication of the translations on ESMA’s website.

According to ESMA’s press release, the guidelines shall provide comprehensive guidance to fund managers when designing performance fee models for the funds they manage, including the assessment of the consistency between the performance fee model and the fund’s investment objective, policy and strategy, particularly when the fund is managed in reference to a benchmark. ESMA’s guidelines aim at harmonising the way fund managers charge performance fees to retail investors, as well as the circumstances in which performance fees can be paid.

Currently there are different practices across the national competent authorities regarding performance fee structures as well as on the circumstances in which performance fees can be paid. This creates risks of regulatory arbitrage and inconsistent levels of investor protection. The common requirements will allow convergence in how national competent authorities supervise performance fees models and disclosure across the European Union.

The guidelines are applicable to UCITS as well as some types of open-ended AIFs marketed

to retail investors, in order to ensure a level playing field and a consistent level of protection to retail investors.

CROSS-BORDER FUNDS DISTRIBUTION | ESMA CONSULTATION

On 31 March 2020, ESMA launched a consultation paper in order to draft implementing technical standards ("**ITS**") in accordance with regulation (EU) 2019/1156 on facilitating cross-border distribution of collective investment undertakings (the "**Regulation**").

According to the Regulation (covered in our October 2019 newsletter) such ITS should determine standard forms, templates and procedures for the publication and notifications that national competent authorities ("**NCAs**") are required to make in relation to national provisions concerning marketing requirements applicable within their jurisdiction.

ESMA seeks input on information relating to:

- the approach to take regarding the format of publications (to ensure up-to-date information and determine main characteristics of the summary of marketing requirements in a clear and simple manner);
- the format of information to be published regarding fees and charges relating to cross-border activities;
- the creation and the maintenance up-to-date of the central database on cross-border marketing of AIFs and UCITS.

The consultation paper represents the first stage in the development of the draft ITS by ESMA and is due by 30 June 2020. ESMA's final report is expected to be published on 2 February 2021.

TAX

LUXEMBOURG PARLIAMENT ADOPTS LAW TRANSPOSING DAC 6 ON MANDATORY DISCLOSURES RULES

On 21 March 2020, the Luxembourg Parliament adopted the law implementing Directive (EU) 2018/822 ("**DAC 6**") which introduces new reporting obligations on Luxembourg intermediaries that design, market or implement reportable cross-border tax arrangements. These reportable arrangements are identified according to certain "hallmarks" which may, in some cases, be combined with a main benefits test (please refer to our April 2018 and August 2019 newsletters for further details).

In light of concerns expressed by the Luxembourg Council of State, the draft law was amended prior to adoption. These amendments concerned in particular the scope of the exemption for certain intermediaries subject to professional confidentiality. As a result of the amendments, lawyers governed by article 35 of the amended law of 10 August 1991, chartered accountants governed by article 6(1) of the amended law of 10 June 1999 and audit professionals are exempted from all reporting obligations to the Luxembourg tax authorities. In practice, these exempt intermediaries will be required to notify other intermediaries (or, in the absence of an intermediary, the taxpayer himself) of their obligation to report a tax arrangement. The taxpayer may nonetheless mandate an exempt intermediary to report a transaction on his behalf.

The Law will enter into effect on 1 July 2020 with retroactive effect for reportable tax arrangements whose first step was implemented between 25 June 2018 and 30 June 2020. These reportable tax arrangements must be reported by 31 August at the latest.

LUXEMBOURG PROPOSES TAX MEASURES AGAINST BLACKLISTED JURISDICTIONS

On 25 March 2020, the Luxembourg Government Council approved a draft law which aims at introducing a specific non-deductibility rule for interest and royalties paid or due to an affiliated enterprise established in a jurisdiction which features on the EU list of non-cooperative jurisdictions for tax purposes. The aim of the new rule is to specifically target certain financial operations which are carried out with related enterprises established in those jurisdictions, in line with the commitment by Luxembourg, at the EU Council meeting of 5 December 2019, to implement such measures.

Indeed, following on from the work of the EU Code of Conduct Group on Business Taxation, the EU Council, in December 2017, adopted an EU list of non-cooperative jurisdictions for tax purposes, which were set out in an Annex to its conclusions. The list of non-cooperative jurisdictions is updated regularly, most recently on 18 February 2020 and currently includes the following jurisdictions, with the next update of the list being anticipated to take place in October 2020:

- Cayman Islands
- American Samoa
- Fiji
- Guam
- Oman
- Palau
- Panama
- Samoa
- Seychelles
- Trinidad and Tobago
- US Virgin Islands
- Vanuatu

Given that the draft law has not yet been published, no further details (such as the expected timing for entry into force) are currently available. Taxpayers should therefore be mindful of the issues that the new rule could cause.

BSP

LUXEMBOURG ISSUES DRAFT LAW AMENDING CRS AND FATCA LAWS

On 20 February 2020, a draft law was presented to the Luxembourg Parliament with the purpose of introducing amendments to the Luxembourg legislation implementing the Common Reporting Standard ("**CRS**") and the Foreign Account Tax Compliance Act ("**FATCA**"), the two main frameworks for automatic exchange of information in Luxembourg.

The amendments impose additional obligations on Luxembourg reporting financial institutions ("**RFIs**") and foresee the possibility of lump sum penalties in case of non-compliance.

CRS AND FATCA OBLIGATIONS FOR LUXEMBOURG RFIS

The draft law will require every Luxembourg RFI to:

- refrain from implementing practices for the purposes of circumventing exchange of information;
- set up policies, controls, procedures and IT systems, proportionate to the RFI's nature, specificities and size, to ensure the fulfilment of the RFI's CRS and FATCA reporting and due diligence obligations;
- maintain registers of the actions undertaken and of evidence relied upon to ensure the execution of reporting and due diligence procedures for 10 years after the end of the year, during which the RFI was required to report the information under the CRS and/or FATCA; and
- submit a nil CRS report to the Luxembourg tax authorities with respect to any calendar year during which the RFI maintained no CRS reportable account, in the form required by the Luxembourg tax authorities and by 30 June of the following year (The existing obligation to file a nil FATCA report, where applicable, will continue to apply and will now be expressly included in the FATCA Law).

The comments to the draft law clarify that RFIs may use service providers to fulfil the above-mentioned obligations, although the RFI remains responsible for their fulfilment and should ensure that any service providers which they engage for this purpose have policies, controls, procedures and IT systems in place that meet the RFIs' compliance responsibilities.

NEW PENALTIES FOR NON-COMPLIANCE WITH CRS AND FATCA RULES

A flat penalty of EUR 10,000 is foreseen in case an RFI does not file a CRS report (neither a nil report nor a report reporting accounts) by the reporting deadline. In addition, the scope of reasons for levying the maximum penalty of EUR 250,000 is broadened such as not only to apply to cases of missing or incomplete reporting, but also in case of non-compliance with any of the other RFI obligations foreseen by the CRS or FATCA laws.

POWERS OF INVESTIGATION OF THE LUXEMBOURG TAX AUTHORITIES

Finally, the draft law also clarifies the powers of investigation of the Luxembourg tax authorities and extends them to allow, upon request, and for a period of 10 years, access to records of the actions undertaken, evidence relied upon for the performance of the reporting and the due diligence procedures, the policies and procedures as well as the IT systems of the RFI.

ENTRY INTO FORCE

The above changes, which still have to pass through the legislative procedure and could thus be subject to amendments, are intended to apply as from 1 January 2021, if adopted in the course of this year.

ECJ DENIES APPLICATION OF PARENT-SUBSIDIARY DIRECTIVE TO GIBRALTAR COMPANIES

On 2 April 2020, the European Court of Justice ("**ECJ**") rendered its judgment in the case '*GVC Services (Bulgaria)'* (C-458/18) following a preliminary ruling requested by the Sofia Administrative Court in Bulgaria (*Administrativen sad Sofia-grad*) addressing the question of Gibraltar within the European Union ("**EU**") and more particularly whether Gibraltar companies could rely on Article 2 of the EU Parent-Subsidiary Directive (2011/96/EU) ("**PSD**") as further amended, together with its Annex I. The ECJ's ruling was long awaited after Advocate General ("**AG**") Hogan had given his opinion on this case on 24 October 2019 (please refer to the article in our January newsletter).

BACKGROUND

The request for a preliminary ruling before the ECJ relates to the distribution of dividends free of withholding tax from a Bulgarian subsidiary to its parent company established in Gibraltar ("**GibCo**"). The Bulgarian distributing company applied the withholding tax exemption of the PSD as implemented in Bulgarian law, arguing that GibCo should be considered as a foreign legal person resident for tax purposes in a Member State of the EU. Such interpretation was rejected by the Bulgarian tax authorities and subsequently challenged before the Administrative Court of Sofia, Bulgaria, which decided to refer the questions to the ECJ for a preliminary ruling.

The questions referred to the ECJ entailed whether the PSD can be interpreted as to apply to GibCo, being established in Gibraltar, a European territory whose external relations are under the responsibility of the United Kingdom, an EU Member State at that time. Since Gibraltar companies are not listed in Annex I to the PSD, the question was thus whether it could rely upon the provisions of Annex I related to the United Kingdom. As far as the United Kingdom is concerned, GibCo must (i) be categorised as falling under the title 'companies incorporated under the law of the United Kingdom' (forms of companies – Part A) and (ii) be subject to 'corporation tax in the United Kingdom' (taxes covered - Part B).

JUDGMENT OF THE ECJ

In its ruling, the ECJ followed the advocate general ("**AG**") Hogan's opinion by clarifying that Article 2 of the PSD, together with its Annex I, are to be interpreted as meaning that the terms 'companies incorporated under the law of the United Kingdom' and 'corporation tax in the United Kingdom' do not refer to companies incorporated in Gibraltar and subject to tax there.

However, in contrast to AG Hogan, the ECJ refused to carry out an analysis of the Bulgarian law in light of the EU freedom of establishment principle. The Bulgarian law distinguishes between dividends paid by a subsidiary to its parent company located in an EU Member State, which are free of withholding taxes and payments made to a parent company located in Gibraltar, which are subject to withholding taxes on the sole ground that the parent company is incorporated in Gibraltar.

With its judgment, the ECJ has thus, once again, interpreted the PSD strictly, however without specifying whether the Bulgarian law violated the EU freedom of establishment.

TAX FORGIVENESS (REMISE GRACIEUSE) DUE TO THE PASSIVITY OF THE TAX AUTHORITIES

In the course of the year 2017, an employee of Company A prepared and filed the 2015 tax return for Company B, a subsidiary of Company A. The employee however had no authority to do so. A few weeks after filing the tax return, the tax office issued a net wealth tax assessment on the basis of §100a (hereinafter a "**100a Assessment**") of the Luxembourg general tax code (*Abgabenordung* hereinafter "**AO**"), which is

exclusively based on the filed tax return without the tax office having carried out any investigation on the correctness of the content of the tax return. Such an assessment can then be reviewed and challenged by the tax authorities within a period of 5 years (or 10 years in certain cases). When the employee received the 100a Assessment, a mistake in the tax return and the resulting 100a Assessment was noticed and the tax office in charge was contacted. The mistake was pointed out and a request for rectification of the mistake was made but the tax office did not answer.

After Company B, in turn, realized that an incorrect tax return had been filed by an unauthorised person and that incorrect assessments were issued, it contacted the tax office explaining the situation and tried to file an amended tax return. The tax office did not take the amended tax return into account as the 100a Assessment had in the meantime become final, given that no action had been taken by the taxpayer during the 3 months' appeal period following their notification. As a result, Company B decided to ask for a tax forgiveness under §131 AO which was rejected by the director of the Luxembourg tax authorities and by the Lower Administrative Court (*Tribunal administratif)*.

The Higher Administrative Court (*Cour administrative*) once again confirmed that a tax forgiveness under §131 AO is not a venue to challenge the basis of the taxation, but is to be granted only in cases where the taxpayer's personal situation is such that a subjective inequity arises (e.g. the payment of the tax would endanger his economic existence for reasons out of his own hands) or if the application of the tax legislation leads to an objective inequity, i,e, an outcome contrary to the intention of the legislator. In the present case, the Court found that the tax office was entitled to issue the 100a Assessment, since the decision to do so falls within the discretionary power of tax offices. However, the Court recalls that a discretionary decision must comply with the criteria of fairness and expediency. According to the criteria of fairness, a discretionary decision must, among other things, be appropriate to the concrete situation of the taxpayer. In the case at hand, the Court found that the tax office adopted a completely passive attitude after the issuance of the 100a Assessment, despite having received additional information to the contrary. Due to this passive behaviour (which included not informing the taxpayer that his email was not tantamount to a formal appeal but that a proper appeal against the tax assessment should be filed), the taxpayer lost any possibility to rectify the error, which led to a situation where he faced a tax burden that turned out to be excessive. The Court concluded that the forgiveness is justified on the basis that the passive attitude of the tax office after the issuance of the 100a Assessment was not appropriate to the taxpayer's situation and led to excessive taxation that was contrary to the intention of the legislator.

This case serves as an important reminder that, not only is the threshold for granting a tax forgiveness under §131 AO very high, resulting in only few judgements being passed in its favour, but also that any communication with the tax authorities should be carefully drafted and labelled, so as to ensure that proper appeals have been lodged in due course.

LOWER ADMINISTRATIVE COURT | ADVANCE TAX AGREEMENTS BINDING ON TAX ADMINISTRATION

In a judgment of 28 January 2020, the Luxembourg lower administrative court (*Tribunal administratif*) held once again that advance tax agreements are binding upon the Luxembourg Tax Administration ("**LTA**").

In February 2013, the taxpayer, a *société anonyme* incorporated under Luxembourg law (the "**Company**"), requested in writing an "advance tax agreement" regarding the tax

treatment of Mandatory Redeemable Preference Shares (“**MRPS**”) which generated a preferred dividend for its sole shareholder representing 85% of the net capital gain booked over the real property owned by the Company.

The taxpayer requested confirmation that the MRPS would be characterised as debt and that payments under the MRPS would be tax deductible. In April 2013, the tax administration responded and expressed its agreement that the content of the Company’s request complied with the tax laws and administrative practices currently in force. Such agreement was valid for one year.

However, the tax authorities challenged the Company’s 2013 tax return and demanded proof that the return on the MRPS complied with the arm’s length principle. The Company responded that this proof was not necessary since the MRPS’ tax treatment had been agreed by the LTA in the advance tax agreement. The Director of the LTA disagreed. The case was thus referred to the lower administrative court.

First, the lower administrative court found that, at the time (2013), advance tax agreements were not subject to any particular legislative framework. Thus, the conditions and scope of such an advance tax agreement would need to be settled by reference to general principles of law, namely the principles of legitimate expectation and of legal certainty. The court concluded that pursuant to the principle of legal certainty, the tax administration was bound to honour promises or assurances it had given. As a reminder, in order to be binding on the LTA, the following conditions should be met:

- the taxpayer’s question must be in writing;
- the taxpayer’s request must be sufficiently clear and complete to allow the LTA to adequately analyse the taxpayer’s situation;
- the LTA’s answer must come from a duly authorised tax official, or an official who the taxpayer could legitimately expect to be duly authorised;
- the LTA must have had the intention of being bound by the information given to the taxpayer (i.e. the answer is provided free of restrictions or caveats); and
- the LTA’s answer must have had decisive influence on the taxpayer.

In the case at hand, the lower administrative court found that all the conditions were met. Interestingly, the court added that in the presence of an advance tax agreement which lawfully binds the LTA, the tax authority cannot characterise the same structure and operations as an abuse of law, even when the structure results in a reduced tax burden, since the LTA has accepted the reality and legality of the taxpayer’s actions. The LTA cannot *ex post* reverse its position by characterising the same arrangement as abusive. This judgement presents welcomed certainty and clarification on the binding effect of past advance tax agreements on the LTA as well as the limitation of abuse of law in this context.

FRENCH CSG/CRDS CONTRIBUTIONS DEDUCTIBLE AS SPECIAL EXPENSES

On 22 January 2020, the Luxembourg lower administrative court (*Tribunal administratif*) handed down a judgment on the deductibility of French CSG/CRDS contributions (*Contribution Sociale Généralisée*/*Contribution pour le Remboursement de la Dette Sociale*) as special expenses related to employment income for Luxembourg income tax purposes.

In the case at hand, an individual resident in France was affiliated to the French social security and partly taxable on his employment income in Luxembourg, as his employment contract foresaw that part of his activity would be carried out in Luxembourg. The Luxembourg tax authorities initially denied the right to deduct the CSG/CRDS as special expenses on his employment income. The lower administrative court however concluded that the CSG/CRDS contributions should qualify as social security contribution within the meaning of Article 110 paragraph 1 of the

Luxembourg income tax law, as their purpose is to finance the French social security, in line with the position taken by the European Court of Justice in its *Ministre de l'Économie et des Finances v Gérard de Ruyter* (C-623/13) decision. Those conclusions were reached despite the fact that the French legislator considers those contributions as a tax. Interestingly, the judgement did not make a difference between the deductible and non-deductible parts of the CSG/CRDS contributions in France and considered the complete amount of the CSG/CRDS contributions related to the Luxembourg employment income as tax deductible. Indeed, with regards to social security contributions in Luxembourg, only part of the contribution is tax deductible, the remaining part (*contribution dépendance*) being non-deductible.

While the case provides helpful clarifications, it did not address the other key point related to the CSG/CRDS contributions, which is their treatment in Luxembourg pursuant to the new tax treaty entered into with France, which clearly includes the CSG/CRDS contributions as some of the taxes falling within the scope of the double tax treaty.

OVERALL ASSESSMENT OF MISCONDUCT DURING DIFFERENT TAX YEARS JUSTIFIES GUARANTEE CALL

On 13 February 2020, the Higher Administrative Court (*Cour administrative*) issued a ruling (docket No. 43707C) after an appeal lodged by the Luxembourg State against a judgment of the Lower Administrative Court (*Tribunal administratif*), which had decided, by reformation of a decision of the Director of the Luxembourg tax authorities (the "**LTA**") to partially declare unjustified a guarantee call (*Haftungsbescheid*), issued against the former manager (the "**Manager**") of a bankrupt company (the "**Company**").

The tax office had issued a guarantee call, declaring the Manager jointly and severally liable for taxes on wages and salaries which should have been withheld and subsequently paid to the LTA by the Company for the years 2000, 2001, 2003, 2004, 2005 and 2006.

In accordance with the tax provisions in force, managers may be held personally liable for taxes due by the managed company, in case of wrongful misconduct in the execution of the tax obligations incumbent on them in their capacity as legal representatives of the company. These obligations include in particular the withholding and payment to the LTA of taxes due on the salaries and wages of the company's staff, which was at stake in the case at hand.

In the first instance decision, the Lower Administrative Court made a distinction between the tax years 2000 to 2004, on the one hand, for which the Manager failed to declare the entire amount of withholding tax due on salaries, constituting misconduct on his part and justifying a guarantee call, and the years 2005 and 2006, on the other hand, for which the Manager declared withholding tax on salaries, but did not thereafter pay the entire amount of the tax withheld to the LTA. The Lower Administrative Court (wrongly) held that the report of the tax audit conducted by the tax office in 2007 for the years 2005 and 2006 did not indicate any outstanding tax, so that the Manager would not have committed any wrongful misconduct triggering his personal liability.

The Higher Administrative Court, following the appeal lodged by the State, confirms that, although the tax audit report does not retain any non-declaration or non-operation of deductions that should have been made, the full amount of the taxes withheld had not been paid to the LTA by the Company, constituting a wrongful act.

The Higher Administrative Court considers that, although it is true that, considered alone, the misconduct in relation to the incomplete declarations committed by the Manager for the

tax years 2000 and 2004, given their small amounts in comparison to the amounts actually declared and paid by the Company, appears to be rather tenuous, the fact remains that, taken together with the blatant omissions of payment committed during 2005 and 2006, they are such as to justify sufficiently the finding of wrongful misconduct on the part of the Manager. It follows that the Manager's personal liability is justified for all the years in question.

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