BSP Newsletter

2022 July edition

FINE-TUNED
LEGAL ADVICE
MADE IN
LUXEMBOURG

SUMMARY

MICA | REGULATION OF DISTRIBUTED LEDGER TECHNOLOGY

The first cornerstone: the adoption of the Markets in Crypto-assets ("MiCA") regulation

On 30 June 2022, the European Parliament and Council reached a provisional agreement on the MiCA regulation (the "**MiCA Regulation**"), providing a long-awaited legal framework for crypto-assets. The MiCA Regulation seeks to "*establish uniform rules for crypto-asset service providers and issuers at an EU level*" and to *"replace existing national frameworks applicable to crypto-assets*".

It is expected that the MiCA Regulation will foster the innovation and adoption of distributed ledger technology ("**DLT**") in Europe whilst ensuring the protection of consumers and investors. The regulation distinguishes between three types of crypto-assets whose issuers would be subject to registration:

- **E-money tokens** or "stablecoins" (e.g. USDC) – a token that can be used as a median of exchange and maintains a stable value by referring to the value of a fiat currency (e.g. Dollar)
- **Asset referenced tokens** (e.g. USDT) – a token that maintains a stable value by referring to several fiat currencies, commodities or a range of asset classes
- **Utility tokens** (e.g. BNB) – a token providing access to a good or service using DLT, and only being accepted by the issuer.

The main focus: E-money tokens or "stablecoins"

E-money tokens or **"stablecoins"** which are pegged to a fiat currency like the Euro seems to be a key focus of the MiCA Regulation. In the explanatory memorandum of the proposal, the European Commission explained that "*while the crypto-asset market remains modest in size and does not currently pose a threat to financial stability, this may change with the advent of global stablecoins*".

The MiCA Regulation shall impose significant regulatory requirements which must be met by both e-money tokens and asset referenced tokens. Under the MiCA Regulation, stablecoins issuers are required to hold 1:1 reserves which means that the same amount issued as e-money has to be held as reserve in fiat or other assets. Crypto-Asset Service Providers ("**CASPs**") will also not be allowed to collect interest on savings schemes using stablecoins.

Decentralised Finance

Another aspect of the developing digital asset industry is *Decentralised Finance* ("**DeFi**"), which describes DLT financial services, which operate without a centralised intermediary. The MiCA Regulation does not specifically regulate assets issued by DeFi protocols, however, these do qualify as crypto-assets and therefore shall be subject to the MiCA Regulation. More specific regulatory frameworks tailored to DeFi will likely follow at a later stage. DeFi cuts out any intermediary and allows, for example, the borrower and lender to use smart contracts to execute obligations directly and autonomously. Such assets are not limited to, but include, for example, interest received on a borrowed amount of crypto-assets.

Some key points of discussion during the drafting/review process

- **Proof-of-work ("PoW") under debate but not banned**

The debate leading up to the provisional agreement on the MiCA Regulation was centred on the question as to whether DLTs using a PoW consensus mechanism should be subject to a blanket ban: such a blanket ban would have stunned the European digital asset markets, as the most prominent PoW blockchain remains Bitcoin, the only "blue chip" crypto currency. The fight against PoW stems from the denunciation of the crypto mining industry and the energy intensive nature of mining. Indeed, the processing power and therefore energy required to mine Bitcoin has exponentially increased over the past decade, because the difficulty to mine Bitcoin increases as more Bitcoin is mined. Nevertheless, no general ban was included in the approved version of the regulation, as the commission preferred to deal with PoW as a necessary part of the industry.

- **Increasing consideration of ESG standards**

Although PoW based DLTs were not banned, the European Commission has become aware of the environmental impact caused by PoW based DLTs. As a result, it has developed strict new disclosure requirements for CASPs to comply with the European Environmental, Social and Governance standards. These standards include the obligation to publish a whitepaper, which explains the consensus mechanism used by the token or coin and its future purpose. Further standards will be determined by ESMA.

- **A possible special regime for Non-Fungible Tokens (NFTs)**

NFTs are non-fungible, which means that they are unique. These tokens represent proof of ownership and can also serve as proof of authenticity. They can be considered as being at the other end of the spectrum from fungible tokens, like Bitcoin, which are identical to each other and are therefore primarily used as payment methods. NFTs will not fall under the scope of the MiCA Regulation. Nevertheless, it remains to be seen whether the European Commission will introduce a special regime for NFTs in the near future given the use of NFTs in an increasing range of fields. For example, memberships, music and entry tickets (to concerts, games, transport, etc.) could be transformed into an NFT. While the MiCA Regulation steers clear of regulating NFTs themselves, the regulation shall regulate NFT marketplaces as CASPs.

A Growing Regulatory Umbrella

Once in force, the MiCA Regulation will join the ranks of a growing number of legislative texts, which are gradually starting to form a comprehensive umbrella of European digital asset and DLT regulation. The MiCA Regulation will complement the EU's Regulation (EU) 2022/858 on a pilot regime for market infrastructures based on DLT (the "**Pilot Regime**"), which was published in the Official Journal of the EU on 2 June 2022. The Pilot Regime regulates entities that provide securities trading and settlement infrastructure to crypto-assets, which qualify as financial instruments under MiFID. This legislation may be particularly important for Luxembourg, especially because the Luxembourg Stock Exchange recently opted to permit the issuance of security tokens through its platform (for more info see our newsletter on the topic here).

Lastly, there are also ongoing negotiations at an EU level relating to Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers of funds (the "**TFR**"). According to the TFR, KYC obligations may be imposed on any centralised crypto platform that sends funds to an "unhosted" digital wallet. This could potentially impose a disproportionate burden on retail customers who hold funds in digital wallets that are not hosted by a centralised CASP.

In conclusion, the EU is pioneering the construction of a legal framework for digital assets that will serve as a basis for countless jurisdictions worldwide. However, in going down this path, EU legislators should be careful not to stunt the growth of the market by "over-legislating" the industry.

CROWDFUNDING REGULATION | LATEST LEGAL AND REGULATORY DEVELOPMENTS

Introduction

Since the entry into force of Regulation (EU) 2020/1503 of 7 October 2020 on European crowdfunding service providers for business (the "**Crowdfunding Regulation**") on 10 November 2021, and its transposition into Luxembourg law by the Law of 25 February 2022, the legislative and regulatory framework for crowdfunding continues to advance.

EBA's final draft RTS

On 13 May 2022, the European Banking Authority ("**EBA**") published its final draft Regulatory Technical Standards ("**RTS**") on credit scoring and pricing disclosure, credit risk assessment and risk management requirements for crowdfunding service providers. Article 19(7) of the Crowdfunding Regulation mandates the EBA to develop and draft such RTS, in close cooperation with ESMA.

The draft RTS (which EBA was mandated to develop in close cooperation with ESMA pursuant to Article 19(7) of the Crowdfunding Regulation) specifies:

- the elements to be included in the information to investors with respect to the description of the method used to calculate credit scores and pricing assigned to crowdfunding projects (Article 19(7)(a) of the Crowdfunding Regulation);
- the information and factors that crowdfunding service providers shall consider when carrying out credit risk assessment and when conducting a loan valuation as referred to in Article 4(4) of the Crowdfunding Regulation (Article 19(7)(b) of the Crowdfunding Regulation);
- the factors that crowdfunding service providers shall take into account to ensure that the price of loans facilitated on its platform are fair and appropriate (Article 19(7)(c) of the Crowdfunding Regulation) and,
- the content and governance of the policies and procedures required for the requirement specified in Article 19 and the risk management framework related to credit risk assessment as referred to in Article 4(4)(f) of the Crowdfunding Regulation.

These draft RTS will be submitted to the European Commission for endorsement, following which they will be submitted for scrutiny by the European Parliament and the Council, before being published in the Official Journal of the European Union.

ESMA Q&As

In addition, on 20 May 2022, ESMA updated its Questions and Answers ("**Q&As**") in relation to the Crowdfunding Regulation. The update covers, *inter alia*, clarifications on various general provisions related to asset safekeeping services, payment services, tied agents and branches. A new Q&A has also been added in respect of investor protection, specifically relating to the role of crowdfunding service providers in relation to the drawing up and information contained in the key investment information sheet (KIIS).

CSSF reminder

On 10 June 2022, the CSSF issued a press release reminding any legal person, facilitating the financing of business activities by soliciting the general public through an online platform, that the transitional period provided by Article 48 of the Crowdfunding Regulation will come to an end on 10 November 2022. Pursuant to Article 48 of the Crowdfunding Regulation, existing crowdfunding service providers operating under national law which benefit from the transitional period may continue to provide services within the meaning of the Crowdfunding Regulation until they obtain authorisation in accordance with the Crowdfunding Regulation. The CSSF explained that Article 48 applies in Luxembourg even though there is no national law on crowdfunding. Platforms, qualifying as crowdfunding service providers within the meaning of the Crowdfunding Regulation before 10 November 2021, and thus benefiting from the transitional period, should inform the CSSF accordingly as soon as possible in view of obtaining an authorisation as a European crowdfunding service provider from the CSSF by 10 November 2022 at the latest.

MAR | CSSF CIRCULAR TRANSPOSING NEW ESMA GUIDELINES ON DELAY OF DISCLOSURE OF INSIDE INFORMATION

On 13 April 2022, ESMA published updated guidelines on delayed disclosure of inside information (the "Guidelines") pursuant to Regulation (EU) 596/2014 of 16 April 2014 on market abuse ("**MAR**"). The purpose of the Guidelines is to provide a non-exhaustive list of legitimate interests of issuers that are likely to be prejudiced by immediate disclosure of inside information (within the meaning of MAR) and situations in which delay of disclosure is likely to mislead the public.

The Guidelines have been updated to include additional scenarios where immediate disclosure of inside information could prejudice the legitimate interests of issuers. A new guideline has also been included on the interaction of MAR with Pillar 2 capital requirements and Pillar 2 capital guidance. For a more detailed summary of the updates to the Guidelines, please consult our previous newsletter on ESMA's final report on the updated Guidelines.

Pursuant to CSSF Circular 22/813 published on 19 May 2022, all issuers who are bound to comply with Article 17 of MAR must duly comply with the updated Guidelines as from 13 June 2022.

SECURITISATION REGULATION | EBA PUBLISHES FINAL DRAFT RISK RETENTION RTS

On 12 April 2022, the EBA published its final draft Regulatory Technical Standards (the "**RTS**") specifying the requirements for originators, sponsors and original lenders related to risk retention as laid down in Regulation (EU) 2017/2402 of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (the "**Securitisation Regulation**") as amended by Regulation (EU) 2021/557 of 31 March 2021.

The RTS have been developed in accordance with Article 6(7) of the Securitisation Regulation, which mandates the EBA, in close cooperation with the ESMA and EIOPA to develop the RTS further specifying the risk retention requirements. The final draft RTS specify in greater detail the risk retention requirements and, in particular, address:

- the requirements on the modalities of retaining risk;
- the measurement of the level of retention;
- the prohibition of hedging or selling the retained interest;
- the conditions for retention on a consolidated basis;
- the conditions for exempting transactions based on a clear, transparent and accessible index;
- the modalities of retaining risk in case of traditional securitisations of non-performing exposures; and
- the impact of fees paid to the retainer on the effective material net economic interest.

Next Steps

The European Commission will now consider and adopt the draft RTS. They will then be submitted to the European Parliament and Council, following which they shall be published in the Official Journal of the European Union.

MIFID II AND MIFIR | ESMA Q&AS

Since October 2016, ESMA has published several Questions and Answers ("**Q&As**") relating to Directive 2014/65/EU on markets in financial instruments ("**MiFID II**") and Regulation (EU) No. 600/2014 on markets in financial instruments ("**MiFIR**"), relating to 6 different topics:

- ESMA/2016/1165: Q&A relating to the provision of CFDs and other speculative products to retail investors under MiFID;
- ESMA/2016/1444: Q&A on MiFID II and MiFIR investor protection topics;
- ESMA/2016/1673: Q&A on MiFID II and MiFIR commodity derivatives topics;
- ESMA/2016/1424: Q&A on MiFID II and MiFIR transparency topics;
- ESMA/2016/1583: Q&A on MiFID II and MiFIR market structures topics; and
- ESMA/2016/1680: Q&A on MiFIR data reporting.

The Q&A on MiFID II and MiFIR investor protection topics is one of the most extensive of these documents.

This Q&A, which was most recently updated in December 2016, covers topics relating to the following areas:

- Best execution obligation (article 27 MiFID II);
- Suitability and appropriateness (article 25(2) and 25(6) MiFID II);
- Recording of telephone conversations and electronic communications (16(7) MiFID II);
- Recordkeeping (article 16(6) and 16(7) MiFID II);
- Investment advice on an independent basis (article 24(4) and 24(7) MiFID II);
- Underwriting and placing;
- Inducements (research) (article 24 MiFID II);
- Post-sale reporting; and
- Information on costs and charges (article 24 MiFID II).

The Q&A clarifies various specific rules in these areas and explains the applicability of "Level 2" regulation (in particular the MiFID II Delegated Regulation of 25 April 2016 and MiFID II Delegated Directive of 7 April 2016 issued by the European Commission) to a wide range of topics, ranging from unrequested research "free of charge" to the encryption of records.

CSSF CIRCULAR 22/811 | UCI ADMINISTRATORS

On 16 May 2022, the *Commission de surveillance du secteur financier* (the "**CSSF**") issued Circular 22/811 on the authorisation and organisation of entities acting as UCI administrators (the "**Circular**").

In the Circular, the CSSF repeals Chapter D of IML Circular 91/75 setting out the rules concerning the central administration of Luxembourg undertakings for collective investment ("**UCIs**").

The Circular applies to entities carrying out the activity (or part of the activity) of administrator of regulated or unregulated UCIs, established in Luxembourg or abroad, and determines the principles of sound governance and the requirements to be complied with by entities providing UCI administration services in terms of substance, internal organisation (including but not limited to delegation models) and reporting.

Scope of the Circular

The following entities are eligible to act as UCI administrator:

- Luxembourg investment fund managers ("**IFMs**"), such as management companies pursuant to chapters 15 and 16 of the law of 17 December 2010 relating to undertakings for collective investment and alternative investment fund managers;
- Foreign investment fund managers ("**IFM**") pursuing the activity of UCI administrator for Luxembourg UCIs;
- Regulated Luxembourg UCIs which, however, may only act as UCI administrator for themselves; and
- Luxembourg external service providers authorised under the Law of 5 April 1993 on the financial sector as amended ("**1993 Law**"), such as credit institutions, registrar agents, client communication agents and administrative agents (in the latter two cases only for certain functions).

Authorisation

The appointment to act as UCI administrator is subject to prior authorisation by the CSSF. This can be through a complete authorisation application (under, for example, the sectorial legislation applicable to a registrar agent or a client communication agent) or through a defined administrative procedure (for management companies, AIFMs, foreign IFMs, regulated UCIs and banks or Luxembourg branches of foreign banks). Annex A of the circular sets out the list of information to be provided to the CSSF to apply for authorisation to act as UCI administrator.

UCI administration activity

The Circular provides that the administration activity may be split into three main functions: the registrar function, the NAV calculation and accounting function and the client communication function. The CSSF considers that only one service provider may be designated and is responsible for a specific UCI administration function. The Circular sets out globally what the UCI administration activity comprises of and then individually details the three functions referred to above.

Organisational Arrangements

The Circular sets out provisions regarding the internal organisation of the UCI administrator including, in relation to the control framework, the level of resources, the need for a written contract with the UCI, rights of access for the CSSF, auditors, etc.

There is a specific section regarding ICT resources, business continuity and disaster recovery planning. The CSSF recommends that UCIs and IFMs comply with the principles of Circular 20/750 on the requirements regarding information and communication technology and security risk management.

Depositary

The Circular clarifies that it is essential that the UCI administrator act independently from the depositary. Where performed by the same entity, functional and hierarchical separation between business lines must be implemented.

Delegation

One or more tasks within UCI administration may be delegated. It is not however permitted to delegate the monitoring of such tasks or the due diligence / oversight of delegates. Adequate initial and ongoing due diligence must be performed by the UCI administrator on its delegates. There must be a written contract between the UCI administrator and each of its delegates, which must set out their respective roles, rights, obligations and responsibilities in detail. A UCI administrator that intends to delegate a critical or important operational task must notify the CSSF in advance of its plans in accordance with the instructions and, where applicable, the forms available on the CSSF's website. In general, this notification must be submitted at least three months before the planned delegation enters into effect (except when delegating to a client communication agent or an administrative agent authorised pursuant to the 1993 Law in which case the notice period is reduced to one month).

Annual reporting

Starting on 30 June 2023, UCI administrators have to file information regarding their business activities and resources on an annual basis to the CSSF, no later than five months from the close of the UCI administrator's financial year. The list of information to be provided is set out in annex B to the Circular.

Entry into force of Circular

The Circular enters into force with immediate effect. Entities already acting as UCI administrators on 16 May 2022 do not need to apply for the CSSF's authorisation to act as UCI. A grandfathering period up until 30 June 2023 is allowed for such entities to comply with the remaining provisions of the Circular.

DRAFT LAWS TRANSPOSING EU DIRECTIVE 2019/1158 OF 20 JUNE 2019 ON WORK-LIFE BALANCE FOR PARENTS AND CARERS

In line with the Government's will to encourage a more equal sharing of family responsibilities between women and men, two draft laws No.8016 and No.8017 have been presented in June before the Luxembourg Parliament (*Chambre des Députés*) (together the "**Draft Laws**" and each a "**Draft Law**"). The Draft Laws aim at implementing into national law Directive 2019/1158 of 20 June 2019 on work-life balance for parents and carers, and repealing Directive 2010/18/UE of 8 March 2010 implementing the revised Framework Agreement on parental leave (the "**Directive**").

This initiative follows the observation that work-life balance remains a considerable challenge for many parents and workers with caring responsibilities, in particular because of the increasing prevalence of extended working hours and changing work schedules, which has a negative impact, more particularly, on women's employment. Consequently, women tend to be underrepresented in the labour market. Based on this observation, the purpose of the Draft Laws is threefold:

- Extending the right to paternity leave;
- Redesigning parental leave entitlements to encourage fathers to take parental leave;
- Introducing the possibility for parents to request flexible working arrangements to accommodate their work patterns and remain in the labour market.

The Draft Laws also provide for two new extraordinary leaves.

Extension of the scope of application of the right to paternity leave

- So far, the Luxembourg Labour Code provides for the right to an **extraordinary leave of 10 days for the father in the event of birth of a child**. Draft Law No.8016 intends to extend the right to paternity leave to **equivalent second parents recognised as such by national law**. The amendment is intended in particular to take into account the situation of same-sex couples, allowing persons who are recognized as equivalent second parents or co-parents by national legislation to benefit from paternity leave in the event of birth of a child, outside of any adoption procedure.
- Draft Law No.8016 also intends to extend the right to paternity leave to **self-employed workers** provided that they can prove registration with a public compulsory insurance for at least six months.
- It is also worth mentioning that the Luxembourg Labour Code currently provides that **the employer must be informed of the expected dates of the paternity leave with a two-month notice**. If the two-month notice period is not respected, the Luxembourg Labour Code currently provides that the paternity leave may be reduced to two days at the discretion of the employer. In this regard, Draft Law No.8016 intends to introduce the following new features:
  - In order not to prejudice employees who are faced with the premature birth of a child (and who are unable to meet the two-month notice period), the Draft Law provides that the two-month notice period does not apply if the birth occurs two months before the expected date.
  - In order to comply with the Directive, which provides that the right to paternity leave is an unconditional right, the Draft Law further intends to remove the possibility for the employer to reduce the paternity leave to two days in case of failure to comply with the two-month notice period. In such a case, the leave will have to be taken all at once and immediately after the birth of the child, unless the employer and the employee agree on a flexible solution, allowing the employee to take the leave in full or in part at a later date.

Adjustment of the right to parental leave

Draft Law No.8017 intends to introduce the following changes to the Luxembourg Labour Code with respect to parental leave:

- With regard to requests for a first split parental leave, the decision of the employer refusing such a request will have to be motivated **in writing**.
- Regarding the possibility for the employer to postpone a second full-time parental leave requested by a parent, the postponement decision will also have to be provided **in writing**. Before any postponement decision of the second parental leave is taken, the employer shall **offer to the employee, to the extent possible, flexible ways of taking parental leave** (i.e. either split parental leave or part-time parental leave).

Possibility for parents to request flexible working arrangements

- Currently, the only provision of the Luxembourg Labour Code that allows a parent to request an adjustment of his/her working hours is Article L.234-47(11). This Article only applies to employees returning to work at the end of a parental leave. These employees are entitled to request a meeting with their employer in order to request an adjustment of their working hours, for a maximum period of one year.
- The Directive goes beyond the current provisions of the Luxembourg Labour Code. The Directive indeed provides for the possibility for **any employee with at least six months' continuous service who is the parent of a child under the age of nine to request a meeting with his/her employer in order to ask for the introduction of flexible working arrangements**.
- Flexible working arrangements refer, for example, to teleworking, flexible working hours or a reduction in working hours. The measures may not exceed one year. The employer must provide a response to the employee within one month. Any decision to refuse or postpone the request must be motivated in writing, by registered letter.

New extraordinary leaves

The Draft Laws provide for **two new extraordinary leaves**:

- a one-day leave for reasons of force majeure related to urgent family reasons in case of illness or accident of a family member making the immediate presence of the employee indispensable;
- a five-day leave to provide personal care or assistance to a family member or a person living in the same household who requires considerable care or assistance for serious medical reasons.

The employer is not entitled to terminate an employee's employment contract based on the employee requesting or benefiting from one of the two extraordinary leaves listed above, from paternity leave or from flexible working arrangements. Such dismissal will be null and void.

An employee shall also not be subject to retaliation or less favourable treatment for having benefited from or asking to benefit from the two extraordinary leaves listed above, from paternity leave or from flexible working arrangements.

The employer will have to maintain the employee's position, or at least a similar position, during the entire duration of the two extraordinary leaves listed above, the paternity leave and the flexible working arrangements.

CSSF CIRCULAR 22/810 | NOTIFICATION AND DE-NOTIFICATION PROCEDURES FOR MARKETING AND PRE-MARKETING ON EDESK

Background

Directive 2009/65/EC of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ("**UCITS**") as amended (the "**UCITS Directive**"), as well as Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers (**"AIFM**" and the "**AIFM Directive**") prescribe notification procedures, for UCITS and for AIFMs respectively, intending to market their shares or shares of the alternative investment funds ("**AIF**") that they are managing, in a European Union ("**EU**") Member State ("**Member State**") other than the State they are registered in (or in their home State for the AIFMs).

The UCITS Directive and the AIFM Directive were amended by Directive (EU) 2019/1160 with regard to cross-border distribution of collective investment undertakings (the "**CBDF Directive**"). The CBDF Directive introduced, among others, an additional procedure to de-notify UCITS and AIF sub-funds (and UCITS share classes). The CBDF Directive also specified conditions for pre-marketing by AIFMs.

Aim and Scope of the Circular

The purpose of Circular 22/810 is to inform Luxembourg UCITs and AIFMs that notification and de-notification procedures for pre-marketing and cross-border marketing will progressively be made available in the eDesk Portal (https://edesk.apps.cssf.lu/edesk-dashboard/dashboard/getstarted).

The CSSF will inform entities falling under the provisions of CSSF Circular 22/810 (which includes, UCITS, AIFMs, managers of EUVECAs and EUSEFs), by means of a separate communiqué, of the procedures available in the eDesk Portal.

Application

In this regard the CSSF issued a press release on 20 June 2022 informing the following entities that they must comply with the marketing notification and de-notification procedures, including any updates, via the E-Desk as and from 1 July 2022.

a. Luxembourg AIFMs wishing to:

- notify arrangements or de-notify arrangements made for marketing in Luxembourg of units or shares of an EU AIF that they manage;

b. Luxembourg AIFMs wishing to:

- notify arrangements or de-notify arrangements made for marketing in another Member State of units or shares of an EU AIF that they manage;

c. Managers of Luxembourg EuVECAs or EuSEFs wishing to market in Luxembourg or another Member State.

The AIFMs mentioned under point a. and b. also include Luxembourg AIFMs of European long-term investment funds ("**ELTIFs**") that wish to (de-) notify arrangements for marketing of units or shares of ELTIFs.

ESMA SUPERVISORY BRIEFING ON SUSTAINABILITY RISKS AND DISCLOSURES IN THE AREA OF INVESTMENT MANAGEMENT

On 31 May 2022, the European Securities and Markets Authority (ESMA) published a supervisory briefing on sustainability risks and disclosures in investment management area ("**Briefing**"). The briefing is addressed to EU National Competent Authorities (NCAs). ESMA has developed this supervisory briefing to promote convergence on the supervision of sustainability-related disclosures as well as the supervision of how fund managers integrate sustainability risks in their organisational framework and decision-making processes. The content of this supervisory briefing is not subject to any "comply or explain" mechanism for NCAs regarding the supervision of sustainability-related disclosures and integration of sustainability risks.

We have summarised some of the topics covered in the Briefing in the sections outlined below.

Guidance for the supervision of fund documentation and marketing material

Verification of the compliance of the pre-contractual disclosures

The pre-contractual information for financial products disclosing under Articles 8(1) and 9(1)-(3) of the sustainable finance disclosure regulation ("**SFDR**") are to be provided in an annex to the prospectus for UCITS, and in an annex to the information which is to be disclosed to investors in accordance with Article 23 of the alternative investment fund managers' directive for alternative investment funds.

ESMA suggests to national authorities to create a checklist based on the disclosures to be made in the pre-contractual templates that will help assessing the compliance of the disclosures of new and existing funds disclosing under Article 8 or 9 SFDR and provides examples to be put on the checklist.

ESMA suggests to include on the checklist that the strategy to attain the objectives must be clearly identified and is part of the investment policy.

In addition, as suggested by ESMA, NCAs could reasonably expect that products disclosing under Article 9 SFDR would disclose Principal Adverse Impacts of investment decisions referred to in Article 7 SFDR, even though it is not mandatory, due to the requirements of DNSH disclosures for sustainable investments under SFDR delegated regulations.

Verification of the consistency of information in the fund documentation and marketing material

ESMA advises that NCAs should, on a risk-based approach, assess and be satisfied that the sustainability-related disclosures made are consistent across the fund documentation and the marketing material. The accuracy of the information provided in each document should first be reviewed. The content of the marketing material may be then reviewed for consistency with the sustainability related disclosures in the fund documentation.

ESMA confirms that fund names should not be misleading. The terms "green" or "sustainable" should only be used where there is evidence of sustainability characteristics.

In addition, ESMA advises that a sustainable investment policy and/or objectives should be included in the fund documentation. The fund's documentation must be based on the policy and the fund must be managed in accordance with it.

Verification of the compliance with the website disclosures' obligation

NCAs are advised by ESMA to verify that the information is published according to Article 24 of the SFDR Delegated Regulation for funds disclosing under Article 8 SFDR and Article 37 of the SFDR Delegated Regulation for funds disclosing under Article 9 SFDR

Verification of the compliance with the periodic disclosures' obligation

Article 11 SFDR refers to the periodic disclosure obligations and Articles 50 and 58 of the SFDR Delegated Regulation refer to the presentation and content requirements for periodic reports for financial products under Article 8(1) and 9(1)-(3) SFDR. This information is to be provided in an annex to the annual report (for UCITS and AIFS) in accordance with the templates set out in Annex IV and V of the SFDR Delegated Regulation. For this purpose, ESMA advises that NCAs could create a checklist based on the information to be provided in periodic reports that will help assessing the compliance of disclosures of funds disclosing under Article 8 or 9 SFDR (and Article 5 or 6 of TR).

Integration of sustainability risks by AIFMs and UCITS managers

The Commission Delegated Regulation (EU) 2021/1255 and Delegated Directive (EU) 2021/1270 set out that all authorised fund managers are required from 1 August 2022 to integrate sustainability risks in their portfolio and risk management processes and overall governance structure.

ESMA advices that NCAs should verify compliance of the UCITS management companies and AIFMs with these requirements by checking the description of the manner in which sustainability risks are integrated in their investment decisions in pre-contractual fund disclosures referred to in Article 6 SFDR and ensuring that UCITS management companies and AIFMs perform a review of the relevant internal policies and procedures on a periodic basis.

ESMA suggests that NCAs should verify the compliance of UCITS management companies and AIFMs with the disclosure of sustainability risk integration on websites referred to in Article 3 SFDR by performing sample checks based on surveys and questionnaires relating to the integration of sustainability risks.

Regulatory interventions in case of breaches

Article 14 SFDR prescribes that Member States shall ensure that the NCAs monitor the compliance of financial market participants and financial advisers with the requirements of SFDR. In this regard ESMA sets out examples of where administrative measures could be taken such as where the relevant disclosure was not made or where it was misleading, noting however that NCAs remain fully responsible for determining which course of actions should be taken to mitigate the supervisory risks and regulatory breaches in order to combat greenwashing and comply with the SFDR.

CLARIFICATIONS ON THE ESAS' DRAFT RTS UNDER SFDR

On 2 June 2022, the European Supervisory Authorities ("**ESAs**") provided clarifications on the ESAs' draft RTS issued under Regulation (EU) 2019/2088 on sustainability–related disclosures in the financial sector ("**SFDR**").

Such clarifications concern the draft RTS included in the final report with regard to the content, methodologies and representation of disclosures according to certain articles under SFDR from 4 February 2021 and the draft RTS with respect to the content and presentation of disclosures under the final report of 22 October 2022. The final report covers both of those draft RTS. The application date of the RTS is delayed until 1 January 2023 in order to provide financial market participants and financial advisers with sufficient time to adapt and adjust their practices (this in particular with regards to the product specific disclosures deriving from Regulation (EU) 2020/852, the Taxonomy Regulation (TR)).

The ESAs provide clarification on key areas of the final reports, including principal adverse impact (PAI) disclosures, financial product disclosures and "do not significantly harm" (DNSH) disclosures.

The ESAs' clarification can be broken down into the following main sub-sections.

- Uses of sustainability indicators,
- PAI calculation methodology,
- Look-through approach and investment instrument scope for PAI disclosures,
- Disclosures for direct and indirect investments in pre-contractual and periodic disclosures,
- Further guidance on the adverse impact indicators in tables 1-3 of Annex I,
- Guidance related to pre-contractual financial product disclosures,
- Guidance related to periodic financial product disclosures,
- Guidance related to taxonomy-related financial product disclosures,
- Guidance related to "do not significantly harm" (DNSH) disclosures,
- Guidance related to disclosures for financial products with investment options.

We will summarise some of the key topics below.

Uses of "sustainability indicators"

The ESAs clarify that the "*sustainability indicators*" and indicators for principal adverse impact referred to in Article 4 SFDR, and Chapter II and Annex I of the draft RTS in the ESAs' final reports refer to different disclosures under SFDR.

Sustainability indicators used to measure the environmental or social characteristics or the overall sustainable impact of the financial product is covered under Articles 10(1)(b), 11(1)(a), 11(1)(b) SFDR. However, it is possible to use the indicators for principal adverse impact to measure the environmental or social characteristics or the overall sustainable impact of the financial product.

The ESAs outlined three possible uses of the adverse impact indicators at financial product level:

- **Disclosure of DNSH for sustainable investments under Article 2(17):** the use of PAI indicators is mandatory to demonstrate that an investment qualifies as a sustainable investment. The PAI indicators to be used are the ones in Table I of Annex 1 and any relevant indicators in Tables 2 and 3 of Annex I. The ESAs consider that using PAI indicators to fulfil the DNSH of SFDR does not require any PAI consideration at entity level pursuant to Article 4 (1) (a), 4 (3) or 4(4) SFDR.
- **Disclosure of PAI consideration under Article 7 SFDR:** the disclosure of PAI consideration at product level is set out in Article 7 SFDR and is not further specified except for fields in the templates to provide the information required by that Article.
- **Measurement of the attainment of environmental or social characteristics and the sustainability related impact (Articles 10(1)(b), 11(1)(a) and 11(1)(b) SFDR:** sustainability indicators used to measure the attainment of the environmental or social characteristics may include PAI indicators. The ESAs clarify that the use of the PAI indicators as sustainability indicators to measure the attainment or

environmental or social characteristics (for Article 8 funds) or impact of the sustainable investments (Article 9 funds) does not require any prior PAI consideration at entity level (pursuant to Article 4 SFDR) or PAI consideration at product level (pursuant to Article 7 SFDR).

PAI calculation methodology

The ESAs provide additional clarifications in the context of periodic disclosures of financial products as regards the value of holdings to be referred to. While the calculation methodology for the disclosure of principal adverse impact of investment decisions on sustainability factors is set out in chapter II of the RTS, the periodic disclosures for financial products are governed by Article 11 (2) SFDR. Hence such periodic disclosures comply with rules under that later article of SFDR.

The ESAs also give examples of calculation of indicators of GHG emissions when the investee company's emissions change throughout the reference period and the size of investment in that company evolve too. In that case for the purposes of the disclosures of principal adverse impacts of investment decisions on sustainability factors, the assessment of the impact should be based on, at least, the average of four calculations made on 31 March, 30 June, 30 September and 31 December of a calendar year reference period.

Look-through approach and investment instrument scope for PAI disclosures

With regard to the calculations to be made as part of the reporting on principal adverse impacts of investment decisions under Articles 4(1)-(5) SFDR, the ESAs consider that all investments, both direct and indirect (funds and funds of funds) should be included in these calculations.

Direct investments in "investee companies" are those securities issued by the investee company (e.g. listed and non-listed equities, corporate bonds for instance). Indirect investments cover investment in funds (UCITS or AIFs where applicable, funds of funds or derivatives). Where the investee company is a holding company, collective investment undertaking or special purpose vehicle, information on the adverse impact of the investment decisions of those companies could look through to the individual underlying investments of those companies.

Disclosures for direct and indirect investments in pre-contractual and periodic disclosures.

Financial products that promote environmental or social characteristics or commit to a sustainable objective, could outline in the pre-contractual and periodic disclosures what share of the investments of the financial product is held directly and what share is held indirectly.

The proportion of the investment used to attain the environmental and social characteristics or proportion of investments used to attain the sustainable investment objective should be disclosed in addition to what the purpose of the remaining proportion of investments is. To clarify, this means that this remaining proportion of investments that do not qualify as sustainable should be disclosed so that accurate information on the entirety of the investments made by the financial product is properly disclosed to end investors. In practice for example an Article 9 fund under SFDR should follow at least one sustainable investment objective. That sustainable objective does not necessarily need to be aligned with the Taxonomy Regulation. Hence pre-contractual disclosures should reflect the real / potential fund allocation.

That means (as stated by the European Commission in its SFDR Q&A from July 2021), that financial products that have sustainable investment as an objective should only make sustainable investments (but that could potentially not be aligned to the Taxonomy Regulation) and that disclosure is still required on the amount and purpose of the remaining assets (not aligned) to demonstrate how those do not prevent the financial product from attaining its sustainable investment objective.

Further guidance on the adverse impact indicators in Tables 1-3 of Annex I

ESAs provide, amongst others, clarifications on indicator 6 of table 1 of Annex I, on energy consumption per high impact climate sector, on indicator 8 (emission to water) of same table and Annex, on the average impacts from indicators 12 (gender gap) and 13 (board diversity) in Table 1 of Annex I. They further provide clarifications on the required metrics for the identification of inefficient real estate assets in indicator 18 of Table 1 of Annex I. With regard to non-cooperative tax jurisdictions referred to in indicator 22 in Table 3 of the Annex I, ESAs view is that reference to non-cooperative tax jurisdictions should be understood to refer to the EU list of non-cooperative jurisdictions maintained and updated by the EU council.

Guidance related to pre-contractual financial product disclosures

In addition to the final report published on 22 October 2021, the ESAs also provide guidance on how products that invest in a mixture of environmental and social objectives that vary over time could address the requirements to calculate the minimum proportion of taxonomy–aligned investments. This commitment should be made in the pre-contractual disclosures. If changes to the financial product require an update of that commitment, guidance on when and how to update pre-contractual disclosures can be found in relevant sectorial legislation referred to in Article 6(3) SFDR.

Disclosure of the taxonomy-alignment of the financial product calculated for non-financial investee undertakings by using capital expenditure or operating expenditure instead of turnover should justify how this is appropriate for the product in the pre-contractual document. If change in the strategy of a taxonomy-aligned financial product is done, the need to adapt its taxonomy-alignment KPI to increase the transparency towards investors is key.

Guidance related to periodic financial product disclosures

As stated in ESAs supervisory statement, periodic reports referred to in Article 11(2) of the SFDR must comply with the requirements laid down in that Article from 1 January 2022 irrespective of reference periods.

Guidance related to taxonomy-related financial product disclosures

The ESAs consider that the commitments on the “minimum proportion” of Taxonomy aligned investments are binding. As such penalties for failing to respect such commitments are set out in the sectorial legislation referred to in Article 6 (3) SDFR.

For the avoidance of doubt, only economic activities compliant with Article 3 TR can count toward the representation of taxonomy-aligned activities.

Guidance related to “do not significantly harm” disclosures

The ESAs draft RTS sets out disclosures for financial products ‘sustainable investments’ (Article 2(17) SFDR) DNSH requirements for pre-contractual disclosures, website and periodic disclosures. Such disclosures require an explanation of how the sustainable investment does not significantly harm any sustainable investment objective with reference to “how the indicators for adverse impacts in Table 1 of Annex I and any relevant indicators of Tables 2 and 3 are taken into account”.

Articles 4 and 7 SFDR contain references to how the financial market participant or financial product considers the principal adverse impacts of its investments. Disclosures under Article 4 SFDR are done by the publication of a statement on the principal adverse impacts of investments decisions on sustainability factors referring to indicators in Annex I.

As regards the types of disclosures for DNSH and PAI they apply independently. Financial products making sustainable investments must make DNSH disclosures, whereas the PAI disclosures at financial product level (Article 7 SFDR) apply separately under that article.

DNSH disclosure of the SFDR and under TR does not apply in the same way. To access whether an economic activity qualifies as environmentally sustainable, the TR sets out detailed DNSH activity level criteria under Article 17 TR and in technical screening criteria in delegated acts. In contrast, SFDR sets out this principle for the purpose of assessing at the level of the investment which may qualify as sustainable. It means that to qualify as a sustainable investment under SFDR, an investment in a taxonomy-aligned economic activity must also respect the DNSH principle under Article 2(17) SFDR.

CSSF UPDATES AML SUB-SECTOR RISK ASSESSMENT FOR THE COLLECTIVE INVESTMENT SECTOR

Purpose and Scope

In January 2020, the CSSF published its first Sub-Sector Risk Assessment ("**SSRA**") on money laundering/terrorist financing ("**ML/TF**") risks faced by the collective investment sector. The conclusions drawn in this first assessment were based on quantitative data collected through different initiatives, in particular the annual AML/CFT survey, and qualitative assessments by the CSSF as part of its onsite and offsite AML/CFT supervision (for more information, check our previous newsletter).

The CSSF now updated the report noting that the update does not repeat general messages which were detailed in the 2020 SSRA but rather focuses on the evolutions to highlight several ML/TF threats and vulnerabilities that are increasingly important for the fund industry in Luxembourg.

Updates and methodology

The report contains some evolutionary facts (*inter alia* the number of existing securitisation vehicles, the aggregate total net assets of Luxembourg funds regulated for AML/CFT purposes, number of Luxembourg investment funds managers) and also a methodology that explains the approach used to update the SSRA.

Inherent risk

Threat Assessment Evolution

The report notes that COVID-19, the lockdown and the latest geopolitical crisis made it difficult in terms of AML communication and controls and that this can lead to an increase in the threat of cybercrimes.

The year 2021 was also marked by a very sharp increase in total market capitalisation of cryptocurrencies and trading volumes of virtual assets such as non-fungible tokens. The underlying technology used by virtual assets can provide a level of anonymity which can be abused by criminals. In addition, the volatility of these assets may be perceived as an opportunity of a higher return of investments by money launderers and terrorist financiers.

Vulnerability Assessment Evolution

The report notes that the Luxembourg collective investments' largest inherent vulnerabilities arise from UCITS management companies. Similar to the 2020 SSRA, within the UCITS management companies category, the Luxembourg chapter 15 management companies present the highest inherent risk, primarily because of the volume of managed assets and because of the cross-border distribution of UCITS.

For Luxembourg authorised and registered AIFMs, the inherent risk scoring remains the same (medium high risk); for UCITS management companies (high risk).

Evolution of mitigating factors and residual risk assessment

For Luxembourg Chapter 15 management companies, the CSSF noted an improvement in terms of the implementation of a risk based approach both on the UCI's liability and asset side; in particular when it comes to the oversight of third parties performing AML/CFT controls on behalf of the investment fund managers ("**IFM**"). The due diligence processes have been more precise and better documented but, in some cases, were still lacking an in-depth analysis and remediation of identified shortcomings.

The content and frequency of AML trainings have improved, which contributed to the overall improvement of the quality of mitigation measures. For Luxembourg authorised AIFMs, the CSSF did not identify any significant change regarding the implementation of a risk based approach, however it noted a moderate modification of the results of the work performed by the external and internal control functions which identified more shortcomings in the AML/CFT framework of these entities. A change of compliance rating from "Compliant" to "Largely Compliant" by these control functions was observed in this cluster, which is in line with the CSSF's own observations. Nevertheless, the CSSF noted significant improvements in the due diligence performed on assets, screening of Targeted Financial Sanctions and oversight on distributors (when applicable). Content and frequency of AML trainings have also improved.

Luxembourg registered AIFMs had been identified as a class needing significant improvements in the 2020 SSRA. The CSSF notes some improvements in terms of their AML/CFT framework, notably through the set-up of tailor-made AML/CFT procedures and policies and the registration with the GoAML platform used by the Financial Intelligence Unit, but also, and more importantly, through a major review of their understanding of their exposure to the risks of ML/TF both on the UCI's liability and assets side. The CSSF noted an improvement in terms of ongoing monitoring of third parties performing AML/CFT controls on their behalf, in particular investment advisors, distributors and registrar and transfer agents. The CSSF also noted an improvement in the quality of their mitigation measures notably through a better understanding of their exposure to the risks of ML/TF.

Outcome of the report

Despite the fact that the CSSF noted an overall improvement of the quality of the mitigation measures implemented by the entities in scope, it also noted some areas requiring further improvement as it still identifies cases where erroneous data has a significant impact on the scoring of the entity and the related risk measures implemented by the entity.

Areas for further improvement

The CSSF addressed, inter alia, recommendations for cross-border intermediaries to consider, with respect to the outsourcing of the screening of the Targeted Financial Sanctions to non-European entities, IT components of AML/CFT systems, improvement in the quality of RC reports.

PRIIPS | APPLICATION DATE OF NEW RULES FOR KEY INFORMATION DOCUMENTS

On 24 June 2022, the European Commission published in the Official Journal of the EU the Commission Delegated Regulation (EU) 2022/975 adopted by the Commission on 17 March 2022 and endorsed by the co-legislators following a scrutiny procedure that ended on 17 June 2022 (the **"Delegated regulation"**).

The Delegated regulation concerns the application date of new rules for the Key Information Document (KID) for packaged retail and insurance-based investment products (PRIIPs).

The Delegated regulation:

- postpones the application date of certain PRIIPs-related disclosures to 1 January 2023 (instead of 1 July 2022 as initially foreseen in the Commission Delegated Regulation (EU) 2021/2268);
- prolongs the application of Article 14(2) of Commission Delegated Regulation (EU) 2017/653 until 31 December 2022 (instead of 30 June 2022 as initially foreseen in the Commission Delegated Regulation (EU) 2021/2268). Article 14(2) allows PRIIP manufacturers to use the key investor information document drawn up in accordance with the UCITS Directive (Directive 2009/65/EC) to provide specific information required pursuant to Regulation 2017/563 where at least one of the underlying investment options is a UCITS or non-UCITS.

ACCOUNT 115 NOT TAKEN INTO ACCOUNT FOR THE LUXEMBOURG PARTICIPATION EXEMPTION

On 31 March 2022, the Higher Administrative Court (*Cour administrative)* ruled that shareholder contributions to a subsidiary's account 115 are not taken into account for computation of the acquisition price of the shareholding under the Luxembourg participation exemption regime.

Background

The account 115 is a specific account under the Luxembourg chart of accounts which enables shareholders to make a contribution to a shareholding's capital without issuance of new shares. Contributions to account 115 can be made under private seal, without formalisation by a Luxembourg notary, which has made them a popular mechanism in Luxembourg. Such contributions have until now been included when assessing the shareholding threshold for the purposes of the Luxembourg participation exemption.

As a reminder, pursuant to the Luxembourg participation exemption regime dividends paid from the subsidiary company to its parent company are exempt from withholding tax if the parent company holds more than 10% of the subsidiary company's share capital, or if it has acquired the subsidiary for an amount of EUR 1.2 million. Gains on the sale of the shareholding are exempt in the hands of the Luxembourg parent company if the latter holds more than 10% of the subsidiary company's share capital or if the shareholding was acquired for at least EUR 6 million.

Facts of the case

In the case at hand, a taxpayer had acquired shares representing less than 10% of a company's share capital (the "**Subsidiary**") for an acquisition price of less than EUR 1.2 million, but had made separate contributions to the Subsidiary's 115 account for a total amount exceeding EUR 1.2 million. In 2016, the Subsidiary distributed a dividend to the taxpayer which was subject to 15% withholding tax. In 2017, the taxpayer submitted a request to the Luxembourg Tax Authorities (the "**LTA**") to obtain a refund of the withholding tax paid, on the grounds that the conditions of the Luxembourg participation exemption regime were satisfied. The reimbursement request was rejected. The taxpayer challenged this decision in an administrative appeal which was rejected by the LTA. The Lower Administrative Tribunal (*Tribunal administratif*) also rejected the taxpayer's appeal. The taxpayer appealed the judgment to the Higher Administrative Court (the "**Court**").

Key features

The Court held that contributions to account 115 are to be disregarded for the computation of the acquisition price for the purposes of applying the Luxembourg participation exemption. In other words, contributions to account 115 are not taken into account for the purposes of determining whether the EUR 1.2 million or EUR 6 million thresholds have been met.

Luxembourg law defines "*acquisition price*" as the expenditure incurred to put the asset in the condition in which it is on the day of its evaluation. In the context of the acquisition price of a shareholding, the Court held that an expenditure should be considered as part of the acquisition price only if it results in an increase of the number of shares or in the nominal value of the shares. Since a contribution to account 115 results neither in a shareholder receiving more shares nor in an increase in the nominal value of the existing shares, the Court concludes that there is no sufficient link between account 115 and the share capital to consider informal contributions as forming part of the acquisition price of the shareholding. The Court's decision is final and cannot be appealed.

Conclusion

This decision represents a significant change to current Luxembourg practice. Taxpayers who do not hold more than 10% of their shareholding's share capital and who do not meet the EUR 1.2 million or EUR 6 million thresholds (excluding any account 115 contributions) should consider their position in light of this ruling.

More broadly, the Court's decision leaves a lot of questions unanswered regarding the tax qualification of account 115 contributions, since the Court did not consider whether these should be treated as hidden capital contributions or as a type of expenses (and thus, in principle, deductible items).

DAC6 | UPDATED GUIDANCE FROM DIRECT TAX ADMINISTRATION

Background

The EU Directive 2018/822 on the mandatory automatic exchange of information in relation to reportable cross-border arrangements was transposed into Luxembourg domestic law by the law of 25 March 2020 (the "**DAC 6 Law**").

As a reminder, the DAC 6 Law applies to cross-border tax arrangements which (i) concern either more than one EU Member State or an EU Member State and a non-EU country and (ii) fall within the scope of one or more of the defined hallmarks. The DAC 6 Law requires certain intermediaries and taxpayers (in certain circumstances) to report to the Luxembourg Direct Tax Administration (*Administration des contributions directes*) ("**DTA**") any cross-border arrangements which, falling within the scope of the hallmarks and – if applicable – meeting the main benefit test, are considered to be potentially fiscally aggressive.

FAQ

The DTA has provided guidance regarding the interpretation of certain provisions of the DAC 6 Law, certain terms and definitions used therein, as well as the transmission of information to the DTA. This guidance was updated on 4 May 2022 in the form of "frequently asked questions" ("**FAQs**") available on the DTA's website. In this article, we focus on just a few of the key clarifications provided by the FAQs, regarding intermediaries and the DTA's position on the application of hallmark E3.

Clarifications regarding intermediaries

The FAQs provide useful clarifications regarding intermediaries, (a) on their obligations in case of application of professional secrecy as well as (b) on the distinction between intermediaries qualifying as promoters and those qualifying as simple service providers and on the respective obligations to be fulfilled in both cases (please refer to questions 4.1 and 4.2 of the FAQ).

The DTA's position on the application of hallmark E3

According to the FAQs cross-border liquidations and mergers should fall under hallmark E3, where these transactions involve a cross-border transfer of functions, risks or assets within the same group and result in a reduction of at least 50% of the annual profit before interests and taxes by the transferor compared to the situation that would have existed if the transaction had not taken place.

The only transactions that would not be relevant for the purpose of hallmark E3 would be transfers of a company's registered office out of Luxembourg or tax neutral mergers, where a Luxembourg permanent establishment with the same functions, risks and assets would continue to be maintained after the transfer of the registered office or the merger (please refer to question 11.5.2 of the FAQs).

These FAQs provide a welcomed clarification of the DTA's views, especially as the positions taken were not unanimously shared by legal scholars and/or practitioners.

HIGHER ADMINISTRATIVE COURT CONFIRMS THAT DTA IS DISALLOWED TO CONTROL SPF COMPANIES

By a decision of 17 May 2022, the Higher Administrative Court (*Cour administrative*) confirmed judgments of the Lower Administrative Court (*Tribunal administratif*) of 15 September 2021 that overturned a decision rendered by the Director of the Direct Tax Administration (*Administration des Contributions Directes)* ("**DTA**").

The cases concerned two private wealth management companies ("**SPFs**") which had subscribed to bonds issued by other Luxembourg companies. The DTA considered that by subscribing to these bonds, the SPFs were granting remunerated loans to other companies and hence carrying out a commercial activity allegedly prohibited to SPFs by law. In order to verify whether the conditions to benefit from the SPF's tax-exempt status were met, the DTA required the two SPFs to submit corporate income tax returns. Both SPFs had lodged an appeal against the decisions of the DTA to try to force them to submit tax returns. The appeal finally ended up before the Higher Administrative Court, which confirmed that the DTA is not competent to control SPFs.

In its decisions, the Higher Administrative Court recalls the provisions of the SPF law dated 11 May 2007 ("**SPF Law**"). According to the SPF Law, the Luxembourg Registration Duties, Estates and VAT Authority (*Administration de l'enregistrement, des domaines et de la TVA)* ("**AEDT**") is the competent authority to control SPFs, under the authority of its director. Only the AEDT's Director can/may, following a procedure organized by the SPF Law, pronounce the withdrawal of the SPF status from a company that no longer meets the conditions set out in the SPF Law. It is worth mentioning that such withdrawal cannot be retroactive. According to the Higher Administrative Court, the clear provisions of the SPF Law exclude any intervention by the DTA in the control of SPFs. Should the DTA have suspicions as to whether the conditions of the SPF Law are met, the sole option is to communicate its suspicions to the AEDT on the basis of the law on inter-administrative cooperation and request the latter to verify the fulfilment of the SPF Law conditions. In the case at hand, the Higher Administrative Court noted that there had been an exchange between the two administrations and that this exchange had led to a decision by the Director of the AEDT confirming that the status of the two SPFs was to be maintained.

The Higher Administrative Court also recalled that the SPF Law qualifies as a special law and that, according to the adage *lex specialis derogat legi generali*, the DTA cannot invoke its competences resulting from the Luxembourg Income Tax Act or the Luxembourg *Abgabenordnung* to justify a control of Luxembourg SPFs.

Finally, the Higher Administrative Court also awarded a procedural indemnity to the SPFs to compensate any incurred costs resulting from a dispute between two administrations on their respective competences.

HIGHER ADMINISTRATIVE COURT |CLARIFICATIONS ON THE CALCULATION OF TIME LIMITS APPLICABLE TO ADMINISTRATIVE REMEDIES

Overview

In a judgment dated 9 June 2022, the Luxembourg Higher Administrative Court (*Cour administrative*) recalled that for the purposes of computing the **three-month statute of limitation** applicable in the case of an **appeal filed against an administrative decision issued by the Director of the Luxembourg Direct Tax Authorities** ("**LDTA**") issued under registered mail, the delay shall start as from the **third day following that on which the tax Director's decision was posted**. If such day falls on a Saturday, a Sunday or a public holiday, the delay shall be postponed to the next working day.

Facts of the case

In the case at hand, the company AB (the "**Company**") failed to submit a tax declaration for the year 2015 ("**FY15**"). The LDTA therefore issued on 14 February 2018 **an *ex officio* tax assessment** pursuant to § 217 of the General Tax Law (the "***ex officio* tax assessment**").

On 11 May 2018, the Company proceeded, under the same cover, with the filing of (i) its FY15 corporate tax return and (ii) a claim challenging of the FY15 *ex officio* assessment (the "**Claim**"). The Claim indicated the name of the same legal entity i.e., *Société Coopérative (DE)*, which has been mentioned as *the person or service provider who participated in the drafting of the tax return* in the Company's FY15 corporate tax return. However, the Company's legal representative mentioned in the FY15 corporate tax return was Mrs.(C) with the indication *(FG)* apposed under the additional address data section. Additionally, the FY15 corporate tax return was signed by Mrs.(C) and stamped with the mention *(C) Manager*. On the same date, an additional claim (named '*Claim filed against the ex officio tax aFssessment issued on 21 February 2018"*) was sent to the Director of the LDTA. This additional claim was signed by Mrs.(C) outlining Mrs.(C)'s full name followed by the indication *(FG).*

Following a request addressed by the Director of the LDTA to Mrs.(C) to justify that the latter was legally authorized to act on behalf of the Company, the Director of the LDTA **rejected**, in a letter dated 4 September 2019 (the "**Directorial Decision**"), **the Claim** on the grounds that **such claim was not filed with a power of attorney *ad litem*** issued and signed by the Company's legal representative fully authorizing Mrs.(C) to bring legal proceedings on behalf of the Company.

On 9 December 2019, the Company brought the matter to the Lower Administrative Court (the "**Administrative Remedy**"), which rejected the taxpayer's claims. In an appeal to the Higher Administrative Court, the Company argued that the Administrative Remedy:

- was, unlike the ruling of the Lower Administrative Court, not time-barred since it had been filed within the legal three-month statute of limitation, and,
- was not lodged by the *Société Coopérative (DE)*, but by the Company itself, filed under the form of the corporate tax return filed for FY15, and signed by Mrs.(C) *"in her capacity as legal representative of the managing director"* of the Company.

Finding of the Court

First, the Higher Administrative Court reminds that, in accordance with § 228 of the General Tax Law, any directorial decisions may be contested within three months by way of opposition to the Director of the LDTA or his delegate. and confirms that the provisions of § 88 sub-paragraph (3) of the General Tax Law shall apply when a decision from the Director of the LDTA was notified to the taxpayer under registered letter: "*The authority may effect service by registered letter. Service shall be deemed to have been effected **on the third day following** that on which the document was posted, unless the addressee proves that the document to be served did not reach him within that period"*. According to the Higher Administrative Court, such paragraph should be read together with the provisions of the European Convention on the calculation of time limits dated 16 May 1996 and 8 of the law dated 7 November 1996 on the organisation of the courts of the judicial order so that if day on which the time limit for appeal expires falls on a non-working day the time limit for appeal is to be reported to the next working day.

In this particular instance, since the Directorial Decision was issued on 4 September 2019, the **Administrative Remedy filed on 9 December 2019 was effectively processed within the legal time limit** as foreseen under § 228 of the General Tax Law.

Secondly, the Higher Administrative Court finds that § 232 sub-paragraph (1) of the General Tax Law only admits **an appeal against a tax assessment imposing a positive obligation to pay a certain tax charge on the taxpayer concerned**. As a result, the Higher Administrative Court states that a taxpayer **is not entitled by law to lodge an appeal directly against the tax assessment fixing a tax liability equal to zero as, under this particular situation, the taxpayer should not have any legal interest in bringing proceedings** *(défaut d'intérêt à agir)* **against such administrative decision**. However, the taxpayer **is entitled to challenge** the amount of the tax losses carry-forward retained upon realisation of a taxable profit in a given financial year and fixing for the first time a tax charge higher than zero. Accordingly, the Higher Administrative Court concluded that the Company had no legal interest in bringing proceedings vis-à-vis the Directorial Decision since the **FY15 *ex officio* tax assessment fixed a nil taxation.**

NEW DOUBLE TAX TREATY SIGNED BETWEEN LUXEMBOURG AND THE UNITED KINGDOM

On June 7 2022, the Luxembourg government announced the signing of a new Double Tax Treaty (“**DTT**”) and a Protocol with the United Kingdom that will replace the existing DTT concluded in 1967. The new DTT introduces a number of significant changes, including an exemption from dividend withholding tax and a “real estate rich” company clause for capital gains. The new DTT shall enter into force upon ratification by both Luxembourg and the UK.

Resident (Article 4 of the new DTT)

Tiebreaker rules

The new resident articles adopts the new tie-breaker rule included in the OECD’s 2017 model convention which provides that dual residency cases shall be resolved via the mutual agreement procedure for dual resident companies.

Amendments to resident definition

The definition of resident is also extended to “state and any political subdivision or local authority” as well as “recognised pension fund” which according to the Protocol to the New DTT includes in the case of Luxembourg: pension savings companies with variable capital (SEPCAV); pension savings associations (ASSEP); pension funds subject to supervision and regulation by the Insurance Commissioner and the social security compensation fund (SICAV-FIS).

Further, treaty access is granted to Collective Investment Vehicles (CIVs) according to §2 of the Protocol which foresees that CIV established and treated as a body corporate for tax purposes in Luxembourg and which receive income from the UK shall be treated as a resident for the purpose of the new DTT, provided that the investors in the CIV are “equivalent beneficiaries”. Equivalent beneficiary is defined as a resident of Luxembourg, or a resident of another jurisdiction with which the UK has a comprehensive and effective information exchange and a rate of tax with respect to the item of income that is at least as low as the rate claimed under the new DTT by the CIV. For the purposes of the DTT the following entities are considered as CIVs:

- UCITS subject to law of 17 December 2010
- UCIs subject to Part II of the law of 17 December 2010
- Specialised Investment Funds (SIF)
- Reserved Alternative Investment Funds (RAIF)

Dividend Withholding tax (Article 10 of the new DTT)

Pursuant to Article 10(2)(a) of the new DTT a full withholding tax exemption shall apply to dividends paid by a company resident of a contracting state provided that the receiving company is the beneficial owner of the dividend. This is a welcome improvement since, as a result of Brexit, UK corporate tax payers are not entitled to the EU Parent Subsidiary Directive and may only rely on the current DTT which provides for a reduced 5% withholding tax.

The withholding tax exemption does not apply to distributions from real estate investment funds like UK REITs which under Article 10(2)(b) of the DTT are subject to a maximum 15% withholding tax (i.e. dividends paid out of income (including gains) derived directly or indirectly from immovable property by an investment fund which distributed most of its income annually and whose income is exempted from tax). If the recipient is a recognised pension fund (as defined in the Protocol), no withholding tax will apply.

Capital gains

The new DTT adopts a new rule regarding capital gains resulting from the sale of shares in “real estate rich companies”, in line with the OECD’s Model Convention. According to this new provision, gains derived by a resident of a Contracting state on the sale of shares deriving more than 50% of their value directly or indirectly from immovable property situated in another contracting state may be taxed in that other State. Under the current DTT, gains from the sale of shares are exclusively taxable in the state of residence of the alienator.

Elimination of double taxation

In general, Luxembourg will continue to apply the exemption method of eliminating double taxation for most types of income. In certain situations like dividends and gains on disposal of real estate rich companies, Luxembourg will apply the credit method. However, concerned taxpayers may nevertheless rely on the domestic participation exemption provided they meet the conditions.

END OF THE EXCEPTIONAL MEASURE REGARDING TELEWORKING FOR CROSS-BORDER WORKERS

As previously detailed in our newsflash dated 19 March 2020 (as updated), the Luxembourg Government had agreed on an "exceptional measure" with the Belgian, French and German Governments regarding the taxation of Belgian, French and German cross-border commuters normally working in Luxembourg and now teleworking from their homes.

As a result, since 14 March 2020, any day of presence of a cross-border worker in its residence country, in particular to carry out teleworking, was not to be taken into account for the calculation of the 34-days (Belgium), 29-days (France) and 19-days (Germany) period.

After numerous renewals of their initial agreements – the last of which provided for an extension until 30 June 2022 – Belgium, France, Germany and Luxembourg have decided that this exceptional measure is coming to an end.

Hence, as of 1 July 2022, each teleworking day carried out by cross-border workers shall be taken into account for the calculation of the aforementioned periods. For the computation of such days for fiscal year 2022, cross-border workers should be entitled to the full amount of days, as compared to a pro rata based on the remaining part of the year.

Notwithstanding the above, the agreements signed with Belgium, France and Germany to maintain the exceptional arrangement to count out teleworking days linked to the COVID-19 pandemic for the determination of the social security legislation applicable to cross-border workers shall remain applicable until 31 December 2022 (publication dated 15 January 2021).

NEW CIRCULAR ON DEFENSIVE MEASURES AGAINST NON-COOPERATIVE JURISDICTIONS

On 31 May, 2022, the Luxembourg tax authorities ("**LTA**") issued a new circular (the "**Circular**") on defensive measures against non-cooperative jurisdictions. This Circular replaces a previous circular (dated 2018) on the same subject and follows the introduction, in 2021, of Article 168 (5) of the Luxembourg income tax law (the "**LITL**").

As a reminder, the latter provision disallows, under certain conditions, the tax deduction of interest and royalty expenses, in case the recipient of the corresponding payments is an associated enterprise established in a jurisdiction or territory appearing on the EU blacklist. The EU blacklist currently includes American Samoa, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, US Virgin Islands and Vanuatu. A more general description of these defensive measures can be found in our newsflash issued on 1 April 2021.

The Circular sets out the background of the defensive measures as well as the criteria according to which blacklisted jurisdictions are identified at EU level. It further provides useful clarifications relating to the scope of Article 168 (5) of the LITL to the relevant version of the blacklist in case of updates during the course of a given year, as well as to certain consequences of and exceptions to the applicable rules. Finally, the Director of the LTA describes certain administrative measures, taken against non-cooperative jurisdictions.

Clarifications on the scope of Article 168 (5)

Article 168 (5) of the LITL applies to any corporate entity ("*organisme à caractère collectif*") that is subject to Luxembourg Corporate Income Tax ("**CIT**"). This means that both Luxembourg tax resident corporate entities and non-resident corporate entities taxed on Luxembourg sourced income (based on Article 156 LITL), as well as permanent establishments of non-Luxembourg resident corporate entities fall within the scope of the defensive measures.

The Circular further explains that Article 168 (5) of the LITL applies to interest and royalty expenses as soon as they are accrued, notwithstanding their actual date of payment. Any kind of interest or arrears on any kind of liabilities, with or without collateral or a participation clause, including bonds, are targeted. Royalties are defined as remuneration of any kind paid for the use or licensing of the intellectual property of a literary, artistic or scientific work (including films, patents, trademarks, drawings, templates, blueprints, etc.)

Finally, it should be noted that interest or penalties for late payment are out of scope.

Relevant version of the EU blacklist

The Circular clarifies that Article 168 (5) LITL in principle only applies with respect to one single version of the EU blacklist per fiscal year. The relevant version of the EU blacklist is the last available version as at 1 January of each year. For the 2021 fiscal year, the relevant version of the EU blacklist is the one dated 26 February 2021, i.e. the last published version as at 1 March 2021, when Article 168 (5) of the LITL entered into force.

An exception applies however to jurisdictions which are removed from the EU blacklist during the course of the fiscal year (without being added back to the EU blacklist before the end of the year). In such circumstances, the defensive measures immediately cease to apply with respect to payments made to associated enterprises in the concerned jurisdiction and a pro rata determination of the portion of expenses falling within the scope of Article 168 (5) of the LITL would need to be carried out.

Tax consequences if the conditions of Article 168 (5) are met and exceptions

Interest and royalties falling within the scope of the defensive measures should not be deductible for tax purposes. The Circular specifies that, in case interest expenses are not deductible based on Article 168 (5) of the LITL, they should not be taken into account as "borrowing costs" for the purpose of determining deductible exceeding borrowing costs based on the interest limitation rules of Article 168bis of the LITL.

By way of exception, interest and royalties in scope of the measures should remain deductible, if the taxpayer evidences that such expenses are incurred in the context of a transaction that is entered into for valid business reasons that reflect the economic reality. The taxpayer needs to provide relevant evidence that the exception can apply, upon request of the LTA. The Circular specifies that an application for a tax ruling may be sought in case the taxpayer wishes the LTA to bindingly confirm the application of the exception provided for by Article 168 (5) of the LITL to a specific fact pattern.

Defensive administrative measures

The previous circular already provided for certain defensive measures, which the LTA decided to maintain, in addition to the application of Article 168 (5) of the LITL. As part of these measures, the LTA notably requires taxpayers to tick a specific box in their tax return if they carry out transactions with related parties in a blacklisted country. The applicable version of the blacklist for this purpose is the one in force at the end of the accounting period concerned by the tax return.

These administrative measures, which are taken in order to allow for an increased scrutiny by the LTA, are state to have a broader scope than the one of Article 168 (5) LITL and are thus not limited to transactions generating interest or royalties payments. In this context, the LTA will be able to request additional information within the framework of the examination of the tax return.

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