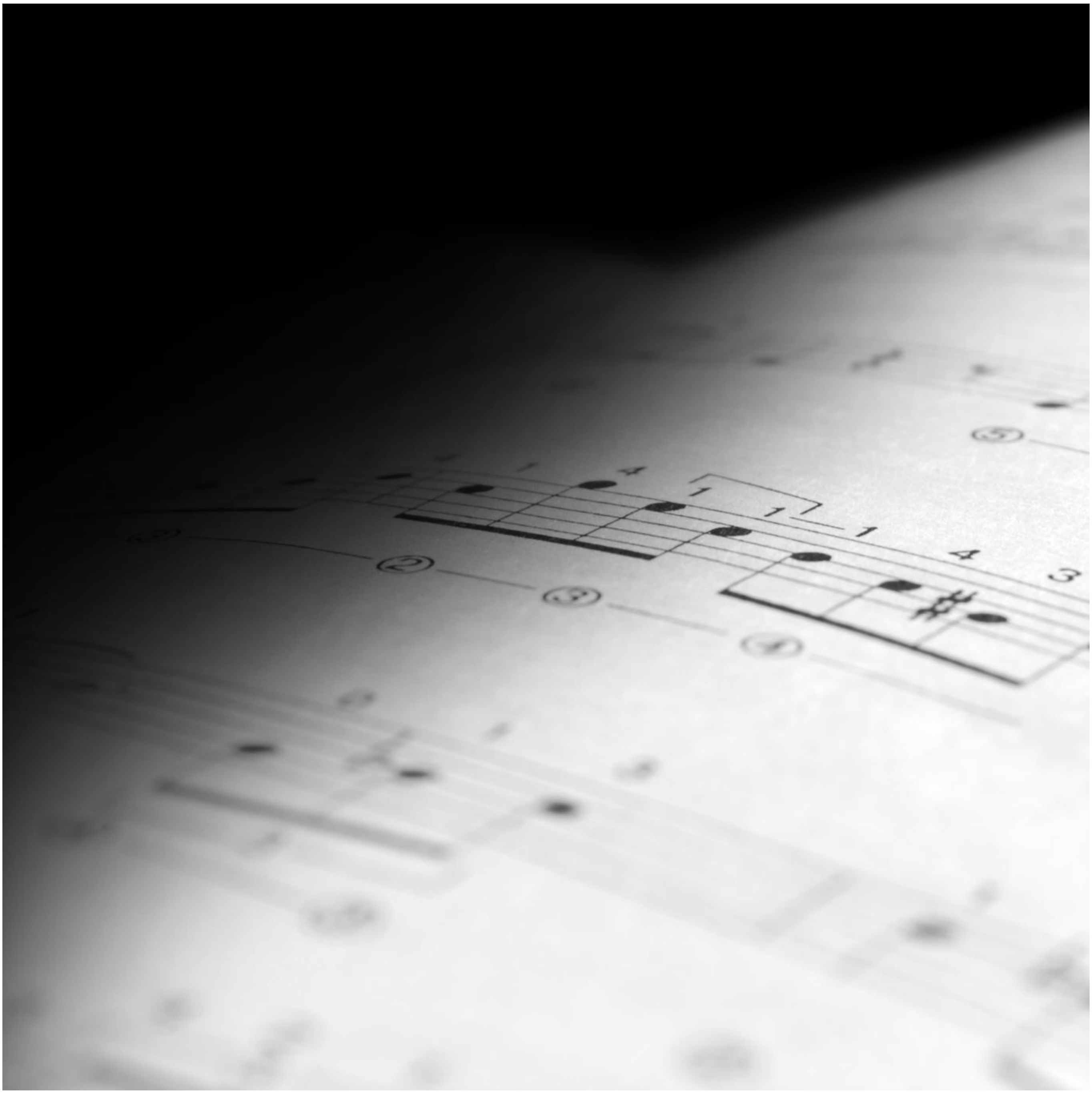

NEWSLETTER

February 2019

BSP

Right by you in Luxembourg

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SUMMARY

AML

LUXEMBOURG LAW SETTING UP A REGISTER OF BENEFICIAL OWNERS

Article 30 of the Directive (EU) 2015/849 of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (the "**AML 4th Directive**"), which requires corporate and other legal entities incorporated within an EU Member State to obtain and hold adequate, accurate and current information on their beneficial owners, including details of the beneficial interests and to establish a central register of beneficial ownership information ("**BO**"), has been transposed in Luxembourg with the law of January 13th 2019 (the "**RBO Law**"), which will come into force on March 1st 2019. The RBO law provides for a six months' grace period which will end on September 1st 2019.

The RBO Law is intended to apply to all entities registered with the Luxembourg register of commerce and companies, including civil and commercial companies, branches of foreign companies, interest groupings (*groupements d'intérêt économique - GIE*), European interest groupings (*groupements européens d'intérêt économique - GEIE*), investment funds (*fonds d'investissement*), all mutual funds (*fonds communs de placement - FCPs*), non-profit associations (*associations sans but lucratif*); foundations (*fondations*); pension savings associations (*associations d'épargnes pensions*); etc. Listed companies are not outside the scope of the RBO Law but shall be subject to a more flexible regime.

Alongside the rules regarding the definition of a BO and the data to be filed with the register of BO, the RBO law provides for specific rules regarding access to the captioned data in the register considering the particular nature thereof as well as sanctions in case of non-compliance with the RBO Law.

For more information on the RBO Law, the obligations it imposes and the penalties for non-compliance, we refer you to our legal alert published earlier this month.

BANKING & FINANCE

EBA GUIDELINES ON REPORTING OBLIGATIONS UNDER THE PSD 2 IN LUXEMBOURG

The CSSF has adopted on December 17th 2018 the guidelines of the European Banking Authority on the notification of major operational or security incidents (EBA/GL/2017/10) (the "**EBA Guidelines**"). CSSF Circular 18/704 (the "**CSSF Circular**") adopting the EBA Guidelines (attached as its Annex 1) is applicable immediately upon issue. The EBA Guidelines provide the criteria, thresholds and methodology to be used by payment service providers (the "**PSP**") as well as contain templates to be used by the PSP in its reporting of "*major operational or security incidents"* to the national authorities. Adoption of the EBA Guidelines by the Luxembourg regulator is an important step in the transposition of Directive (EU) 2015/2366 on payment services ("**PSD2**") into the Luxembourg regulatory regime on payment services after the law of July 25th 2018 transposed PSD2 by amending the Luxembourg law of November 10th 2009 on *payment services* (the "**PSL**").

We refer you to our January 2018 Newsletter where we discussed the transposition of PSD2 in Luxembourg and related guidelines of the EBA on the information to be provided by the payment institutions to the competent national authorities.

Not only has the Luxembourg regulator formally adopted the EBA Guidelines in Luxembourg but also provided further details in respect of the reporting obligation under Article 105-2 paragraph 1 of the PSL which provides that "*payment service providers shall report major operational or security incidents to the CSSF without undue delay*".

The CSSF confirms the scope of the obligation to report a "*major operational or security incident*" by stating that it shall extend to both external and internal events that could be either malicious or accidental. The CSSF Circular further provides the relevant deadlines for each type of the report to be submitted by the PSP to the CSSF. For instance, once a PSP detects a "*major operational or security incident*", it has a maximum of 4 hours to report it to the CSSF in the form of an "*initial report*". Furthermore, if there is any relevant status update after the "*initial report*" has been submitted to the CSSF, the PSP should also report it to the CSSF in the form of an "*intermediate report*". The PSP also needs to submit its "*final report*" within a maximum of 2 weeks after business is deemed back to normal. Finally, although such possibility is not excluded under the EBA Guidelines, the CSSF confirms that no delegation of the reporting obligation of the PSP can be made to any third party.

THE EU SECURITISATION REGULATION

Background

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**") establishes a new European legal and regulatory framework for securitisation. Its purpose is twofold: firstly, it harmonises the existing fragmented sectoral regulation of securitisation in areas such as banking, insurance or credit rating. Secondly, it introduces new rules for simple, transparent and standardised securitisations ("**STS**") in response to the excesses that led to the financial crises of 2008.

The Securitisation Regulation is a cornerstone of the European Union's efforts to establish a capital markets union. It is a testimony to the EU's recognition that securitisation plays an important role in the diversification of funding sources and allows a broader distribution of financial-sector risk, among other things.

The Securitisation Regulation is applicable from January 1st 2019.

Rules applicable to STS securitisations

Investors in STS securitisations will benefit from a more favourable prudential treatment compared to non STS securitisations.

The designation "**STS securitisation**" applies only to securitisations that meet all the (numerous) requirements related to:

- "simplicity" (Article 20),
- "standardisation" (Article 21) and
- "transparency" (Article 22).

Due diligence, risk retention and transparency requirements applicable to all securitisations

The Securitisation Regulation sets out various obligations applicable to institutional investors exposed to a securitisation as well as to the originators and sponsors.

Institutional investors are required pursuant to Article 5 to carry out an extensive due diligence to assess the risks involved in a securitisation prior to acquiring a position and after acquiring a position they must monitor its performance on an ongoing basis.

Originators and sponsors are obliged under Article 6 to retain a material net economic interest in the securitisation of not less than 5%. The same entities, as well as the securitisation vehicles, are obliged to follow transparency requirements under Article 7 by making information available to investors, potential investors and the relevant regulators.

The Luxembourg angle

The Luxembourg law of March 22nd 2004 on securitisation, as amended, (the "**Luxembourg Securitisation Law**") provides sufficient flexibility to accommodate the changes introduced by the Securitisation Regulation. In particular, the definition of securitisation in the Luxembourg Securitisation Law is broad enough to encompass most, if not all, transactions that qualify as securitisation under the Securitisation Regulation.

COURT OF APPEAL CONFIRMS STRONG POSITION OF PLEDGEE UNDER COLLATERAL LAW

The strong protection of secured parties under pledge agreements governed by the Luxembourg law of August 5th 2005 on financial collateral arrangements, as amended, (the "**Collateral Law**") has been further reinforced by the Luxembourg court of appeal (*Cour d'Appel*) (the "**Court**"), which confirmed in a judgment rendered on May 16th 2018 (No. 63/18, No. 39827) and published in the *Journal des Tribunaux de Luxembourg* (issue No. 60) on December 5th 2018 that the enforcement of a pledge agreement by way of a private sale cannot be reversed even if successfully challenged in court.

The Court gave its judgment in a situation where the appellant party being the insolvency receiver (*curateur de la faillite de la société*) (the "**Appellant**") contested the legal validity of a share purchase agreement by which the pledgee sold the shares of the pledged company (the "**SPA**") for a price of 4 euros (in total). Firstly, the Appellant invoked the inapplicability of the Collateral Law to this SPA for not qualifying as a collateral arrangement itself. Secondly, it further claimed that the SPA concluded for a very low price (*vil prix*) was fraudulent, which should make the SPA null and void under i) Article 445 of the Luxembourg *Code de commerce* applicable to insolvency proceedings, or ii) Article 931 of the Luxembourg *Code civil* related to donations, or finally iii) the general principle of law *fraus omnia corrumpit* (fraud invalidates everything).

Based on this factual matrix, the Court held:

- firstly, that the exemption from the provisions of the *Code de commerce* applicable to insolvency proceedings (in particular the hardening period rules) provided for by Article 20 (4) of the Collateral Law applies not only to collateral arrangement governed by the Collateral Law (such as a pledge agreement) but also to any action taken to enforce the collateral arrangement, such as the SPA in the case at hand;

- secondly, that the general rules on nullity of contracts are not applicable to actions covered under the Collateral Law;
- thirdly, that even if the enforcement of the pledge agreement by way of a private sale does not take place under the normal commercial conditions (*conditions normales du marchés* i.e., market value) as it must under Article 11 b) of the Collateral Law, the only remedy available is damages and not nullity, even in case of fraud.

MIFID II & MIFIR | UPDATE OF ESMA Q&A

Since our last newsletter on the topic, the European Securities and Markets Authority ("**ESMA**") updated a number of its Q&A regarding the Markets in Financial Instruments Directive – Directive 2014/65/EU of 15 May 2014 ("**MiFID II**") and the Markets in Financial Instruments Regulation – Regulation No. 600/2014 of 15 May 2014 ("**MiFIR**") on the following topics:

- Q&A on investor protection and intermediaries;
- Q&A on ESMA's temporary product intervention measures on the marketing, distribution or sale of CFDs and Binary options to retail clients;
- Q&A on MiFID II and MiFIR transparency topics;
- Q&A on MifID II and MiFIR commodity derivatives products;
- Q&A on MiFID II and MiFIR market structures topics, and
- Q&A on MiFIR data reporting.

We will focus here on just a few of the updates to the Q&A on investor protection and intermediaries topics in the field of investment advice on an independent basis and inducements.

Firstly, in the field of independent investment advice, the question was posed whether an investment firm can hold itself out as providing investment advice on an independent basis in a scenario where it only offers financial instruments issued or provided by itself or by entities having close links to it, if a look-through approach is taken, on the basis that the financial instruments offered (e.g. wrappers/investment funds) allow an investment in entities without close links. ESMA has answered in the negative, and confirmed that a look-through approach is not appropriate. When determining the range of financial instruments assessed by it, it should consider the financial instruments (directly) offered by the investment firm.

On the subject of inducements, ESMA confirmed that a free trial period of research services would qualify as an inducement (i.e. a non-monetary benefit) where it is provided in connection with the provision of an investment service or ancillary service. In light of Article 12(3)(e) of Commission Delegated Directive (EU) 2017/593 supplementing Directive 2014/65/EU with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits (the "**MiFID II Delegated Directive**") which provides that Member States may qualify certain *"minor non-monetary benefits"* as acceptable, ESMA went on to clarify the circumstances in which a free trial period of research services may qualify as non-monetary benefits under Article 12(3)(e) of the MiFID II Delegated Directive.

CAPITAL MARKETS

LUXEMBOURG STOCK EXCHANGE INTRODUCES TWO NEW PROFESSIONAL SEGMENTS

The Luxembourg Stock Exchange now offers issuers the possibility to admit their securities to trading on a professional segment (each a "**Professional Segment**") of each of its two markets, the BdL market (the EU-regulated market) and the Euro MTF market (Exchange-regulated market).

Trading on these Professional Segments is only allowed between professional investors and therefore securities admitted to trading on a Professional Segment will not be accessible to retail investors.

What are the benefits?

- Pursuant to Regulation (EU) 2017/1129 of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market (the "**New Prospectus Regulation**"), by admitting their non-equity securities only to a Professional Segment of the BdL Market, the issuers of those non-equity securities can avail of the (i) exemption from the requirement to include a summary in the related prospectus (ii) lighter disclosure requirements within that prospectus and (iii) more flexible language requirements for that prospectus.
- With respect to the product governance requirements under Directive 2014/65/EU of 15 May 2014 on markets in financial instruments ("**MiFID II**") which oblige issuers to identify and communicate to distributors, a compatible target market of investors and periodically review that target market, admission of securities on a Professional Segment is an easy way of demonstrating that an issuer is not targeting retail investors.
- Issuers who, pursuant to Regulation (EU) 1286/2014 on key information documents for packaged retail and insurance-based investment products (the "**PRIIPs KIID Regulation**") would be required to prepare a key information document ("**KIID**") if targeting retail investors, can now, by admitting their "packaged products" to trading only on a Professional Segment, easily demonstrate that these products are not intended for retail clients and therefore that no KIID is required.

As a consequence of the introduction of the Professional Segments, the rules and regulations of the Luxembourg Stock Exchange have been updated accordingly and the updated version can be found here. Likewise, updated application forms for admission to trading on both markets of the Luxembourg Stock Exchange are now available for downloading here; these have been updated to include an option for admission to the Professional Segments.

MARKET ABUSE | UPDATE OF ESMA Q&A

In the last quarter of 2019, ESMA has twice updated its Questions and Answers ("**Q&A**") on Regulation (EU) No. 596/2014 of 16 April 2014 on market abuse (the "**Market Abuse Regulation**"), to provide some more clarification regarding the delay of disclosure of inside information by credit/financial institutions for the purposes of financial stability and to confirm the applicability of the prohibition in Article 19(11) of the Market Abuse Regulation to issuers.

Pursuant to Article 17.5 of the Market Abuse Regulation credit/financial institutions may delay the disclosure of inside information in order to preserve the stability of the financial system, subject to specific conditions laid out in that article. In its October 2018 update of the Q&A, ESMA has elaborated on the elements to be considered by a credit/financial institution when assessing whether those conditions have been met. ESMA also confirmed that credit/financial institutions notifying a national competent authority ("**NCA**") of their intention to proceed with a financial stability delay, must also notify that NCA of the expected duration of the delay, and thereafter, of any new element or event that may affect the duration of the delay. Finally, in case of a denial by the NCA of a delay pursuant to Article 17.5 of the Market Abuse Regulation (because the relevant conditions are not met), the credit/financial institution shall be required to immediately disclose the relevant inside information and shall **not** be permitted to resort to a delay of disclosure pursuant to Article 17(4) of the Market Abuse Regulation.

Pursuant to Article 19(11) of the Market Abuse Regulation, a person discharging managerial responsibilities ("**PDMR**") within an issuer shall not conduct any transactions on its own account or for the account of a third party, directly or indirectly, relating to the shares or debt instruments of the issuer, or to derivatives or other financial instruments linked to them during a closed period of 30 calendar days before the announcement of an interim financial report or a year-end report which the issuer is obliged to make public. In its November 2018 update of the Q&A, ESMA has confirmed that this prohibition does **not** encompass transactions of the issuer relating to its own financial instruments even if it is the PDMRs taking the decision or bringing a previous decision into practice. The reasoning is that in this scenario the PDMR is acting in its capacity as a director of the issuer and therefore the transaction is a transaction of the issuer itself. ESMA takes this opportunity to remind issuers, however, that any transactions carried out by it during a closed period should still be treated with caution given that the prohibition of insider dealing still applies.

TRANSPARENCY LAW | CSSF ENFORCEMENT

The CSSF has published Press Release 19/02 (the "**Press Release**") for the attention of issuers of securities subject to the Law of January 11th 2018 on transparency requirements for issuers of securities, as amended. The CSSF wishes to highlight to those issuers and auditors preparing and auditing, respectively, financial statements for the year ending December 31st 2018 (the "**2018 Financial Statements**") under the International Financial Reporting Standards (the "**IFRS**"), a number of points that shall be subject to specific monitoring by CSSF during 2019. The European Securities and Markets Authority (the "**ESMA**"), together with the European national accounting enforcers, including the CSSF, have identified European common enforcement priorities for the 2018 Financial Statements. Having assessed these common priorities, the CSSF declares in the Press Release, that its enforcement campaign will focus on the following:

- **Application of IFRS 15 *Revenue from Contracts with Customers.***
  The CSSF will monitor specific issues related to the application of IFRS 15 as well as issuers' overall first-time application process.
- **Application of IFRS 9 *Financial Instruments.***
  The CSSF elaborates on the disclosures required under IFRS 9 and emphasises (i) that boilerplate descriptions should be avoided when making the disclosures on the assessment of significant increase in credit risk and expected credit losses and (ii) that such disclosures should be entity-specific.
- **Impact of the implementation of IFRS 16 *Leases*.**
  The CSSF reminds issuers to pay particular attention to the key aspects of IFRS 16 when determining the impact on their 2018 Financial Statements.

- **Disclosure of non-financial and diversity information in the management report.**
The CSSF will continue to monitor the implementation of the Law of 23 July 2016 on disclosure of non-financial and diversity information for certain large undertakings and groups and ensure that issuers provide useful and meaningful information to users of financial statements.
- **Alternative Performance Measures (APMs).**
The CSSF will continue to monitor how issuers comply with the ESMA Guidelines on APMs in their published financial information. The CSSF reminds issuers that the ESMA Guidelines on APMs apply to prospectuses and regulated information, including management reports (disclosed under the Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market) and *ad hoc* disclosures (made pursuant to Article 17 of Regulation (EU) No. 596/2014 on market abuse).
- **Hyperinflationary economy - Argentina.**
In light of the classification of Argentina as a hyperinflationary economy as of July 1st 2018, the CSSF reminds issuers, having business operations and/or subsidiaries in Argentina to consider the application of paragraph 43 of IAS 21 *The Effects of Changes in Foreign Exchange Rates*, when having subsidiaries whose functional currency is Argentinian peso, and IAS 29 *Financial Reporting in Hyperinflationary Economies*.
- **Brexit.**
In light of expectation that the United Kingdom will leave the European Union on March 29th 2019, the CSSF emphasises that, to the extent that further details on the Brexit agreement are available at the time the 2018 Financial Statements are being prepared, these further details should be reflected therein.

DRAFT LAW TO TRANSPOSE EU DIRECTIVE ON LONG-TERM SHAREHOLDER ENGAGEMENT INTO LUXEMBOURG NATIONAL LAW

On January 11th 2019, the Council of the Government (*Le Conseil de gouvernement*) discussed a draft law (the "**Draft Law**") which has as its purpose the transposition into Luxembourg law of Directive (EU) 2017/828 of 17 May 2017 as regards the encouragement of long-term shareholder engagement (the "**Shareholder Engagement Directive**").

The Shareholder Engagement Directive amended Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies (the "**Shareholder Rights Directive**"), which was transposed into Luxembourg law by the law of May 24th 2011 (the "**Luxembourg Shareholder Rights Law**"). The main objective of the Shareholder Engagement Directive is to improve the long-term viability of listed companies within the European Union and to create a more attractive environment for shareholders of those companies. We previously discussed (in our September 2014 Newsletter) the Shareholder Engagement Directive when a draft of it was first proposed by the European Commission. The final version of that directive provides, *inter alia*, for the following:

- the establishment of a framework for listed companies within the European Union to identify their shareholders which shall facilitate direct communication between companies and their shareholders ;
- the obligation for intermediaries to promptly transmit shareholder information, thus facilitating the exercise of shareholders' rights;
- mandatory transparency of voting such that any shareholder who casts a vote in a general meeting should have the possibility to verify if that vote has been validly recorded and counted;

- mandatory transparency on costs charged by intermediaries and other aspects of their engagement;
- the obligation for proxy advisors to provide information on their methods and to disclose any conflicts of interest;
- the requirement on companies to establish a remuneration policy and submit it to a vote by the general meeting;
- the requirement for a company to draw up a remuneration report on the preceding year and to submit it to the general meeting for an advisory vote;
- increased transparency and independent advice on related parties transactions, as well as the submission of material related party transaction to the shareholders for approval.

The Draft Law is not yet publicly available but given that the Shareholder Engagement Directive should be transposed into national law by June 10th 2019, we expect the Draft Law to be published in the near future.

INVESTMENT FUNDS

UPDATE ON THE EU LEGISLATIVE PROPOSAL TO FACILITATE CROSS-BORDER DISTRIBUTION OF INVESTMENT FUNDS

On December 6th 2018, the Committee on Economic and Monetary Affairs (the "**Committee**") adopted the report issued by Wolf KLINZ on the proposal for a directive of the European Parliament and of the Council amending Directive 2009/65/EC of the European Parliament and of the Council and Directive 2011/61/EU of the European Parliament and of the Council with regard to cross-border distribution of collective investment funds (the "**Proposal**").

As mentioned in our newsletter dated April 2018, the Proposal amends certain provisions in order to remove the regulatory barriers that currently restrict the cross-border distribution of investment funds in order to make their cross-border distribution simpler, faster and cheaper.

The amended proposal for approval by the European Parliament contains the following changes from the initial proposal:

Support for local investors (facilities)

The Proposal establishes rules to modernise and specify the requirements for providing facilities to retail investors.

Under the amended text, Member States shall ensure that the UCITS management company offers, in each Member State where it intends to market units of a UCITS, facilities to perform the following tasks: process subscription; repurchase and redemption orders and make other payments to unit-holders relating to the units of the UCITS; provide investors with information on how orders can be made and how repurchase and redemption proceeds are paid; make available to investors (by way of inspection or by requesting for copies of) the latest published annual report of the UCITS and the latest published half-yearly report if more recent; the prospectus of the UCITS; the most up-to-date key investor information document for the UCITS.

Withdrawal of notifications related to the use of the marketing passport

The competent authorities of the UCITS home Member State shall ensure that UCITS may proceed to the de-notification of the marketing activities of its units in a host Member State provided it offers to repurchase all units held by investors in such jurisdiction.

The notice sent to investors shall make clear the consequences for investors if they do not accept the offer to repurchase their units.

As long as investors remain invested in the UCITS after marketing is discontinued, the UCITS shall provide them, and the competent authorities of the Member State where the marketing has been discontinued, with the information required under the UCITS Directive.

Similar provisions are proposed with respect to the de-notification of marketing of units or shares of an EU AIF provided that it is not required to offer to repurchase units of closed-ended AIFs and European long term investment funds (ELTIFs).

Conditions for pre-marketing in the Union by an EU-based AIFM

In order to ensure that national competent authorities can exercise their control over pre-marketing activities, the AIFMs should send an informal letter or e-mail to (i) the competent authorities of their home Member State, and (ii) the competent authorities of the Member State or Member States where they intend to engage in pre-marketing activities, indicating in which Member State or Member States they intend to conduct pre-marketing activities.

AIFMs shall ensure that their pre-marketing activities are appropriately documented and made available, upon request, to the relevant national competent authorities. Such information should include a reference to the Member States and the period of time in which the pre-marketing activities took place as well as a description of the investment strategies or investment ideas presented during the course of the pre-marketing activities.

Subscriptions by investors that were subject to pre-marketing, within 18 months of the AIFM becoming engaged in pre-marketing shall be considered the result of marketing and shall be subject to the applicable notification procedures.

LUXEMBOURG - HONG KONG MUTUAL RECOGNITION OF FUNDS MOU SIGNED BY CSSF AND SFC

On January 15th 2019, the *Commission de Surveillance du Secteur Financier* ("**CSSF**") agreed to a Memorandum of Understating ("**MoU**") with the Securities and Futures Commission ("**SFC**") on the mutual recognition of funds. This MoU will allow Luxembourg-domiciled UCITS and Hong Kong public funds to be distributed, marketed and offered in each other's market.

The MoU will facilitate an easier system for funds in either country to register in the market of the other.

The process has been streamlined and it will now take between 1-2 months for standard application approvals. This significantly reduces the timeline allowing funds to be available to the public in an efficient manner.

For Hong Kong funds wishing to market to retail investors in Luxembourg they must meet the eligibility requirements set out in CSSF streamlining requirements and process for mutual recognition of Hong Kong Funds. Such funds would be considered alternative investment funds and so are subject to the marketing rules set out in Article 45 of the law of 12 July 2013 on alternative investment fund managers, as amended. Such funds must appoint a paying agent in Luxembourg. Following receipt of an application to be authorised to market in Luxembourg, the CSSF has 5 days to respond and one month from receipt of all documents to grant the authorisation to a Hong Kong fund.

The SFC in their circular Mutual Recognition of Funds between Luxembourg and Hong Kong outline the process for Luxembourg UCITS to market to retail investors in Hong Kong. In addition to the fund having a firm in Hong Kong as its representative, the CSSF must provide the SFC with a certificate confirming eligibility.

The SFC and the CSSF may consider extending the regime to include other types of funds in the future.

CROWDFUNDING SERVICE PROVIDERS FOR BUSINESS | UPDATE

On November 5th 2018, the Economic and Monetary Affairs Committee (the "**Committee**") voted on the European regulation on European Crowdfunding Service Providers for Business proposed by the European Commission in March 2018.

The aim of the proposed regulation is to end the current *status quo* in which each European Member State regulates online capital formation pursuant to its own national rules resulting in a patchwork of compliance and mandates which in turn engender unnecessary hurdles for issuers, investors and listing platforms. The proposed regulation makes a number of proposals to help crowdfunding services to function smoothly in the internal market and facilitate cross-border business funding by creating a single uniform set of rules on the provision of crowdfunding services across Europe.

For further information on the Commission's proposal, please see our previous article.

Cap Increase

One notable change that the Economic and Monetary Affairs Committee adopted in its text was to expand the scope of the regulation by increasing the maximum threshold for each crowdfunding offer to EUR 8,000,000 (an eightfold increase from the level of EUR 1,000,000, proposed by the European Commission), to be calculated over a period of 12 months.

Investor Protection: clear information, transparency, and complaint filing

The Committee proposed amendments to provide that crowdfunding service providers should give clients clear information about financial risks and charges related to their investment, including insolvency risks and project selection criteria.

In addition, they recommend that crowdfunding service providers disclose the default rates of the projects offered on their platform every year.

The Committee proposes that crowdfunding service providers provide a standard template for complaints.

Conflict of interests

Contrary to the blanket prohibition on crowdfunding service providers investing in crowdfunding offers on their platform proposed by the European Commission, the Committee proposes that they be allowed to do so subject to such crowdfunding service providers making this information available well in advance to clients.

National authorities in charge

The Committee recommended that a prospective crowdfunding platform would need to receive authorization from the national competent authority of the member state in which it is established, rather than from the European Securities and Markets Authority, as initially proposed by the European Commission.

Negotiations with the European Commission and the Council will continue prior to the final text being voted.

BENCHMARKS REGULATION| UPDATE OF ESMA Q&A

The European Securities and Markets Authority ("**ESMA**") has recently updated its Q&A on Regulation (EU) No. 2016/1011 of 8 June 2016 on indices used as benchmarks ("**Benchmarks Regulation**" or "**BMR**").

One of the new questions considered by ESMA is whether or not the methodology of a benchmark can include factors that are not input data.

ESMA answered this question in the affirmative.

ESMA clarified its position, however, by explaining that such factors (i.e., factors that were not input data) should not measure the underlying market or economic reality that the benchmark intends to measure. Instead, ESMA reasoned, these factors should be elements that improve the reliability and representativeness of the benchmark. ESMA expounded on its rationale by explaining that the methodology of an equity benchmark could include a number of elements, together with the values of underlying shares, such as the free-float quotas, dividends, volatility of the underlying shares, etc. These factors, ESMA reasoned, are included in the methodology to adjust the formula in order to get a more precise quantification of the equity market that the benchmark intends to measure. ESMA cautioned, however, that such factors do not actually represent the price of the shares part of the equity benchmark.

To help distinguish between input data and factors that were not input data, ESMA noted that input data changes are taken into account by the methodology every time the value of the benchmark is to be updated, as they reflect the changes in the underlying economic reality measured by the benchmark. By contrast, ESMA noted, changing values of the factors are not taken into account in every computation of the benchmark, but only in instances pre-determined by the methodology.

Nevertheless, ESMA noted that factors that are not considered input data were still relevant elements of the methodology, and that, as such, it was important for such factors to comply with all of the requirements of Article 12 of the BMR, and that administrators were expected to use these factors in accordance with the pre-determined and BMR-compliant methodology.

The other question ESMA considered is whether or not the methodology of a regulated-data benchmark can include factors that are not covered by Article 3(1)(24) BMR.

ESMA answered this question in the affirmative.

Regulated-data benchmarks can only include input data that is covered by Article 3(1)(24) BMR.

However, the methodology of a regulated-data benchmark can still include factors that were not covered by Article 3(1)(24) BMR, but only if those factors were not considered input data (i.e., elements that improve the reliability and representativeness of the benchmark, as described above).

IMPROVEMENTS IN FOREIGN EXCHANGE ADMINISTRATION FOR QFIIS/RQFIIS AND OPENING UP OF CHINESE CAPITAL MARKETS

The State Administration of Foreign Exchange ("**SAFE**") released an updated version of the Foreign Exchange Administrative Provisions on the Domestic Securities Investment by Qualified Foreign Institutional Investors ("**QFII**") (the Regulation) on June 10th 2018.

Two days later, SAFE, together with the People's Bank of China, jointly issued an updated version of the Circular on Administration of Domestic Securities Investment by Renminbi Qualified Foreign Institutional Investors ("**RQFII**") (the Circular).

The Regulation and the Circular, taking effect as of their respective issuance date, have removed the relevant restrictions on funds remittance and repatriation, and further streamlined the foreign exchange administration under the QFII and RQFII regime.

Said Regulation has facilitated investments made by QFII and RQFII by removing, among other things 1) the 20% monthly repatriation limit for QFIIs, 2) the three-months lock-up period requirement for both QFII and RQFII products/accounts which are not open-ended funds and by permitting QFIIs and RQFIIs to engage in foreign exchange hedging to offset the risks arising from foreign exchange rate in domestic investments.

Developments brought by the Regulation and the Circular help address several concerns which market participants previously held, including liquidity, cross-border remittance restrictions and hedging demand.

The issuance of the Regulation and the Circular is another important step taken by the Chinese government to further open up its capital market.

TAX

PREVIOUS TAX TREATY BETWEEN FRANCE AND LUXEMBOURG STILL APPLIES FOR 2019

As a reminder, a new double Tax Treaty was signed between Luxembourg and France (hereafter the "**New Tax Treaty**") on March 20th 2018. For a detailed review of the various impacts, please refer to [our newsletter dated March 2018](#).

It was long speculated that the New Tax Treaty could already enter into force as of January 1st 2019, if both countries ratified it before December 31st 2018. As the ratification process has not been completed in time, the New Tax Treaty did not yet become applicable and taxpayers thus have at least until January 1st 2020 to assess the impact of the New Tax Treaty and take the necessary steps, all while falling under the provisions of the previous tax treaty.

PRINCIPLE OF LEGITIMATE EXPECTATIONS ONCE AGAIN CONFIRMED BY THE LUXEMBOURG ADMINISTRATIVE COURT

In a recent decision (No.40352 dated December 20th 2018), the Lower Administrative Court ("*Tribunal administratif*") confirmed, as in previous decisions, that by application of the principle of legitimate expectations (*principe de confiance légitime*), a confirmation given by the Luxembourg tax authorities remains applicable unless a change of law occurs or the taxpayer acted in bad faith.

In the present case, a Luxembourg company financed various investments through profit participating certificates ("*Genussscheine")* and filed an advance tax agreement to confirm the nature for tax purposes of said certificates and their related tax treatment. The advance tax agreement was granted on March 18th 2009 and confirmed that those certificates are to be treated as debt instruments for Luxembourg income tax and net wealth tax purposes. Thereafter, the taxpayer failed to file his 2011 net wealth tax return and the Luxembourg tax authorities thus had to proceed to an *ex officio* taxation of the net wealth tax. For this purpose, the Luxembourg tax authorities based their assessment solely on the annual accounts of the company, in which the certificates had been booked as equity. Since the tax balance sheet, where the tax treatment confirmed by the advance tax agreement should have been reflected and which should have been appended to the net wealth tax return, had not been filed by the taxpayer, the Luxembourg tax authorities treated the profit participating certificates as equity instruments and disallowed their deductibility for net wealth tax purposes. The question the Lower Administrative Court had to answer was thus in essence, whether the qualification retained for the profit participating certificates in the advance tax agreement should remain binding on the Luxembourg tax authorities by application of the principle of legitimate expectation, even in case of deficiency by the taxpayer to file his tax returns, leading to an *ex officio* taxation.

The Lower Administrative Court considered that, in line with constant case law, the principle of legitimate expectation is of the outmost importance and can only be rescinded by the Luxembourg tax authorities in very limited cases. Indeed, provided that the well-established four constitutive conditions for a legitimate expectation have been met, i.e. that (i) a written request has been filed by the taxpayer with the Luxembourg tax authorities, (ii) which includes all the relevant information and (iii) that the request has been validated without restrictions or reserves by a competent public official that is allowed to issue individual administrative decisions and (iv) that this request and the outcome thereof had a determining impact on the taxpayer's affairs, such a legitimate expectation can only be rescinded in case of a subsequent change of law or of bad faith of the taxpayer. In this context the notion of bad faith has to be limited to situations where the taxpayer provided incomplete or inaccurate information, thus preventing the Luxembourg tax authorities from having full knowledge of the facts when granting the advance tax agreement. A failure by the taxpayer to file its tax return, which leads to an *ex officio* taxation, is not to be considered as bad faith given that it occurs after the granting of the advance tax agreement.

ATAD 1 IMPLEMENTATION LAW ENTERS INTO FORCE

On December 18th 2018, the Luxembourg Parliament (*Chambre des Députés*) passed Draft Law No. 7318 which transposes into domestic law the Anti-Avoidance Tax Directive ("**ATAD**"). The law was adopted without any substantial amendments to the draft version we previously covered (please refer to our July 2018 newsletter article for more details) and entered into force on January 1st 2019, except for the provisions related to the exit tax, which will be applicable as of January 1st 2020.

As a reminder, the law introduces interest deductibility limitations and anti-hybrid measures, to which taxpayers should pay specific attention, as well as a whole set of other measures, such as a new general anti-abuse rule, a controlled foreign company regime and a new exit tax. The law also introduces two non-ATAD related provisions, firstly amending the definition of a permanent establishment and secondly excluding debt-to-equity conversions from the scope of the roll-over relief regime (please refer to our July 2018 newsletter article for more details).

LUXEMBOURG GOVERNMENT ANNOUNCES TAX POLICY FOR THE COMING TERM (2018-2023)

The 2018 legislative elections having delivered their results, the previous coalition formed by liberals (DP), socialists (LSAP) as well as ecologists (Déi Gréng) has been re-elected for another 5-year term. In the course of the coalition formation, a new coalition agreement (*projet de gouvernement*) has been signed by the parties, detailing, *inter alia*, the goals to be achieved in tax matters over the coming years.

While recalling the determination to continue a high level of investment, which requires an increase of tax revenues, the newly formed government emphasises that this should be achieved by attracting new taxpayers and by encouraging the economic development of existing ones. The country's tax competitiveness, transparency and the prevention of tax avoidance will remain high priorities for the government. The tax aspects of the coalition agreement can be divided into two sections; one regarding individual taxpayers and one regarding corporate taxpayers.

For individual taxpayers, the government seeks simplification, digitalisation, and increasingly eco-friendly tax system. Simplification will be achieved by, e.g. introducing lump-sum exemptions for benefits-in-kind, simplifying the deductibility of charitable gifts and a reform of the various tax classes. The government will encourage digitalisation, by increasing the amount of tasks that can be performed digitally (electronic filing of tax returns and electronic delivery of various tax certificates). An increase in eco-friendliness of the Luxembourg tax system will be ensured by introducing new incentives with regard to the mobility of taxpayers (e.g. promotion of zero emission company cars), by encouraging teleworking for cross-border workers or by extending the super-reduced VAT rate (3%) for certain environmentally friendly home repair or renovation work. Finally, other tax measures such as a reduction of the VAT rate on basic sanitary products have been announced.

For corporate taxpayers, the new government confirmed its international commitment to the "level playing field" and its continued participation in the drawing up of new regulations at both the OECD and the EU Level, while remaining opposed to the idea of a financial transaction tax. The government also acknowledged that as a result of the evolving tax landscape, the corporate tax base has been broadened, so that in order to remain competitive within the other OECD and EU countries, a reduction of the aggregate tax rate by 1% in 2019, as well as an increase of the tax bracket subject to the reduced 15% corporate income tax rate (from EUR 25,000 to EUR 175,000) is envisaged. Finally, the government confirmed its continuing objective of attracting company executives and highly qualified individuals, which should be achieved by a favourable amendment to the existing "impatriate" regime.

LUXEMBOURG VAT GROUP REGIME IN FORCE

The Draft Law No. 7278 introducing the VAT group regime in Luxembourg (please refer to our newsletter dated June 2018 for more details) was adopted without any substantial changes on August 6th 2018 with retroactive effect as of July 31st 2018.

The concept of normal value (*valeur normale*) included in the same Draft Law thus also became applicable to all transactions within the scope of VAT that are entered into between related entities or members of the same family. The normal value concept, which is akin to the arm's length concept in direct tax matters, will from now on serve as the taxable basis for VAT purposes in cases where such normal value is higher than the consideration agreed upon among the parties and where the beneficiary of the supply or the service recipient / service provider (as the case may be) has no (or limited) input VAT deduction right.

ECJ CLARIFICATION OF CONDITIONS FOR INPUT VAT DEDUCTION IN SHARE DISPOSALS

In a ruling issued on November 8th 2018 (C-502/17), the ECJ clarified the conditions for input VAT deduction on expenses incurred in the context of share disposal transactions.

The plaintiff, C&D Foods Acquisition ApS (the "**Parent**"), a Danish company, was the parent of Arovit Holding A/S, which, in turn, held all shares of Arovit Petfood. The Parent had entered into an agreement with its sub-subsidiary Arovit Petfood for management and IT services. In 2008, the ownership of the Arovit group fell into the hands of a bank (as a result of a loan default by the former owner). The bank sought to sell all the shares of Arovit Petfood and, in that context, the Parent entered into various consultancy agreements. With no potential buyer by the end of 2009, the sale process was closed. The Parent nevertheless deducted the input VAT on the consultancy services, which was denied by the Danish VAT authorities.

The ECJ had to respond to the questions, referred to it by the High Court of Western Denmark, whether (i) a failed share disposal, falls within the scope of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the "**VAT Directive**") and (ii) if so, whether the VAT Directive grants the right to deduct input VAT on expenditures incurred in the context of the disposal of shares in a sub-subsidiary to which the selling company provided VAT taxable management services.

The ECJ first recalled that only payments which are consideration for a transaction/ economic activity come within the scope of VAT; such is not the case for payments arising from the ownership of an asset (such as dividends or other income derived from shareholding). This analysis does not apply when the holding is accompanied by a direct/indirect involvement in the management of a company, insofar as that involvement entails carrying out transactions which are subject to VAT.

The ECJ further referred to case law, according to which a share disposal, implemented to enable a parent company to restructure a group, could be regarded as a transaction that consisted in obtaining income on a continuing basis from activities which went beyond a simple share sale.

In conclusion, the reason for the transaction must be a decisive criterion: in order for a share disposal to be able to fall within the scope of VAT, the direct and exclusive reason for that transaction must be the taxable economic activity of the shareholder, or that transaction must constitute the direct, permanent and necessary extension of that activity. The latter is the case where the share disposal is carried out with a view to allocating the sale proceeds directly to the taxable activity of the seller or to the economic activity carried out by the group of which it is the parent company. As, in the case at hand, the proceeds of the sale of shares of Arovit Petfood were to be used to settle the bank debt of the group, the sale did not – according to the ECJ – fall within the scope of VAT, so that the input VAT incurred on consultancy services was not deductible.

ECJ CLARIFIES FORMAL CONDITIONS FOR THE RIGHT OF INPUT VAT DEDUCTION

In a ruling issued on November 8th 2018 (case C-502/17), the Court of Justice of the European Union (the "**ECJ**") had to rule on the question whether a real estate property developer who did not register for VAT purposes, despite being under the obligation to do so, and who has failed to keep accounting records and invoices, is entitled to benefit from an input VAT deduction, solely on the basis of an assessment resulting from an expert report ordered by a national court.

In order to reach its conclusions, the ECJ recalled that the right to deduct input VAT is a fundamental principle of the common system of VAT, which in principle may not be limited and is exercisable immediately in respect of all the taxes charged on the taxable person's input transactions. Two types of conditions are however required for the right of deduction to be available. Regarding, on the one hand, the *substantial conditions*, the person concerned must be a taxable person and the goods or services must (a) be used by the taxable person for the purpose of his own taxed output transactions and (b) be supplied by another taxable person as inputs. Regarding, on the other hand, the *formal conditions*, the exercise of the right to deduct input VAT is subject to holding an invoice drawn up in accordance with the provisions of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the "**VAT Directive**").

In the past, the ECJ had consistently found that the fundamental principle of neutrality of VAT requires deduction to be allowed if the substantive requirements are satisfied, even though the taxpayer may have failed to comply with some of the formal conditions. Nevertheless, the burden of proof to establish that the conditions for eligibility to deduct input VAT are met rests with the taxpayer, who is thus required to provide objective evidence that goods and services were actually provided as inputs by taxable persons for the purpose of his own transactions subject to VAT, in respect of which he has actually paid VAT. The evidence may include, according to the ECJ, documents held by the suppliers or service providers from whom the taxable person had acquired goods or services in respect of which he had paid VAT.

As the taxpayer in question was unable to produce invoices and only submitted illegible documents, which were not sufficient to determine the existence and scope of the right to deduction, an expert report, commissioned by a national court, was the only way to support the taxpayer's case. The ECJ however found that, while such a report may supplement the evidence collected by the taxpayer and/or support his credibility, it could not replace such evidence, as it would not, by itself, be able to establish that the taxpayer actually paid the tax in respect of the input transactions carried out for the purpose of its construction activities.

ECJ CONFIRMS RIGHT TO DEDUCT INPUT VAT FOLLOWING A FAILED TAKEOVER BID

On October 17th 2018, the Court of Justice of the European Union (the "**ECJ**") handed down a ruling (C-249/17) confirming the right to deduct, in full, input VAT paid on expenditure incurred in the context of a takeover bid, provided that the exclusive reason for that expenditure was to be found in an intended economic activity, such as the provision of management services, to the target company and notwithstanding the fact that the economic activity was ultimately not carried out as a result of the failure of the takeover. In doing so, the ECJ clarified the meaning of "taxable person" in relation to preparatory acts and of the condition of "a direct and immediate link" within the meaning of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the "**VAT Directive**").

In the case at hand, Ryanair had launched a takeover bid for all the shares of Aer Lingus (the "**Target Company**"). The takeover failed and Ryanair was only able to acquire part of the shares of the Target Company. Ryanair requested the deduction of input VAT on consultancy services and other services, incurred in connection with the purchase of shares, indicating that it had intended to provide management services subject to VAT to the Target Company. The Irish tax authority refused that deduction and the Irish Supreme Court referred a preliminary reference to the ECJ.

First, the ECJ recalled that for the purposes of the VAT Directive, a company whose sole object is the acquisition and holding of shares does not constitute a taxable person. However, a company, such as Ryanair, which acquires shares in another company with the intention, as established by objective elements, of providing management services subject to VAT to that company must be considered a taxable person. The ECJ also repeated that preparatory acts also constitute economic activity within the meaning of the VAT Directive.

Second, regarding the conditions of the right to deduct, the ECJ recalled that, while said right is integral to the VAT system, it is in principle conditioned upon the existence of a "direct and immediate link" between particular input and output transactions. A taxable person shall nevertheless also have the right to deduct, even where there is no such direct and immediate link, in case the expenses in question are part of the general costs of the taxpayer and are as such components of the price of the goods or services he supplies and linked to his economic activity as a whole. In each case however, the exclusive reason for the expenditure at stake must be found in the (intended) economic activity.

Applying these principles to the facts at hand, the ECJ concluded that Ryanair acted as a taxable person when it intended, through the acquisition of shares in the Target Company, to pursue an economic activity consisting in providing the Target Company with management services subject to VAT. Ryanair should thus be entitled to deduct input VAT, even if, ultimately, the contemplated economic activity was not carried out. The ECJ finally found that the conditions for Ryanair to exercise its right to deduct input VAT were met, as the expenditure had to be regarded as attributable to the performance of the intended economic activity and thus had a direct and immediate link with Ryanair's economic activity as a whole.

INPUT VAT DEDUCTION ON OVERHEAD COSTS IN HIRE PURCHASE TRANSACTIONS

On October 18th 2018, the Court of Justice of the European Union (the "**ECJ**") handed down an important ruling (case C-153/17), providing new guidance regarding the deduction of input VAT on general overhead costs in hire purchase transactions.

The dispute at hand involved Volkswagen Financial Services (UK) Ltd ("**VWFS**"), a financial company offering hire purchase solutions for the purchase of vehicles produced by the Volkswagen AG Group, and Her Majesty's Revenue and Customs ("**HMRC**"). The hire purchase transactions carried out by VWFS consisted of (i) a VAT taxable supply of a vehicle (at cost) and (ii) a VAT exempt provision of a credit (in consideration for interest, charged to the customer). As regards the input VAT incurred by VWFS in the context of its business, part of it is related only to taxable or exempt supplies, while part of it is related to both types of supplies. The parties disagreed to which extent VWFS should be entitled to deduct this latter input VAT, which is described in the United Kingdom as "residual VAT".

As a preliminary remark, the ECJ recalled that every transaction must normally be regarded as distinct and independent, without however artificially splitting a single supply from an economic point of view into two or more elements, so as not to distort the functioning of the VAT system. With respect to the hire purchase transactions carried out by VWFS, the ECJ took the view that they consist of several separate supplies, namely the supply of a vehicle on the one hand and the supply of credit on the other hand.

The ECJ thereafter referred to the general principles regarding the right to deduct input VAT and recalled in particular that a taxable person may deduct input VAT on general costs, even where there is no direct and immediate link between a particular input transaction and an output transaction giving rise to the right to deduct, given that general costs, as such, are components of the price of goods and services the taxable person supplies and thus have a direct and immediate link with the taxable person's economic activity as a whole. In the view of the ECJ, the fact that VWFS had decided to include the costs of its overhead expenses solely in the price of the exempt portion of its transactions (i.e. the interest charged on the credit supply) should have no effect whatsoever.

As VWFS' general costs concerned goods and services used to effect both transactions giving rise to a right to deduct and transactions not giving rise to such a right, a deductible portion must be established in accordance with the provisions of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the "**VAT Directive**"). As a general rule, the deductible portion is to be determined by reference to turnover. Nevertheless, the VAT Directive allows Member States to apply a different method or allocation, under the condition that the alternative method guarantees a more precise result.

Regarding the hire purchase transactions carried out by VWFS, the ECJ ruled that a method, such as the one selected by HMRC, which did not take account of the initial value of the goods (i.e. the vehicles) concerned when they are supplied, was not capable of ensuring a more precise apportionment of the input VAT than that which would arise from the application of the turnover-based method.

NON-EXTENSION OF SPECIALLY REDUCED TAX RATE ON REAL ESTATE CAPITAL GAINS

After a 1-year extension early last year, the specially reduced tax rate on capital gains realised by individual taxpayers on certain real estate assets has not been extended for the tax year 2019. As a reminder, this specific regime, initially introduced for the tax years

2016 and 2017 and aimed at capital gains realised by individual taxpayers on real estate assets, allowed for a reduced tax rate of one-fourth (1/4) of the overall tax rate instead of the generally applicable one-half (1/2) of the overall tax rate.

While the non-extension of the specially reduced rate was expected due to the temporary nature of the measure, it nonetheless shows a change in strategy of the new Luxembourg government on how to tackle the lack of supply of real estate and soaring real estate prices. Indeed, other measures have been deemed more apt to tackle such issues, such as significantly increasing the state sponsored construction of affordable housing.

OECD GUIDANCE ON THE CONCEPT OF SUBSTANCE FOR NO OR ONLY NOMINAL TAX JURISDICTIONS

On November 15th 2018, the Organisation for Economic Co-operation and Development ("**OECD**") published technical guidance for the application of the substance requirement to "low or no tax jurisdictions". In a report dated 1998, the OECD had already taken the view that one of the most effective means of combating harmful tax practices (i.e., no-tax jurisdictions and harmful preferential tax regimes) adopted by certain jurisdictions, was to oblige them to provide for a substantial activity requirement in their national legislation. Under this requirement, taxpayers could only benefit from a favourable tax treatment, if they had a sufficient presence on the territory of the jurisdiction.

While Action Point 5 of the Base Erosion and Profit Shifting ("**BEPS**") Project mainly dealt with the substantial activity requirement with regard to preferential tax regimes, the OECD, in this newly released report, extends the substance requirement to "no or low tax jurisdictions", in order to avoid harmful relocations of activities to low or no tax jurisdictions. This requirement should apply not only to jurisdictions which do not impose a corporate income tax, but also to jurisdictions which impose only nominal corporate income tax.

In addition, the OECD specifies that the substance requirements should only apply to activities that are geographically mobile, such as financial and other service activities. It nonetheless makes a distinction between activities generating income from intellectual property ("**IP income**") and all other geographically mobile activities ("**non-IP income**").

With regard to non-IP income, "no or only nominal tax" jurisdictions should introduce legislation to: (i) define the core income generating activities; (ii) ensure that these activities are effectively undertaken in the jurisdiction, (iii) require the entity to have an adequate number of qualified employees and (iv) have a transparent mechanism to ensure compliance and provide for an effective enforcement mechanism if these activities are not effectively undertaken within the jurisdiction (e.g. striking an entity from the register).

With regard to IP Income, the OECD recommends that the jurisdiction implements the "nexus approach". This approach consists in (i) defining a formula to identify the income eligible for a reduced rate and (ii) providing for a rule to determine the tax treatment of non-eligible income. Since "no or only nominal tax" jurisdictions will not levy tax at an ordinary rate, the OECD proposes to apply a similar approach as for non IP activities, meaning that taxpayers must have sufficient activity in order to benefit from a no or only nominal tax rate.

OECD PUBLISHES PEER REVIEWS ON THE EXCHANGE OF TAX RULINGS

On December 13th 2018, the OECD published the 2017 Peer Review Reports on the Exchange of Information on Tax Rulings.

These reports reflect the outcome of the second peer review of the Implementation of Action 5 of the BEPS Project and cover the tax year 2017.

The reports review the implementation of the BEPS Action 5 minimum standard which aims to provide tax administrations with timely information on rulings and covers 92 jurisdictions. Overall, the OECD notes that, as of December 21st 2017, 16,000 rulings had been issued by the jurisdictions under review and 21,000 exchanges had taken place between tax administrations. In addition, all 92 reviewed jurisdictions will or have already undertaken steps to implement the necessary legal framework for spontaneous exchange of information on rulings for the year in review.

As regards Luxembourg, the report notes that Luxembourg granted 1,922 so-called past rulings (i.e. rulings granted between January 1st 2014 and April 1st 2016 or before if they were still in effect as at January 1st 2014), 73 rulings for the period April 1st 2016 to December 31st 2016 and 18 rulings for the year 2017. The reports conclude that Luxembourg satisfies, in all aspects, the criteria for information gathering, exchange of information and in matters related to intellectual property regimes. The report notes the efforts made by Luxembourg to meet the last peer review's recommendations such as improving its information gathering on past rulings. The OECD makes no recommendations for this year's review and adds that the information exchanged by Luxembourg is complete, in a correct format and almost always communicated in a timely manner.

LUXEMBOURG FISCAL UNITY REGIME – REQUEST FOR PRELIMINARY RULING FROM ECJ

By a decision of November 29th 2018, the Luxembourg Higher Administrative Court (*Cour administrative*) referred three questions to the European Court of Justice of ("**ECJ**") for a preliminary ruling concerning the former tax consolidation regime applicable in Luxembourg until 2015 and which provided for a vertical fiscal unity (between the Luxembourg parent company and its direct or indirect Luxembourg subsidiaries). The specific article of the Luxembourg Income Tax Law ("**LIR**") was amended in the course of the year 2015, in order to also provide for a horizontal fiscal unity (between sister companies of the same group whose common parent company is non-resident). This change took place to comply with a judgment of the ECJ dated June 12th 2014, where the ECJ held that the Dutch tax provisions prohibiting horizontal tax consolidations constituted an unjustified discrimination under European Union law.

Pursuant to this judgment, the Luxembourg subsidiaries of a French parent company submitted in December 2014 an application to be granted the horizontal tax consolidation regime already for the fiscal years 2013 and 2014. This request was refused by the Luxembourg tax authorities on the grounds that the former fiscal unity regime, still in force at that time, did not provide for this possibility. While the Lower Administrative Court (*Tribunal administratif*) ruled in favour of the applicant with regard to the year 2014, it refused to grant the benefit of the fiscal unity for the year 2013 on the grounds that the request had not been filed prior to the year end of the tax year in question, which is one of the formal requirements of the fiscal unity regime. In the context of the appeal of this decision, the Higher Administrative Court considered it necessary to seek a preliminary ruling from the ECJ on the following three questions:

The first question concerns the conformity of the former fiscal unity regime with EU law. After highlighting the differences between the Luxembourg provisions and the Dutch ones, which were invalidated in 2014 by the ECJ, the administrative judges doubt that the Luxembourg regime should suffer the same fate.

The second question concerns whether the condition, set out in the new fiscal unity regime and which prohibits a company to be simultaneously part of more than one fiscal unity, could be considered as contrary to EU law.

Finally, the third question concerns whether the condition requiring that the request for a fiscal unity be submitted no later than the end of the tax year for which the fiscal unity regime is requested could be considered as contrary to the freedom of establishment.

Depending on the answers provided by the ECJ, the consequences could be considerable as certain taxpayers may have the right to request the retroactive application of the fiscal unity regime for a significant number of tax years.

TAX TREATY UPDATE

With draft law No. 7390 (the "**Draft Law**"), which was submitted to the Luxembourg Parliament on December 4th 2018, Luxembourg aims at further expanding its already comprehensive double tax treaty network. If adopted, the Draft Law will ratify a new double tax treaty, replace an existing one and approve an amendment agreement (*avenant*) as well as a protocol to two other existing tax treaties.

Firstly, with respect to the two new double tax treaties, the first one is with the French Republic and aims at replacing the existing double tax treaty, as further detailed in another section of the present newsletter and our previous newsletter dated March 2018; the second one which is with the Republic of Kosovo generally follows the latest OECD Model Tax Treaty and includes, *inter alia*, the confirmation that investment funds qualify as residents under the double tax treaty. Interestingly, it does not provide for a real estate rich clause, unlike other recent double tax treaties entered into by Luxembourg.

As regards the amendment agreement, it relates to the double tax treaty entered into with the Kingdom of Belgium and amends, in particular, the article dealing with employment income, by providing for a 24-day period, during which residents of one contracting state working in the other contracting state can either work in the first contracting state or in a third contracting state, without jeopardising the taxation right of the other contracting state for the overall employment income. This change will be welcomed by Luxembourg workers commuting from across the border who, as a result, can be assured that working 24 days or less outside of Luxembourg (in their home country or in a third country) will not impact Luxembourg's taxation right of their overall employment income (unless the third country is entitled to a taxation right on said days spent on his territory under another double tax treaty).

Finally, as regards the protocol, this relates to the double tax treaty entered into with Uzbekistan and aims at updating the existing double tax treaty in order to implement the latest OECD recommendations, such as an updated preamble, updated exchange of information language as well as the inclusion of a limitation of benefit based on the principle purpose test.

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