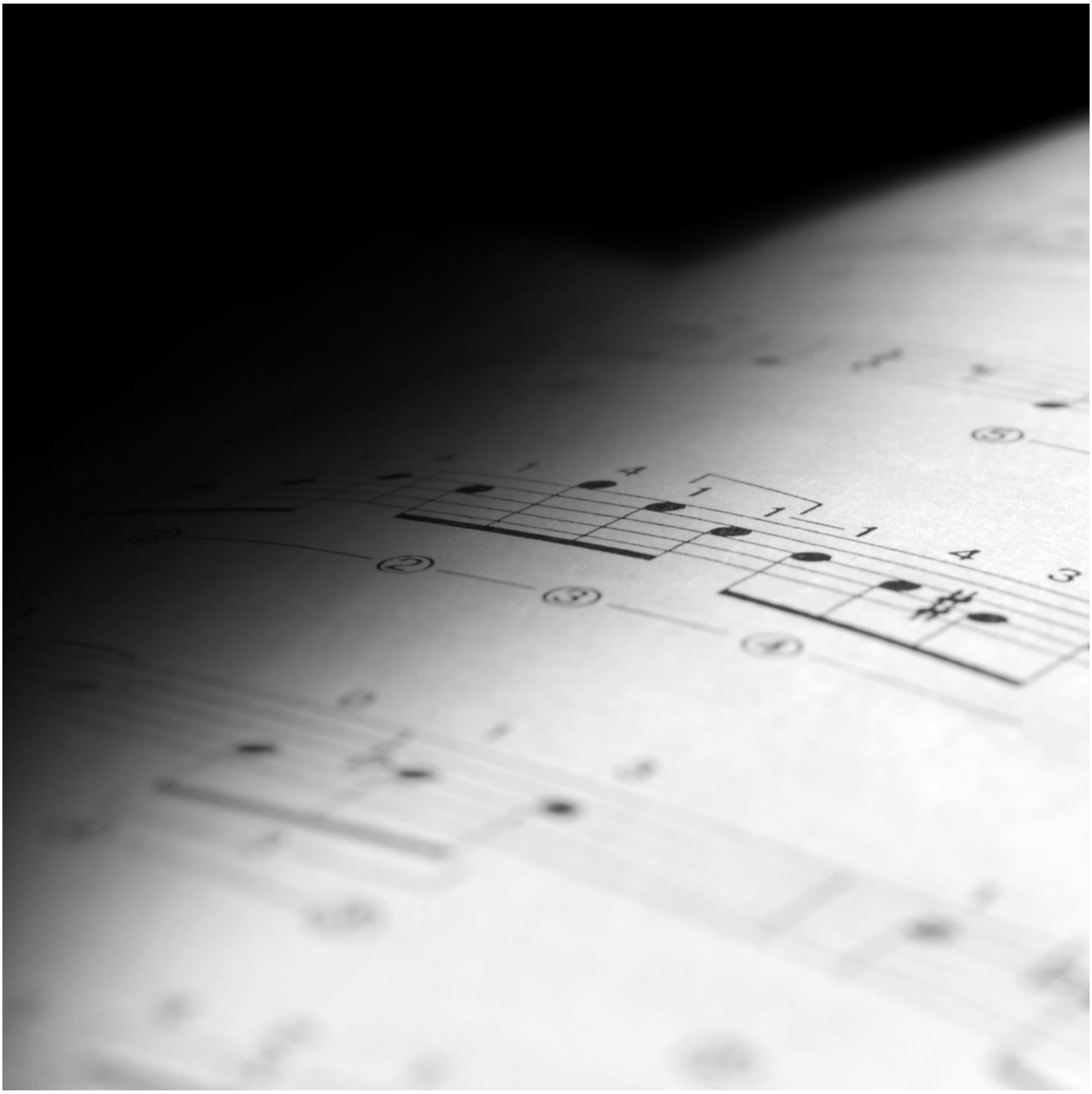

NEWSLETTER

April, 2019

Right by you in Luxembourg

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AML

REGISTER OF BENEFICIAL OWNERS | LAW OF 13 JANUARY 2019

Pursuant to and in compliance with the AML 4th Directive amended by the AML 5th Directive, Luxembourg parliament enacted the law of 13 January 2019, setting-up a register of beneficial owners ("**BOs**") ("**RBO Law**").

The RBO Law creates a register of BOs ("**RBE**"), which aims to preserve and make available information on BOs of registered entities.

The scope of the RBO Law is large and covers all forms of commercial companies as well as 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. Companies listed on regulated markets fall within the scope of the RBO Law as well.

In particular, the RBO Law requires registered entities to determine their BOs based on a definition by reference to the AML law of 2004. In substance, a first arithmetical test must be performed to determine possession; failure of which requires a second test (quality test) to determine control. If, after exhausting all possible means no person(s) could be identified as beneficial owner(s), any individual holding the position of senior manager must be taken into consideration for registration into the RBE.

The RBO Law requires the registered entities to register BOs (or the senior managers) in the RBE with a determined set of information (the name; first name(s); nationality; day, month, year and place of birth; country of residence; for natural persons, identification number provided for by the amended law of 19 June 2013 on the identification of natural persons or similar for non-resident; nature and scope of interests held).

Additionally, registered entities must as well collect and maintain, at their registered office, the same information into an internal register which may be consulted by national authorities. In any case, such information must at all times, be adequate, accurate and up-to-date as well as the supporting documents relating thereto.

Access to the RBE by national authorities (e.g. the public prosecutor, investigating judges, the *cellule de renseignement financier*, the judicial police officers), within the scope of their duties is unrestricted whereas access by the public is restricted; the public will have no access to the addresses and national or foreign identification numbers of the BOs.

This being said, it is possible for BOs, on an exceptional basis, to request restriction of access in specific exceptional circumstances where such access would expose BOs to a disproportionate risk. However, such restriction of access is only granted subject to stringent conditions and, if granted, a specific notice to that effect will be published in the RBE.

Failure by the registered entities and the relevant BOs to comply with their respective obligations deriving from the RBO Law will be subject to criminal fines of up to Euro 1,250,000.

The RBO Law entered into force on March 1st 2019 and will benefit from a 6 months grace period. Consequently, registered entities and BOs must start complying with the RBO Law at the latest on September 1st 2019. For more information please read the full text of our article available on https://www.bsp.lu/publications/newsletters-legal-alerts/legal-alert-law-january-15th-2019-setting-register-beneficial

BANKING & FINANCE

CSSF ADOPTION OF EBA PSD2 GUIDELINES

On March 14th 2019, the CSSF published:

- CSSF Circular 19/712 (the “**Fraud Data CSSF Circular**”) adopting the guidelines of the European Banking Authority (“**EBA**”) on reporting requirements for fraud data under Article 96(6) of Directive (EU) 2015/2366 on payment services (“**PSD2**”) - EBA/GL/2018/05, and
- CSSF Circular 19/713 (the “**Security Measures CSSF Circular**”) adopting the EBA guidelines on the security measures for operational and security risks of payment services under PSD2 - EBA/GL/2017/17.

The Security Measures CSSF Circular took effect immediately whereas the Fraud Data CSSF Circular shall only take effect from January 1st 2020.

According to Article 105-2 of the Luxembourg law of 10 November 2009 on payment services, as amended (the “**2009 Law**”), payment services providers (“**PSPs**”) shall provide the CSSF, at least on an annual basis, with statistical data on fraud relating to the different means of payment which the CSSF, in turn, provides, in aggregate form, to the EBA and the European Central Bank (the “**ECB**”). The EBA guidelines adopted by the Fraud Data CSSF Circular provide details on how such statistical data on fraud shall be reported to the relevant competent authorities by clarifying the types of payment transactions and fraudulent payment transactions to be reported as well as the reporting frequency, reporting timelines and reporting periods. In addition to clarifying the half yearly reporting periods, the Fraud Data CSSF Circular explains that the fraud reporting is to be provided even if no fraud occurred during the reporting period. Furthermore, in case an adjustment to a previous report is required, PSPs should submit the revised reporting table (in accordance with the applicable technical instructions), indicating the relevant past reporting period.

According to Article 105-1(2) of the 2009 Law, PSPs shall provide to the CSSF, at least on an annual basis, an up-to-date and comprehensive assessment of the operational and security risks associated with the payment services they provide, and information on the adequacy of the mitigation measures and control mechanisms which have been implemented so as to address these risks. The EBA guidelines adopted by the Security Measures CSSF Circular provide details with regard to the annual auditing requirements as regards the security measures taken and the annual reporting requirements regarding the assessment of major operational and security risks. The Security Measures CSSF Circular clarifies the form and time frame in which the above-mentioned assessments and information must be provided to the CSSF.

LUXEMBOURG SUPREME COURT’S DECISION ON THE ENFORCEMENT OF FINANCIAL COLLATERAL

In our [January 2019 Newsletter]() we reported on a judgment rendered by the Luxembourg court of appeal (*Cour d’Appel*) (the “**Court of Appeals**”) 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, according to which the enforcement of a pledge by a pledgee cannot be subsequently declared null and void by a court, even if successfully challenged on the basis of the application of the general principle of law *fraus omnia corrumpit* (fraud invalidates everything). The doors, having initially been closed by the Court of Appeals, by depriving the pledgors the right to invalidate the enforcement actions performed by the pledgee under Article 11 of the Luxembourg law of 5 August 2005 on financial collateral arrangements, as amended, (the "**Collateral Law**"), the Luxembourg *Cour de Cassation* (the "**Supreme Court**"), in a recent judgment rendered on February 14th 2019 (No. 27 / 2019, No. 4022), might have reopened them again.

The decision of the Supreme Court has been handed down in a case initially brought by the pledgor before the Luxembourg *Tribunal d'arrondissement* (District Court) for restitution of all the shares appropriated by the pledgee in the enforcement of its pledge (governed by the Collateral Law) over these shares. The case was subsequently appealed. The Court of Appeals found that the lender had in fact induced the borrower, who was already in default under the existing unsecured facility agreement, to enter into a new secured refinancing facility which the lender accelerated right after it informed the borrower that the loan had been granted to it. The Court of Appeals held that the lender had committed an "*abus de droit*", i.e. an unlawful use of a contractual right.

Unlike the court of appeals, in the case from May 2018 referred to above, the Supreme Court decided that the Collateral Law does not prevent a court from declaring void an appropriation of pledged assets by the pledgee and ordering the restitution of such assets to the pledgor if the enforcement of the pledge is tainted by an "*abus de droit*" or fraud. Given the authority of the Supreme Court, it is likely that this result will be the prevailing legal rule.

MIFID II & MiFIR | UPDATE OF ESMA Q&A

Since our last newsletter on the topic, 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 MiFID II and MiFIR transparency topics;
- Q&A on MifID II and MiFIR commodity derivatives products;
- Q&A on MiFIR data reporting, and
- Q&A on MiFID II and MiFIR market structures topics

We will focus here on just a couple of the updates to the Q&A on investor protection and intermediaries topics in respect of inducements and in respect of provision of investment services and activities by third country firms.

Pursuant to Article 24(8) of MiFID II, "*when providing portfolio management the investment firm shall not accept and retain fees, commissions or any monetary or non-monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation to the provision of the service to clients…*"

ESMA has confirmed in this latest update to the relevant Q&A that only ongoing inducements accrued until January 2nd 2018 (subject to being compliant with MiFID I) may be received by investment firms. Furthermore, such investment firms must be in a position to clearly show that such ongoing inducements do in fact relate to that period.

As regards the provision of investment services and activities by third country firms, pursuant to Article 42 of MiFID II, "*Member States shall ensure that where a retail client or professional client within the meaning of Section II of Annex II established or situated in the Union initiates at its own exclusive initiative the provision of an investment service or activity by a third-country firm, the requirement for authorisation under Article 39 shall not apply to the provision of that service or activity by the third country firm to that person including a relationship specifically relating to the provision of that service or activity. An initiative by such clients shall not entitle the third-country firm to market otherwise than through the branch, where one is required in* *accordance with national law, new categories of investment products or investment services to that client*". ESMA has clarified that this reverse solicitation exemption does not mean that a firm that, within the context of a one-off service to the client, has sold/had the chance to sell a product or service under this rule, may, at a future point in time, offer products or services from the same category (unless this is done through a branch).

BREXIT

MEMORANDA OF UNDERSTANDING BETWEEN ESMA, EU/EEA SECURITIES REGULATORS AND THE FCA ON EXCHANGE OF INFORMATION AND HARD BREXIT RELATED MEASURES

On February 1st 2019, ESMA issued a press release regarding Memoranda of Understanding (the "**Memoranda**") it has entered into with EU/EEA securities regulators and the FCA.

In case the United Kingdom leaves the European Union without a withdrawal agreement, the Memoranda will allow continuing supervisory cooperation, enforcement and information exchange between individual regulators and the FCA allowing them to share the information relating to market surveillance, investment services, and asset management activities. The Memoranda are similar to those already concluded on the exchange of the information with many third country supervisory authorities.

The Memoranda include:

1. memorandum of understanding between ESMA and the FCA concerning the exchange of information in relation to the supervision of credit rating agencies and trade repositories;
2. multilateral memorandum of understanding between ESMA, the FCA and EU securities regulators (the "**Multilateral Memorandum**"). The Multilateral Memorandum confirmed that the exchange of information needed for the orderly functioning of markets will continue regardless of the outcome of the Brexit negotiations, consequently enabling entities based in the United Kingdom to continue to carry out services in relation to portfolio and investment management on behalf of counter-parties based in the European Union.

   The Multilateral Memorandum has been confirmed by the CSSF in the press release 19/07 dated February 1st 2019.

TRANSPARENCY DIRECTIVE | UPDATE OF ESMA Q&A.

ESMA updated its Q&A (the "**Q&A**") on Directive 2004/109/EC ("Transparency Directive"), to clarify the obligations applicable to issuers with respect to its choice of home Member State in case the UK withdraws from the EU without any withdrawal agreement in place (the so-called "**Hard Brexit**" scenario).

An issuer's obligations under the Transparency Directive regime are determined by reference to the requirements of its home Member State for Transparency Directive purposes. For an issuer incorporated in an EU Member State which has its shares (or debt securities with a denomination of less than 1,000 Euro (or equivalent)) admitted to trading on an EU regulated market, it has no choice: its home Member State is automatically the Member State in which it has its registered office. Any other issuer will have, to a limited extent, a choice.

Upon a Hard-Brexit, the UK will become a third country and therefore issuers who have previously chosen the UK as their home member state (or issuers whose home Member State was automatically designated as the UK) will have to choose (and disclose in accordance with Articles 20 and 21 of the Transparency Directive) a new Home Member State among the 27 EU Member States and the three EEA EFTA States, namely Iceland, Liechtenstein and Norway. The choice of a new home Member State must be disclosed, if applicable, to:

- The competent authority in the Member State where the issuer has his registered office;

- The competent authority in the new home Member State of the issuer; and
- The competent authority of all host Member States.

The issuers concerned should make the required disclosures, without delay, and in any case, within three months following the withdrawal of the UK from the EU. Failure to make the required choice and subsequent disclosure, means that the Member State or Member States where the issuer's securities are admitted to trading on a regulated market will be designated as its home Member State, until a subsequent choice has been made and disclosed by the issuer.

PROSPECTUS DIRECTIVE | UPDATE OF ESMA Q&A

ESMA published new Q&A (the "**Q&A**") on Directive 2003/71/EC (the "Prospectus Directive"), to clarify various issues which may arise in relation to the implementation of the Prospectus Directive rules in case the UK withdraws from the EU without any withdrawal agreement in place (the so-called "**Hard Brexit**" scenario). In particular, these new Q&A deal with:

- the choice of a home Member State for third country issuers under the Prospectus Directive; and
- the use of prospectuses approved by the UK.

As regards the choice of a home Member State, ESMA explains that, for the issuers whose home Member State is currently the UK, the withdrawal of the UK from the EU will effectively reset the choice, at the time of the withdrawal. For the purposes of applying Article 2(1)(m)(iii) of the Prospectus Directive, the issuers concerned should choose between the 27 EU Member States and the three EEA EFTA States, namely Iceland, Liechtenstein and Norway, in which they have activities after the withdrawal. ESMA describes two practical scenarios for explanatory purposes.

As regards the use, following a Hard Brexit, of a prospectus approved by the FCA (as UK competent authority) prior to UK withdrawal:

- such prospectuses shall no longer be capable of being passported to the 27 EU Member States and the three EEA EFTA States;
- these FCA - approved prospectuses, if passported to an EU/EEA EFTA State before withdrawal, can no longer be supplemented; and
- those FCA - approved prospectuses which have been passported to an EU/EEA EFTA State and need to be supplemented, can no longer be used for an offer to the public/admission to trading on a regulated market.

In the same context, ESMA explains how it sees the situation with FCA - approved prospectuses post a Hard Brexit, in four distinct scenarios:

(i) The continuance of an offer to the public in an EU/EEA EFTA State – ESMA considers that it is unlikely to be possible; more likely the issuer will have to start a new offer once a prospectus is approved by the new home Member State.

(ii) The continued maintenance of an admission to trading on a regulated market – ESMA considers that the admission to trading will remain valid without the need for any new prospectus approval by the new home Member State.

(iii) The making of a new offer to the public – ESMA considers that a prospectus must be approved by the competent authority of the new home Member State.

(iv) The new admission to trading on a regulated market – ESMA considers that a prospectus must be approved by the competent authority of the new home Member State.

However, ESMA makes clear that the issuers concerned won't necessarily have to draw up a new prospectus as they may be able to submit the FCA - approved prospectus to the new home Member State's competent authority so long as it contains the necessary information.

TWO NEW BREXIT LAWS FOR THE LUXEMBOURG FINANCIAL SECTOR.

In anticipation of the UK leaving the EU (or simply "**Brexit**" as it is more commonly referred to) without an agreement in place (the so-called "**Hard Brexit**" scenario), the Luxembourg legislator has taken swift action to facilitate a smooth transition for those who may be most affected – it has adopted two new laws for the Luxembourg financial sector.

On April 11th 2019, a new law of 8 May 2019 was published relating to the measures to be taken in relation to the UK's withdrawal from the EU, and amending:

- the law of 5 April 1993 on financial sector;
- the law of 10 November 2009 on payment services;
- the law of 17 December 2010 on undertakings for collective investment;
- the law of 12 July 2013 on alternative investment fund managers;
- the law of 7 December 2015 on the insurance sector; and
- the law of 18 December 2015 on resolution, recovery and liquidation measures of credit institutions and some investment firms;

(hereinafter the "**Financial Sector Brexit Law**").

Pursuant to the Financial Sector Brexit Law, extraordinary powers are vested in the Luxembourg competent authorities – the CSSF and the *Commissariat aux Assurances* ("**CAA**") in order to maintain financial stability and ensure consumer protection in the context of a Hard Brexit.

On a case-by-case basis, the CSSF and the CAA may decide on the right for UK companies to continue providing services or for a branch office to continue operating in Luxembourg following a Hard Brexit, but for a maximum period of 21 months. This power is limited to contracts concluded before the Hard Brexit or to contracts concluded thereafter where there is a close link with prior existing contracts. These remedial powers granted to the CSSF concern UK credit institutions, UK investment firms, UK payment services providers, UK electronic money institutions as well as UK UCITS management companies and UK AIFMs. The corresponding powers granted to the CAA concern insurance and reinsurance companies.

Furthermore, the Financial Sector Brexit Law shall extend to certain third country payment and securities settlement systems the protection which is afforded to EEA systems (under the Settlement Finality Directive) against the insolvency of a Luxembourg participant. To benefit from this protection, the third country systems must be admitted to a list managed by the Luxembourg Central Bank.

On April 11th 2019, another new law of 8 May 2019 was published relating to the measures to be taken in relation to the UK's withdrawal from the EU, but amending only the following laws:

- the law of 17 December 2010 on undertakings for collective investment; and
- the law of 13 February 2007 relating to specialized investment funds.

(hereinafter "**the Financial Sector – UCI Brexit Law**" and together with the Financial Sector Brexit Law, the "**Brexit Laws**").

The Financial Sector – UCI Brexit Law provides for transitional measures in case of not only a Hard Brexit scenario but any Brexit scenario.

Pursuant to this Law, in case of a Hard Brexit, the CSSF is empowered to allow:

- a UK-established UCITS with a UK management company to continue marketing to Luxembourg retail investors for a period of 12 months;
- a UK-established UCITS with a non-UK management company to continue marketing to Luxembourg retail investors for a period of 12 months **if they are authorized as an AIFM prior to Brexit**

Furthermore the Financial Sector – UCI Brexit Law introduces a notion of passive infringement to deal with any potential breach of investment restrictions in a UCITS, Part II Fund or SIF as a consequence of a Brexit (not only a Hard Brexit). Such funds will have 12 months to rectify passive breaches relating to positions taken prior to the withdrawal date.

With these two new laws, the Luxembourg financial sector is hopefully well-positioned to face Brexit head-on, whenever it may occur (if at all). In the meantime, the CSSF has announced in its Press Release 19/18 regarding the new Brexit Laws, that it is adopting a wait-and-see approach, noting that it will inform the public in due course, of any actions to be taken by UK firms, to benefit from the transitional period provided for in those laws.

CONSEQUENCES OF BREXIT IN THE SPHERE OF INTERNATIONAL DATA TRANSFERS

The National Commission for Data Protection ("*Commission nationale pour la protection des données*", or **CNPD**) recently published a report on the consequences of the UK leaving the EU ("**Brexit**") in the sphere of international data transfers. This report is intended to guide Luxembourg companies, public bodies and associations that transfer personal data to the United Kingdom and that intend to continue such transfers after Brexit.

In principle, all primary and secondary EU law will cease to apply to the United Kingdom as from date of Brexit, unless a withdrawal agreement is ratified.

On 14 November 2018, the negotiators of the European Commission and the United Kingdom reached political agreement on the entire agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (**the Withdrawal Agreement**). However, this Withdrawal Agreement still has to be ratified.

The ratification or non-ratification of this Agreement will have significant consequences for international data transfers between the United Kingdom and Luxembourg.

I. If the Withdrawal Agreement is ratified

If the Withdrawal Agreement is ratified, European data protection rules will continue to apply in and to the United Kingdom for a transitional period, i.e. from date of Brexit to December 31st 2020 (unless the transitional period is extended).

After the end of the transitional period, in accordance with the Withdrawal Agreement, the United Kingdom will continue to apply European data protection rules to personal data exchanged between the United Kingdom and the Member States of the European Economic Area before the end of the transitional period, until the European Union has established that the level of protection provided by the United Kingdom regime offers data protection guarantees that are "essentially equivalent" to those provided by the European Union (Article 45 of the General Data Protection Regulation, "**GDPR**").

II. If the Withdrawal Agreement is not ratified

In the event of a "no deal", European Union law will cease to apply in and to the United Kingdom from Brexit date. The United Kingdom will therefore leave the European Union and be considered a third country within the meaning of the GDPR.

Therefore, as from Brexit date, in order to continue to legally transfer personal data to the United Kingdom, the Luxembourg entities concerned will have to comply with the legal provisions of Chapter V of the GDPR, which concerns transfers of personal data to third countries or international organisations.

Thus, transfers of personal data from a Member State of the European Union to the United Kingdom may continue to take place after date of Brexit:

- if the European Commission has decided that the United Kingdom ensures an adequate level of protection (article 45 of the GDPR), or failing that

- if the controller or processor has provided appropriate safeguards and on condition that enforceable data subject rights and effective legal remedies for data subjects are available (article 46 of the GDPR). These appropriate safeguards may be:
  - standard data protection clauses adopted by the Commission or by a supervisory authority and approved by the Commission;
  - binding corporate rules;
  - an approved code of conduct or certification mechanism;
  - a legally binding and enforceable instrument between public authorities or bodies.
- in the absence of an adequacy decision or of appropriate safeguards, transfers of personal data to the United Kingdom shall take place only on one of the following conditions:
  - the data subject has explicitly consented to the proposed transfer, after having been informed of the possible risks of such transfers for the data subject due to the absence of an adequacy decision and appropriate safeguards;
  - the transfer is necessary for the performance of a contract between the data subject and the controller or the implementation of pre-contractual measures taken at the data subject's request;
  - the transfer is necessary for the conclusion or performance of a contract concluded in the interest of the data subject between the controller and another natural or legal person;
  - the transfer is necessary for important reasons of public interest;
  - the transfer is necessary for the establishment, exercise or defence of legal claims;
  - the transfer is necessary in order to protect the vital interests of the data subject or of other persons, where the data subject is physically or legally incapable of giving consent;
  - the transfer is made from a register which according to Union or Member State law is intended to provide information to the public and which is open to consultation either by the public in general or by any person who can demonstrate a legitimate interest, but only to the extent that the conditions laid down by Union or Member State law for consultation are fulfilled in the particular case.
- failing that, finally, a transfer to the United Kingdom may take place only if the transfer is necessary for the purposes of compelling legitimate interests pursued by the controller, and under certain conditions enounced in article 49 of the GDPR.

All the rules set out above are to be added to the obligations normally applicable to controllers as set out in the GDPR (compliance with the principle of lawfulness in particular, compatibility of the communication with the original processing operation, information to data subjects, etc.).

RIGHTS OF BRITISH NATIONALS IN LUXEMBOURG AFTER BREXIT

As the exit of the UK from the EU will have consequences for the rights of British nationals to reside and access employment in Luxembourg, the Luxembourg Government has recently published an information folder on Brexit.

In this respect, the impact of Brexit will differ depending on whether the withdrawal agreement agreed between the European Commission and the UK in November 2018 (the "**Withdrawal Agreement**") is ratified or not. If the Withdrawal Agreement is ratified before October 31st 2019, it will enter into force on the first day of the following month. A transitional period will apply until December 31st 2020, during which Union law will continue to apply in the UK. However, if the UK is still a member of the EU between May 23rd and May 26th 2019 and has not ratified the Withdrawal Agreement by May 22nd 2019, it must hold elections to the European Parliament in accordance with Union law. If the UK fails to comply with this obligation, the Withdrawal Agreement will enter into force on June 1st 2019.

I. In the event of the entry into force of the Withdrawal Agreement

A. Right of residence of British nationals and their family members

British nationals and their family members will continue to benefit from a **right of residence** in the Member States of the EU after the UK's withdrawal from the EU. This concerns:

- British nationals and their family members residing in Luxembourg **before Brexit**;
- British nationals and their family members arriving in Luxembourg **after Brexit but before the end of the transitional period** (December 31st 2020);
- persons who are family members of a British national covered by one of the two previous points and who arrive in Luxembourg **after the end of the transitional period** (January 1st 2021).

British nationals and their family members covered by the Withdrawal Agreement will thus be able to benefit from a right of residence in Luxembourg despite the withdrawal of the UK from the EU, **even after the end of the transitional period**, on the same basis as EU citizens.

The persons concerned by the Withdrawal Agreement will be issued with a specific residence document, which will attest their status as beneficiaries of the Withdrawal Agreement.

B. Access to the employment market for British nationals and their family members

British nationals and their family members covered by the Withdrawal Agreement will enjoy the same rights as EU citizens to **access the employment market**.

Thus, British nationals and their family members **residing in Luxembourg and employed in Luxembourg before Brexit** may continue to work in Luxembourg after Brexit without specific prior authorisation. The same rules will apply to:

- British nationals and their family members arriving in Luxembourg **after Brexit but before the end of the transition period** (December 31st , 2020);
- British national cross-border workers who started to work in Luxembourg **before December 31st, 2020**;
- family members of a British national residing in Luxembourg before December 31st 2020, who will arrive in Luxembourg **after the end of the transitional period** (January 1st 2021).

However, British nationals and their family members who will arrive in Luxembourg **after December 31st 2020**, as well as cross-border workers who will start working in Luxembourg after that date, will no longer benefit from a right of access to the employment market, and should apply for a **residence permit as third-country nationals enabling them to exercise a salaried activity** in accordance with the amended law of 29 August 2008 on the free movement of persons and immigration (the "**Law of 29 August 2008**").

II. In the absence of ratification of the Withdrawal Agreement ("no deal")

A. Right of residence of British nationals and their family members

In the absence of a Withdrawal Agreement, British nationals will be considered as third-country nationals. This concerns:

- British nationals and their family members residing in Luxembourg before Brexit;
- British nationals and their family members who settle in Luxembourg after Brexit.

British nationals and their family members will therefore no longer benefit from a right of residence as EU citizens **after Brexit**. They will be considered third-country nationals and should apply for a residence permit on this basis pursuant to the Law of 29 August 2008.

However, for British nationals and their family members who are already residing in Luxembourg **before Brexit** on the basis of a residence permit issued in accordance with Directive 2004/38/E[1], the Luxembourg Government has decided to allow them to continue to reside in Luxembourg after Brexit and **for one year after the withdrawal** on the basis of their current residence permit. However, after that date, the persons concerned should apply for a residence permit as third-country nationals in accordance with the Law of 29 August 2008.

B. <u>Access to the employment market for British nationals and their family members</u>

In the absence of a Withdrawal Agreement, British nationals and their family members will be considered as **third-country nationals after Brexit**. They should therefore apply for a residence permit enabling them to exercise a salaried activity as third-country nationals in accordance with the Law of 29 August 2008.

However, British nationals and their family members who reside and have started their professional activity in Luxembourg **before Brexit** will have the possibility to continue to **reside** in Luxembourg after that date and **for one year after the withdrawal**, pursuant to their current residence permit[2]. However, they will have to apply for a residence permit in order to be able to **exercise a salaried activity**. The persons concerned will be able to **continue working until the residence permit is issued**. The same rules will apply to British nationals who are cross-border workers and who are already employed in Luxembourg before Brexit.

On the other hand, British nationals who arrive in Luxembourg **after Brexit** should **first apply for a residence permit as third-country nationals** in accordance with the Law of 29 August 2008, before they can reside and start working in Luxembourg. The same rules will apply to British nationals who are cross-border workers and wish to start working in Luxembourg after Brexit.

[1] Directive 2004/38/EC of the European Parliament and of the Council of 29 April 2004 on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States.

[2] See footnote 1.

CAPITAL MARKETS

NEW PROSPECTUS REGULATION | NEW ESMA Q&A

On March 27th 2019, ESMA published new Questions & Answers on the Prospectus Regulation documents ("**Q&A**") relating to Regulation (EU) 2017/1129 of 14 June 2017 (the "**Prospectus Regulation**"). The Prospectus Regulation shall be fully applicable from July 21st 2019.

The Q&A currently covers three main subjects:

I. The so-called "grandfathering" provision of Article 46 (3) of the Prospectus Regulation (the "**Grandfathering Provision**") and the implementation of the regulation;
II. The status of existing level 3 guidance, established under the Directive 2003/71/EC of 4 November 2003, as amended (the "**Prospectus Directive**"); and
III. Updating or supplementing information included in the registration document or the universal registration document.

ESMA has clarified that advertisements do not fall within the scope of the Grandfathering Provision and therefore all advertisements published after the full entry into application of the Prospectus Regulation must comply with the Prospectus Regulation. A registration document does not qualify as a prospectus without a securities note and summary and therefore is not within the scope of the Grandfathering Provision. Therefore, it will not be possible to use a registration document approved or filed under the Prospectus Directive as a constituent part of a prospectus approved under the Prospectus Regulation. On the other hand, information in a registration document approved under the national laws implementing the Prospectus Directive can be incorporated by reference into a prospectus that will be approved under the Prospectus Regulation subject to such information being compliant with the disclosure requirements of the Prospectus Regulation.

For a maximum of 12 months from July 21st 2019 it will be possible to passport prospectuses approved in accordance with the national laws implementing the Prospectus Directive. Any prospectus approved in accordance with the national laws implementing the Prospectus Directive will need to be supplemented in accordance with those laws. When filing final terms in relation to a base prospectus approved in accordance with the national laws implementing the Prospectus Directive, the rules of those same national laws must be applied to the filing of the related final terms.

Previously established level 3 texts (specifically, the ESMA Questions & Answers on Prospectuses and the ESMA Update of the CESR recommendations) are to be applied to prospectuses drawn up under the Prospectus Regulation, to the extent they are compatible with the provisions of the Prospectus Regulation.

Information in a registration document shall be updated by a supplement pursuant to Article 10(1) of the Prospectus Regulation if it is not part of a prospectus. Withdrawal rights do not apply where a registration document is supplemented because there is no offer of securities to the public.

The rules on updating information included in a universal registration document ("**URD**") differ under the Prospectus Regulation, depending on whether the update happens before or after the URD is part of a prospectus. ESMA has provided diagrams to assist in the interpretation of the applicable rules.

PROSPECTUS REGULATION | ESMA GUIDELINES ON RISK FACTORS

Pursuant to Article 16(4) of the Regulation (EU) No. 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 "Prospectus Regulation") ESMA has been mandated to issue guidelines to assist competent authorities in their review of the specificity and materiality of risk factors and of the presentation of risk factors across categories depending on their nature. On March 29th 2019 ESMA published its final report on the guidelines (which are attached as annex II to the report) (the "Guidelines"). Although the Guidelines are addressed to competent authorities in Member States, they should be taken into consideration by any person responsible for drafting a prospectus.

The Guidelines deal with six key topics related to risk actors:

1. Specificity;
2. Materiality;
3. Corroboration of the materiality and specificity;
4. Focused/concise risk factors, and
5. Risk factors in the summary.

The Guidelines must now be translated into each of the official languages of the European Union and then published on ESMA's website, taking effect two months after the publication in all official languages. The Prospectus Regulation itself will be fully applicable as from July 21st 2019.

MARKET ABUSE | UPDATE OF ESMA Q&A

The financial sector is not immune to the rapid evolution of modern technologies, which are undergoing profound transformations. After the introduction of dematerialised securities and the development of the notion of "book entry securities", a new law of 1 March 2019 (the "**New Law**") has now amended the existing legal framework with the view to strengthen and ensure legal certainty in order to take into account technological developments in secure electronic recording, such as distributed ledger technology (DLT) and, in particular, the blockchain type technology, following the trend of neighbouring countries, some of which are particularly active in this field.

The New Law aims to extend the scope of the law of 1 August 2001 on the circulation of securities (the "**2001 Law**") in order to allow account holders to hold securities accounts and to register securities by means of secure electronic recording devices including registers or distributed electronic databases of the blockchain type.

The New Law operates a legal fiction essential for its proper functioning by recognising that successive registrations of securities in a blockchain have the same effect as those resulting from transfers between securities account. For the sake of legal certainty, it expressly confirms that the maintenance of securities accounts within DLTs or the recording of securities in securities accounts through such DLTs does not affect the fungibility of the securities concerned.

Luxembourg has reacted promptly to the legal advances made by neighbouring countries, while still proceeding cautiously by limiting itself to a partial recognition of this new form of dematerialisation. Is this a first step towards the emergence of a new form of financial securities, a dematerialized security represented by a token in the blockchain? A necessarily more global reflection will be needed before reaching such a conclusion.

For a more in-depth review of the New Law, please refer to our March legal alert.

NEW LAW AMENDING THE LAW OF AUGUST 1ST 2001 ON THE CIRCULATION OF SECURITIES

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DISPUTE RESOLUTION

INTERNATIONAL PUBLIC ORDER IN LUXEMBOURG: PUNITIVE DAMAGES ARE *PERSONA NON GRATA*

Under US law, punitive damages are damages "awarded in addition to actual damages in certain circumstances. Punitive damages are considered punishment and are typically awarded at the court's discretion when the defendant's behaviour is found to be especially harmful" (definition of the Legal Information Institute of Cornell Law School).

Punitive damages aim to punish the wrongdoer and set an example for others, while most of European tort law systems, including Luxembourg, only allocate compensatory damages. Given their purpose as a deterrent, the amounts of punitive damages are usually astronomical and go far beyond what Luxembourg courts would ever grant.

The question arising is therefore, would a foreign claimant obtain recognition of a US judgment seeking the enforcement of punitive damages in Luxembourg?

A recent case allowed Luxembourg courts to contemplate the question, and examine the compatibility of punitive damages with Luxembourg international public order, which refers to the rules and principles affecting the fundamental conceptions of the moral, social, political or economic order of a country and its legal system.

In the case at hand, several claimants, having been granted hundreds of millions of punitive damages in the US, carried out a garnishment ("*saisie-arrêt*") on assets located in Luxembourg, allegedly held by a foreign State (called hereafter the "**Foreign State**"), solely on the basis of the awarded punitive damages.

Since the US judgments had not been recognised in Luxembourg, the Foreign State brought, besides the validation proceedings, summary proceedings seeking the quashing of the garnishment.

The Foreign State alleged that the punitive damages constituting the basis of the garnishment were violating Luxembourg public order, while the initial claimants argued that the public order was a fluid notion, evolving over time, and that Luxembourg and French case law were on the verge of accepting punitive damages into their legal orders.

Luxembourg scholars had already cast significant doubt as to the admission of such damages under Luxembourg law. According to such scholars, the reservation of international public order entails the exclusion of any foreign rule which could cause a real disturbance to the order of society, through its incompatibility with the fundamental principles and structures of Luxembourg law.

In the case at hand, the summary judge followed these footsteps and found that:

I. the allocated punitive damages contravene the fundamental principle of Luxembourg tort law, according to which the victim can only seek compensatory damages, as their aim is not only to repair the loss suffered by the victim, but also to punish the perpetrator of the damage;

II. the amounts granted by the US judgments were disproportionate compared to what the Luxembourg courts would have allocated in similar circumstances.

As the garnishment was purely based on US judgments granting punitive damages, deemed contrary to the Luxembourg international public order, the judge found that there was a manifestly unlawful disorder and quashed the garnishment. This decision has been appealed.

Consequently, claimants should be more cautious when recovering damages awarded by US judgments in Luxembourg, and should voluntarily exclude punitive damages from the scope of their recognition proceedings.

INVESTMENT FUNDS

CIRCULAR 19/708 ON ELECTRONIC TRANSMISSION TO THE CSSF

On January 28th 2019 the CSSF published Circular 19/708 concerning electronic transmission of documents ("**Circular**"). The Circular provides that, as of February 1st 2019 the following entities are obliged to submit documents only via electronic means to the CSSF:

I. alternative investment fund managers and alternative investment funds managed internally within the meaning of the Law of 12 July 2013 on Alternative Investment Fund Managers;
II. management companies within the meaning of the Law of 17 December 2010 on undertakings for collective investment;
III. undertakings for collective investment within the meaning of the Law of 17 December 2010 on undertakings for collective investment;
IV. specialized investment funds that fall under the law of 13 February 2007 on specialized investment funds; (v) investment companies in risk capital within the meaning of the Law of 15 June 2004 relating to the investment company in risk capital;
V. securitisation entities regulated by the Law of 22 March 2004 on securitisation;
VI. pension funds regulated by the Law of 13 July 2005 on institutions for occupational retirement provision in the form of pension savings companies with variable capital and pension savings associations.

Annex I to the Circular which is published on the CSSF website provides a regularly updated and detailed list of the documents which, as of February 1st 2019, cannot be provided to the CSSF via means other than the e-file or SOFiE communication platforms. The list of the documents (in definitive form) includes *inter alia:* prospectus, management regulations, annual report, risk management report or compliance report and contains a specific nomenclature to be used for each type of document.

UCITS ESMA Q&A

On March 29th 2019, ESMA released an updated version of Questions and Answers application of the Undertakings in Collective Investments in Transferable Securities Directive ("**UCITS Q&A**"). The UCITS Q&A modifies section II on the KIID for UCITS by adding additional clarifications on the benchmark disclosure obligations for UCITS.

The first modification relates to question 4b. ESMA clarified that the obligation to include a bar indicating the performance of a benchmark also applies in the cases where: (i) the comparator is not named a 'benchmark', but the objectives and investment policy makes it clear that it is a comparator the UCITS aims to outperform or (ii) where UCITS targets outperformance of the benchmark index over a period of time.

The second modification, a newly added question 4cbis, clarifies that in ensuring that a UCITS KIID is fair, clear and not misleading, the management company managing UCITS is obliged to ensure its consistency with other disclosures and communications made to investors, including the following:

I. any offering documents, marketing materials, and prospectus;
II. consistency across the distribution channels;
III. consistency across all investors.

The third modification relates to the newly added question 8a by means of which ESMA clarified that regardless of whether the UCITS has an index tracking objective or allows for discretionary choices the following must be disclosed:

I. In cases where the index tracking objective is used, ESMA recommends for the management companies to ensure that terms “passive” or “passively managed” in addition to index tracking are used. Furthermore, an index-tracking (passive) UCITS must disclose the index it is tracking and show performance against that index in the past performance section of the KIID.

II. In cases of actively managed UCITS (where the manager has discretion as to the composition of the UCITS portfolio), ESMA also recommends clear use of the terms ‘active’ or ‘actively managed’. ESMA further distinguished two types of actively managed UCITS:

   a) managed in a reference to a benchmark and obliged to disclose (in the KIID) the use of benchmark index, show past performance against the benchmark, indicate the degree of freedom against it and include the statement that it is actively managed.

   b) managed without a reference to a benchmark and obliged to disclose (in KIID) its own past performance, a statement that it is actively managed and that it is not managed by reference to a benchmark.

The fourth modification provides a new question 8b which clarifies the scope of Article 7(1)(d) of the Commission Regulation No. 583/2010 (“**Regulation**”) and cases where it can be considered that the UCITS are managed by reference to a benchmark or when it is implied. In that respect, ESMA provided a non-exhaustive list of examples which includes the following:

- the UCITS uses a benchmark index as a universe from which to select securities;
- performance fees are calculated based on performance against a reference benchmark index;
- the UCITS has an internal or external target to outperform a benchmark index;
- contracts between a management company and third parties, such as the investment management agreement covering delegation of investment management or between the management company and its directors and employees, state that the portfolio manager must seek to outperform a benchmark index;
- marketing issued by the UCITS management company to one or more investors or potential investors shows the performance of the fund compared with a benchmark index.

The fifth and final modification relates to the newly added question 8c which clarifies how the degree of freedom from the benchmark should be described for the purposes of Article 7(1)(d) of the Regulation. According to ESMA, investors should be provided with an indication of how actively managed the UCITS is, compared to its reference benchmark index. On that basis a UCITS management company should indicate in the KIID to what extent the target investments are part of the benchmark index or not and include a description of a level of deviation of the UCITS in regard to the benchmark index.

The clarifications in the UCITS Q&A should be reflected by UCITS management companies in the KIID as soon as practicable, or by the next KIID update following the publication of the UCITS Q&A.

AIFMD | ESMA Q&A

On March 29th 2019 ESMA released an updated version of Questions and Answers on the Application of Alternative Investment Fund Managers Directive. It includes two new questions in section VIII on the leverage calculation.

The first question provides clarity on treatment of short-term interest rate futures for the purpose of leverage exposure calculations. According to ESMA, calculation of leverage exposure of an AIF resulting from a short-term interest rate future should not be adjusted for the duration of the future. Paragraph 1(a) of Annex II of the Commission Delegated Regulation (EU) No. 231/2013 (“**Delegated Regulation**”) sets out the method to be applied as the product of the number of contracts and the notional contract size regardless of the duration of the financial instrument. Nevertheless, it does not preclude an AIFM form applying duration netting rules under the commitment method, in accordance with paragraph (9) of Article 8 of the Delegated Regulation for the AIFs which primarily invest in interest rate derivatives.

The second question relates to the required frequency of leverage calculation conducted by the AIFM for each AIF it manages. In that respect, ESMA takes the view that leverage should be calculated at least as often as the net asset value or more frequently if it is required for the AIF to comply with its leverage limits. ESMA further provides that the circumstances which may lead to increased frequency of leverage calculation include material market movements and changes to portfolio composition or any other factors subject to the assessment of the AIFM.

TAX

COMMISSION OPENS INVESTIGATION INTO TAX RULINGS GRANTED TO HUHTAMAKI GROUP

On March 7th 2019, the European Commission ("**Commission**") announced it was opening an in-depth investigation into the tax treatment of the Huhtamaki group in Luxembourg in order to determine whether Huhtamaki, a multinational consumer packaging manufacturer, was granted an unfair advantage contrary to EU state aid rules.

The formal investigation concerns three tax rulings granted in 2009, 2012 and 2013 by Luxembourg to Huhtalux S.à.r.l ("**Huhtalux**"), a Luxembourg based company. The 2009 ruling was part of the tax rulings uncovered by the "LuxLeaks" investigation. Huhtalux is part of the Huhtamaki group headquartered in Finland and conducts intra-group financing activities for the group. In that capacity, it received an interest free loan ("**IFL**") from another member of the Huhtamaki group based in Ireland, which it then used to grant interest bearing loans to other group companies.

The tax rulings in question confirmed the deductibility of a deemed interest on the IFL. According to the Commission, since Huhtalux did not in fact pay this interest, the deductions allowed Huhtalux to reduce its taxable base and thus its tax liability. Such "downward adjustment" granted by Luxembourg could amount, according to the Commission, to an unlawful selective advantage because "*it allows the group to pay less tax than other stand-alone or group companies whose transactions are priced according to market terms*".

According to the Commission's press release, Luxembourg's position is that the deemed interest deductions are in line with the arm's length principle since a third party lender would have charged Huhtalux interest on the loan and such interest would have been deductible, so that Huhtalux was in fact in the same position as a stand-alone company who would not have received an IFL.

The opening of an in-depth investigation is the first step of the formal state aid investigation procedure. While other state aid procedures against Luxembourg are currently underway (e.g. Amazon, Fiat and Engie), the Commission found, in September 2018, that Luxembourg's treatment of McDonald's did not amount to illegal state aid (Please refer to our October 2018 Newsletter for further details).

ECJ JUDGMENT ON BENEFICIAL OWNERSHIP CONCEPT UNDER EU LAW

On February 28th 2019, the Grand Chamber of the Court of Justice of the European Union ("**ECJ**" or "**the Court**") handed down a set of two judgments on the meaning of beneficial owner and abuse of rights under EU law.

In six cases (Joined cases C-115/16, *N Luxembourg 1*, C-118/16 *X Denmark*, C-119/16 *C Danmark I*, C-299/16 *Z Denmark*, and Joined Cases C-116/16 *T Danmark* and C-117/16 *Y Denmark*), the ECJ was asked to clarify the conditions under which an entity may be denied the benefits of the Interest and Royalties Directive ("**IRD**") and the Parent Subsidiary Directive ("**PSD**").

First, in relation to Article 1(1) and 1(4) of the IRD, the ECJ held that "*beneficial owner of the interest*" has an autonomous meaning under EU law and must be interpreted as designating "*an entity which actually benefits from the interest that is paid to it*" or, in other terms, not "*the formally identified recipient but rather the entity which benefits economically from the interest received and accordingly has the power to freely determine the use to which it is put*". The Court added that the OECD Model Tax Convention and commentary, including successive changes thereto, are relevant when interpreting the IRD.

Secondly, the ECJ found that, pursuant to the general principle of prohibition of abuse of rights under EU law, the absence of a domestic or agreement based anti-abuse provision does not prevent national authorities from refusing the benefits of the IRD or PSD. By this decision, the Court appears to depart from its previous position (C-321/05 *Kofoed*) whereby it had held that a Member State could not rely, against its citizens, on the non-transposed anti-abuse provision of a directive (in that case Article 15 of the Merger Directive). In the present proceedings, the Court emphasised that the general prohibition of abuse in EU law applies irrespective of whether the rights and advantages in question find their source in the treaties, in a regulation or in a directive.

Thirdly, the ECJ provided useful indications to assess an abuse of right in conduit company cases. The ECJ held that the use of a conduit company and the fact that the beneficial owner of the income does not meet the requirements of the IRD or PSD are indicia of abuse. Regarding the use of conduit companies in particular, the ECJ noted that the conduit company's inability to make economic use of the income and its *de facto* obligation to pass it on are also to be taken into account. Further, the ECJ found that intra-group financial flows by which profits are transferred from one profit making entity to a loss making one is also an indication of artificiality and of abuse.

Finally, the ECJ made some interesting findings in relation to the Luxembourg SICAR (*Société d'investissement en capital à risque*) regime. The ECJ noted that while the SICAR is subject to corporate income tax, it is in fact exempt from tax. As a result, according to the ECJ, a SICAR may not fulfil the last of the three cumulative conditions set out at Article 3(a) of the IRD (the "subject to tax" condition) and as such may be denied the exemption provided by the Directive. The final determination on this point was left to the referring national court. This position thus confirms the ECJ's previous findings in C-448/15 *Belgische Staat v. Wereldhave Belgium Comm. VA et al.*, dated March 8th 2017 (Please refer to our May 2017 newsletter for further details).

UPDATE ON EU LIST OF NON-COOPERATIVE JURISDICTIONS

On March 26th 2019, the Council's conclusions on the revised EU list of non-cooperative jurisdictions for tax purposes (2019/C 114/02) (hereinafter the "**List**") have been published in the Official Journal of the European Union.

The List, which was already composed of American Samoa, Guam, Samoa, Trinidad and Tobago and the US Virgin Islands, has been expanded to include, in addition to those jurisdictions already on the list, Aruba, Barbados, Belize, Bermuda, Dominica, Fiji, Marshall Islands, Oman, Samoa, the United Arab Emirates and Vanuatu.

The reasons for the presence of a jurisdiction in the List may vary; it can be, for example, because such jurisdiction does not apply any automatic exchange of financial information or because it has a harmful preferential tax regime and does not commit to address this issue.

As detailed previously (please refer to our newsletter dated April 2018), the Luxembourg tax authorities pay particular attention to transactions between Luxembourg companies with related companies located in the jurisdictions mentioned in the List. Those taxpayers will have to indicate in their tax return if they had transactions with such related companies and the details of the transactions will have to be provided on demand to the Luxembourg tax authorities.

AMENDMENT OF THE EXCHANGE OF INFORMATION UPON REQUEST LAW

The law of 1 March 2019, amending the law of 25 November 2014, providing for the procedure applicable to the exchange of information upon request in tax matters, has been voted on February 14th 2019 by the Luxembourg parliament and published on March 5th 2019 (hereinafter the "**2019 Law**").

The 2019 Law is the direct consequence of the so-called ECJ Berlioz case rendered on May 16th 2017 by the European Court of Justice (please refer to our BSP legal alert dated June 16th 2017). Unsurprisingly, the 2019 Law remains unchanged from the draft bill (please refer to our BSP Legal alert dated December 28th 2017) and re-establishes a complete judicial remedy for the information holder, i.e. not only the possibility of an appeal against the fine imposed by the tax authorities on non-communication of the information requested, but also an action for annulment against the request for information, if it does not meet the principle of foreseeable relevance. Although, by application of the Berlioz case-law, the Luxembourg administrative courts already granted the possibility of an appeal, the 2019 Law now provides for a clear framework and sets out the applicable procedure and the related deadlines of the appeal. Albeit, solely for the information holder and not for the person ultimately concerned by the request.

Hence, as of March 9th 2019, appeals must now be filed with the lower administrative court (*tribunal administratif*) within one month of notification of the request to the holder of the requested information.

INPUT VAT DEDUCTION OF BRANCHES

On January 24th 2019, the Court of Justice of the European Union (the "**ECJ**") published its judgment in the *Morgan Stanley* case (C-165/17), clarifying the rules governing the right to deduct input VAT incurred by a branch in connection with goods and services used for the purpose of transactions carried out by its head office.

Morgan Stanley's French permanent establishment provided banking and financial services to its local customers. These services were subject to VAT, as the branch had opted to be taxed thereon in accordance with the rules applicable in France. It also supplied services to its head office in the UK. The French tax authorities, to a large extent, disallowed the deduction of input VAT relating to the expenses used solely for internal transactions between the French branch and the UK head office.

In the appeal proceedings against the additional assessments issued by the French tax authorities, the Council of State (*Conseil d'Etat*) referred two questions for preliminary ruling to the ECJ, regarding the rules governing the determination of the deductible portion of input VAT, incurred by a branch, on (a) expenditures used exclusively for transactions carried out by the branch's head office established in another Member State and (b) general costs used for both transactions of the branch and transactions of its head office.

The ECJ decided, with regard to the first question, that a branch registered in a Member State should be entitled to deduct, in that Member State, all input VAT incurred on goods and services which have a direct and immediate link with taxed output transactions of its head office established in another Member State (with which that branch forms a single taxable person), subject to the condition that these output transactions would also give rise to deduction entitlement if they had been carried out in the branch's Member State. The latter condition may notably be fulfilled in case the transactions taxed in the Member State of the head office would also be taxed in the Member State of the branch as a result of the exercise of an option by the branch in accordance with domestic legislation.

The ECJ further considered the situation where the transactions carried out by the head office are partially taxed and partially VAT-exempt and concluded that the deductible portion shall correspond to a fraction, whose (a) denominator is formed by the turnover, exclusive of VAT, made up only of the transactions for which the expenditure had been incurred (to the exclusion of the other economic transactions of the taxpayer), and whose (b) numerator is formed by the taxed transactions in respect of which VAT would also be deductible, if they had been carried out in the Member State of the branch.

On the second question, regarding the general costs relating to both, transactions to local customers as well as to services provided to the head office, the ECJ held that the *prorata* to be applied shall correspond to a fraction made up by (a) a denominator composed of all the transactions carried out both by the branch and the head office and (b) a numerator composed, besides the taxed transactions carried out by the branch, solely of the taxed transactions carried out by the head office, in respect of which VAT would also be deductible if they had been carried out in the State in which the branch concerned is registered.

COURT OF CASSATION CLARIFIES VAT ASSESSMENT NOTIFICATION RULES

On January 17th 2019 (ruling No. 08/2019, docket No.4067), the Court of Cassation (*Cour de Cassation*) ruled that the Luxembourg VAT Authorities (*Administration de l'Enregistrement, des Domaines et de la TVA*) could validly continue to notify VAT assessments to a corporate taxpayer's former registered seat, despite the publication of the termination of its domiciliation agreement, to the extent the taxpayer had not previously informed the authorities of a change of its address.

In the case at hand, the Luxembourg VAT Authorities sent VAT assessments to the address which a corporate taxpayer had previously indicated, to the relevant tax office, as corresponding to its registered seat. However, prior to the notification of these assessments, the company's domiciliation agreement had been terminated by the service provider and the termination had been duly published in the Luxembourg register of commerce and companies (the "**RCS**"). The company's insolvency receiver challenged the validity of the notification, arguing that the authorities had to take into account the publication in the RCS and could thus no longer use an address which they had to know was incorrect. Both the Luxembourg-City District Court (*Tribunal d'arrondissement de et à Luxembourg*) and the Court of Appeal (*Cour d'appel*) decided in favour of the taxpayer.

The Court of Cassation however overturned these rulings and recalled the taxpayer's statutory duty to inform the VAT authorities of any change of the address of its domicile, residence or registered seat. This obligation, read together with the provision in the Luxembourg VAT law, dealing with the notification of VAT assessments and specifying that said notification can be made either to the taxpayer's domicile, residence, registered seat or to the address, which the taxpayer previously communicated to the authorities, needs – according to the Supreme Court - to be interpreted as allowing the authorities to validly choose to use the address known to them, as long as they are not informed by the taxpayer of any changes.

LUXEMBOURG RATIFIES THE OCDE MLI

The OECD's Multilateral Instrument Convention ("**MLI**"), which was signed in Paris on June 7th 2017, has been adopted by the Luxembourg parliament on February 14th 2019 (draft bill No. 7333), signed on March 7th 2019 and deposited with the OECD on April 9th 2019, which means that Luxembourg has now finalized the ratification process of the MLI and that its provisions will enter into force on August 1st 2019. As at April 9th 2019, the MLI has also been ratified by 24 other jurisdictions.

As a reminder, the MLI's aim is to enable rapid changes to Double Tax Treaties ("**DTT**") in a synchronised manner, without requiring long bilateral negotiations between jurisdictions. The MLI provides for a set of amended provisions, which, once applicable, are mainly aimed at limiting a taxpayer's entitlement to benefit from a DTT (e.g. by restating the preamble of the DTT and including a principle purpose test). In terms of procedure, the MLI becomes applicable to a particular DTT when both jurisdictions concerned ratified the MLI and both included the specific DTT within the scope of the MLI. Luxembourg has decided to include 81 DTTs in the MLI, from a total of 83 DTTs it currently has in force.

In theory, the MLI can impact the following aspects of a DTT, depending on whether the choices expressed by both jurisdictions in their ratification instruments match:

- Improved mutual agreement procedure, dispute resolution and cooperation;
- Limitation of mismatches arising for tax transparent entities and hybrid mismatches;
- Tightening of the methods used for the avoidance of double taxation;
- Tightening of the collection mechanism of withholding taxes;
- Specific rules for the taxation of share disposal regarding real estate rich companies;
- Anti-abuse provision for establishments located in third jurisdictions;
- Taxation rights of a jurisdiction on its own tax resident;
- Tackling artificial permanent establishment status;
- Cooperation between jurisdictions on the adjustment of profits of affiliated undertakings;
- Improvement of the arbitration procedure.

In order to assess the effective impact of the MLI on a specific DTT, one will thus have to review if the ratification´s process in the other jurisdiction involved has been finalised, if the specific DTT is covered therein as well as the options and reservations expressed by both jurisdictions to find matching ones. The effective starting date of application of the MLI provisions with respect to a specific DTT will depend on the type of taxes concerned, withholding taxes or other taxes, and will generally start on the first day of the next calendar year or after a six month period respectively starting from the latest of the dates on which the MLI enters into force for the jurisdictions covered by the DTT, unless agreed otherwise. In order to facilitate the overview, the OECD is releasing updates on the advancement of the ratification process in each jurisdiction part of the MLI as well as an MLI matching database.

CASE-LAW ON THE CONCEPT OF SERIOUS ECONOMIC REASONS IN THE CONTEXT OF SHARE CAPITAL REDUCTIONS

While under Luxembourg tax law dividend distributions are subject to withholding tax, share capital reductions are out-of-scope provided that (i) no distributable reserves are available, which would be deemed to be distributed firstly and that (ii) the share capital reduction is motivated by serious economic reasons. The lower administrative court (*tribunal administratif*), in a decision dated March 26th 2019, had to decide whether a share capital reduction undertaken by a taxpayer was motivated by serious economic reasons, in order to decide whether said reduction should not be subject to Luxembourg withholding taxes.

In the present case, a Luxembourg limited liability company, whose corporate object was to develop real estate projects, undertook a share capital reduction after its last two development projects were finalised. The company was subsequently liquidated a year later. At the time of the share capital reduction, the sole assets held by the company were cash and a non-constructible land plot, which was left over from a previous development project and which could not be sold. The company had no intention to continue its activities and could not distribute the cash it held due to the lack of distributable reserves caused by previously suffered losses. A capital reduction was thus the sole possibility, from a corporate law perspective, to return the cash to the shareholders.

The lower administrative court ruled that the share capital reduction was motivated by serious economic reasons, as the company did not want to carry on any further development projects, which was corroborated by the liquidation of the company a year later, keeping in mind that liquidation proceeds are not subject to withholding taxes in Luxembourg. While the lower administrative court did not provide for a clear definition of the concept of serious economic reasons in its decision, since it appreciated the situation *in concreto*, based on the fact and activities carried out by the company, it is, to the best of our knowledge, the first case-law to cover this topic. The acceptance by the lower administrative court of the reduction of the activity of a taxpayer, without an immediate liquidation, as an example of serious economic reasons, provided that it is evidenced by conclusive supporting documentation, is welcome guidance.

DRAFT LAW ON TAX DISPUTE RESOLUTION MECHANISM

On April 11th 2019, the Luxembourg government published a draft law transposing Directive 2017/1852 on dispute resolution mechanisms in the European Union (hereafter the "**Directive**"). This draft law aims to establish a more effective mechanism on resolving tax disputes between Luxembourg and other EU Member States, when such disputes arise from the interpretation and application of bilateral tax treaties or the Union Arbitration Convention, leading to double taxation. The Directive was developed as part of Action 14 of the OECD's Base Erosion and Profit Shifting project, which seeks to make dispute resolution more effective in tax matters.

The mechanism requires an affected person to submit a complaint on a dispute simultaneously to each of the competent authorities of each of the Member States concerned, requesting the resolution thereof. Such a complaint shall be submitted within 3 years from the receipt of the first notification of the action resulting in the dispute. The competent authorities of each of the Member States concerned must then take a decision on the acceptance or rejection of the complaint within six months of the receipt thereof.

Once the competent authorities of the Member States concerned accept a complaint, they shall endeavour to resolve the question in dispute by mutual agreement within 2 years, starting from the last notification of a decision of one of the Member States on the acceptance of the complaint. If the competent authorities of the Member States reach an agreement on how to resolve the dispute, this decision will be binding on the authority and enforceable by the affected person. In case the competent authorities do not reach an agreement, they must inform the affected person of the reasons they failed to find an agreement.

If the complaint is not accepted or if no agreement is reached, the affected person still has the possibility to request the competent authorities to establish an advisory commission. This commission must be composed of one independent person of standing, one representative of each competent authority and one chair. The competent authorities may however also decide to establish an alternative advisory commission of which the composition can differ from the ordinary advisory commission. Any commission which is set up must deliver an opinion to the competent authorities within 6 months from the date of its establishment.

Following this opinion, the competent authorities must, within 6 months, reach a final decision on how to resolve the dispute. Although they may deviate from the opinion provided by the commission, the opinion will become binding if the competent authorities do not reach an agreement.

The Directive and, by extension, the draft law represent a positive step towards strengthening taxpayers' rights when facing double taxation, by providing a more efficient, effective and accessible resolution of disputes.

EXCHANGE OF INFORMATION | NEW REQUEST FOR PRELIMINARY RULING FROM THE ECJ

In 2017, the Luxembourg tax authorities, on the basis of a request for exchange of information from the Spanish tax authorities, issued two injunctions against a Luxembourg company and a Luxembourg bank in order to oblige them to provide a certain amount of information on a Spanish taxpayer.

Following the *Berlioz* judgment (C-682/15) of the Court of Justice of the European Union ("**ECJ**") which ruled against Luxembourg due to the absence of an effective remedy allowing a review of the legality of an injunction (please refer to our legal alert dated June 16th 2017), two claims were brought before the lower administrative court (*tribunal administratif*) against the injunctions. In the first instance, the lower administrative court partially annulled both decisions on the grounds that the information requested by Spain could not be qualified as "*reasonably relevant*".

In the appeal pending, the higher administrative court (*Cour Administrative*) adopted a prudent approach, by pointing out the differences between the present case and the *Berlioz* case. Unlike the case at hand, *Berlioz* concerned a claim that was brought by a holder of information against the penalty decision issued for non-compliance with the injunction. Since the ECJ has not yet expressed an opinion on the compliance with EU law of an absence of a direct recourse against an injunction, as well as on the possibility for the taxpayer or an interested third party to bring a claim against a decision issued in this context, the Court considered it useful to request a preliminary ruling from the ECJ to clarify the EU law requirements of an effective remedy. In essence, the Luxembourg Court asked (i) whether the right to an effective remedy should be interpreted as obliging Member States to provide in their domestic law for a direct recourse against injunctions which would not only enable the holder of information, but also the taxpayer concerned, respectively a third party concerned, to act against it, and (ii) whether the Directive 2011/16, providing for exchange between Member States, should be interpreted in an evolving manner, taking into account all interpretative changes made by the OECD to the notion of "*reasonably relevant* " after the adoption of the Directive, knowing that the notion of "*reasonably relevant* " in the Directive is based on the one developed by the OECD.

Depending on the answers given by the ECJ, Luxembourg might be obliged to further amend the law of 1 March 2019 providing for the procedure applicable to the exchange of information on request in tax matters, since the recently introduced right to appeal is limited to holders of information and not granted to the taxpayer effectively concerned or to interested third parties.

EU PARLIAMENT ADOPTS REPORT ON FINANCIAL CRIMES, TAX EVASION AND TAX AVOIDANCE

On March 26th 2019, the European Parliament ("**EP**") adopted a report on financial crime, tax evasion and tax avoidance (the "**Report**"). The Report was prepared by the EP's special committee, commonly referred to as "TAX3" and carries a strong political message. The recommendations range from criticising Member States' behaviour, existing tax rules and the US "**FATCA**" regime. The Report equally appeals for an urgent tax reform, ideally within the framework of a new body within the United Nations ("**UN**").

The TAX3 special committee was established in March 2018 as a response to several revelations such as the LuxLeaks, the Paradise Papers and the Panama Papers. Building on the work of previous committees, TAX3 is responsible for monitoring the efforts of Member States in fighting tax evasion and tax avoidance. It takes positions with regard to legislative measures on the taxation of the digital economy and follows the workings of other institutions, such as the OECD and the UN.

The Report begins by asserting that existing tax rules are often unable to keep up with the increasing speed of the economy. The rules that are currently in force were developed in the early 20th century and are no longer suitable for the technological challenges of the 21st century. This in turn provides opportunities for certain market participants to avoid paying their fair share of tax, thereby harming the rule of law and producing inequality in society. In this context, the Report pleads for an effort by all EU Member State to undertake urgent tax reform. The Report recalls the criticism that had been voiced by the European Commission towards Belgium, Cyprus, Hungary, Ireland, Luxembourg, Malta and the Netherlands due to the "unusually high level of foreign direct investments", which are usually held by special purpose entities.

The intergovernmental agreements ("**IGA**") on the US Foreign Account Tax Compliance Act ("**FATCA**") were also subject to criticism for lacking reciprocity, giving the US far more information than it provides in return. The Report requests the European Commission to negotiate an agreement with the US that ensures more reciprocity in FATCA. Further, a common approach by the European Commission and the Council is called for so as to adequately protect the rights of European citizens and 'accidental Americans' against the exchange of information that derives from FATCA.

Going forward, the Report believes that the creation of an intergovernmental tax body within the UN with sufficient resources and enforcement powers would ensure that all countries can participate on an equal footing in the formulation and reform of a global tax agenda to fight harmful tax practices effectively and ensure an appropriate allocation of taxing rights. It suggests that this could be realized by upgrading the UN Committee of Experts on International Cooperation in Tax Matters to an intergovernmental UN Global Tax Body.

EU TRANSFER PRICING FORUM'S REPORT ON THE PROFIT SPLIT METHOD

In March 2019, the EU's Joint Transfer Pricing Forum ("**JTPF**") published a report (the "**Report**") on the application of the Profit Split Method ("**PSM**") within the EU. The PSM is one of the five transfer pricing methods recommended by the OECD's transfer pricing guidelines to establish whether conditions of an intragroup transaction are at arm's length. The Report builds on the OECD's revised guidelines and clarifies the appropriate and correct application of the PSM.

Whereas former guidelines described the PSM as a method of 'last resort', the OECD is now increasingly recommending the PSM as the most appropriate method. The OECD justifies this change in approach by the increased integration of multinational enterprises and the globalisation of national economies and markets, which calls for appropriate transfer pricing methods. In this context, the JTPF believes that the PSM could be applied more often in the future, to accommodate the emergence of these new business models, especially in the digital economy.

The Report first discusses when the PSM should be applied. It is most suitable in cases where all relevant parties make unique and valuable contributions and when there is a high degree of integration. Moreover, the PSM is appropriate when there is insufficient information on comparables to apply another transfer pricing method and/or where parties share the assumption of economically significant risks or assume closely related risks. By contrast, the PSM should not be applied when one of the parties to the transactions performs only simple functions and/or when the transactions can be benchmarked adequately.

The second part of the report then describes how to apply the PSM. Two approaches are foreseen: the contribution analysis and the residual analysis. Under the contribution analysis, the combined profits or losses from controlled transactions are allocated among the associated enterprises on the basis of the relative value of the functions performed, assets used and risk assumed. Under the residual analysis, the relevant profits are divided into two categories. While the first category includes profits attributable to contributions for which a benchmark exists, the second category of profits should derive from unique and valuable contributions, shared assumption of economically significant risks and/or a high level of business integration.

In identifying these key value-drivers and weightings, the Report recommends that an inventory of profit splitting factors should be established, which differentiates between people-based factors, sales/volume based factors, asset-based factors, cost-based factors and other factors. With regard to splitting profits derived from intangibles, the Report stresses that no significant value should be attributed to mere legal ownership of such assets.

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