Newsletter

April 2016

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THIS NEWSLETTER IS INTENDED ONLY AS A GENERAL DISCUSSION OF THE TOPICS WITH WHICH IT DEALS. IT SHOULD NOT BE REGARDED AS LEGAL ADVICE. IF YOU WOULD LIKE TO KNOW MORE ABOUT THE TOPICS COVERED IN THIS NEWSLETTER OR OUR SERVICES PLEASE CONTACT US.

AML

THE STRENGTHENING OF LUXEMBOURG CRIMINAL PROCEDURE

Considering the increase in terrorist attacks, the legislator has decided to strengthen Luxembourg's criminal procedure by introducing draft law N° 6921 ("Draft Law"), inspired by Belgian and French Law. This strengthening can be summarised as follows.

On the one hand, with regard to offenses relating to terrorism, financing of terrorism and crimes against state security, the Draft Law provides for the following:

1. In the matter of monitoring and control of all forms of communication, the Draft Law introduces into Luxembourg law the "wiretap of private premises";
2. The scope of monitoring and control of all forms of communication, including computer data is extended in order to allow these measures to be practised on private premises;
3. The French term "cyber infiltration" is introduced into Luxembourg law, by allowing the investigating authorities to carry out an inquiry to discover offenses relating to terrorism;
4. During the preliminary examination, the investigating authorities have powers of search at any time of day or night;
5. In exceptional circumstances and with a special and motived court order, the duration of the period of retention in matters of offences and crimes is prolonged up to 48 hours.

On the other hand, the Draft Law foresees two other solutions that have a wider scope of application:

- The first one concerns all flagrant crimes, and ensures that the Prosecutor General shall be able to track the data or to locate the origin or destination of every telecommunications by a "mini-preliminary investigation" ("*mini-instruction*").

- The second one concerns offenses, crime investigation, and preliminary examination, and plans to confer to both, the Prosecutor General and the Examining Magistrate, the power to call electronic communication services to identify one of their subscribers, or to identify the electronic communication services themselves. This provision represents a simple and effective procedure, indispensable in matters of prevention of terrorist activity, and also relevant in other criminal matters.

BANKING & FINANCE

CHANGES TO THE INVESTOR COMPENSATION SCHEME REGIME IN LUXEMBOURG

With the entry into force of the law of December 18th 2015 on the resolution, reorganisation and winding-up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes (the "Law of December 18th 2015"), the institutional architecture of the investor compensation scheme in Luxembourg has been renewed.

The Law of December 18th 2015 introduces a new public system of indemnification of investors (*Système d'indemnisation des investisseurs au Luxembourg, the "SIIL"),* based on European Parliament and Council Directive 97/9/EC of March 3rd 1997 on investor-compensation schemes and repeals the regime in the Law of April 5th 1993 on the financial sector. The SIIL is operated by the Luxembourg financial markets authority (*Commission de Surveillance du Secteur Financier*, the "CSSF") and managed by the Council of protection of depositors and investors (*Conseil de protection des déposants et des investisseurs*, the "CPDI"), a newly created internal body of the CSSF.

The regime covers investors in Luxembourg credit institutions and investment firms or Luxembourg branches of credit institutions and investment firms with a head office in a third country, whether those investors are natural persons or legal entities. The SIIL indemnifies investors for claims up to a maximum amount of EUR 20,000 if

1. the CSSF has concluded that a credit institution or investment firm is and will be unable to satisfy those claims at the moment and for reasons directly related to its financial condition, or
2. the Luxembourg district court issued a ruling declaring the suspension of payments or liquidation of the company involved.

Under the current regime, some types of claims are excluded from the scheme. The new list specifically excludes claims arising from operations with respect to which a criminal conviction for a violation of laws prohibiting anti-money laundering or terrorism financing has been imposed. The SIIL is required to pay eligible claims at the latest three months after the eligibility and the amount of the claim have been established. After it has indemnified investors, the failing credit institutions and investment firms involved are required to pay contributions to the SIIL (*ex-post* contributions).

The new rules are accompanied by information duties. As under the former regime, credit institutions and investment firms must inform investors of the investor compensation scheme, upon request. In addition, the CPDI must set up a website dedicated to informing investors on the functioning of the scheme. According to the CSSF, this website is currently under construction.

CAPITAL MARKETS

PROSPECTUSES - APPROVAL, PUBLICATION AND DISSEMINATION OF ADVERTISEMENTS

The Delegated Regulation (EU) 2016/301 of November 30th 2015 (the "Delegated Regulation"), laying down regulatory technical standards for approval and publication of the prospectus and dissemination of advertisements under Directive 2003/71/EC (the "Prospective Directive"), has been published and entered into force on March 24th 2016.

Some of the most important areas covered by the Delegated Regulation are as follows:

1. the arrangements for the approval of prospectuses:
   - all drafts of the prospectus must be submitted in searchable electronic format to the competent authority;
   - amongst other items which must be submitted with the first draft or during the review process, is a reasoned request regarding any information required by the annexes to the EU Prospectus Regulation which will be omitted from the prospectus;
   - the competent authority must acknowledge receipt of the initial application in writing, via electronic means, no later than close of business on the second working day following receipt;
2. the arrangements for the publication of prospectuses and final terms:
   - the publication of the prospectus in electronic form must be easily accessible, downloadable, printable and in a format that cannot be modified and does not contain hyperlinks (exception for information incorporated by reference);
   - if a prospectus is made available on a website, measures must be taken to avoid targeting residents in Member States or third countries where the offer does not take place;
   - access to the prospectus must be free and not subject to completion of a registration process or acceptance of a disclaimer limiting legal liability;
   - it is now confirmed that the publication method for final terms related to a base prospectus does not have to be the same as the one used for the base prospectus, but must be one of the acceptable methods indicated in the Prospectus Directive for publication of prospectuses;
3. the dissemination of advertisements:
   - if the prospectus is changed after an advertisement has been published, an amended advertisement shall be disseminated (specifying the differences between the two versions) if the new information renders the contents of the previously disseminated advertisement inaccurate or misleading;
   - when no prospectus is required in accordance with the Prospective Directive, any advertisement shall include a warning to that effect;
4. consistency of disclosed information:
   - information disclosed in oral or written form about the offer or trading admission (whether for advertisement or other purposes) must not contradict the information contained in the prospectus, present a materially unbalanced view of the information contained in the prospectus or contain alternative performance measures concerning the issuer, unless they are contained in the prospectus.

While the entering into force of the Delegated Regulation will not substantially change the

process for prospectus approval in Luxembourg, the CSSF has helpfully issued Circular CSSF 16/635 which updates the previous circular CSSF 12/539 on the technical specifications regarding the submission to the CSSF of documents under the Luxembourg law on prospectuses.

PROSPECTUSES - UPDATE OF ESMA Q&A

On April 6th 2016, the European Securities and Markets Authority ("ESMA") published an update of its Questions and Answers on prospectus related issues (the "Q&A") to include two new questions and answers.

The newly-added questions and answers, Nos. 97 and 98 concern (i) the inclusion of an additional column in capitalisation and indebtedness statements and (ii) the possibility for offers to go beyond the validity of a base prospectus.

Q.97 Whether a prospectus can include an additional column to reflect recent or future material changes to the capitalisation and indebtedness statements.
ESMA notes that when there has been a recent change, or a future material change, which has or will trigger the requirement to disclose pro forma financial information, an additional column illustrating pro forma capitalisation and indebtedness can be presented. The additional column should be consistent with the pro forma financial information presented elsewhere in the prospectus and adjustments may be explained by referring to pro forma financial information elsewhere in the prospectus.

Q.98 a) and b) Whether it is possible for an issuer to continue an offer beyond the validity of a base prospectus and if so, the conditions which apply to continuing an offer in that scenario.
ESMA has established that the prospectus regime does not outlaw certain offer periods as the terms of the offer period and the term of validity of the base prospectus are distinct. However, when used for an offering programme of non-equity securities, ESMA considers that the offer must have a start and an expected end-date. Certain conditions should be fulfilled in order for the issuer to continue the offer beyond the validity of the initial base prospectus: the issuer is required to have a complete and up-to-date base prospectus, and if the issuer wishes to continue an offer, the issuer should have a new base prospectus approved and published before the initial base prospectus expires. Where the issuer wishes to continue using the final terms related to the initial base prospectus, the new base prospectus should include or incorporate by reference the form of the final terms from the initial base prospectus. The final terms relating to the initial base prospectus must also contain a prominent warning indicating the last day of validity of the initial base prospectus and where the succeeding base prospectus will be published.

MARKET ABUSE - INSIDER LISTS

On March 11th 2016 Commission Implementing Regulation (EU) 2016/347 of March 10th 2016 (the "Implementing Regulation") was published in the Official Journal. The Implementing Regulation lays down implementing technical standards with regard to the precise format of insider lists and for updating insider lists in accordance with Regulation (EU) N° 596/2014 of the European Parliament and of the Council of April 16th 2014 on market abuse ("MAR").

The precise format, including standard templates, is established with a view to facilitate the uniform application of the requirement to draw up and update insider lists laid down in MAR and also to ensure that competent authorities are provided with the information necessary to fulfil the task of

protecting the integrity of the financial markets and investigate possible market abuse. In particular:

- the insider lists are required to be divided into separate sections relating to different inside information and each section should list all persons having access to the same specific piece of inside information. To avoid multiple entries, a list of "permanent insiders" who have access at all times to all inside information may be inserted as a supplementary section;
- the insider list should in principle contain personal data (including the date of birth, the personal address and where applicable, the national identification number of the individuals concerned) that facilitate the identification of the insiders, as well as certain data such as telephone numbers to be provided at the outset permitting the competent authorities to act swiftly when necessary and to request data traffic records;
- the insider list should be drawn up in electronic format using the electronic means specified by the competent authority and shall be updated at all times without delay; it shall ensure that the information included in the list is kept confidential, that information included is accurate and it shall facilitate the access to and the retrieval of previous versions of the insider lists;
- although issuers on an SME growth market are exempted from drawing up and keeping insider lists up to date and are not required to keep that information in electronic format, their insider lists (which should be drawn up in accordance with the template in Annex II of the Implementing Regulation) should be in any case submitted, upon request of the competent authority, in a way that ensures the completeness, confidentiality and integrity of the information during transmission.

The Implementing Regulation entered into force on March 12th 2016 and its provisions will apply from the same date as those laid down by MAR, July 3rd 2016.

MARKET ABUSE - NOTIFICATIONS TO COMPETENT AUTHORITIES

On March 17th 2016 Commission Implementing Regulation (EU) 2016/378 of March 11th 2016 (the "Implementing Regulation") was published in the Official Journal. The Implementing Regulation lays down implementing technical standards with regard to the timing, format and template of the submission of notifications to competent authorities in accordance with Regulation (EU) N° 596/2014 of the European Parliament and of the Council of April 16th 2014 on market abuse ("MAR").

The main purposes of the technical standards laid down by the Implementing Regulation were to ensure the coherence of reporting obligations, to reduce the administrative burden for entities subject to reporting obligations, to enable the competent authorities and the European Securities and Markets Authority (**"ESMA"**) to ensure data quality and effective monitoring.

The Implementing Regulation therefore specifies the timing and manner for notifications by trading venues to competent authorities, and the onward transmission of those notifications by the competent authorities to ESMA, as required by MAR. The Annex to the Implementing Regulation sets out the standards and formats of the notifications.

The Implementing Regulation entered into force on March 18th 2016 and its provisions will apply from the same date as those laid down by MAR, July 3rd 2016.

MARKET ABUSE - UPDATE OF ESMA Q&A

On April 1st 2016 the European Securities and Markets Authority ("ESMA") published an update of its questions and answers (the "Q&A") on the common operation of Directive 2003/6/EC of the European Parliament and of the Council of January 28th 2003 on insider dealing and market manipulation (the "Current MAD") in order to include one new question regarding investment recommendations.

Reference is made to Commission Directive 2003/125/EC of December 22nd 2003 implementing Current MAD, as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest (the "MAD Implementing Directive"); in particular, reference is made to the definitions of "recommendation" and "research or other information recommending or suggesting investment strategy" therein which read as follows:

- *"recommendation" means research or other information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers of financial instruments, including any opinion as to the present or future value or price of such instruments, intended for distribution channels or for the public;*
- *"research or other information recommending or suggesting investment strategy" means:*

(a) information produced by an independent analyst, an investment firm, a credit institution, any other person whose main business is to produce recommendations or a natural person working for them under a contract of employment or otherwise, that, directly or indirectly, expresses a particular investment recommendation in respect of a financial instrument or an issuer of financial instruments;

(b) information produced by persons other than the persons referred to in (a) which directly recommends a particular investment decision in respect of a financial instrument.

ESMA confirms in its answer to the new question 3 in the Q&A that if material intended for distribution channels or for the public, concerning one or several financial instruments, contains a valuation statement as to the price of the financial instruments concerned or any other elements of opinion on the value of such financial instruments, such material will fall within the MAD Implementing Directive definitions of "recommendation" or "research or other information recommending or suggesting investment strategy" and hence will be subject to the related obligations and standards set out in that directive.

MARKET ABUSE - DELEGATED REGULATION

On April 5th 2016 Commission Delegated Regulation (EU) 2016/522 of December 17th 2015 (the "Delegated Regulation") was published in the Official Journal. The Delegated Regulation, supplementing Regulation (EU) N° 596/2014 of the European Parliament and of the Council of April 16th 2014 on market abuse ("MAR"), lays down detailed rules with regard to an exemption for certain third countries' public bodies and central banks, the indicators of market manipulation, the disclosure thresholds, the competent authority for notifications of delays, the permission for trading during closed periods and types of notifiable managers' transactions.

In particular, the Delegated Regulation, *inter alia*:

- provides a list of the public bodies and central banks of third countries which are exempted from the obligations and prohibitions in MAR in carrying out monetary, exchange-rate or public debt management policy;
- sets out (i) the practices which are deemed to be indicators of manipulative behaviour relating to false or misleading signals and to price securing and (ii) the practices which are deemed to be indicators of manipulative behaviour relating to the employment of a fictitious device or any other form of deception or contrivance;
- specifies the minimum thresholds of carbon dioxide and rated thermal input for the disclosure by emission allowance market participants of inside information.
- determines the competent authority for the notifications of delays of public disclosure of inside information;
- sets out the conditions under which trading by a person discharging managerial responsibilities ("PDMR") within an issuer may be conducted during a closed period and requires that a PDMR prior to any trading during a closed period, submit a reasoned written request to the issuer for permission to proceed with an immediate sale of the shares of that issuer during the closed period;
- sets out the indicators to be considered by the issuer when examining whether to grant permission to a PDMR to proceed with an immediate sale of the shares of that issuer during a closed period;
- provides a non-exhaustive list of the types of transactions triggering the duty to notify managers' transactions, including but not limited to acquisition, disposal, short sale, subscription or exchange; acceptance or exercise of a stock option, entering into or exercise of equity swaps, transactions in or related to derivatives, gifts and donations made or received, and inheritances received; and borrowing or lending of shares or debt instruments of the issuer or derivatives or other financial instruments linked thereto.

The Delegated Regulation entered into force on December 18th 2015 and its provisions will apply from the same date as those laid down by MAR, July 3rd 2016.

MARKET ABUSE - NOTIFICATION AND PUBLIC DISCLOSURE OF MANAGERS' TRANSACTIONS

On April 5th 2016 Commission Implementing Regulation (EU) 2016/523 of March 10th 2016 (the "Implementing Regulation") was published in the Official Journal. The Implementing Regulation lays down implementing technical standards with regard to the format and template for notification and public disclosure of managers' transactions in accordance with Regulation (EU) N° 596/2014 of the European Parliament and of the Council of April 16th 2014 on market abuse ("MAR").

The purpose of the Implementing Regulation is to foster efficiency in the process of notifying managers' transactions and to provide comparable information to the public by providing a single template which shall be used for the submission of notifications of transactions by persons discharging managerial responsibilities and persons closely associated. The Implementing Regulation also specifies that the notifications must be transmitted by electronic means which ensure that the completeness, integrity and confidentiality of transmitted information and certainty as to its source.

The Implementing Regulation entered into force on March 11st 2016 and its provisions will apply from the same date as those laid down by MAR, July 3rd 2016.

COMPETITION

ACTIONS FOR DAMAGES FOR INFRINGEMENTS OF COMPETITION LAW

The draft law N° 6968 on certain rules governing actions for damages for infringements of competition law (hereinafter the "Draft Law") amends the law of October 23rd 2001 on competition law and transposes into Luxembourg law the Directive of the European Parliament and of the Council on antitrust damages actions dated 26 November 2014 (hereinafter the "Directive").

The majority of the Directive's provisions in the matter of antitrust damages actions already exist under Luxembourg law. As a consequence, the Draft Law will be applicable in addition to actions for damages as already foreseen in the national law and in case of conflict, the Draft Law shall prevail.

Until now, the exercise of the right to compensation faced a major obstacle which was that of access to evidence. Actions for damages in cases involving agreements generally require consideration of many facts. The difficulty inherent to agreements is that relevant evidence is difficult to bring because the parties are often subject to professional secrecy.

The Draft Law's purpose is to optimise the interaction between implementation of competition rules by the public sphere and the implementation at the initiative of the private sphere.

However, the Draft Law's main interest is to keep a consistent policy of implementation of competition law in the public sphere, while, at the same time, allowing the victims of violations of the competition law to obtain compensation for the damage they have suffered.

As a consequence, the Draft Law sets the rules of access to evidence and allows both parties to the legal proceedings to ask the judge to require disclosure of certain information necessary for their action.

For the sake of avoiding that the disclosure of evidence would jeopardize the confidentiality of evidence in the public sphere, the Draft Law foresees some limits. For example, the disclosure of the statements made by companies for the purpose of a leniency application may never be ordered in the framework of the actions for damages.

Under certain circumstances third parties and authorities, such as the Competition Council ("*Conseil de la Concurrence*") may be requested to divulge evidence.

CORPORATE

MODERNISATION OF LUXEMBOURG COMPANY LAW

The draft law (*Projet de Loi*) N° 5730 regarding notably a modernisation of the Law of August 10th 1915 on commercial companies (as amended) (the "Company Law") has still not been adopted by the Luxembourg parliament despite the plan that was previously drawn to the attention of the readers of our newsletter for this to have happened at the end of 2015.

The draft law has been subject to further discussions and input from interested parties notably the Luxembourg Bar Association (*Ordre des Avocats du Barreau de Luxembourg*), the Association of Notaries (*Chambre des Notaires*), the Chamber of Commerce and the Council of State (*Conseil d'Etat*). The discussions have served to clarify certain imprecise wording and fill in gaps contained in the proposed bill.

Following such discussions, the bill has now been consolidated and sent back to the Council of State.

The following amendments to the proposed bill are noteworthy:

- Clarification that the document containing the terms for the issue of a debt instrument can derogate from the provisions contained in the Company Law by providing for a different law or different provisions to govern such issue and that the issue of other type of securities (other than shares) can be submitted to the legal regime contained in the Company Law;
- The minority action by shareholders holding at least 10% of votes against directors or members of the management or supervisory board can be brought even by those shareholders who have voted in favour of a discharge;
- In respect of general meetings of a public limited company in which shareholders participate by using videoconferencing or similar communication devices, it will not now be necessary that a shareholder or a proxy of a shareholder be present in Luxembourg;
- Despite criticism by the Bar Association and the Council of State, the bill maintains the requirement that in order to carry out a simplified liquidation a Luxembourg company needs in future to provide confirmations to the notary by the social security office, the tax office and customs & excise that such company has abided by all its obligations regarding social security and tax payments;
- Clarification that for redemptions of shares to be carried out in a private limited liability company this can either be provided for in the articles in the form of redeemable shares or the company may, even if no disposition is inserted in the articles, redeem shares with the consent of the concerned shareholders;
- If the shareholders of a private limited liability company have not approved the transfer of shares to a third party, the bill no longer requires the existing shareholders to acquire the shares being transferred but only gives them the option to do so.

We understand that the draft law is close to being finalised and should now be adopted in the course of 2016.

DISPUTE RESOLUTION

HELLAS CASE – JUDGEMENT OF LUXEMBOURG COURT

On December 23rd 2015 the district court of Luxembourg delivered its much awaited decision in the case between the liquidators of the company Hellas Communications II SCA and two investment funds being the ultimate beneficiaries of the structure.

For further information we refer you to our Newsflash of February 2016.

DOMICILIATION OR PROVISION OF OFFICE SPACE: COURT RECALLS THE PRINCIPLES

The law dated May 31st 1999 regulating the activity of domiciliation applies if a company sets up office with a third party service provider with a view to carrying out an activity in connection with its corporate purpose and if that third party provides services to the company in relation with that activity. The company and the third party, the so-called agent, are then required to enter into a domiciliation agreement. The agent is subject to a number of obligations under the law of April 5th 1993 on the financial sector, as amended, just like any specialised professional of the financial sector (PFS). In practice, the line is blurred between a domiciliation and an office accommodation, especially in the case where the office rental is complemented by the provision of other services by the third party service provider.

In its decision dated December 16th 2015, the Court of Appeal ruled that the qualification of a contract for the provision of services including the provision of office space must be qualified as a contract of domiciliation, entered into by a company with a business center, because the provision of services had prevailed over the mere rental of offices. After referring to the long list of services to be provided by the third party service provider to the company, and after having noted that the contract contained a mobility clause of the allocated office space, the Court of Appeal concluded that the provision of an office was not the dominant element of the contract between the parties. The Court of Appeal reiterated that "*In exercising its discretionary powers, the judge must consider the respective roles of the agent and the company that has established its headquarters with the latter. To determine if there is a domiciliation or not, the judge must take into account indicators such as the lack of space, the failing or non-existent infrastructure, the number of people who actually work in the premises and the activity of the concerned companies*".

This decision does not shed new light on this matter. Courts had indeed already ruled in the same direction in the past (see, in particular TA Diekirch, ch correct., January 15th 2004, n° 28/2004, or, CA Luxembourg, 5e ch correct., July 11th 2006, n° 398/06). This decision aims above all to reiterate, for the record, the components of domiciliation of companies and seriously discourage the setting up of “letter box companies" at the risk of being in breach of the law and being sentenced to a criminal offence.

INVESTMENT MANAGEMENT

ESMA CONSOLIDATED Q&A ON THE APPLICATION OF THE UCITS DIRECTIVE

On February 1st 2016, the European Securities and Markets Authority ("ESMA") published an amended updated Questions and Answers on the application of Directive 2009/65/EC ("UCITS Directive") as amended by Directive 2014/91/EU ("UCITS V Directive") ("Q&A").

The purpose of the Q&A is (i) to promote common supervisory approaches and practices in the application of the UCITS Directive and its implementing measures and (ii) to clarify the content of the rules provided under the UCITS Directive.

The Q&A introduces the following new clarifications on the updates which UCITS shall perform to some of their documents in order to meet the requirements under the UCITS V Directive:

- **Remuneration disclosures in KIIDs and prospectuses:** UCITS are requested to update their KIIDs in order to include remuneration-related information at the first occasion after March 18th 2016 or at the next annual update after this date. Similarly, UCITS shall update their prospectuses in order to add such information at the next occasion they are revised for another purpose and in any event by March 18th 2017 at the latest. In the meantime, UCITS (or their management companies, if relevant) should make available on a relevant website the additional information about their remuneration arrangements as soon as ready and at any event by March 18th 2017 at the latest.

- **Remuneration disclosures in annual reports**: it is not necessary to include remuneration-related information in annual reports for periods ending before March 18th 2016. For annual reports relating to periods ending on or after March 18th 2016, but before the UCITS has completed its first annual performance period in which it has to comply with the provisions on remuneration policies under the UCITS V Directive, the remuneration-related information shall be included in the report on a best efforts basis and to the extent possible, explaining the basis for any omission.

- **Deadlines for updates of depositary contracts**: UCITS depositary contracts should be revised promptly in accordance with the transitional arrangements outlined in the Delegated Regulation (EU) 2016/438 with regard to the obligations of depositaries (the "Regulation"). According to ESMA, any provisions in existing depositary agreements relating to the liability of depositaries which are not consistent with the liability provisions of depositaries under the UCITS V Directive will be void with effect from March 18th 2016 and shall be supplemented by the liability provisions of depositaries under the UCITS V Directive. Therefore, the liability provisions in existing depositary contracts should be amended to comply with the UCITS V Directive when such depositary contracts are revised to comply with the Regulation.

The Q&A further repeals and replaces the following four existing ESMA Q&As on UCITS funds:

- Key Investor Information Document (KIID) for UCITS;
- guidelines on ETFs and other UCITS issues;

- notification of UCITS and exchange of information between competent authorities; and
- risk measurement and calculation of global exposure and counterparty risk for UCITS.

UCITS V AND PART II FUNDS – CSSF PRESS RELEASE

On March 2nd 2016 the Luxembourg supervisory authority, the *Commission de Surveillance du Secteur Financier* ("CSSF"), published the press release 16/10 on practical issues in relation to (i) the implementation of Directive 2014/91/EU amending Directive 2009/65/EC (the "UCITS V Directive") and (ii) depositary aspects in relation to UCIs subject to Part II of the law of December 17th 2010, relating to undertakings for collective investment (the "UCI Law") ("Part II UCIs") .

We refer to our Legal alert of March 4th 2016 for further information on the content of the press release.

ELECTRONIC "TAXE D'ABONNEMENT" DECLARATIONS AS FROM 2018

On March 3rd 2016 draft law N° 6963 ("Draft Law") was tabled before the Luxembourg Parliament by the Luxembourg Ministry of Finance. The Draft Law contemplates the introduction of an obligation for UCITS and Part II UCIs under the Law of December 17th 2010 on undertakings for collective investment ("2010 Law") and SIFs subject to the law of February 13th 2007 on specialised investment funds ("2007 Law") to fill in and submit their subscription tax return electronically as from January 1st 2018.

The electronic subscription tax return will be made by using a method authorised by the tax administration which will guarantee the authenticity, integrity, and confidentiality of the content.

Following the successful implementation of the electronic VAT return system for taxpayers in Luxembourg ("eTVA"), the government continues taking the approach of modernisation and innovation of tax administration procedures.

The Association of Bailiffs and *Chambre des Métiers* have issued their opinion on the proposed text. The Draft Law will possibly be voted in Summer 2016. Once passed, it is anticipated that the electronic submission of subscription tax returns may be extended by Grand-Ducal Regulation to other types of investment funds that may, in the future, be introduced in Luxembourg.

SECURITIES FINANCING TRANSACTIONS - ESMA DISCUSSION PAPER

On March 11th 2016 ESMA published its Discussion Paper on Draft Regulatory Technical Standards and Implementing Technical Standards under the Regulation (EU) 2015/2365 of November 25th 2015 on transparency of securities financing transactions and of reuse (the "Regulation") (the "Discussion Paper"). This Discussion Paper is published as part of ESMA's consultations on Level 2 measures under the Regulation and includes 145 questions addressed to all interested stakeholders.

As described in our previous article, the Regulation responds to the need to enhance the transparency of securities financing markets and thus of the financial system. It creates a European Union framework under which (i) details of securities financing transactions ("SFTs") can be efficiently reported to trade repositories ("TRs") and (ii) information on SFTs and total return swaps are disclosed to investors in collective investment undertakings.

The Discussion Paper includes information on the procedure and criteria for registration as a TR which wants to accept reports on SFTs and focuses on the SFTs reporting obligation, providing details on the use of internationally agreed reporting standards, the reporting logic under the Regulation and the main structure of a SFTs report. Moreover, it covers the requirements regarding transparency of data and aggregation and comparison of data and provides tables of fields for the relevant types of SFTs.

Regarding the disclosure requirements for UCITS and AIFMs as set in the Annex to the Regulation, ESMA states that drafting regulatory standards in order to further specify the contents of the Annex would not be the best approach at this stage. However, ESMA will consider working on this in the future after having monitored developments in market practice.

Finally, regarding the publication of implementing technical standards which will determine the procedures and forms for exchange of information on administrative and criminal sanctions imposed by the competent authorities of Member States, ESMA clarifes that it will publish a consultation paper on this matter at a later stage.

The Discussion Paper is therefore the first big step for the creation of a standardised and detailed reporting framework for SFTs. The Discussion Paper is open for comments until April 22nd 2016. ESMA will consider the feedback received and expects to publish a consultation paper early in Q3 2016. Thereafter, the final report and the draft technical standards will be submitted to the European Commission for endorsement by January 13th 2017.

UCITS V UPDATE – PUBLICATION OF LEVEL 2 MEASURES ON DEPOSITARY OBLIGATIONS

On March 24th 2016 the European Commission Delegated Regulation (EU) 2016/438 supplementing Directive 2009/65/EC of July 13th 2009 (the "UCITS Directive") as amended by Directive 2014/91/EU of July 23rd 2014 (the "UCITS V Directive") with regard to the obligations of depositaries was published in the Official Journal of the European Union (the "Regulation").

The Regulation does not differ from the official draft that was adopted by the European Commission on December 17th 2015. Reference to the official draft has been made in our previous article.

For UCITS, be they structured as investment companies or mutual funds (in which case the requirements set out in the Regulation apply to their management company) (the "Funds"), the Regulation clarifies:

- that a written contract shall be entered into between the Fund and the depositary. In this respect the Regulation specifies that a management company which manages several common funds is also allowed to enter into a single contract with the depositary, in respect of all of the common funds it manages,
- the minimum requirements that shall be included in depositary contracts,
- the duties of depositaries in relation to the performance of their functions (safekeeping duties with regard to assets held in custody and other assets, cash monitoring...). Further, the Regulation sets out the due diligence procedure to be followed with respect to the selection of third parties to whom safekeeping functions are to be delegated,
- that the depositary shall ensure that in case of insolvency of a third party located in a

third country to whom custody functions have been delegated, UCITS assets will be unavailable for distribution to or realisation for the benefit of, creditors of that third party,

- the conditions under which financial instruments held in custody are deemed to be lost as well as the conditions under which the depositary is allowed to discharge its liability in case of such loss,
- the independence requirements for UCITS and depositaries by laying down detailed rules which do not allow UCITS and depositaries to be under common management. In addition, it clarifies that employees of UCITS shall not be at the same time members of the management body of the depositary and that inversely, employees of depositaries shall not hold such positions in UCITS,
- the requirement to have in place a decision-making process for choosing the depositary so as to meet the sole interest of the UCITS and its investors. Additional requirements apply in case a link or group-link exists between a UCITS and its depositary,
- the requirement to manage conflicts of interests. In case of the existence of a link or group-link between the depositary and the Fund, conflicts of interests shall be identified and shall be further managed and disclosed in case they cannot be avoided.

The Regulation entered into force on April 13th 2016 and will apply directly in all Member States of the European Union from October 13th 2016.

Existing depositary agreements shall be revised promptly in order to comply with the Regulation and the UCITS V Directive as it will be shortly transposed into Luxembourg law.

UCITS V AND AIFMD – FINAL ESMA REPORT ON REMUNERATION GUIDELINES

On March 31st 2016 the European Securities and Markets Authority ("ESMA") published its final report on guidelines on sound remuneration policies (the "Report") under Directive 2009/65/EC of July 13th 2009 as amended by Directive 2014/19/EU of July 23rd 2014 (the "UCITS Directive") and under Directive 2011/61/EU of June 8th 2011 on Alternative Investment Fund Managers (the "AIFMD").

The Report aims to:

- provide feedback received from market participants on the consultation paper released by ESMA on July 23rd 2015 on guidelines on sound remuneration policies under the UCITS Directive and the AIFMD (the "Consultation Paper"). For further information on the Consultation Paper, please read our previous article;
- set out the final text of the guidelines on remuneration policies under the UCITS Directive ("UCITS Remuneration Guidelines");
- provide an update to the Guidelines on sound remuneration policies under the AIFMD ("AIFMD Remuneration Guidelines").

UCITS Remuneration Guidelines and proportionality issue

The UCITS Remuneration Guidelines integrated into the Report do not differ substantially from the draft guidelines set out in the Consultation Paper.

In its Consultation Paper, ESMA had allowed to waive the application of certain provisions under the UCITS Directive for certain UCITS funds when this would be justified by their small size and/or limited scope and complexity of activities. Such provisions referred mainly to the pay-out process (i.e. the requirements on variable remuneration

on instruments, retention, deferral and ex-post incorporation of risk for variable remuneration).

ESMA has removed this waiver from the final UCITS Remuneration Guidelines. However, it has published a letter on the same date of the Report to the European Commission, European Council and European Parliament, proposing that the waiver of these provisions be permitted on the basis of the proportionality principle. In this letter ESMA calls for the European legislators to provide clarity on the application of the proportionality principle, mainly in relation to its application on the pay-out process, in view of ensuring the consistent application of the remuneration requirements in the asset management sector.

AIFMD Remuneration Guidelines

The AIFMD Remuneration Guidelines integrated into the Report have had the section referring to the application of the remuneration rules in a group context amended, notably to acknowledge the potential outreach of the CRD rules in a banking group.

Next steps

The UCITS and AIFMD Remuneration Guidelines will be translated into the official languages of the European Union and the final texts will be published on the ESMA website.

The UCITS Remuneration Guidelines will apply to UCITS (or their management companies, if relevant) and the competent authorities from January 1st 2017. The amendment to the AIFMD Remuneration Guidelines will equally apply from such date.

PRIIPS REGULATION – UPDATE

On March 31st 2016 the Joint Committee of the European Supervisory Authorities ("ESAs"), consisting of the European Banking Authority ("EBA"), the European Insurance and Occupational Pensions Authority ("EIOPA") and the European Securities and Markets Authority ("ESMA") finalised their proposal for Regulatory Technical Standards on Key Information Documents ("KIDs") for Packaged Retail and Insurance-based Investment Products ("PRIIPs") in accordance with Regulation (EU) 1286/2014 ("Draft RTS").

The Draft RTS are accompanied by impact assessments and the feedback received by market participants on the previous two Discussion Papers and the Joint Consultation Paper on KID for PRIIPs that was published on November 11th 2015 (the "Consultation Paper"). For more information on the Consultation Paper, please read our previous article.

According to the ESAs, the final rules contained in the Draft RTS benefited from the public feedback received on the two Discussion Papers and the Consultation Paper, from extensive consumer testing and from a consultative expert group.

The final rules address the content and presentation of the KIDs and include:

- a common mandatory three-page template for the KID;
- a summary risk indicator of seven classes for the risk and reward section of the KID;
- a methodology to assign each PRIIP to one of the seven classes contained in the summary risk indicator, and for the inclusion of additional warnings and narrative explanations for certain PRIIPs;
- details on performance scenarios and a format for their presentation;
- costs presentation; and
- specific layouts and contents for the KID for products offering multiple options that cannot effectively be covered in three pages.

In addition, the Draft RTS include:

- rules on the yearly revision and republication of the KID and
- rules on providing the KID in a timely manner to retail investors in order to allow them to take its contents into account when making an investment decision.

Regarding the Consultation Paper, in total 103 stakeholders responded to the questions raised by the ESAs. The majority of stakeholders expressed their concerns on the lack of time to practically implement the RTS. Stakeholders also pointed out the absence of a grandfathering provision in relation to PRIIPs produced in the past, not actively marketed any more but still available in secondary markets. The ESAs responded that they will raise such practical issues with the European legislators and will try to ensure a smooth implementation of the new rules by providing Q&As and further guidance.

The Draft RTS have been submitted to the European Commission for endorsement, and will come into force on December 31st 2016.

AIFMD - ESMA UPDATED Q&A

The European Securities and Markets Authority ("ESMA") published on April 1st 2016 an updated version of its questions and answers ("Updated Q&A") on the application of the Alternative Investment Fund Managers Directive ("AIFMD"). The Updated Q&A provides for a clarification on notifications of alternative investment funds ("AIFs").

ESMA has confirmed that in case an EU AIF decides to offer additional units of a fund to investors and the offer is limited to the investors who have already invested in such AIF, the AIFM is not obliged to submit a new notification to the national competent authorities in accordance with article 31(2) of the AIFMD. It is to be noted that article 31(2) only deals with the marketing of units in the home Member State of the AIFM.

UCITS SHARE CLASSES – ESMA DISCUSSION PAPER

Following the feedback received from industry representatives, institutional investors and depositaries on the discussion paper ESMA/2014/1577 on UCITS share classes dated December 22nd 2014, in which ESMA had identified diverging practices as to the types of share classes that are permitted across the various jurisdictions of the European Union, ESMA has published on April 6th 2016, an updated Discussion Paper ESMA/2016/570 on the topic (the "Discussion Paper").

UCITS market participants expressed their desire for a harmonised framework for share classes throughout the EU having in mind the diverging national practices as to the types of share classes that are permitted, ranging from very simple share classes (e.g. with different levels of management fees) to much more sophisticated ones (e.g. with potentially different investment strategies). This divergence arises due to the lack of definition and scope of share classes at the level of the UCITS Directive. In addition, there are some uncertainties regarding the line that has to be drawn between the activities which could be permitted at share class level and the ones which should only be limited to the level of the UCITS or sub-fund. From a practical perspective, in order to meet investors' customisation needs, UCITS promoters will tend to create an additional share class rather than a new sub-fund or UCITS for various reasons, such as reduced costs, economies of scale and shorter authorisation periods for launch. Therefore, it is of paramount importance to define what is allowed under a

share class and what would require the creation of an additional sub-fund or UCITS.

The aim of the Discussion Paper is to provide ESMA additional feedback which will be used as a basis for future regulatory provisions on share classes, which will likely take the form of an ESMA opinion.

It appears from the discussions led by ESMA that four cumulative key features have to be retained as a common definition of what a share class is:

- “Common investment objective”: Share classes of the same fund should have a common investment objective reflected by a common pool of assets. However, hedging arrangements applying to some of the share classes and not to others shall be accepted (especially for currency hedging purposes) provided that the below “Non-contagion” principle is complied with ;
- “Non-contagion”: UCITS or their management companies should implement appropriate procedures to minimise the risk that features that are specific to one share class could have a potentially adverse impact on other share classes of the same fund (in particular the hedging arrangements which may benefit to some of the share classes but could have a negative impact on the whole structure) ;
- “Pre-determination”: All features of the share class should be pre-determined before it is set up;
- “Transparency”: Differences between share classes of the same fund should be disclosed to investors when they have a choice between two or more classes.

ESMA will consider the feedback it receives on the Discussion Paper until June 6th 2016, and also intends to take further steps in this matter by the end of the year.

LUXEMBOURG TRANSPOSES EMIR INTO NATIONAL LAW

On March 15th 2016, the Luxembourg Parliament passed the Law 6846 on OTC derivatives, central counterparties and trade repositories (“Law”). The Law was published in the Memorial (Luxembourg Official Journal) on March 17th 2016 and entered into force on March 21st 2016.

The Law aims to ensure the implementation of Regulation (EU) N° 648/2012 of the European Parliament and of the Council of July 4th 2012 on OTC derivatives, central counterparties and trade repositories (“EMIR”) by the *Commissariat aux Assurances* (“CAA”) and the *Commission de Surveillance du Secteur Financier* (“CSSF”) who are the entities responsible for ensuring the correct application of EMIR.

In line with the provisions of Article 2 of EMIR the Law empowers the CSSF and the CAA with the function of supervision, intervention, inspection and investigation as necessary for the exercise of their functions and defines their roles.

The Law further gives those authorities a disciplinary power to sanction such financial counterparties and non-financial counterparties in case of non-respect of the requirements under EMIR.

The *Commissariat aux assurances* will supervise and sanction such financial counterparties that fall under its supervision whereas the CSSF will be entitled to grant and withdraw approval to financial and non-financial counterparties, central counterparties and trading venues and to sanction them as the case may be.

The sanctions range from a warning and may go up to an administrative fine (up to EUR 1,500,000) or even to the withdrawal of the authorisation to

exercise one or more operations and/or activities. Some of the sanctions are also requested to be published without delay on the website of the CSSF or the CAA as relevant, and be made available during five years after the date of the sanction.

The Law also transposes Directive 2013/14/EU pursuant to which Institutions for Occupational Retirement Provision ('IORPs'), UCITS management companies (UCITS, ManCos) and AIFMs should avoid relying solely or mechanistically on credit ratings disclosed by credit rating agencies notably by supervising the references to such ratings in the investment policy of their products and by integrating that principle into their risk-management. The implementation of the Law results in the amendment of several laws in Luxembourg, including the CSSF Law of December 23rd 1998, the UCITS Law of December 17th 2010, the AIFM Law of July 12th 2013 and the SEPCAV and ASSEP Law of July 13th 2005. The new provisions introduced in the UCI Law and the AIFM Law require UCITS (or their management companies) and AIFMs to perform their own credit risk assessment and not to rely solely or mechanically on credit ratings when assessing the creditworthiness of the assets of the funds they manage or to otherwise use them as the only parameter when assessing the risk involved in the investments they make.

The Law further clarifies that in respect of the provisions applicable to such entities, CSSF and the CAA are granted the power to supervise the risk management methodology used by those entities and ensure that there is no over-reliance on credit ratings.

LABOUR LAW

DISMISSAL FOR IMPROPER USE OF INTERNET

Court of Appeal, November 12th 2015

While accusing his receptionist (hereinafter the "Employee") of using the company's internet to play indie games during working time, the employer alleged that the Employee had breached the company's internal regulations and terminated the Employee's employment contract with notice.

The Employee denied having received communication of the internal regulations and challenged her employer's decision alleging that the decision to terminate her contract was unfair as her employer, by monitoring her use of the internet, had violated article L.261-1 of the Labour Code (hereinafter the "Article").

According to the Article, processing for the purposes of supervision at the workplace is only possible if needed for the security or the health of employees, for the protection of the property of the company, for the control of the production process handled by machines, for the temporary control of the production or the service of employees if this is the only way to ascertain the exact salary, or for the organisation of flexible working hours.

The Employee argued (1) that she had not been informed about the ban on playing games on the internet during her working hours, and (2) that her employer violated the Article to the extent that he made no prior notification to the Data Protection Supervisory Commission (*Commission de Surveillance de la Protection des Données*) and that the conditions of the Article had not been met.

(1) The Court of Appeal (hereinafter the "Court") ruled that the employment contract, signed by

the Employee, clearly stated that the way the employer operates internally is governed by internal regulations, with which the Employee undertakes to comply.

The Court noted that, even assuming that the Employee was not informed of the internal regulations, quod non, it must be stated that by its nature, its definition and its meaning, the employment contract shall oblige the Employee to do her work, and not to surf on the internet.

(2) The Court stated that the employer did at no time monitor the Employee's personal emails or record her personal data, but carried out a spot check of the most visited websites by his Employee, in accordance with the internal regulations. This means that the Article is not applicable.

In conclusion, the Court stated that the Employee, while playing on her office computer during working time, violated her employment contract's obligations and compromised, by her wrong doing, the confidence that should exist between the parties to an employment contract, so that the employer was entitled to dismiss the Employee.

SURVEILLANCE OF INTERNET USAGE IN THE WORKPLACE

BARBULESCU v ROMANIA

By its decision of January 12th 2016, the European Court of Human Rights (hereinafter the "ECHR") ruled that the monitoring of an employee's use of the Internet did not violate Article 8 of the European Convention on Human Rights (right to respect for private and family life, the home and correspondence), and hence, his resulting dismissal was justified.

At his employers' request, Mr. Barbulescu (hereinafter the "Employee") created an email account for the purpose of responding to clients' enquiries. Later, the Employee was informed by his employer that his email communications had been monitored and that the records showed he had used the employer's system for personal purposes. The employer terminated the Employee's employment contract alleging that he had breached the company's internal regulations, which stated that "*it is strictly forbidden to disturb order and discipline within the company's premises and especially … to use computers … for personal purposes*".

In response to the allegations, the Employee claimed that the use of the internet had been professional only. This was rejected by his employer who explained that he had read the emails and knew that they were sent to the Employee's girlfriend and brother.

The Employee brought a claim stating that his dismissal was unfair. His main argument was that his employer had breached his right to respect his private and family life (Article 8 ECHR).

However, the ECHR considered that even if Article 8 ECHR was applicable, because the employer's behaviour was sufficient to engage the Employee's "private life" and "correspondence", it did not find it unreasonable that an employer would want to verify that the Employee was completing his professional tasks during working hours, especially because the employer had accessed the Employee's account on the belief that it contained client-related communications.

REORGANISATION OF THE HIGH COUNCIL OF SOCIAL SECURITY

Draft Law N° 6928 (hereinafter the "Draft Law") proposes to reorganise the High Council of Social Security (hereinafter the "High Council"), the court of second instance in matters of social security.

The current functioning of the High Council represents several difficulties.

Firstly, the High Council is a non-permanent jurisdiction, which means that it is composed of members of other permanent jurisdictions without the social security being their main activity. Hence, the Draft Law proposes that appeals in matters of social security litigation shall be attributed to a permanent jurisdiction composed of members with functions exclusively dedicated to social security.

Secondly, appeals in matters of social security litigation are expanding and diversifying, which is why such matters need to be analysed by members that are highly qualified. As a consequence, the Draft Law foresees that an appeal in the matter of a social security litigation shall be attributed to one of the divisions of the Court of Appeal.

However, as the High Council must remain an independent jurisdiction, the Draft Law anticipates the creation of a new division in the Court of Appeal, as well as the creation of three different judicial positions in this new division.

Thirdly, since the High Council fails to ensure judicial independence, the Draft Law proposes that the members of the High Council shall be designated by the General Assembly of the Superior Court of Justice.

Lastly, the Draft Law foresees to maintain the oral procedure, and as such, a person may choose to represent themselves or to be represented by a lawyer. Therefore the Draft Law breaks new grounds in matters of judicial representation, as a person could also be represented by a member of the staff delegation, by a member of the represented trade union or by a family member.

TAX

EU ANTI-TAX AVOIDANCE PACKAGE

On January 28th 2016, the European Commission unveiled new anti-tax avoidance measures, the most notable of which being a draft Anti-Tax Avoidance Directive (“ATAD”). This draft directive still requires unanimous agreement from Member States prior to finalisation, at which point it will have to be transposed by each Member State.

The ATAD proposes to introduce anti-avoidance rules in the six following areas, identified as directly affecting the functioning of the EU internal market:

- **Limitation on deductibility of interest**

The rule aims at limiting the amount of net interest a taxpayer is entitled to deduct in a given tax year. It is proposed that the net interest (i.e. the negative difference between the interest income and the interest expenses) would only be deductible up to the highest of 30% of the taxpayer’s EBITDA or EUR 1,000,000. In case of a higher debt-to-equity ratio at group level, exemptions could apply, provided certain conditions are met. The non-deductible part of the interest expenses could however be carried forward indefinitely. Finally, financial undertakings (i.e. credit institution, insurance and reinsurance companies, UCITS, pension funds or AIFs) are completely excluded from this provision.

- **Exit taxation**

This rule aims at ensuring that any transfer of assets or residency out of a Member State that would cause said Member State to lose its taxation rights, is recognised and taxed based on the fair market value. This would apply in cases where assets are contributed from the head office to a foreign permanent establishment and vice-versa or in case of a migration of a taxpayer or its permanent establishment from one Member State to another. Under certain conditions, the

resulting tax charge could be deferred and paid in instalments.

- **Switch-over clause**

Pursuant to this provision, capital gains and income from dividends and permanent establishments from/in a non-EU country would not be exempted at the level of the shareholder/head office in case the subsidiary/permanent establishment is subject to a tax on profits at a statutory corporate tax rate lower than 40% of the statutory tax rate that would have been charged under the tax system of the shareholder/head office. Taxes effectively paid in the country of the subsidiary/permanent establishment on the gain/income should however be credited on the tax charge at the level of the shareholder/head office. With regards to losses incurred on the disposal of shares/by the permanent establishment, said mechanism would not apply.

- **General anti-abuse rule**

Pursuant to this rule, any non-genuine arrangement carried out for the essential purpose of obtaining a tax advantage that defeats the object or purpose of a tax provision shall be ignored when calculating the applicable corporate tax liability.

- **Controlled foreign company rule (“CFC”)**

This rule aims at taxing at the level of the shareholder the non-distributed income of a subsidiary, provided that (i) the shareholder holds directly or indirectly more than 50% of the voting rights, capital or income entitlement, (ii) the subsidiary is taxed on profits at an effective tax rate lower than 40% of the effective tax rate of the shareholder and (iii) the subsidiary earns a majority of passive income (i.e. interest, dividend, royalties, financial leasing, insurance, banking or related parties services income) from which more than half is derived from transactions with related parties. Subsidiaries whose shares are regularly traded on recognised stock exchanges as well as financial undertakings (as detailed above) are however excluded from the above rule. The CFC rule would not apply to EU subsidiaries unless their establishment is wholly artificial or in case they engage in non-genuine arrangements, with the essential purpose of obtaining a tax advantage.

- **Anti-hybrid mismatches**

This last measure requires that the legal characterisation of a hybrid entity or a hybrid instrument made by the source country should be followed by the other country, thus avoiding cases where a deduction of a payment is not followed by an inclusion or where expenses are deducted in more than one country. This rule is only applicable where two Member States are involved and hence not to a situation involving a non-EU country.

The ATAD only provides for *de minimis* rules and thus does not preclude the application of more stringent domestic rules.

DRAFT LAW ON THE AUTOMATIC EXCHANGE OF RULINGS AND APAs

On March 22nd 2016, the draft law transposing EU directive 2015/2375/EU of October 6th 2015 (the “Directive”) which introduces an automatic exchange of information as regards advance cross-border rulings (“Rulings”) and advance pricing arrangements (“APA”) has been submitted to the Luxembourg parliament (the “Draft Law”).

For more information on the Directive, please refer to our newsletter of January 2016 .

The exchange of information will apply to existing Rulings or APA issued, amended or renewed since January 1st 2012 and those that will be issued, amended or renewed after December 31st 2016.

Rulings and APA issued, amended or renewed between January 1st 2012 and December 31st 2013 should however only be subject to the communication if they were still valid on January 1st 2014.

Rulings and APA issued, amended or renewed before April 1st 2016 for the benefit of persons, excluding those performing essentially financial or investment activities, whose annual net turnover at the level of the group is lower than EUR 40 million, will not be subject to the exchange of information.

Bilateral and Multilateral APA concluded with non EU countries fall outside the automatic exchange of information when the international treaty under which the APA has been negotiated does not allow its communication to third parties.

The automatic exchange of information will not apply to Rulings and APA issued for the benefit of individuals.

The law should become applicable as from January 1st 2017.

EXCHANGE OF INFORMATION AND FUNDAMENTAL RIGHTS: NO EXPEDITED ECJ PROCEDURE

We reported in our January 2016 newsletter that, in a ruling issued on December 17th 2015, the Luxembourg Higher Administrative Court ("*Cour Administrative*") decided to ask the European Court of Justice (the "ECJ") for a preliminary ruling on the question of the compliance of the Luxembourg procedural rules, applicable to requests for exchange of information, with the EU Fundamental Rights Charter, proclaimed on December 7th 2000 in Nice and legally binding as from the entry into force of the Lisbon Treaty in December 2009 (the "Charter").

The Luxembourg judges asked the ECJ to rule according to an expedited procedure, arguing

(i) that an important number of similar disputes could potentially arise,

(ii) that the disputed Luxembourg law provisions foresee strict deadlines applicable to any judicial appeal thereunder before the Luxembourg courts and that

(iii) Luxembourg's obligation to sincere cooperation under the Treaty on the European Union might be affected.

On February 15th 2016 (case n° C-682/15), the President of the ECJ decided to reject the petition to rule according to an expedited procedure, by referring to its prior case law: none of the arguments brought forward by the Luxembourg Higher Administrative Court was considered as constitutive of exceptional circumstances, justifying the application of an accelerated procedure.

As a consequence, the ECJ will deal with the preliminary ruling according to its standard procedure. The case thus does not enjoy any priority over other cases and a decision should not be available before a 12 to 15 month period.

2017 LUXEMBOURG TAX REFORM - PRELIMINARY PROPOSAL

On February 29th 2016, the Luxembourg government released a set of preliminary proposals that forms part of the envisaged 2017 tax reform.

Measures for corporate taxpayers

The first proposed measure is a gradual reduction of the corporate income tax rate, from currently 21%, to 19% for the tax year 2017 and to 18% from the tax year 2018 going forward. For corporate taxpayers resident in Luxembourg City, their aggregate tax rate (including the contribution to the unemployment fund and the

municipal business tax) would be reduced from 29.22% to 26.01% which represents a 3 percent reduction.

The other proposed measures include:

a) Increase of the minimum net wealth tax for financial companies from EUR 3,210 to EUR 4,815;
b) Limitation of the carry forward period of tax losses (currently the losses can be carried forward for an unlimited period of time);
c) Reduced corporate income tax rate for companies having a taxable result of less than EUR 25,000 per year;
d) Introduction of a tax roll-over mechanism for the transmission of a family business; and
e) Repealing of the 0.24% stamp duty currently due upon voluntary registration of debt claims.

Measures for individual taxpayers

The main proposed measure is the introduction of a new top tax rate of 42% for individuals earning more than EUR 200,000 per year, which coupled with a reshuffling of the lower tax brackets and related rates aims at relieving the tax burden currently carried by the middle-income classes.

The other proposed measures include:

a) Increase of the RELIBI final withholding tax on interest income earned by Luxembourg resident individuals from 10% to 20%;
b) Increase (coupled with a degressive scale) of the tax credits available to certain taxpayers (e.g. single parents);
c) Increase of the allowances for interest expenses in relation with the acquisition of private housing;
d) Benefits for the acquisition of emission free vehicles; and
e) Repealing of the temporary 0.5% budget balancing tax.

DIRECTORS' FEES ARE SUBJECT TO VAT

The Luxembourg VAT Authorities recently confirmed to the Luxembourg Association of Company Directors that independent director's fees are subject to VAT at the standard rate of 17%. Although this statement was viewed by many as a new administrative practice, the Head of the Luxembourg VAT Authorities insisted that his position did not change and that he always considered company directors as VAT taxable persons carrying out economic activities in an independent and usual manner.

This position seems to be in line with the view taken by the European Commission, which had initiated an action for infringement against the Netherlands in 2011. At that time, the Dutch VAT rules did not consider company directors as VAT taxable persons unless they carried out an important number of corporate mandates. Under pressure from the European Commission, the Netherlands finally changed their law one year later, so that the issue was never brought to the European Court of Justice.

In practice, Luxembourg directors should thus register for VAT purposes, charge VAT to their client companies and file VAT returns according to the Luxembourg VAT law unless the *de minimis* rule applies. This rule provides that any VAT taxable person whose annual turnover, including but not limited to director's fees, amounts to less than EUR 25,000 does not have to register and charge VAT, provided that it does not carry out any cross-border activities.

Companies that either do not qualify as VAT taxable persons or that have only limited input VAT deduction rights, might as a result suffer irrecoverable VAT costs.

From an income tax perspective, director's fees are subject to a 20% withholding tax, computed

on the gross amount, exclusive of VAT, allocated to the director.

It should finally be noted that, according to several press reports, the Head of the Luxembourg VAT Authorities seems to have announced that his administration would adopt a lenient approach for the past tax years. Furthermore, the Minister of Finance suggested in a response to a parliamentary question that further guidance may be provided soon. Directors should nevertheless carefully consider their VAT situation as soon as possible.

FISCAL UNITY: CLARIFICATIONS ON THE USE OF TAX CARRIED FORWARD LOSSES

On March 24th 2016, the Higher Administrative Court ("*Cour Administrative*") confirmed a judgment rendered by the Lower Administrative Court *("Tribunal Administratif*") on the use of tax carried forward losses within a fiscal unity.

In the case at hand, the Luxembourg holding company ("Lux HoldCo") applied for a fiscal unity with two of its Luxembourg subsidiaries ("LuxCo 1 and LuxCo 2") in 2004. In 2008, two other Luxembourg subsidiaries ("LuxCo 3 and LuxCo 4") joined the fiscal unity. For the determination of its taxable result in 2008, Lux HoldCo offset the profits realised by the newly integrated companies against the tax carried forward losses of the fiscal unity.

The tax authorities considered that the tax carried forward losses realised by Lux HoldCo and LuxCo 1 and LuxCo 2 belonged to the fiscal unity including Lux HoldCo as the integrating company and LuxCo 1 and LuxCo 2 as integrated companies and refused to compensate such losses with the profits derived by LuxCo 3 and LuxCo 4 which they considered as forming a second fiscal unity with Lux HoldCo.

The Higher Administrative Court confirmed that the integration of new subsidiaries to an existing fiscal unity at a different point in time does not form a new fiscal unity, but an extension of the existing fiscal unity. Lux HoldCo, as the head of the fiscal unity, was the owner of the tax carried forward losses realised by the fiscal unity before the entry of LuxCo 3 and LuxCo 4 to the group. As such, Lux HoldCo was allowed to offset these losses against its profits which included the profits realised by LuxCo 3 and LuxCo 4 once they had joined the fiscal unity.

For more information, please refer to our Legal alert .

NEW CIRCULAR ON TAXATION OF CAPITAL GAINS OR TRANSFER OF USUFRUCT

On March 7th 2016, the Luxembourg Tax Authorities published a new circular regarding the taxation of capital gains stemming from the disposal of real rights relating to immovable property (Circular n°99ter/1bis, the "Circular"). The aim of the new Circular is to give guidance on the legal provisions in this matter (Art. 108bis Luxembourg income tax law - "LITL"), dealing with the taxation of the transfer of bare ownership (*nue-propriété*) or usufruct (*usufruit*). According to the Circular, any capital gain resulting from the disposal of solely the bare ownership or solely the usufruct gives rise to taxation, but only if the capital gain upon disposal of the full ownership would have been taxable.

The taxable capital gain is strictly limited to the gain linked to the increase in value of the bare ownership or usufruct. Any random gain (e.g. death of the tenant for life) or actuarial gain (i.e. value of the usufruct depending on the age of the tenant for life) will not be taken into consideration and the taxable capital gain will be adjusted accordingly.

The relevant provisions applicable to capital gains (Art. 99bis and Art. 99ter LITL) must be observed.

The applicable tax rate (full progressive or half progressive rate) will depend on whether the taxable operation falls within the speculative period between acquisition and disposal (i.e. within two years) or not (i.e. more than two years).

For this purpose, the Circular gives guidance on how to calculate the holding period of the immovable property:

- In case of acquisition of the full ownership with subsequent disposal of the usufruct, the holding period starts upon the acquisition of the full ownership;
- In case the bare ownership and the usufruct have been acquired at different dates but the disposal relates to the full ownership of the property, the holding period starts upon the first acquisition (i.e. bare ownership or usufruct);
- In case the usufruct or the bare ownership have been acquired separately and disposed of separately, the holding period starts with the acquisition of that relevant right.

Although the Circular exclusively gives examples relating to the transfer of real rights to immovable property, the same principles are applicable to other assets having a usufruct attached to them (e.g. share).

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THANKS TO THOSE WHO CONTRIBUTED TO THIS NEWSLETTER:
ANN ANDRE-OLMES, CHRISTINE BEERNAERTS, ANNA CAMPBELL, NUALA DOYLE, MARIE-CLAUDE FRANK, ELODIE GIRAULT, ALEKSANDRA GUCWA, PEIK HEIRMAN, SABINE HINZ, VALERIE KOPERA, HELEN LIU, ORIANA MAGNANO, EVELYN MAHER, POL MELLINA, ANNE MOREL, MAGDALENA PIETRAS, ROLAND PLIGER, DANIEL RIEDEL, VIKTORIA SOURLAGKA, MELVIN TJON AKON.

BSP BONN STEICHEN & PARTNERS

Avocats
2, rue Peternelchen I Immeuble C2 I L-2370 Howald I Luxembourg
T. +352 26025-1 I F. +352 26025-999
mail@bsp.lu I www.bsp.lu
www.twitter.com/BSP_Luxembourg I www.linkedin.com/company/bonn-steichen-&-partners