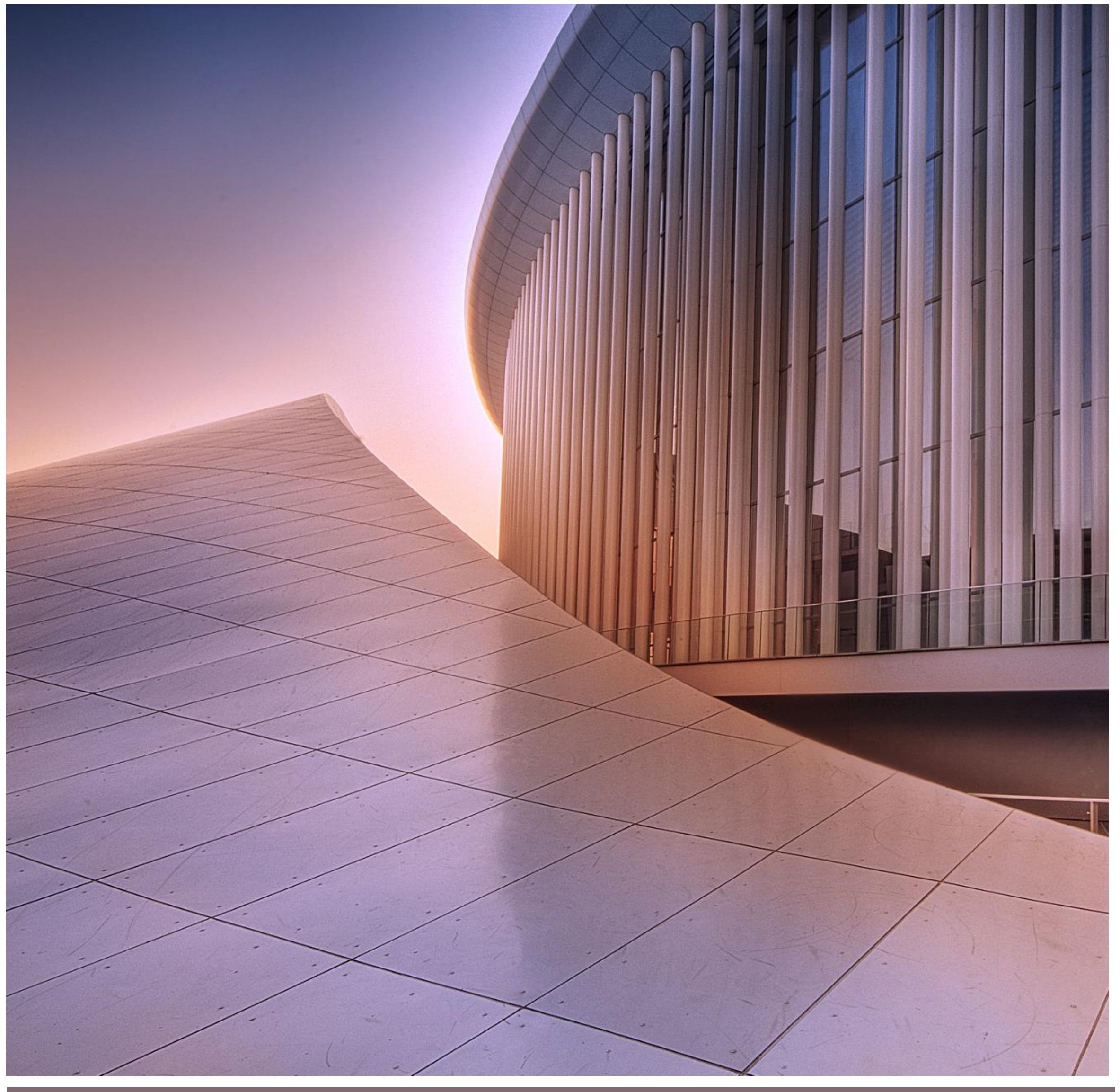
Newsletter – 10.2017



BONN STEICHEN & PARTNERS

NEWSLETTER

DATED

OCTOBER 2017

BSP BONN STEICHEN & PARTNERS
LUXEMBOURG LAW FIRM

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.

SUMMARY

AML ... 4

4TH AML DIRECTIVE: SIGNIFICANT IMPACTS FOR BUSINESSES IN LUXEMBOURG ... 4

BANKING & FINANCE ... 5

MIFID II | DRAFT LAW AND GRAND DUCAL REGULATION ... 5

CAPITAL MARKETS ... 6

NON-PERFORMING LOANS | EU COUNCIL'S ACTION PLAN ... 6

MARKET ABUSE| UPDATE OF ESMA Q&A ... 6

NEW PROSPECTUS REGULATION ... 7

DATA PROTECTION ... 8

DATA PROTECTION | DRAFT LAW ... 8

DISPUTE RESOLUTION ... 9

SMALL CLAIMS PROCEDURE - REGULATION (EU) 2015/2421 ... 9

INVESTMENT FUNDS ... 11

ASSET SEGREGATION AND DEPOSITARY DELEGATION | ESMA OPINION ... 11

BREXIT | ESMA OPINION TO SUPPORT SUPERVISORY CONVERGENCE ... 12

AIFMD | CSSF UPDATED FAQ ... 13

UCITS | CSSF UPDATED Q&A ... 14

AIFMD | ESMA UPDATED Q&A ... 16

UCITS | ESMA UPDATED Q&A ... 17

PRIIPS KID ... 17

VENTURE CAPITAL AND SOCIAL ENTREPRENEURSHIP FUNDS - UPDATE ... 18

IP/IT ... 19

IT OUTSOURCING RELYING ON CLOUD COMPUTING - CSSF CIRCULAR 17/654 ... 19

TAX ... 21

LUXEMBOURG RELEASED ITS POSITION ON MLI ... 21

THE MUTUAL AGREEMENT PROCEDURE - TAX CIRCULAR ... 22

EXCHANGE OF INFORMATION - NEW DEVELOPMENT FOR EFFECTIVE JUDICIAL REMEDY ... 23

NEW IP REGIME | DRAFT LAW ... 23

VAT | THE IGP EXEMPTION DOES NOT APPLY TO THE FINANCIAL AND INSURANCE SECTOR ... 25

VAT | DRAFT LAW ON VAT TREATMENT OF VOUCHERS ... 26

TAX TREATMENT OF THE REVERSAL OF AN IMPAIRMENT ... 26

AML

4TH AML DIRECTIVE: SIGNIFICANT IMPACTS FOR BUSINESSES IN LUXEMBOURG

Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 (the "**4th AML Directive**") had to be implemented in the Member States at the latest on June 26th 2017.

However, the Luxembourg draft law of April 26th 2017 (the "**Draft Law**") to implement the provisions of the 4th AML Directive is not formally adopted yet.

Most companies have already dealt with anti-money laundering and counter terrorist financing ("**AML/CTF**") when working with professionals, such as lawyers or banks, within the meaning of the law dated November 12th 2004 on the fight against money laundering and terrorist financing, as amended from time to time (the "**AML Law**"), which constitutes the current applicable legal framework in Luxembourg; but are not directly subject to the obligations of the AML Law.

Implementation of the 4th AML Directive may change this fact.

Pursuant to recital 12 of the 4th AML Directive, "*there is a need to identify any natural person who exercises ownership or control over a legal entity. In order to ensure effective transparency, Member States should ensure that the widest possible range of legal entities incorporated or created by any other mechanism in their territory is covered*."

This clearly demonstrates a will to increase the scope of AML/CTF obligations as regards the identification of ultimate beneficial owners ("**UBO**") so as to include as many corporate forms as possible.

Article 30 paragraph 1 of the 4th AML Directive provides that "*Member States shall ensure that corporate and other legal entities incorporated within their territory are required to obtain and hold adequate, accurate and current information on their beneficial ownership, including the details of the beneficial interests held*".

In other words, legal persons must identify their own ultimate beneficial owners and the exact structure of ownership. Furthermore, such legal entities will have to keep such information updated. Compliance with such obligation will imply, from a practical standpoint, setting up adequate internal rules to ensure that information is always up-to-date.

In addition, the information on the UBO will have to be held in a central register.

At this stage, legal entities can reasonably expect that the UBO obligations, which are however not yet provided for in the Draft Law, will be implemented in Luxembourg with a new law modifying the AML Law. Even though the Draft Law does neither implement the obligation related to UBOs for legal entities nor the central register for UBOs, it does however implement the new definition of UBOs as per the 4th AML Directive.

BANKING & FINANCE

MIFID II | DRAFT LAW AND GRAND DUCAL REGULATION

According to the Directive 2014/65/EU of 15 May 2014 on markets in financial instruments (**"MiFID II"**), Member States must transpose the directive in national law by July 3rd 2017 and apply those laws and regulations from January 3rd 2018. We have written on MiFID II and the delegated directive and regulations supplementing MiFID II in earlier newsletters.

In July of this year, the Draft Law 7157 transposing MiFID II (the **"Draft Law"**) and the related Draft Grand Ducal Regulation (the **"Draft GDR"**), have come before the Luxembourg parliament.

THE DRAFT LAW

Pursuant to the provisions of the Draft Law, in its current form, there is no gold-plating of the MiFID II provisions. Furthermore, Luxembourg does not intend to exercise national discretion in most of the cases expressly provided for in MiFID II, such as Articles 3 (optional exemptions), 16 (organisational requirements), 29 (tied agents) and 70 (powers of competent authorities). In a limited number of instances, the Draft Law concretises a more general obligation under MiFID II. For example, the obligation to require market operators to communicate the list of members of participants to the competent authority "on a regular basis" (Article 53(7) MiFID II) is concretised by the obligation to communicate the list to the Luxembourg supervisory authority of the financial sector (the *Commission de Surveillance du Secteur Financier - CSSF*) on a semi-annual basis.

THE DRAFT GDR

The Draft GDR with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits, is divided into three chapters:

(1) Chapter 1 transposes Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing MiFID II with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits (the **"Delegated Directive"**);

(2) Chapter 2 modifies the Grand Ducal Regulation of 13 July 2007 with respect to the maintenance of an official listing for financial instruments; and

(3) Chapter 3 repeals the Grand Ducal Regulation of 13 July 2007 with respect to organisational requirements and rules of conduct in the financial sector.

In its current form, Chapter 1 of the Draft GDR closely follows the text of the Delegated Directive.

NEXT STEPS

On September 26th 2017, the European Commission sent two letters of formal notice to Luxembourg about a "non-transposition", or the non-implementation of MiFID II at a national level. At present, the Luxembourg parliament has yet to adopt the Draft Law and the Draft GDR. This adoption will provide the Luxembourg financial sector with the regulatory clarity necessary to adapt their organisational processes to the MiFID II rules before the deadline of January 3rd 2018.

CAPITAL MARKETS

NON-PERFORMING LOANS | EU COUNCIL'S ACTION PLAN

On July 11th 2017 the EU Council announced its action plan to tackle non-performing loans ("**NPLs**") in Europe (the "**Action Plan**"). There is a strong connection between the high levels of NPLs and overall economic performance because high levels of NPLs reduce profitability, increase funding costs and negatively impact credit supply. Thus, the Action Plan outlines a mix of policy actions to help reduce and prevent stocks of NPLs with a focus on three main areas:

1. the development of secondary markets for NPLs (distressed assets);
2. the reform of the insolvency and debt recovery framework; and
3. banking supervision.

Some of the specific actions which shall be taken between summer 2017 and the end of 2018 include the following:

- the Commission shall issue an interpretation of existing supervisory powers in EU legislation with a view to identifying their usability as regards banks' provisioning policies for NPLs; this was expected to be issued by the end of summer 2017, but has not been issued to date;
- the Commission shall publish the results of an analysis of national enforcement and insolvency rules with a view to a reform of the EU wide insolvency regime, by the end of 2017;
- the Commission shall develop a European-wide approach for the development of secondary markets for NPLs with a view to removing impediments to the transfer of NPLs by banks to non-banks; the European Banking Authority shall issue (i) general guidelines on NPL management consistent with the Single Supervisory Mechanism ("**SSM**") Guidance to banks on non-performing loans for significant institutions and (ii) detailed guidelines on banks' loan origination, monitoring and internal governance, by summer 2018; and
- the Member States shall carry out dedicated peer reviews on insolvency regimes across the EU, by the end of 2018.

Banks are primarily responsible for restructuring their business models and resolving their NPL issues. However, due to the current magnitude, NPL stocks in some Member States may not decrease sufficiently, notwithstanding the economic recovery of those Member States. Incentives for banks to deal with NPLs proactively should be enhanced, whilst avoiding the disruptive effects of fire sales. Measures should both address existing stocks of NPLs and prevent a further accumulation of NPLs in the future. The Council is of the view that the Action Plan will be beneficial for the EU as a whole.

MARKET ABUSE| UPDATE OF ESMA Q&A

On September 29th, the European Securities and Markets Authority ("**ESMA**") published a further update of its Questions and Answers ("**Q&A**") on Regulation (EU) No 596/2014 of 16 April 2014 on market abuse (the "**Market Abuse Regulation**") to

include a new question and answer in Section 5 - Questions and answers on the disclosure of inside information.

With this latest update, ESMA has clarified the obligations on an issuer in a situation where such issuer has delayed the disclosure of inside information in accordance with Article 17(4) of MAR and during the period of that delay, the information concerned lost its feature of price sensitivity. The issuer is not obliged either to disclose the information to the public or to inform the competent authority of the delay. On the other hand, the issuer must still comply, with respect to that information, with the obligations under the Market Abuse Regulation and related delegated and implementing regulations to keep insider lists and to keep information regarding the delay of disclosure.

NEW PROSPECTUS REGULATION

On July 20th 2017, Regulation (EU) 2017/1129 of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC (the "New Prospectus Regulation") entered into force. The New Prospectus Regulation is part of the broader Capital Markets Union action plan and aims to make it easier and less costly for smaller companies to gain access to capital and to generally make the EU capital markets framework more flexible and simpler for the benefit of all issuers. Furthermore, it aims to improve the quality of prospectuses for the investor with the introduction of a summary of key information tailored to the needs of investors. The provisions of the New Prospectus Regulation will apply on a rolling basis with the majority being applicable by July 21st 2019. For more information, please see our previously published Newsflash – Publication of the New Prospectus Regulation.

DATA PROTECTION

DATA PROTECTION | DRAFT LAW

Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (the "**GDPR**") will apply as of May 25th 2018 directly in all Member States of the EU.

The GDPR has been exhaustively commented upon and, for an overview of the top ten significant changes introduced by the GDPR, we refer to our previous Newsflash on the subject.

Despite being a regulation (thus directly applicable in all EU Member States) the GDPR leaves room for adaptation of certain provisions to the EU Member States, in particular regarding the powers of the national supervisory authority (i.e. the *Commission Nationale pour la Protection des Données*, "**CNPD**") and the administrative penalties which may be faced by business in breach of the GDPR provisions.

The Luxembourg draft law No. 7184 of 12 September 2017 (the "Draft Law") aims to adapt the existing legal framework in such a sense.

Such approach is consistent with the new *ex-post* model introduced by the GDPR. Indeed, the current rules are based on an *ex-ante* model whereas the GDPR introduces an *ex-post* model. In other words, the current regime rests on a system of preliminary notifications to the competent authority in each EU Member State whereas, as per the GDPR, the processors and controllers must self-assess the legality of their practices and the said competent authority only intervenes afterwards with powers of sanction if such practices breach the GDPR provisions.

Therefore, it is of tremendous importance for the CNPD to be granted with sufficient and necessary powers of investigation and sanction.

In addition to investigative powers (Article 58 paragraph 1 of the GDPR) and corrective powers (Article 58 paragraph 2 of the GDPR), the CNPD may impose administrative fines (Article 58 paragraph 2 (i) GDPR).

The GDPR provides for strict pecuniary sanctions which vary according to the provisions that have been violated. These fines vary (i) from a maximum of 10 million Euro to a maximum of 20 million Euro, or, (ii) for an undertaking, from of a maximum of 2% to a maximum of 4% of the worldwide annual turnover of the previous financial year.

These rules have been strictly followed by the Draft Law which directly refers to the GDPR for the amounts of such administrative fines.

Sanctions are always the ultimate step in front of a defaulting controller, therefore for sake of ensuring efficient application of the GDPR, it clearly states that "*supervisory authority shall ensure that the imposition of administrative fines* […] *shall in each individual case be effective, proportionate and dissuasive*."

In addition, in exceptional circumstances where sanctions could not be efficient towards controllers, the CNDP, pursuant to the GDPR, should be able to impose penalty payment (*astreintes*) in compliance with the Luxembourg Civil Code.

As far as the scope of administrative fines is concerned, the GDPR is clear and states that "*each Member State may lay down the rules on whether and to what extent administrative fines may be imposed on public authorities and bodies established in that Member State*".

Article 49 (1) of the Draft Law provides that the administrative fines of Article 83 of the GDPR may equally be imposed upon public legal persons.

DISPUTE RESOLUTION

SMALL CLAIMS PROCEDURE - REGULATION (EU) 2015/2421

Regulation (EU) 2015/2421 of 16 December 2015 (the "**Regulation**") amending Regulation (EC) No. 861/2007 establishing a European Small Claims Procedure and Regulation (EC) No. 1896/2006 creating a European order for payment procedure entered into force on July 14th 2017. A draft law (No. 7121) aiming at introducing into the Luxembourg Procedure Code the changes brought by the Regulation is currently pending.

Regulation (EC) No. 861/2007 established the European Small Claims Procedure which aims at improving access to justice for both consumers and businesses by reducing costs and accelerating civil procedures with regard to claims within its scope. In general, the European Small Claims Procedure is considered to have facilitated cross-border litigation for small claims in the European Union. However, the low ceiling set out in Regulation (EC) No. 861/2007 as regards the value of the claim deprives many potential claimants in cross-border disputes of the use of a simplified procedure. Furthermore, several elements of the procedure could be further simplified in order to reduce the costs and the duration of litigation. These are the reasons why the Regulation has been adopted.

The Regulation introduces the following amendments:

1. Expansion of the definition of Small Claims with regard to the value of a claim from EUR 2,000 to EUR 5,000.
2. Extension of the list of matters which are excluded from the scope of application of Regulation (EC) No. 861/2007.
   The European Small Claims Procedure applies to both contested and uncontested cross-border civil and commercial claims with the exception of a limitative list of matters such as employment law, arbitration, etc. The Regulation extends this limitative list to exclude matters concerning maintenance obligations arising from a family relationship, parentage, marriage or affinity, and wills and succession, including maintenance obligations arising by reason of death, from the Small Claims procedure.
3. Expansion of the scope of application to court settlements.
   The Regulation shall be applied not only to decisions of the court but also to court settlements approved by or concluded before a court or tribunal. As such, court settlements shall be recognised and enforced in all other Member States under the same conditions as a judgment given in the European Small Claims Procedure.
4. Indication of appeal information.
   Where the claim is dismissed on the basis that it is clearly unfounded or if the application is ruled as being inadmissible or where the claimant fails to complete or rectify the claim form within the time specified, the court or tribunal shall inform the claimant of such dismissal and whether an appeal is available against such dismissal.
5. Use of modern communication technology.
   The European Small Claims Procedure is essentially a written procedure. To further reduce the costs of litigation and the length of proceedings, the Regulation provides that the service of documents and other written communications can be done via electronic means and sets out the circumstances where

modern communication technology could be used.

6. Limitation of the cases where a judgement can be reviewed.
   Only defendants who did not enter an appearance are allowed to apply for a review of the judgment within 30 days.

7. Measures to reduce costs.
   The court shall use the simplest and least burdensome method to determine the means of taking evidence, and the extent of the evidence necessary for its judgment.
   The court fees charged in a Member State for the European Small Claims Procedure shall not be disproportionate and shall not be higher than the court fees charged for national simplified court procedures in that Member State. The parties can pay the court fees by means of distance payment methods.
   The court or tribunal, at the request of one of the parties, shall issue a certificate concerning a judgment given in the European Small Claims Procedure using the standard Form D, as set out in Annex IV, at no extra cost.

8. Amendment of Regulation (EC) No. 1896/2006 creating a European order for payment procedure to clarify that, where a dispute falls within the scope of the European Small Claims Procedure, that procedure should also be available to a claimant in a European order for payment procedure in the event that the defendant has lodged a statement of opposition against the European order for payment.

INVESTMENT FUNDS

ASSET SEGREGATION AND DEPOSITARY DELEGATION | ESMA OPINION

On July 20th 2017, the European Securities and Markets Authority ("**ESMA**") issued its opinion on asset segregation and application of depositary delegation rules to central securities depositaries (the "**Opinion**") where it sets out its view on the optimal approach to asset segregation under the framework of both the AIFMD Directive and the UCITS Directive, and how the depositary delegation rules should apply to central securities depositaries ("**CSDs**").

Segregation of a depositary's own assets from those of its customer's assets by way of separate accounts as well as at the levels below between a delegate's own assets, the depositary's own assets and customer assets is generally regarded as an efficient way of protecting the customer's assets.

The Opinion outlines that feedback to an earlier consultation process on asset segregation under AIFMD made it clear that an overly prescriptive individual asset segregation regime was undesirable for a number of reasons:

- Individually segregated accounts do not necessarily provide additional insolvency protections for clients.
- It would see an increase of the number of accounts in the custodial chain thus leading to an increase in complexity, transaction costs and operational risk.
- The system developments required, the additional KYC/AML and administrative requirements would lead to significant costs which would ultimately be borne by investors.
- It would prevent EU investment funds from participating in tri-party collateral management arrangements.
- Depositary delegates in certain (non-EU) jurisdictions may be unwilling to facilitate such requirements because of existing local market practice, rules or infrastructure.

Taking the above into account ESMA is of the view that only minimum EU-wide segregation requirements should be prescribed. There can be no "one model fits all" approach. As such it proposes as follows:

(i) Alignment of the insolvency related provisions under the UCITS Directive and AIFMD.
The EU institutions should consider mirroring the insolvency related provisions of Articles 22(8) and 22a(3)(d) of the UCITS Directive as well as Article 17 of the UCITS V Regulation in the AIFMD framework.

(ii) Asset segregation requirements at the depositary Level.
The EU institutions should clarify that the depositary shall ensure that the financial instruments are properly registered at all times, even in case of delegation.

(iii) Asset segregation requirements at the second level (i.e. delegate level). The minimum requirements to be prescribed for at the level of the delegate should consist of a minimum of 3 segregated accounts per depositary as follows (1) own assets of the delegate, (2) own assets of the depositary and (3) assets of the depositary's clients.

As a consequence, omnibus accounts i.e. those comprising assets of different clients of depositaries, but excluding own assets of the delegate or of the depositary, would be admissible subject to certain requirements.
ESMA recommends legislative clarifications to both the UCITS and AFIMD frameworks in order to achieve the above and to remove any interpretive doubts arising from the AIFMD and the UCITS V regulation especially concerning the co-mingling of AIF and UCITS assets.

(iv) Asset segregation requirements at the third and further levels.
ESMA is of the view that on the level of the sub-delegate there should be a minimum of 3 segregated accounts per delegate as follows (1) own assets of the sub-delegate, (2) own assets of the delegate and (3) assets of delegate's clients. This means that assets from various depositaries (level 1) may be held in one omnibus account.
ESMA recommends legislative clarifications to both the UCITS and AFIMD frameworks in order to achieve the above.

ESMA also considered, in its Opinion, the application of depositary delegation rules to central securities depositaries ("**CSD**").

After an analysis of the regulatory framework applicable to CSDs, ESMA concluded that depositary arrangements with Issuer CSDs (those providing the core service of initial recording of securities in a book-entry system or providing and maintaining securities accounts at the top tier level) should not be subject to depositary delegation rules because the use of the Issuer CSD is mandatory for the holding of securities in a particular jurisdiction. An Issuer CSD should therefore not be a delegate for purposes of AIFMD and the UCITS Directive.

Depositary delegation requirements should apply in the case of Investor CSDs (a CSD that either is a participant in the securities settlement system operated by another CSD or that uses a third party or an intermediary that is a participant in the securities settlement system operated by another CSD in relation to a securities issue). In considering how to satisfy the depositary delegation requirements where an investor CSD is used, the existing regulatory framework for CSDs is important. It could be reasonable for the depositary to rely on the CSD's authorisation under CSDR to satisfy some of the depositary delegation requirements.

As a consequence ESMA invites EU institutions to consider legislative clarifications in the UCITS and AIFMD framework in order to prescribe the regime applicable to CSDs.

BREXIT | ESMA OPINION TO SUPPORT SUPERVISORY CONVERGENCE

On July 13th 2017, the European Securities and Markets Authority ("**ESMA**") issued three opinions setting out relocation principles specific to investment firms, investment management and secondary markets, sixteen months after the Brexit vote to end the UK's 43-year membership of the European Union.

Those opinions complete the previous ESMA opinion "general principles to support supervisory convergence in the context of the United Kingdom withdrawing from the European Union" published in May 2017.

Through these three opinions, ESMA aims at promoting consistency in the authorisation,

supervision and enforcement of laws relating to the relocation of entities, activities and functions from the United Kingdom.

With respect to the investment management sector, the principles are based on the objectives and provisions of Directive 2009/65/EC of July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities as amended ("**UCITS Directive**") and Directive 2011/61/EU of 8 June 2011 on alternative investment fund managers ("**AIFM Directive**"). The investment management opinion focuses particularly on authorisation, governance and internal control, delegation and effective supervision risks of the investment management sector.

ESMA particularly refers to "white-label" business and states that national competent authorities ("**NCAs**") should give special consideration to entities engaged in this business. These types of entities may gain additional business as a result of the UK withdrawing from the EU. A significant rise in business activities within a relatively short period of time may create additional operational risks. ESMA states that NCAs should assess whether the structures put in place by such entities and the resources they employ are appropriate.

The opinion has given rise to some debate especially concerning the provisions on delegation. ESMA particularly highlights the risk of circumvention of delegation rules relating to investment management activities when authorised entities appoint investment advisers. Where the authorised entity follows their advice without carrying out their own additional qualified analysis, such arrangement should be considered as a delegation of investment management activities. NCAs should be satisfied that the policies and procedures of authorised entities provide for clear documentation and recordkeeping of their own qualified analysis carried out after the receipt of the investment advice.

Regarding the area of investment firms, ESMA sets out principles based on the objectives and provisions of the MiFID framework with emphasis on authorisation, substance requirements and effective supervision aspects.

The ESMA opinion relating to secondary markets mainly addresses regulatory and supervisory arbitrage risks stemming from third country trading sites relocating in the EU 27 seeking to outsource activities to their jurisdiction of origin.

The *Commission de Surveillance du Secteur Financier* ("**CSSF**") has already confirmed in a press release dated July 14th 2017 that the three opinions were in line with the CSSF's practice.

AIFMD | CSSF UPDATED FAQ

The CSSF's updated AIFMD FAQ dated July 6th 2017 relates to the impact on Luxembourg alternative investment funds (**AIFs**) of Regulation (EU) No. 1286/2014 of 26 November 2014 on key information documents (**KIDs**) for packaged retail and insurance-based investment products ("**PRIIPs Regulation**"). As per the PRIIPs Regulation, all PRIIPs manufacturers must issue a PRIIPs KID before retail investors may invest in the relevant PRIIP (including investment funds).

The CSSF confirmed that Luxembourg AIFs that are offered or sold to retail investors must issue a PRIIPs KID as of January 1st 2018 unless they publish a UCITS KIID (Key Investor Information Document) like document. Such an exemption would apply to undertakings for collective investment subject to Part II of the Luxembourg Law of 17 December 2010 on undertakings for collective investment, as amended (Part II Funds), specialized investment funds (SIFs), investment

funds in risk capital (SICARs) and reserved alternative investment funds (RAIFs). Per the updated AIFMD FAQ, additional sub-funds and classes launched after January 1st 2018 may also benefit from the exemption if the Luxembourg AIF in question has issued a UCITS KIID-like document prior to that date.

The CSSF also confirmed that Luxembourg AIFs that are offered or sold only to professional investors need not issue a PRIIPs KID. In that respect, the CSSF strongly recommends that Luxembourg AIFs that fall into this category amend their offering documents to note expressly that they are offered or sold only to professional investors and that they will not issue a PRIIPs KID. As an alternative to such an amendment to the offering document, the Luxembourg AIF may complete, sign and send to the CSSF the self-assessment form which is available on the CSSF's website. This form serves as an assessment of the status of the AIF on whether it is only offered or sold to professional investors.

The CSSF also confirmed that the PRIIPs KID does not need to be provided to investors outside the European Economic Area (EEA), unless the non-EEA country requires it.

Furthermore, a PRIIPs KID must be provided each time an investor makes a subscription in the same class, except in the case of an investment through a savings plan with a regular subscription.

The CSSF also advised that it does not require receipt of drafts of the PRIIPs KID but only the final version thereof (or, if applicable, of the UCITS KIID-like document), as well as any updates. The CSSF took the same approach that it took for the UCITS KIID and confirmed that the PRIIPs KID will not be visa-stamped by the CSSF.

UCITS | CSSF UPDATED Q&A

The CSSF's updated UCITS Q&A dated July 6th 2017 includes the following new topics:

- Independence requirements set forth in Chapter 4 of the Commission Delegated Regulation (EU) 2016/438 of 17 December 2015 ("**UCITS V Regulation**").
- Impact of Regulation (EU) 1286/2014 of 26 November 2014 on key information documents (KIDs) for packaged retail and insurance-based investment products ("**PRIIPs Regulation**").
- ESMA Opinion on UCITS share classes.

INDEPENDENCE REQUIREMENTS

As per the UCITS Q&A the independence requirements set out in the UCITS V Regulation are applicable between the UCITS management company (or the self-managed SICAV) and the depositary. In the case of a depositary or UCITS management company having its registered office in another EU Member State and having only a branch in Luxembourg, one would need to look at the level of the head office and of the Luxembourg branch to assess the independence requirements vis-à-vis the other party.

With respect to these requirements, the Regulation refers to "management body" and "body in charge of the supervisory functions". The CSSF clarifies what bodies these terms refer to for a monistic or dualistic *société anonyme* (SA), for a *société à responsabilité limitée* (S.à r.l.) and for a *société en commandite par actions* (SCA).

For ease of reference, the CSSF has included summary tables which elucidate the implications for the composition of the various bodies of the UCITS Management Company (or the self-managed SICAV) and of the depositary.

The CSSF has also clarified what the minimum number of independent board members should be, depending on the total number of board members of each entity.

Finally, the CSSF advises that a cooling-off period of 12 months should be respected for a person to be considered as an independent member who was previously involved with, or linked to, either the UCITS Management Company (or the self-managed SICAV) or the depositary (or any other entity within the group to which they belong).

IMPACT OF THE PRIIPS REGULATION

The CSSF reminds that UCITS are exempt from the obligations of the PRIIPs Regulation until December 31st 2019.

The CSSF confirms that a UCITS will have to issue a PRIIPs KID as of January 1st 2020, unless such deadline is extended by the European Commission on the basis of the review of the transitional arrangements of the PRIIPs Regulation.

ESMA OPINION ON UCITS SHARE CLASSES

On February 13th 2017, the CSSF published press release 17/06 adhering to the ESMA share classes opinion that lays down common principles for setting up classes of shares in UCITS fund ("**Share Classes Opinion**").

The ESMA opinion sets out high level principles which UCITS with different share classes must follow and the CSSF clarified the following points:

- **Impact on existing share classes**
  The CSSF advised that if the UCITS asks the investors of a non-eligible share class to convert into an eligible share class, the investors should be given a 30-day notice period during which they may redeem free of charge if this conversion into another share class constitutes a change which is material enough to potentially affect the investors' interests and impact the basis on which they made their investment. This position is consistent with CSSF Circular 14/591 on the protection of investors in case of a material change to an open-ended undertaking for collective investment.

- **Common investment objective**
  It is clarified that not all overlay share classes that are derivatives-based, with the exception of derivatives-based currency risk hedging, are still permissible. Currency risk hedging arrangements which systematically hedge out part or all of the foreign currency exposure in the common pool of assets into the share class currency are compatible with the principle of a common investment objective if they comply with all the requirements of the Share Classes Opinion.

- **Non-contagion**
  The CSSF confirmed that the Share Classes Opinion allows for a portion of the net asset value ("**NAV**") of the share class to be hedged against currency risk. In addition, the CSSF indicated that a breach of the hedge ratio would not trigger CSSF Circular 02/77 on the protection of investors in case of NAV calculation error and correction of the consequences resulting from non-compliance with the investment rules applicable to undertakings for collective investment. Indeed, the CSSF expects monitoring and control processes and procedures to be implemented to ensure compliance with the hedge ratios on an ongoing basis.

- **Pre-determination**
  The features of a share class should be pre-determined before the share class is

set up and in share classes with hedging arrangements, this pre-determination should also apply to the currency risk which is to be hedged out systematically. The CSSF clarifies that these requirements do not provide for any discretionary elements in the currency risk hedging strategy. However, discretion as to the type of derivative instrument used to hedge the currency risk and the operational implementation is not limited by the pre-determination requirement.

- **Transparency**
  The Share Classes Opinion provides that UCITS Management Companies and self-managed SICAVs should, with respect to the share classes with a contagion risk, provide a list of share classes which should be kept current. The CSSF confirmed that this requirement can be met by means of a website publication if the prospectus of the UCITS includes a link to the relevant website.
  If the prospectus of the UCITS is updated so as to comply with the Share Classes Opinion, the affected shareholders should be notified if the changes have an impact on their rights or interests.
  In addition, the relevant investors must also be informed if a share class in which they have invested is closed to investment by new investors by July 30th 2017 and should be closed to additional investment by existing investors by July 30th 2018.

AIFMD | ESMA UPDATED Q&A

Section III of the ESMA AIFMD Q&A, relating to reporting to national competent authorities, was updated on July 11th 2017 with three new questions.

- The first question relates to how AIFMs should convert the total value of assets under management into Euro.
  ESMA advises that AIFMs should use the rounded values of the AIFs in the base currency of the AIFs. Then, AIFMs should divide these rounded values by the corresponding rate of one unit of the base currency in Euros.

- The second question added to the ESMA AIFMD Q&A relates to a situation where an AIF purchases a loan in the secondary market and how the AIF should measure its exposure in relation to that loan.
  In this case the notional value of the loan may overestimate the risk exposure. Therefore, the AIF should report the valuation of the loan, as it is reported in the calculation of its Net Asset Value ("**NAV**"). For example, if an AIF purchases a distressed and unlevered loan for EUR 10 cash (without the use of leverage) and the notional amount of that loan (i.e. the outstanding principal) was EUR 100, the AIF should report the amount it actually spent to acquire the loan i.e. EUR 10, which corresponds to the maximum potential loss on the loan transaction, not the AIF's exposure with respect to that loan which would be EUR 100. During the life of the loan, the AIF should then measure the exposure in relation to that loan using the same valuation rules as the ones used for the calculation of its NAV.

- The last question added to the ESMA AIFMD Q&A relates to the currency in which the NAV of the AIF should be reported. It was confirmed that AIFMs should report NAV in the base currency of the AIF.

UCITS | ESMA UPDATED Q&A

The ESMA UCITS Q&A was updated on July 11th 2017 with two new questions.

The first question relates to issuer concentration and whether the limit set out in Article 52(2) of the UCITS Directive whereby the total value of the transferable securities and money market instruments held by the UCITS in issuers in each of which it invests more than 5% of its assets shall not exceed 40% of the value of its assets, applies to index-tracking UCITS that are subject to Article 53 of the UCITS Directive. The answer is no.

The second question relates to the independence of management boards and supervisory functions. Where a group link exists for the purpose of Article 24 of the Commission Delegated Regulation (EU) 2016/438 (“**UCITS V Level 2**”), does the person who served in the management body or supervisory body of an entity within the group or was otherwise employed by such an entity fulfil the independence requirement under Article 24(2) of the UCITS V Level 2 where the person has ceased any function within the entity. ESMA answered that a person who served in the management or supervisory body of an entity or was otherwise employed by such an entity should be deemed to fulfil the independence requirement only after an appropriate cooling-off period following the termination of his/her relationship with the relevant entity. That period should start from the final payment of any outstanding remuneration due to him/her which entails a margin of discretion from the entity (e.g. in case any portion of variable remuneration which is deferred and still subject to contraction, including through malus or clawback arrangements) and is linked to his/her previous employment or other relationship with that entity. Non-discretionary outstanding payments from the entity to the person should not be taken into account for this purpose.

The cooling-off period should be proportionate to the length of the employment or other relationship that the individual had with any of the companies within the group and to the type of functions performed within such company(ies). The CSSF has stated that there should be a cooling-off period of 12 months.

PRIIPS KID

Level 3 and 4 measures relating to the Commission Delegated Regulation on Key Information Documents (“**KIDs**”) for Packaged Retail and Insurance-based Investment Products (“**PRIIPs**”) were published at the beginning of July.

On July 4th 2017, the European Supervisory Authorities (ESAs) published a Q&A on the PRIIPS KID (“**ESA Q&A**”). The ESA Q&A aims at promoting common supervisory approaches and practice in the implementation of the KID. It deals with questions linked with the presentation, content and review of the KID including the methodologies underpinning the risk, reward and costs information.

In addition, the European Commission issued guidelines on the Level 1 PRIIPS Regulation (Regulation 1286/2014) (“**Guidelines**”). The objective of these Guidelines is to facilitate the implementation of the PRIIPs Regulation by clarifying the interpretation of the Level 1 requirements and mitigating as far as possible the difference of interpretation between the European Member States. This clarification touches different areas such as multi option PRIIPS, territorial application and running offers. The Guidelines make clear that where a PRIIP is no longer made available to retail investors as of January 1st 2018 and changes to the existing commitments are only subject to the contractual terms and conditions agreed before that date, a KID is not required. Neither is it required where those contractual

terms and conditions allow exiting the PRIIP but that PRIIP is no longer made available to other retail investors after January 1st 2018.

The CSSF published on July 6th 2017 the latest version of its Frequently Asked Questions relating to AIFMD with a new section specially dedicated to the impact of PRIIPs KID. The CSSF has clarified or has developed several points. For further information please see above AIFMD Updated CSSF FAQ.

The CSSF has, in addition, published an additional Q&A relating to SIFs and SICARs that do not qualify as alternative investment funds. They clarify that the PRIIPS Regulation does apply to such funds if their units are being advised on, offered or sold to retail investors.

VENTURE CAPITAL AND SOCIAL ENTREPRENEURSHIP FUNDS - UPDATE

On September 14th the European Parliament voted to adopt a regulation amending the European venture capital funds (“**EuVECA**”) and the European social entrepreneurship funds (“**EuSEF**”) Regulations (the “**New Regulation**”).

In September 2015 the European Commission launched a consultation on the review of the EuVECA and EuSEF regulations with a view to improving the take-up of these funds. In its review in 2016 the Commission identified a number of obstacles to further growth and suggested measures to increase investment in these types of funds.

The adoption by the European Parliament of the New Regulation in September followed extensive discussions between the Commission, Parliament and Council. The revised rules will enter into force on the twentieth day following that of their publication in the Official Journal of the European Union.

The amendments to the EuVECA and EuSEF regime include:

- Extending the scope of the regime to above threshold alternative investment fund managers under the alternative investment fund directive (“**AIFMD**”). Previously it was reserved to below threshold managers.
- Clarifying the capital and own fund requirements.
- Simplifying the registration process under AIFMD and these regimes.
- Clarifying that fees and other charges may not be imposed by competent authorities of host Member States in relation to cross border marketing of such funds.

In addition, for the EuVECA regime, the New Regulation amends the definition of qualifying portfolio undertaking to allow EuVECAs to invest in undertakings employing up to 499 employees, as opposed to 250 employees, and in undertakings that are already listed on an SME growth market. The changes also allow for follow on investments in undertakings that do not meet the definition criteria at the time of such follow on investments but met them at the time of the first investment by the fund.

IP/IT

IT OUTSOURCING RELYING ON CLOUD COMPUTING - CSSF CIRCULAR 17/654

On May 17th 2017, the *Commission de Surveillance du Secteur Financier* ("**CSSF**") published four new circulars including Circular 17/654 ("**Cloud Circular**") concerning IT outsourcing, which modify the existing regulatory framework, and relate to cloud computing infrastructure. The purpose of the Cloud Circular is to clarify the regulatory framework governing IT outsourcing relying on a cloud computing infrastructure provided by an external provider.

The Cloud Circular applies to all credit institutions and professionals of the Financial Sector ("**PFS**") within the meaning of the Law of 5 April 1993 on the financial sector as well as to all payment institutions and electronic money institutions within the meaning of the Law of 10 November 2009 on payment services, and contributes to the sound and prudent management and the proper organisation of such entities.

Before the publication of the Cloud Circular, no dedicated regulatory requirements for IT outsourcing were applicable for cloud technology. It was established that cloud solutions were generally not allowed, due to potential risks regarding data protection, in particular clients' data protection and internal controls' transparency.

The Cloud Circular introduces a specific definition of "cloud computing" by establishing the following seven criteria:

- on-demand self-service;
- broad network access;
- resources pooling;
- rapid elasticity;
- measured service;
- apart from exceptional situations, the provider does not access the data and systems of the consumer ("**ISCR**") without its prior consent and without monitoring mechanism available to the ISCR;
- no manual interaction of the provider as regards the day-to-day management of resources.

Previously, two circulars were coexisting for IT outsourcing: (i) CSSF Circular 12/552 (sub-chap. 7.4), applicable for credit institutions and investment firms ("**IF**") and (ii) CSSF Circular 05/178 applicable for payment institutions, e-money institutions and PFS other than IF, now abolished and replaced by Circular 17/654.

Since the publication of the Cloud Circular, if an IT outsourcing meets the seven criteria of the Cloud Circular, the Cloud Circular applies directly. If not, the CSSF Circulars 12/552 and 17/656 (ex 05/178) remain applicable respectively to the types of entities concerned.

The Cloud Circular also classifies four groups of cloud (private, community, public and hybrid cloud) and describes the different players' roles in a cloud computing infrastructure based outsourcing model.

The Cloud Circular foresees governance requirements (no discharge of liability at the level of the ISCR), reaffirms existing requirements on outsourcing in the context of cloud computing (i.e., compliance with the ISCR's formal outsourcing policy, clear documentation on respective roles and responsibilities, etc.), notification to or authorisation by the CSSF, risk management, continuity measures and the contractual clauses to be found in the contractual

relationship with the Cloud computing service provider.

Finally, the Cloud Circular allows direct and indirect outsourcing by a provider (in Luxembourg or abroad):

- **direct outsourcing**: the ISCR needs to appoint a cloud officer who will be responsible for the cloud computing services' use and guarantees the competences of employees involved;
- **indirect outsourcing**: the ISCR may use a support PFS or a non-regulated entity that may be located abroad (group or not) or in Luxembourg (group or not). In such a case, the support PFS or non-regulated entity appoint the cloud officer.

As a conclusion, the Cloud Circular today allows outsourcing abroad and outside a group, taking into account the Cloud Circular requirements.

TAX

LUXEMBOURG RELEASED ITS POSITION ON MLI

On June 7th 2017, Luxembourg took part in the first signing session of the Multilateral Convention developed by the Organisation for Economic Co-operation and Development ("**OECD**") to implement tax treaty related measures to prevent base erosion and profit shifting ("**MLI**") in accordance with BEPS action 15 (please refer to January 2017 Newsletter).

On the same day, Luxembourg released the list of the reserves and options that may apply to its Covered Tax Treaties (i.e. tax treaties signed with jurisdictions that have also signed the MLI). The position of Luxembourg is still subject to change.

The MLI imposes on the signing jurisdictions a duty to implement certain minimum standards in their Covered Tax Treaties such as (i) the preamble that states that the purpose of a double Tax Treaty is to be interpreted as to eliminate double taxation without creating opportunities for non-taxation, (ii) measures to improve dispute resolution and (iii) the principal purpose test ("**PPT**"), which aims at denying the benefit of a Covered Tax Treaty if the principal purpose of a transaction or an arrangement is to obtain that benefit.

For those jurisdictions that want to go beyond the minimum standards, options are available. Luxembourg has taken the following positions:

- On transparent entities (Article 3): Luxembourg decided to apply this option to its Covered Tax Treaties. This article provides that income derived by or through an entity or arrangement that is treated as wholly or partially fiscally transparent under the tax law of either Contracting Jurisdiction shall be considered to be income of a resident of a Contracting Jurisdiction but only to the extent that the income is treated, for the purpose of taxation by that Contracting Jurisdiction, as the income of a resident of that Contracting Jurisdiction.
- On the elimination of double taxation (Article 5): various options were available. The option selected by Luxembourg consists in not applying provisions of a Covered Tax Treaty that would otherwise exempt income derived by a resident of a Contracting Jurisdiction from tax in that Contracting Jurisdiction for the purpose of eliminating double taxation if the other Contracting Jurisdiction applies the provision of the Covered Tax Treaty to exempt such income or capital from tax or to limit the rate at which such income or capital may be taxed.
- On artificial Permanent Establishment ("**PE**") (Article 13): Option B has been selected by Luxembourg. Under this option, the exemptions of PE status for storage, display or delivery of goods and for purchasing of goods or merchandise in existing treaties are preserved whether or not these activities are of preparatory or auxiliary character. Any other activities or a combination thereof carried out through a fixed place of business will not be deemed to constitute a PE if they are of a preparatory or auxiliary character.
- On the arbitration mechanism (Part VI): Luxembourg has chosen to apply the arbitration mechanism available where the competent authorities were not able to solve double tax issues under the mutual agreement procedure.

THE MUTUAL AGREEMENT PROCEDURE - TAX CIRCULAR

The new Circular released by the Luxembourg tax administration on August 28th 2017 clarifies the modalities of the «Mutual Agreement Procedure» foreseen by double tax treaties entered into by Luxembourg and which are based on Article 25 of the OECD Model Tax Convention.

SCOPE OF APPLICATION

The Mutual Agreement Procedure ("**MAP**") applies in three cases:

- a disagreement between the tax administration and a taxpayer, who considers that the action of one or both of the contracting States results, or will result, in taxation for such taxpayer which is not in accordance with the provisions of the relevant double tax treaty;
- difficulties or doubts arising as to the interpretation or application of a double tax treaty requiring a common action of the contracting States;
- the contracting States want to consult with each other for the elimination of double taxation in cases not provided for in the double tax treaty.

The MAP is also available when anti-abuse provisions deriving from a double tax treaty or national legislation are applied by a contracting State and it shall apply for transfer pricing issues (adjustment of intra-group transactions or income allocation to a permanent establishment).

REQUIREMENTS

The MAP is subject to two conditions: the request must be submitted within the time-limit (i.e. three years as from the first notification of a tax assessment, a tax base or a tax audit) and the applicant must be tax resident in Luxembourg.

COMPETENT AUTHORITIES

In practice, the application for a MAP must be addressed to one of the three subdivisions of the «*Direction of Luxembourg Inland Revenue*»: the «*Executive Committee*» for all the mutual agreement procedures, the «*Economic Division*» for matters related to transfer pricing and the «*Division for International Relations*» for all other matters. The competent authority for procedures related to discrimination will depend on the nationality of the taxpayer.

IMPACTS

The request for a MAP does not entitle the tax payer to submit a demand for deferral of tax payment. Such a request is only possible if a tax claim is introduced. The MAP gives, however, a chance to taxpayers to avoid the statute of limitation for some tax claims. Further, it provides additional remedies for taxpayers during a tax audit.

In practice, the mutual agreement procedure is mostly relevant for taxpayers involved in transfer pricing issues or taxation of permanent establishments. Indeed, it enables taxpayers to obtain a tax adjustment in two jurisdictions simultaneously. In the future, the recourse to the mutual agreement procedure may be more frequent, especially with the introduction of the «principle purpose test» in the double tax treaties by mean of the Multilateral Instrument ("**MLI**") which covers the treaty related issues of the base erosion and profit shifting reports.

EXCHANGE OF INFORMATION - NEW DEVELOPMENT FOR EFFECTIVE JUDICIAL REMEDY

On May 16th 2017 the European Court of Justice ("**ECJ**") ruled in the Berlioz case that where a pecuniary penalty has been imposed on a person due to a failure to comply with an information order (*injonction)*, which itself derived from an information request made by foreign tax authorities, such order shall be open to judicial review. Pursuant to Luxembourg law, only an indirect judicial remedy was available to recipients of an information order in the context of exchange of information between tax authorities, who were penalised by the director of the Luxembourg direct taxation administration for not having provided the requested information. This indirect remedy did not facilitate the recipient disputing the relevance of the information request. Moreover, interested third parties had no recourse to challenge the validity of the information request. We refer you to our previously published legal alert on the Berlioz case.

On July 21st 2017 the President of the Administrative Court ("*Tribunal administratif*") issued orders (*ordonnances*) in response to a request to put on hold the effects of information orders (*injonctions)* issued by the Luxembourg tax authorities, to three Luxembourg companies, regarding a structure whose beneficial owner is an internationally recognised Spanish-resident singer.

The information orders (*injonctions)* resulted from an exchange of information request made by the Spanish tax authorities to the Luxembourg tax authorities.

In line with the outcome of the aforementioned Berlioz case, the *ordonnances* of the President of the Administrative Court suggested that the validity of the information request shall be open to a direct judicial remedy by the Administrative Courts so as to ensure that the request is not devoid of any foreseeable relevance.

The President noted "the national court has an obligation to apply Community law in its entirety and to protect the rights conferred by Community law on individuals, setting aside any conflicting national law provision, whether dating from before or after the coming into force of the relevant Community law and, since infringements of Community law are in effect contrary to public policy, it seems clear that the courts on the merits will, when the time comes, be inclined to grant interested third parties a direct right of appeal against an information order (*injonction)"*.

Although the President of the Administrative Court ultimately decided that it was not appropriate to put on hold the effects of these particular information orders (*injonctions)*, it is reasonable to expect that the Administrative Court will, going forward, follow the reasoning of its President and deem itself competent to review a claim against an information order (*injonction)*, brought by the recipients of such order as well as interested third parties. Moreover, the President has highlighted that it is the responsibility of the Luxembourg tax administration to thoroughly consider and analyse a request and determine the relevance of the information request; a brief and formalistic check will not be sufficient.

NEW IP REGIME | DRAFT LAW

On August 4th 2017, the Minister of Finance submitted a draft law to the Luxembourg Parliament, which intends to introduce a new intellectual property regime. The draft law introduces a new Article 50ter in the Luxembourg income tax law in order to fill the void caused by the staggered withdrawal of the former Article 50bis. If enacted as such, the new Article 50ter would be applicable as of the tax year 2018.

The new Article 50ter, akin to the previous regime, would provide for a 80% exemption on the adjusted and compensated net eligible income (including royalty income, capital gains, income embedded in the sale price of products and services as well as indemnities) derived from certain intellectual property rights and a full net wealth tax exemption of the qualifying intellectual property rights. Additionally, an uplift of up to 30% of the eligible expenses is foreseen.

The scope of the Article 50ter is, however, more restrictive than the one of the previously existing regime, in order to ensure its compliance with the Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting Action 5. The restrictions are two-fold, a narrower scope of qualifying assets and the introduction of a nexus ratio.

Under Article 50ter, solely

- software protected by copyright, or
- patents and functionally equivalent intellectual property rights protected in conformity with national or international norms (i.e. marketing related intellectual property assets such as trademarks and domain names are excluded);

can benefit from the regime, provided that they are developed or improved (a) after December 31st 2007, (b) by the taxpayer directly or by a foreign permanent establishment located within the European Economic Area of a taxpayer, if such permanent establishment remains in place and does not benefit from a similar tax regime in its country of location; and (c) they result from effective research & development activities ("**R&D**").

The nexus ratio, in its turn, is introduced in order to limit the partial exemption to the value creation effectively undertaken by the taxpayer. The adjusted and compensated net eligible income (as further detailed below) which may benefit from the 80% exemption is, therefore, determined on the basis of the ratio between the eligible expenses (with up to 30% uplift) and the total costs of the intellectual property right. The eligible expenses include all expenditures incurred by the taxpayer for the creation, development or improvement (R&D) of the qualifying intellectual property as well as the fees paid to unrelated parties to which the R&D is outsourced.

The adjusted and compensated net eligible income is, akin to the previous regime, computed by taking into account the gross income from which the directly related expenses are deducted. As a novelty however, the eligible income has to be adjusted for previous year expenses related to the intellectual property rights (the draft law provides for different options depending on whether the costs were deducted or capitalized from an accounting perspective), in order to ensure that losses incurred by intellectual property rights benefiting from the partial exemption regime cannot be used to offset other types of income that would have been taxable. Lastly, the eligible income from all qualifying intellectual property rights has to be aggregated, in order to ensure that solely the "global net income" is effectively partially exempted.

The draft law introduces stringent documentation obligations, which require the taxpayers to track and provide sufficient evidence with regard to all (qualifying and total) expenses incurred and income earned on a per asset basis or a per product family basis in case of complex businesses, thus effectively reversing the burden of proof. Of course, all intra-group related transactions will continue to be covered by the existing transfer pricing documentation requirements.

VAT | THE IGP EXEMPTION DOES NOT APPLY TO THE FINANCIAL AND INSURANCE SECTOR

On September 21st 2017, the European Court of Justice (the "**ECJ**") rendered its judgements in three different cases regarding the interpretation of the VAT exemption of services supplied by independent groups of persons ("**IGP**") to their members.

In the case Commission vs. Germany (C-616/15), the ECJ had to rule on the compliance with Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the "**VAT Directive**") of a national legislation restricting the availability of the exemption to IGPs, whose members are doctors, exercise paramedical professions or carry out activities in the health care sector.

The European Commission argued that, by introducing such a limitation to the scope of the IGP exemption, Germany failed to fulfil its obligations under Article 132 (1) (f) of the VAT Directive. In the Commission's view, the exemption provided for by the aforementioned provision should cover all IGPs whose members carry on VAT exempt activities, including economic activities in the banking and insurance sector. Advocate General Melchior Wathelet supported this position (please refer to our May 2017 Newsletter) in his opinion. The Commission maintained that, even if the ECJ considered that the exemption only covers IGPs whose members carry out activities in the public interest, its scope should not be limited to the health care sector.

The ECJ dismissed the Commission's main complaint and went against Advocate General Wathelet's opinion. Noting that Article 132 (1) (f) appears in Chapter 2, entitled "Exemptions for certain activities in the public interest" of Title IX of the VAT Directive, the ECJ concluded that this particular heading indicates that the exemption only covers IGPs whose members carry on activities in the public interest. The structure of Title IX of the VAT Directive, which deals with "Exemptions" in general, furthermore supports the ECJ's conclusion, as it is divided into different chapters, containing, besides the provisions on certain activities in the public interest laid down in Chapter 2, also "general provisions" (Chapter 1) and "exemptions for other activities" (Chapter 3). According to the ECJ, it has to be for a reason that Article 132 (1) (f) had been included in Chapter 2, as opposed to Chapters 1 and 3.

The ECJ however accepted the Commission's alternative complaint and held that, in addition to the transactions carried out in the health sector, the VAT Directive envisages other exempt transactions in the public interest (such as for instance welfare and social security, education, sport and culture), which should thus also fall within the scope of the IGP exemption.

The two remaining decisions rendered by the ECJ on September 21st 2017 respectively confirmed that the VAT exemption does not apply to services supplied by IGPs whose members carry on activities in the area of financial services (C-326/15, *DNB Banka AS*) or insurance (C-605/15, *Aviva*).

Luxembourg will have to take into account the above mentioned decisions when adapting its legislation pursuant to the ruling dated May 4th 2017 (C-274/15), in which the ECJ considered the domestic implementation of the IGP exemption as too broad (please refer to our May 2017 Newsletter).

VAT | DRAFT LAW ON VAT TREATMENT OF VOUCHERS

With a view to adopting the EU Directive 2016/1065 (the "**Directive**") amending Directive 2006/112/EC as regards the treatment of vouchers, the Luxembourg Government issued on August 9th 2017 a draft law No. 7166 (the "**Draft Law**").

The main objective of the Draft Law is to regulate the VAT treatment of vouchers, issued after December 31st 2018, by introducing specific rules and definitions, in order to avoid inconsistencies in Member States legislations which may result in a distortion of competition or double non-taxation. Telecommunications and broadcasting services are not within the scope of the Directive since these are governed by Regulation 1042/2013/EU of 7 October 2013 which entered into force on January 1st 2015.

In order to achieve this objective, and to distinguish vouchers from payment instruments, the Draft Law defines the notion of "Voucher", which can have a physical or electronic form, and introduces the distinction between "single-purpose voucher" (the "**SPV**") and "multi-purpose voucher" (the "**MPV**").

A "Voucher" is defined as "*an instrument where there is an obligation to accept it as consideration or part consideration for a supply of goods or services and where the goods or services to be supplied or the identities of their potential suppliers are either indicated on the instrument itself or in related documentation, including the terms and conditions of use of such instrument*". Therefore, only vouchers which can be used for redemption against goods or services should be targeted by these rules. Instruments entitling their holder to a discount upon purchase of goods or services but carrying no right to receive such goods or services are not considered as Vouchers.

The Draft Law provides that, for a SPV, which is defined as a voucher where the goods or services supply as well as the VAT due are already known upon issuance of the Voucher, a supply of goods or services occurs upon each transfer of the SPV. A voucher that entitles its holder to a meal in a specific restaurant is a SPV.

For a MPV, the supply is only deemed to take place upon the actual handing over of the goods or the actual provision of the services upon voucher redemption. A voucher that entitles its owner to a hotel stay in a selected list of countries is a MPV.

In the case of a MVP, to ensure that the amount of VAT paid in respect of the MPV where VAT on the underlying supply of goods or services is charged only upon redemption is accurate, the supplier of the goods or services should account for the VAT based on the consideration paid for the MPV. In the absence of such information the taxable amount should be equal to the monetary value indicated on the MPV itself or in the related documentation, less the amount of VAT relating to the goods or services supplied.

Finally, the Directive provides that, by the end of 2022 at the latest, the Commission shall, on the basis of the information obtained by the Member States, issue an assessment report on the application of the Directive and, where necessary, a proposal of amendment of the rules.

TAX TREATMENT OF THE REVERSAL OF AN IMPAIRMENT

In a decision handed down on August 9th 2017 (docket No. 38981C), the Higher Administrative Court (*Tribunal administratif*) ruled on the tax treatment of the reversal of an impairment provision on financial assets.

In the case at hand, the taxpayer chose to write down long term loans granted to related parties.

The book entry was done in a way that did not imply any movements on the profit and loss accounts (the "**P&L**"). As a consequence, the impairment provision did not decrease the company's taxable result.

In a subsequent tax year, the value of the company's financial assets was reassessed and the previously booked provisions were reversed by debiting the balance sheet account "Financial provisions" and by crediting the profits account "Exchange gains". The reversal of the value adjustment increased the profit of the company whereas no loss was booked when the impairment was recorded.

The Luxembourg tax authorities considered the P&L impact of the reversal as a taxable profit, which was not off-set by carried forward losses (as the initial impairment had no P&L impact).

The Higher Administrative Court reversed this decision and held that, from a Luxembourg tax point of view, a reversal of value adjustments increasing the taxable profit was conceivable only if value adjustments reducing the company's taxable profits had been accounted for in respect of a previous financial year.

As, in the present case, the impairment initially booked by the taxpayer had not reduced its taxable profits, the judges held that the subsequent reversal should not be included in the company's taxable profit either.

Besides this substantive point, the Higher Administrative Court also dealt with an interesting procedural question. The government representative argued that a provisional tax assessment issued on the basis of §100a of the General Tax Law, i.e. in accordance with the taxpayer's tax return, could only be disputed to the extent it did not effectively follow the filed tax return. The judges rejected this argumentation and ruled that the taxpayer is entitled to reconsider the position expressed in its tax returns in the context of an appeal against a provisional tax assessment.

BONN STEICHEN & PARTNERS THANKS ALL THE CONTRIBUTORS

Christine Beernaerts, Marc-Alexandre Bieber, Marie Casanova, Pierre-Alexandre Degehet, Nuala Doyle, Jean Gaspard, Aleksandra Gucwa, Marie Jacquot, Isabel Høg-Jensen, Emmanuel Lebek, Evelyn Maher, Pol Mellina, Anne Morel, Marylou Poncin, Daniel Riedel, Christophe-Nicolas Sicard, Melvin Tjon Akon, Valerio Vitelli.

Newsletter – 10.2017

www.bsp.lu

2, rue Peternelchen | Immeuble C2
L-2370 Howald | Luxembourg

T. +352 26025 – 1
mail@bsp.lu

© 2017 Bonn Steichen & Partners., *société en commandite simple inscrite au barreau de Luxembourg* - All rights reserved