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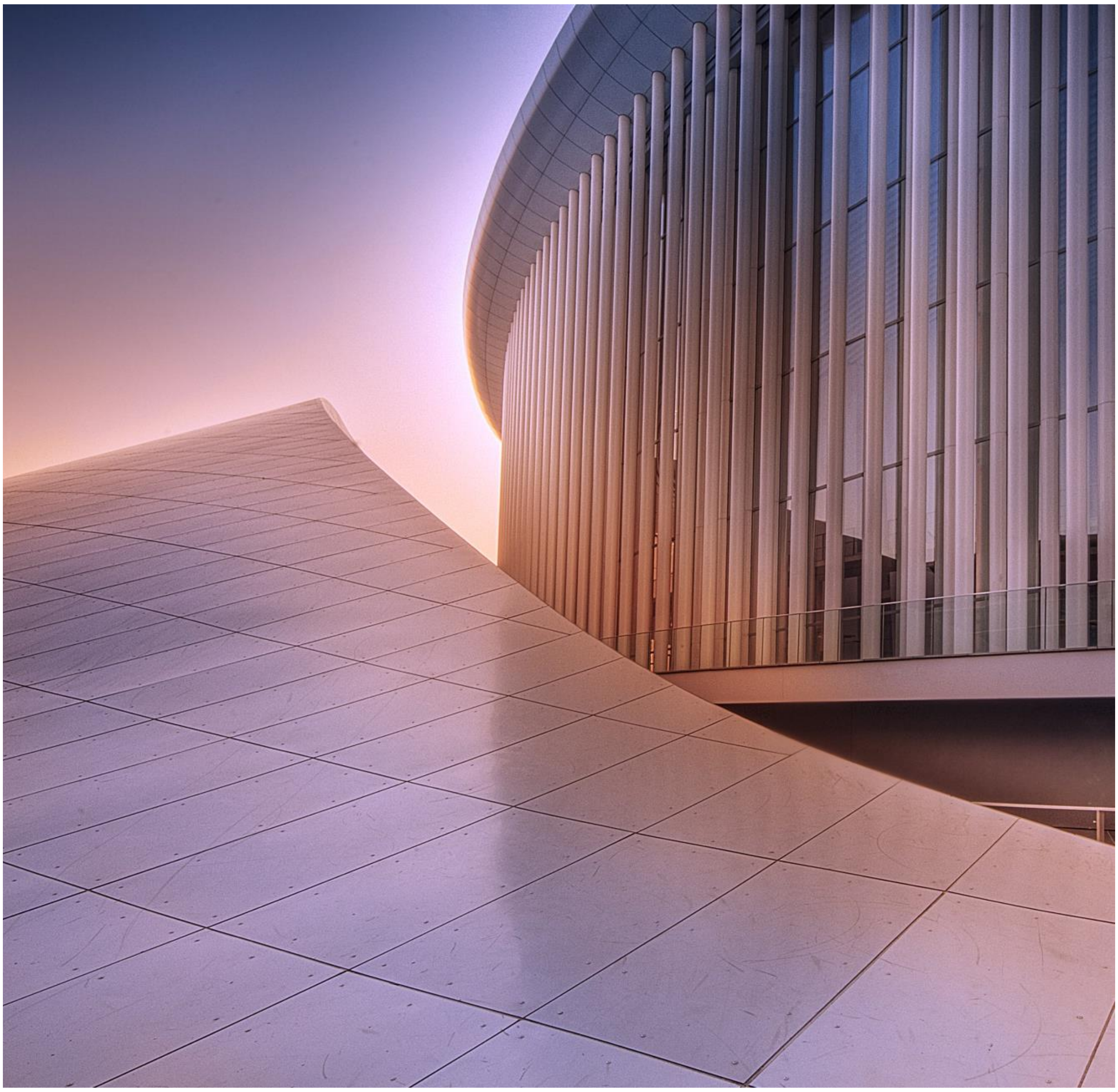

BONN STEICHEN & PARTNERS

NEWSLETTER

DATED

JULY 2018

BONN STEICHEN & PARTNERS
LUXEMBOURG LAW FIRM

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AML

EUROPEAN PARLIAMENT ADOPTS 5TH AML DIRECTIVE

On April 19th 2018, the European Parliament announced it had adopted the new directive which will amend the 4th AML Directive on the prevention of the use of the financial system for the purposes of money laundering or terrorism financing. This new directive (the 5th AML Directive) is part of the European Commission's Action Plan of February 2nd 2016 in response to the recent terror attacks in Europe and the Panama papers revelations. The 5th AML Directive was published in the Official Journal of the European Union on June 19th 2018 and entered into force on July 10th 2018. Member States must comply with this directive by January 10th 2020.

The new directive is not a replacement of the existing framework but rather amends the 4th AML Directive in order to better counter terrorism financing and increase transparency.

There will now be a "clear rule of public access" to beneficial ownership with registers becoming publicly available. Those who can demonstrate a legitimate interest will have access to registers of beneficial ownerships of trusts. These registers will be interconnected to ensure cooperation between Member States to facilitate the fight against anti-money laundering.

The European Commission had initially proposed to lower the threshold above which it is necessary to identify beneficial owners of certain corporate entities from 25% plus one share to 10% but this amendment was finally not adopted in the 5th AML Directive.

Member States will have to set up a national register of bank and payment accounts or data retrieval system which will require the name of the account holder. Access to such information will be limited to Financial Intelligence Units ("**FIUs**") and national competent authorities.

The powers of the EU Financial Intelligence Units have been extended in order to ensure their access to information in a timely and efficient manner. The cooperation between FIUs and Member States' financial supervisory authorities will also be enhanced.

The 5th AML Directive has extended the scope of AML rules to include anonymous prepaid cards, providers engaged in exchange services between virtual currencies and fiat currencies and custodian wallet providers. As a result, entities providing these services will be required to apply customer due diligence controls. It has been extended further to include estate agents (but only in relation to transactions where monthly rent amounts to EUR 10,000 or more), traders of art or intermediaries in trade of works of art and also persons who give advice on tax matters.

The threshold with respect to electronic money and prepaid instruments in which Member States may exempt obliged entities from due diligence measures has been lowered from a monthly transaction limit of EUR 250 to EUR 150. Furthermore, a new derogation to the exemption has been introduced for remote payment transactions where the amount exceeds EUR 50.

Article 13(1) of the Directive now permits identification of beneficial owners or customers via electronic identification enabling verification remotely. This process must be approved and regulated by the relevant national authorities.

Enhanced customer due diligence measures will also apply in the context of transactions involving high-risk third countries. There will now be a minimum set of enhanced customer due diligence measures to be applied in these circumstances. This will strengthen the monitoring of these transactions and improve safeguards in order to combat terrorist financing.

CSSF ANNOUNCES AML/CTF SURVEYS

On April 20th 2018, the CSSF published a press release stating that they will be conducting an annual online survey of entities subject to its supervision and subject to the law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended.

This survey, which will comprise sector specific questionnaires, will compile key information in relation to risks associated with money laundering and terrorist financing and the measures put in place to mitigate those risks.

The CSSF has announced that they will be using these surveys after recommendations from the Financial Action Task Force ("**FATF**") which proposed that Member States should "apply a risk-based approach ("**RBA**") to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified".

In addition to allowing the CSSF to assess whether the preventative and mitigation measures put in place by supervised entities are commensurate with the related money laundering or terrorist financing risks, the surveys should allow the CSSF to draw conclusions on the national money laundering/terrorist financing risk assessment.

BANKING & FINANCE

MIFID II & MIFIR | APPLICATION IN LUXEMBOURG

On May 15th 2018 the Luxembourg law transposing Directive 2014/65/EU on markets in financial instruments ("**MiFID II**") and Article 6 of the related Delegated Directive EU 2017/593 and implementing Regulation 600/2014 ("**MiFIR**"), was adopted by the Luxembourg Parliament (the "**New Law**"). The New Law dated May 30th 2018 was published in the Luxembourg *Mémorial A* under number 446 on May 31st 2018.

Part I of the New Law relates to markets in financial instruments and repeals and replaces the law of 13 July 2007 on markets in financial instruments (with the exception of Article 37 thereof relating to an official listing). Part II of the New Law significantly modifies the law of 5 April 1993 on the financial sector and also makes some small modifications to other financial laws including the law of 5 August 2005 on financial collateral arrangements.

We refer you to our previous articles on the New Law while it was still in draft form, in our October 2017 Newsletter and our February 2018 Newsletter.

MIFID II & MIFIR | UPDATE OF ESMA AND CSSF Q&A

In May and June this year, the European Securities and Markets Authority ("**ESMA**") updated a number of its Q&A regarding the Markets in Financial Instruments Directive (recast) – Directive 2014/65/EU ("**MiFID II**") and Markets in Financial Instruments Regulation – Regulation 600/2014 ("**MiFIR**"), specifically:

- Q&A on investor protection and intermediaries topics;
- Q&A on transparency topics;
- Q&A on MiFIR data reporting, and
- Q&A on markets structures topics

On May 15th 2017, the CSSF also added a new question and answer regarding post-trade transparency under the CSSF Q&A on MiFID II and MiFIR.

We will focus here on just a few of the updates to the Q&A on investor protection and intermediaries topics.

ESMA has clarified a number of points on client categorisation. As to when an investment firm should assess whether a private individual investor may be treated as a professional client under Section II of Annex II of MiFID II, ESMA explains that the request must be made by the client in writing at its own initiative and that written statement must be separate from other agreements and terms of business. The client must specify whether it wishes to be treated as a professional client generally or just in respect of a specific transaction. ESMA stresses the importance of investment firms refraining from any form of practice that induces or incentivises clients to request to be treated as a professional client.

As to how an investment firm should assess whether a private individual investor may be treated as a professional client under Section II of Annex II of MiFID II, ESMA explains that firms must avoid relying solely on the self-certification by the client and should consider obtaining additional evidence to support the client's assertions. Investment firms should also maintain adequate reporting and retention requirements in order to demonstrate to their competent authorities, compliance with the procedure under Section II of Annex II of MiFID II.

To assess whether transactions are of a significant size in accordance with the first limb in the fifth paragraph of Section II.1 of Annex II of MiFID II, ESMA explains that firms must take into account the size of the transactions on the relevant market and should consider whether the transactions are individually large enough to enhance the client's knowledge and expertise to the extent required in view of the envisaged transaction or service.

ESMA confirms that a private individual client who has been trading on the relevant market for less than a year, cannot meet the conditions under the first limb in the fifth paragraph of Section II.1 of Annex II of MiFID II, because the investment firm cannot review the trading history for the past four quarters.

Finally, ESMA confirms that if an investment portfolio contains leveraged financial instruments, the net equity of the specific position or positions should be used to determine the size of a financial instrument when assessing the size of a client's financial instrument portfolio in accordance with the second limb in the fifth paragraph of Section II.1 of Annex II of MiFID II.

CAPITAL MARKETS

PROSPECTUSES | DRAFT LAW

On June 29th 2018, the Chamber of Deputies of the Grand-Duchy of Luxembourg issued a draft law 7328 on prospectuses (the "**Draft Law**") for the purposes of implementing Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market (the "**New Prospectus Regulation**").

The majority of the provisions of the New Prospectus Regulation must be transposed into the national law of Member States no later than July 21st 2019. The Draft Law, once implemented, will repeal the law of 10 July 2005 on prospectuses, as amended (the "**Existing Law**").

In a similar way to the Existing Law, the Draft Law is divided into five parts. Part I comprises the purpose of the law, definitions and a provision regarding the rules applicable to securities issued in a currency other than Euro. Part II implements certain provisions of the New Prospectus Regulation by, *inter alia*, setting out the obligations to publish a prospectus and designating the CSSF as the competent authority for enforcement of the New Prospectus Regulation and setting out its powers of supervision and investigation. Part III of the Draft Law sets out the rules regarding drawing up, approval and distribution of prospectuses for offers of securities to the public and admission of securities to trading on a regulated market of securities not covered by Part II and the New Prospectus Regulation. Part IV sets out the legal framework for admissions of securities to trading on a Luxembourg market other than a regulated market included in the list of regulated markets published by the European Securities and Markets Authority. Part V includes the transitional, repealing and final provisions.

We refer you to our previous article on the New Prospectus Regulation in our October 2017 Newsletter and our previously published Newsflash.

DISPUTE RESOLUTION

ENFORCEABILITY OF *A MANDAT DE PROTECTION FUTURE*

In a judgment dated June 6th 2018, the District Court of Luxembourg (*le Tribunal d'Arrondissement de et à Luxembourg*) made a *mandat de protection future*, under French law, enforceable, for the first time in the Grand Duchy of Luxembourg.

The *mandat de protection future* is a protective measure which consists of appointing in advance one or more persons ("**mandatary**") to represent any emancipated adult or minor ("**principal**") who is not the subject of a judicial guardianship or a family authorisation.

As this concept does not exist under Luxembourg law and the Grand Duchy of Luxembourg has not ratified the Hague Protection of Adults Convention of 13 January 2000, the plaintiff, as principal (*mandant*), had no choice but to bring the matter before the courts in order to have the mandate recognised and declared enforceable in Luxembourg.

The State Prosecutor, defendant in the proceedings, claimed that the plaintiff lacked an interest to act as, according to him, the mandate had not yet taken force in France. For the Public Prosecutor's Office "*the hypothetical and future need to have an exequatur judgment does not constitute an interest to act*".

The fact that the plaintiff is a party to the notarial deed where exequatur is requested; that the mission entrusted to the mandatary was to be exercised with respect to Luxembourg companies; and the main objective of the mandate, (i.e. the anticipated organisation of the protection of the principal's property interests), were raised by the plaintiff to contest this plea.

The District Court then ruled that "*the interest to act by the plaintiff or the defendant is not a particular condition of admissibility when the action is brought by the very person who claims to hold the right against the person he has summoned*".

The existence of the right is thus not a condition of admissibility but a condition to the merits of the claim.

Therefore, the District Court decided that the plaintiff had an interest to act.

As to the exequatur of the *mandat de protection future*, the District Court recalled that "*the judge hearing an application for exequatur does not consider the merits of the claim which was submitted to the foreign judge*".

Having recalled the conditions for the admissibility of exequatur, in particular the jurisdiction of the foreign court which rendered the decision, the compliance of the decision with international public policy and the enforceability of the foreign decision, the Court decided to apply these conditions by analogy to notarial deeds.

The Court recalled that an executory title was to be understood as any act, which is covered by the executory formula, including notarial deeds, and held that the notarial deed in question was in no way contrary to Luxembourg public policy.

The Court thus concluded that the *mandat de protection future* fulfilled all the conditions required to be declared enforceable in the Grand Duchy of Luxembourg.

This decision is still potentially subject to appeal by the Public Prosecutor.

EMPLOYMENT

AMENDMENTS TO LABOUR CODE | "OMNIBUS" LAW OF APRIL 8TH 2018

The "omnibus" law of April 8th 2018, effective since April 15th 2018 (hereinafter the "**Law**"), amends many provisions of the Labour Code in order to strengthen the protection of employees. The main changes are as follows:

FULL MAINTENANCE OF SALARY IN CASE OF INCAPACITY FOR WORK DUE TO ILLNESS

Article L. 121-6 of the Labour Code sets out the rules which are to apply when determining the salary to be paid during a period of incapacity.

A distinction is made between employees who had their work schedule at the time of the occurrence of the illness and those who did not. While the first category of employee is paid as if they had worked according to the predefined work schedule during sick days, the second category is paid a daily allowance corresponding to the average daily salary of the last 6 months. Employees paid by performance or by the task and those with less than 12 months' seniority are entitled to a daily allowance corresponding to the average daily salary calculated over the last 12 months or during the period of actual occupation. The Law also specifies that non-periodic benefits, including incidental work, overtime and bonuses are not taken into account.

INCREASE OF STUDENTS WORKING TIME

The weekly duration of a fixed-term contract entered into between an employer and a student is increased from 10 to 15 hours on average, over a period of 1 month or 4 weeks (article L. 122-1 (5) of the Labour Code). This maximum working time of 15 hours per week does not apply to salaried activities carried out during school holidays.

RIGHT TO COMPENSATION FOR AN EMPLOYEE RESIGNING DUE TO GROSS MISCONDUCT OF HIS EMPLOYER

Taking into account the case law of the Constitutional Court (Constitutional Court, July 8th 2016, No. 00124), Articles L. 124-6 and L. 124-7 of the Labour Code introduce the principle that an employee who has resigned with immediate effect for gross misconduct by the employer is entitled to the same compensation as an employee whose dismissal with immediate effect has been declared abusive by the Labour Court, namely compensation in lieu of notice and, where applicable, severance pay.

REIMBURSEMENT OF UNEMPLOYMENT BENEFITS

The Labour Code is amended in order to provide that if the resignation of the employee results from the employer's serious misconduct (such as non-payment of salaries), the employer must reimburse to the Employment Fund the unemployment benefits paid to the employee for the period covered by the salaries or allowances that the employer is required to pay pursuant to the judgment.

On the contrary, if the dismissal is justified or the resignation for fault of the employer is declared unjustified by the Labour Court, the employee must reimburse the unemployment benefits paid.

A new article L. 521-4 bis is inserted in the Labour Code providing that in cases where the action brought by the employee due to i) a dismissal for serious reasons, ii) a resignation motivated by an act of sexual harassment or iii) for serious reasons arising from the employer's act or fault, is not completed as a result of the employee's withdrawal, the employee is required to reimburse to the Employment Funds the unemployment benefits provisionally paid to him.

If this withdrawal results from a settlement agreement entered into between the employee and the employer, half of the unemployment benefits are to be reimbursed by the employee and the other half by the employer.

Improvement of the employee's situation in the event of bankruptcy or liquidation of his employer

The Law also amends the conditions for opening the indemnity in lieu of notice for an employee whose salary is guaranteed by the Employment Fund because of the bankruptcy or liquidation of his employer (Articles L.125-1§1, L.631-1 and L.631-3 of the Labour Code). From now on, the starting point of the notice period giving entitlement to compensation in lieu of notice depends on the day on which bankruptcy or liquidation is declared:

- Where bankruptcy or judicial liquidation has been declared before the 15th day of the month, the period of notice shall begin to run from the 15th day of the month in which the bankruptcy or liquidation was declared;
- Where bankruptcy or judicial liquidation has been declared after the 15th day of the month, the period of notice shall begin to run from the 1st day of the month following the pronouncement of bankruptcy or liquidation.

Temporary re-employment assistance

The Law introduces new articles L. 541-7 to L. 541-13 concerning temporary re-employment assistance (“*aide temporaire au réemploi*”). It is now provided that the temporary re-employment assistance guarantees the employee, taking into account the new salary received, an annual maximum salary equal to 90% of the previous salary for the first 48 months of the new hiring. For the calculation of temporary re-employment assistance, the previous remuneration is capped at 350% of the minimum social wage for an unqualified employee aged 18.

Changes in conditions for obtaining the tax credit in the event of hiring unemployed persons

The conditions for obtaining the income tax credit in case of hiring unemployed persons by an employer have been modified. Entitlement to the income tax credit is now subject to the condition that the hired individual has been registered with the ADEM for at least 6 months (instead of 3 months). In addition, the length of the income tax credit has been reduced from 36 months to 12 months. Finally, the monthly tax credit per unemployed person has been reduced from 15% to 10% of the gross monthly remuneration deductible as an operating expense.

INVESTMENT FUNDS

ELTIF LEVEL 2 COMES INTO FORCE

On March 23rd 2018, Delegated Regulation (EU) 2018/480 ("**Level 2 Regulation**") aimed at supplementing the European Long Term Investment Fund Regulation ("**ELTIF**") (Regulation (EU) 2015/760) (the "**ELTIF Regulation**") was published.

HEDGING DERIVATIVES

The Level 2 Regulation sets out the circumstances in which the use of financial derivative instruments ("**FDIs**") can be considered as solely serving the purpose of hedging the risks inherent in other investments of an ELTIF. Such FDIs must meet all of the following criteria:

I. FDIs shall only be used for hedging risks arising from exposures to assets referred to in the ELTIF Regulation; this purpose shall be considered fulfilled where the use of that FDI results in a verifiable and objectively measurable reduction of such risks at the ELTIF level. Where FDIs to hedge the risks arising from the exposure to the assets referred to above are not available, FDIs with an underlying of the same asset class may be used.

II. FDIs used to provide a return for the ELTIF shall not be deemed to serve the purpose of hedging the risks.

III. The manager of the ELTIF shall ensure that the FDIs used to hedge the risks inherent to other investments of the ELTIF reduce the risks at the ELTIF level, including in stressed market conditions.

SUFFICIENT LENGTH OF THE LIFE OF THE ELTIF

The Level 2 Regulation sets out the conditions pursuant to which the life of an ELTIF shall be considered sufficient in length to cover the life-cycle of each of the individual assets of the ELTIF.

DISPOSAL OF ELTIF ASSETS

Pursuant to the ELTIF Regulation, the ELTIF shall adopt a schedule for the orderly disposal of its assets. That schedule should include (a) an assessment for the market for potential buyers and (b) a valuation of the assets to be divested. The Level 2 Regulation sets out criteria to be used in assessment of these criteria, including consideration of legislative and political risks that could affect the market for potential buyers, and that the valuation of the assets to be divested should be concluded no more than 6 months before the deadline for disclosure of the schedule.

SPECIFICATIONS ON THE FACILITIES AVAILABLE TO RETAIL INVESTORS

For those ELTIFs marketing shares or units to retail investors there is a requirement to provide facilities for such retail investors.

The Level 2 Regulation provides that the manager of an ELTIF shall put in place facilities in order to perform an exhaustive list of tasks including processing subscription, payment, repurchase and redemption orders, providing information and facilitating the exercise of investors' rights.

Regarding the technical infrastructure of the facilities, the manager of the ELTIF shall ensure that the facilities perform their tasks in official languages of the Member States where the ELTIF is marketed; and perform their tasks in person, by telephone or electronically.

The manager of an ELTIF shall ensure that the facilities are performed by one or more entities which are either the manager of the ELTIF or a third entity subject to regulation governing the tasks to be performed.

The Delegated Regulation adopted on December 4th 2017 entered into effect on April 12th 2018. Transitional provisions are provided allowing existing ELTIFs authorised under the ELTIF Regulation before April 12th 2018 to comply with the Delegation Regulation from May 1st 2019 only.

SUSTAINABLE FINANCE | EUROPEAN COMMISSION LEGISLATIVE PROPOSALS

The EU Commission, following the publication of its Sustainable Finance Action Plan in March 2018, published on May 24th 2018 the following legislative proposals: (i) proposal for a regulation on the establishment of a framework to facilitate sustainable investments (the "**Taxonomy Proposal**"), (ii) proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341 (the "**ESG Risk Proposal**"), (iii) proposal for a regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks (the "**Benchmark Proposal**") and (iv) proposal for a regulation amending certain MiFID II Level 2 measures (the "**MiFID Amendments**").

The aim of these proposals is to place Environmental, Social and Governance ("**ESG**") considerations at the heart of the investment decision making process by ensuring that financial market participants (such as UCITS management companies and AIFMs) integrate ESG considerations into their internal processes.

TAXONOMY PROPOSAL

The Taxonomy Proposal identifies which and to what degree economic activities can be considered environmentally sustainable for the purposes of establishing the degree of environmental sustainability of an investment. It will apply to any financial products or corporate bonds that are marketed as environmentally sustainable as well as financial market participants that offer financial products as environmentally sustainable investments.

The degree to which an investment can be considered environmentally sustainable is assessed against whether the related economic activity meets certain criteria including whether it contributes to the following environmental objectives:

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy, waste prevention and recycling
5. Pollution prevention and control
6. Protection of healthy eco-systems

The aim of this proposal is not to establish a label for sustainable financial products but to provide a framework to set out the criteria that need to be taken into account when setting up such labels.

ESG RISK PROPOSAL

With the ESG Risk Proposal, the Commission aims to create a harmonised approach to integrating consideration of ESG risks into the investment decision-making process. The draft proposal lays down harmonised rules on the transparency to be applied by financial market participants, insurance intermediaries and investment firms on the integration of sustainability risks in the investment decision-making process or advisory process and the transparency of financial products that have as their targets sustainable investments. Financial market participants include, *inter alia*, UCITS management companies, AIFMs and managers of EuVECAs or EuSEFs.

Such financial market participants shall publish written policies on the integration of sustainability risks in the investment decision-making process on their websites and shall include certain information relating thereto in pre-contractual disclosures such as in, for example, a UCITS prospectus. Where a financial product has as its target sustainable investments, certain additional pre contractual information will be required.

Benchmark Proposal

The Benchmark Proposal relates to the creation of two new benchmarks by the Commission; (i) the low carbon benchmark, which would cause underlying stocks to be selected on account of their reduced carbon emissions when compared to stocks constituting a standard benchmark and (ii) the positive-carbon impact benchmark, which has underlying stocks selected on account of their carbon emission savings exceeding the stock's residual carbon footprint.

MIFID Amendment

The MiFID Amendment proposes to amend Regulation 2017/565 supplementing MiFID II in order to require investment firms providing investment advice and investment management as part of their client suitability assessment, to question clients on their ESG preferences and take these answers into account when advising them.

EU PROPOSAL IN RELATION TO CROWDFUNDING SERVICE PROVIDERS FOR BUSINESS

On March 8th 2018, the European Commission released a new proposal for a European Regulation on European Crowdfunding Service Providers ("**CSP**") for Business (the "**Proposal**"). The Proposal has come about due to the current lack of consistency across the European Union in the treatment of CSPs, and the need to improve access to finance for innovative companies, start-ups and other unlisted firms.

The creation of a harmonised legal base through a regulation would mean that an investment or a lending based crowdfunding platform would be able to provide cross border services through a form of passporting. The Proposal only applies to "crowdfunding services" which it defines as

"the matching of business funding interest of investors and project owners through the use of a crowdfunding platform and which consist of any of the following: (i) the facilitation of granting of loans; (ii) the placing without firm commitment… of transferable securities issued by project owners and the reception and transmission of client orders… with regard to those transferable securities."

Donation and reward based crowdfunding are excluded from the scope of the Proposal. The Proposal only relates to transferable securities and not to other types of financial instruments.

The draft regulation proposes to establish uniform requirements for the operation and organisation of CSPs as well as their authorisation and supervision. It does not apply to:

i. Crowdfunding services that are provided to consumers;
ii. Crowdfunding services that are provided by investment firms or natural or legal

persons in accordance with national law; and

iii. Crowdfunding offers with a consideration of more than EUR 1 million per crowdfunding offer calculated on a twelve month basis.

In order to qualify as a CSP in the European Union in accordance with the Proposal, the CSP must receive prior approval of the European Securities and Markets Authority ("**ESMA**"). The application will include details on the procedures in place in relation to administration and accounting processes, proof of the provider's experience and all standard regulatory documents.

Another facet of the Proposal is the introduction of an obligation for CSPs to provide a key investment information sheet (the "**KIIS**") to prospective investors. Within the KIIS, it is suggested to include information such as the risk to investors and the lack of guarantee by any authority. Additionally, it also notes that CSPs will be required to run an "entry knowledge test" on every prospective investor in order to properly determine that investor's ability to bear loss, and sets a maximum limit of possible investment of 10% of the investor's net worth. These tests should be completed at least every two years. The CSP must also provide for its clients, an appropriate procedure and outlet for complaint handling.

CSPs shall inform their clients whether asset safeguarding services are provided by them or by a third party and whether payment services and the holding and safeguarding of funds are provided by the CSP or a third party provider.

ESMA will maintain a public registry of CSPs, which would include, among other things, information on any withdrawals of authorisation for a period of five years as well as any sanctions that have been imposed on a CSP or its managers. ESMA also may impose fines (maximum of 5% of the annual turnover of the CSP) in the case of non-compliance.

As this is only in its proposal phase, the draft regulation could still see a lot of changes, but it is clear that overall there is an inherent intention at the Commission to expand and create unison in the crowdfunding services market in Europe.

UCITS | ESMA UPDATED Q&A

On May 25th 2018, ESMA issued the updated version of its UCITS Q&A creating a new Section on "Remuneration". ESMA clarified that the remuneration-related disclosure requirements under Article 69(3)(a) of the UCITS Directive also apply to the staff of the delegate of a management company to whom investment management functions (including risk management) have been delegated.

ESMA mentioned two ways to comply that are in line with ESMA's UCITS remuneration guidelines:

1. If the delegate is subject to regulatory requirements on remuneration disclosure for its staff that are equally as effective as those prescribed by Article 69(3)(a) of the UCITS Directive, the management company should use the information disclosed by its delegate to fulfill its own obligations.

2. In any other cases, appropriate contractual arrangements should be put in place with the delegates. These agreements should allow the management company to receive (and disclose in the annual report for the relevant UCITS that it manages) necessary information to comply with the UCITS remuneration-related disclosure requirements. ESMA established the minimum information that should be

included. ESMA further noted that the disclosure should be done on a prorated basis for the part of the UCITS' assets which are managed by the identified staff within the delegate.

In both situations, the disclosure may be provided on an aggregate basis meaning the presentation of a total amount for all the delegates of the management company in relation to the relevant UCITS.

SECURITIES FINANCING TRANSACTIONS | ADMINISTRATIVE SANCTIONS

The law of June 6th 2018 on transparency of securities financing transactions ("**Law**") implements provisions of Regulation (EU) 2015/2365 on transparency of securities financing transaction and of reuse ("**Regulation**") relating to the imposition of sanctions for non-respect of the provisions of the Regulation.

The Law provides that the *Commission de Surveillance du Secteur Financier* ("**CSSF**") and the *Commissariat aux Assurances* ("**CAA**"), where they are the relevant competent authority, can impose sanctions in case of violations of Article 4 or Article 15 of the Regulation.

A securities financing transaction or SFT includes repurchase transactions, securities or commodities lending or borrowing, buy-sell back or sell-buy back transactions and margin lending transactions. Pursuant to the Regulation counterparties to SFTs are obliged to report the details of the SFTs to trade repositories (Article 4). The Regulation also imposes conditions on the right of counterparties to reuse financial instruments received as collateral (Article 15).

Pursuant to the Law, the CSSF or the CAA have the power to impose sanctions in respect of breach of these provisions. In case of legal persons the CSSF or CAA may impose the sanctions on the members of their management board. The sanctions that may be imposed are the following:

a) an order requiring the responsible person to cease the conduct and to desist from a repetition of that conduct;
b) a public statement which indicates the person responsible and the nature of the infringement;
c) a temporary ban against any person discharging managerial responsibilities, or any natural person who is held responsible for such an infringement, from exercising management functions;
d) maximum administrative sanctions of at least three times the amount of the profits gained or losses avoided because of the infringement where those can be determined by the relevant authority, even if those sanctions exceed the amounts referred to in points (e) and (f);
e) in respect of a natural person, a maximum administrative sanction of at least EUR 5 000 000;
f) in respect of legal persons, a maximum administrative sanction of at least:

    (i) EUR 5 000 000 or up to 10 % of the total annual turnover of the legal person according to the last available accounts approved by the management body for infringements of Article 4 of the Regulation;

    (ii) EUR 15 000 000 or up to 10 % of the total annual turnover of the legal person according to the last available accounts approved by the management body for infringements of Article 15 of the Regulation.

The Law also amends the law of December 17th 2010 relating to UCITS and the law of July 12th 2013 on alternative investment managers to provide that the CSSF is competent to issue sanctions and other administrative measures against UCITS, management companies and their depositaries and AIFMs in case of breach of Articles 13 and 14 of the Regulation which set out the rules on transparency concerning SFTs and total return swaps in periodical reports and pre-contractual documentation such as prospectuses.

DEPOSITARY SAFE-KEEPING RULES | PROPOSALS FOR AMENDMENT

On May 29th 2018, the European Commission published two draft delegated regulations which contain proposals to amend certain rules relating to the safe-keeping duties of depositaries under the alternative investment fund managers directive, Directive 2011/61 EU (the "**AIFMD**") and the undertakings for collective investment in transferable securities directive (the "**UCITS**" Directive).

Experience gained since July 22nd 2013 has shown that further clarification is needed on the requirements laid down in Article 21 (11)(d)(iii) of the AIFMD. Since securities and insolvency laws are not harmonised at EU level, it is imperative to have common rules to ensure protection of assets safe-kept by depositaries or custodians for their clients.

The draft regulations propose to amend Delegated Regulation (EU) 231/2013 (AIFMD Level 2) and Delegated Regulation (EU) 2016/438 (UCITS V Level 2) in accordance with ESMA's opinion of July 2017. We refer to our earlier newsletter dated October 2017.

Reconciliation – Article 89(1)(c) of the AIFMD Level 2 and Article 13(1)(c) of UCITS V Level 2

These articles are to be amended in order to foresee that reconciliations are conducted as often as necessary (rather than on a regular basis) between the depositary's internal accounts and records and those of any third party to whom custody functions are delegated. The trading frequency of the relevant client, any trade which would occur outside the normal trading activity and also trades carried out by other clients whose assets are kept in the same omnibus account should be taken into account in determining the frequency.

Record-keeping – Article 89(2) of the AIFMD Level 2 and Article 13(2) of UCITS V Level 2

The drafts clarify that when custody functions are delegated, the depositary remains subject to the requirement to maintain a segregated account in the name of the UCITS or AIF or of the AIFM/UCITS management company acting on behalf of the UCITS/AIF, where the financial assets are recorded. The depositary shall also ensure that the delegate maintains accurate records and accounts.

Contract between the depositary and an appointed third-party - a new paragraph 2a is inserted in Article 98 of the AIFMD Level 2 and in Article 15 of UCITS V Level 2

This new paragraph sets out the minimum provisions to be included in the contract between the depositary and its delegate. Such contract should guarantee the depositary's right to sufficient information, inspection, and access to the records and accounts of the third party held in custody to enable the depositary fulfil its oversight and due diligence obligations and in particular to allow the depositary to verify all entities within the custody chain and verify that the quantity of the financial instruments opened in the depositary's books in the name of the fund or its management company, matches the quantity of the identified financial instruments held in custody by the third party for that fund as recorded in the financial instruments account opened in the third party's books.

In case of further sub-delegation of the custody function, the contract must detail the equivalent rights and obligations agreed on between the delegate and the sub-delegate.

Segregation requirements at the level of the delegate – Paragraph 1 of Article 99 of the AIFMD Level 2 and Article 16 of UCITS Level 2

The depositary shall ensure that the third party to whom safe-keeping functions are delegated correctly records all identified financial instruments in the financial instruments account opened in the third party's books in order to be separated from the delegate's own assets, from the depositary's own assets and from the assets belonging to other clients of the delegate. This means that a third party may hold assets of UCITS clients, AIF clients and other clients of one depositary all together in one omnibus account.

In addition, the depositary in its oversight functions must be supplied, by the delegate, with a statement detailing the assets of the depositary's clients whenever a change relating to those assets occurs.

AIF's assets held in third countries- a new paragraph 2a is inserted in Article 99 of the AIFMD Level 2

The depositary must ensure a) to receive legal advice confirming that the segregation of assets is recognised generally and by the applicable insolvency laws of the third country and b) that the third party complies with the segregation requirement he is himself subject to.

The third party located in a third country should immediately inform the depositary of any change in insolvency laws and in its effective application.

STATISTICAL REPORTING | NON-REGULATED FUNDS

On May 18th 2018, the *Banque Centrale du Luxembourg* ("**BCL**") released [Circular BCL 2018/241] on new statistical data collection for non-regulated alternative investment funds (the "**Circular**"). The purpose of the Circular is to inform non-regulated alternative investment funds of their reporting obligations under regulation ECB/2013/38 concerning statistics on the assets and liabilities of investment funds ("**Regulation ECB/2013/38**") as well as the ECB guideline on monetary and financial statistics ("**ECB/2014/15**"). Regulated funds are already subject to such reporting requirements pursuant to joint circular BCL 2014/237 - CSSF 14/588 (the "**2014 Joint Circular**").

Collection of statistical data

Identifying data

Non-regulated alternative investment funds must provide the BCL with data within a week starting from their first day of activities, whether they expect to be subject to or exempt (see Section 1.3 below) from, the obligation to submit the statistical reporting.

Statistical reporting

In order to comply with Regulation ECB /2013/38, compartments of investment funds must submit to the BCL their statistical reporting composed of the following reports:

- S 1.6 "Information on valuation effects on the balance sheet of non-MMF investment Funds" (the "**S. 1.6 Report**");
- Monthly security-by-security report of investment funds; and
- S 2.13 "Quarterly statistical balance sheet for non-MMF investment funds" (the "**S. 2.13 Report**").

Derogations

Regulation ECB/2013/38 allows the smallest investment funds to be exempted from reporting requirements.

The BCL may grant non-regulated alternative investment funds a derogation from their monthly and quarterly reporting obligations if the total assets of non-regulated alternative investment funds remain below a fixed initial threshold of EUR 500 million, which the BCL may adjust by means of a circular letter. For funds that include several compartments, the total assets taken into account are those of all compartments.

Use of the collected data

The data collection is carried out primarily for statistical purposes, but may also be used for other purposes. The confidentiality of individual data collected is guaranteed by the professional secrecy of Central Bank bodies and staff members, although the BCL may exchange information with other agencies such as the CSSF, as needed.

Quality of the data transmitted and respect of deadlines

The BCL establishes and publishes on its website a calendar of remittance dates on which the monthly and quarterly statistical reports are due. The European Central Bank and the Central Bank of Luxembourg monitor the compliance of reporting agents with the minimum standards required to meet their reporting obligations. The European Central Bank may impose sanctions following an infringement procedure in the event of failure to comply with minimum standards for transmission, accuracy and conceptual compliance.

Implementation of the new collection

The implementation of the new collection consists in a two-step process:

1. The transmission of the completed form (see link below), available on the BCL's website, and of the latest available balance sheet before May 31st 2018 by e-mail to reporting.opc@bcl.lu.
2. The instructions and completed form for the statistical reporting can be found here.
3. For those funds not exempted by the BCL, the transmission of the quarterly S 2.13 Report and of the monthly security-by-security report for the September 2018 reference period must be submitted before October 26th 2018.

If applicable, the S 1.6 Report for the October 2018 reference period must be submitted before November 29th 2018.

TAX

DRAFT LAW FOR THE ATAD 1 IMPLEMENTATION

On June 18th 2018, the Luxembourg government published a draft law implementing the first Anti-Tax Avoidance Directive (hereafter "**ATAD**") into Luxembourg law (please see our Newsletter of April 2016 on the topic of the ATAD). The draft law still needs to go through the Luxembourg legislative process and may be subject to amendments before the final vote by the Luxembourg Parliament. As a general theme, where options and opt-outs were provided by the ATAD, the Luxembourg government decided to implement the most favourable options.

EXIT TAXATION

The draft law provides, starting January 1st 2020, for the taxation at market value of the assets transferred upon change of tax residency, upon transfer from the domestic head office to a foreign permanent establishment, upon transfer from a domestic permanent establishment to a foreign permanent establishment or head office. The same rule would apply to transfers of complete activities from a domestic permanent establishment to another country. The above only applies in cases where Luxembourg loses taxation rights over said transferred assets or activity. In case the above transfers occur within the European Union or to an EEA country with which Luxembourg concluded a mutual assistance agreement, the taxpayer may pay the exit tax by instalments over a maximum of 5 years.

CONTROLLED FOREIGN COMPANY (HEREAFTER "CFC") RULES

These rules aim at reallocating undistributed income of 50% owned subsidiaries or permanent establishments (hereinafter "**PE**") to the parent company, even when no income has been distributed. The parent company will then have to pay corporate income tax on the income of the subsidiary pro rata to its ownership or control of the subsidiary (or PE). Luxembourg took the option to limit the application of the CFC rules to non-genuine arrangements. As from January 1st 2019, Luxembourg will therefore tax the non-distributed income of a subsidiary or PE which qualifies as a CFC, solely if the non-distributed income arises from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage. In case a subsidiary or a PE is deemed as non-genuine, Luxembourg will solely include the income that was generated from assets and risks that are linked to the important functions performed by the parent company that controls the subsidiary or the PE in accordance with transfer pricing rules. In addition thereto, a subsidiary or PE will not qualify as a CFC in case (i) its accounting profits do not exceed EUR 750,000 or (ii) the accounting profits do not exceed 10% of the operating expenses.

INTEREST LIMITATION RULES

The draft law proposes to limit, as of January 1st 2019, the deductibility of net borrowing costs (i.e. the interest expenses that exceed interest income) to 30% of the taxpayer's fiscal EBITDA (Earnings before Interest, Tax, Depreciation and Amortisation) with a *de minimis* exception if the net borrowing costs do not exceed EUR 3 million. Standalone entities as well as some financial undertakings are expressly excluded from the scope of the interest limitation rule. Additionally, taxpayers who can demonstrate that their equity ratio is equal to or lower than the ratio of the consolidated group they belong to can, subject to certain conditions, fully deduct the net borrowing costs. Lastly, loans issued before June 17th 2016 will be grandfathered and remain out-of-scope of the present limitation, unless they are modified after that date.

HYBRID MISMATCH RULE

Hybrid mismatches could result from different tax characterisation of a financial instrument or an entity between different countries. According to the anti-hybrid mismatch rule, an expense will become non-deductible in Luxembourg either when (i) the same expense has already been deducted in another Member State of the European Union or (ii) the expense is not included in the taxable result of the counterparty resident in another Member State of the European Union. In practice, a Luxembourg resident taxpayer will have to be able to demonstrate, upon request, that no deduction without inclusion or no double deduction took place (e.g. by producing tax certificates issued by other Member States or copies of the foreign tax returns).

GENERAL ANTI-ABUSE RULE (HEREAFTER "GAAR")

As from January 1st 2019, the domestic abuse of law concept will be replaced with the GAAR included in the ATAD. This will allow Luxembourg to ignore an arrangement or a series of arrangements, when computing the tax liability of the taxpayer, provided they have been put into place for the main purpose, or as one of the main purposes, of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, being not genuine having regard to all relevant facts and circumstances. An arrangement, which may comprise more than one step or part, is regarded as non-genuine to the extent it has not been put in place for valid commercial reasons which reflect economic reality.

BEPS RELATED AMENDMENTS TO THE LUXEMBOURG TAX LAW

In the framework of the June 18th 2018 draft law implementing the first Anti-Tax Avoidance Directive (hereafter "**ATAD**") into Luxembourg law, the Luxembourg government decided to propose additional changes to the Luxembourg tax law that were not required by the ATAD but nonetheless fall, in the eyes of the government, within the broader Basis Erosion and Profit Shifting (BEPS) context. These changes aim at modifying two specific provisions, which could lead to mismatch situations resulting in a deduction without a corresponding inclusion and which were used in structures that are currently reviewed by the European Commission in its on-going State Aid investigations.

The first change aims at restricting, as of January 1st 2019, the Luxembourg rollover relief regime for exchange of assets, by excluding debt-to-equity conversions from its scope. As a result, such conversions would follow the general tax treatment applicable to exchanges, i.e. be treated as a deemed sale of the debt at fair market value followed by a subsequent acquisition of the shares.

The second change aims at amending the domestic definition of permanent establishment (hereafter "**PE**"), in order to confirm that, in cases involving a country with which Luxembourg has concluded a double tax treaty, the treaty definition of the PE should replace the domestic definition of a PE. Additionally, the draft law foresees that the taxpayer has to provide, if relevant, the Luxembourg tax authorities, upon request, with a certificate issued by the other contracting state, confirming that the foreign tax authorities recognize the existence of the PE in their country.

DRAFT LAW ON THE VAT GROUP REGIME

The Luxembourg Minister of Finance submitted to the Parliament on April 13th 2018 a new draft law No. 7278, introducing the VAT group regime in Luxembourg (the "**Draft Law**"). This follows the repeal on November 23rd 2017 of the Grand-Ducal Decree dated January 21st 2004 regarding the VAT exemption of services supplied by independent groups of persons to their members, aimed at aligning the Luxembourg VAT legislation with the conclusions of the ruling of the European Court of Justice dated May 4th 2017 (C-274/15) (please refer to our December 2017 Article).

The Draft Law provides that persons established in Luxembourg and closely linked in financial, economic and organisational terms may opt to be considered as a single taxable person for VAT purposes. For the purpose of assessing the existence of a financial link between legally independent entities, the Draft Law refers to the provisions of the Luxembourg company law regarding group consolidation, where either a majority of voting rights, the right to appoint a majority of board members or an exclusive control by virtue of a shareholders' agreement or similar contractual agreement is required. The economic link is defined in the Draft Law as the situation where (i) two or more entities share a principal activity of the same nature, (ii) two or more entities carry out activities which complement or influence each other or are part of the pursuit of a common economic objective or (iii) the activity of one entity is carried out in whole or in part for the needs of the economic activities of one or several other entities. Finally, an organisational link is deemed to exist, where (i) two or more entities are legally or factually under a common management, (ii) two or more entities organise their activities wholly or partially in consultation or (iii) two or more entities are legally or factually under the control of the same person.

The Draft Law provides that each entity can only be a member of one single VAT group and that the election for the VAT group regime needs to cover a period of at least two calendar years. The consequence of the formation of a VAT group is that transactions between the members of the VAT group are considered as out of scope of VAT.

Besides the main objective of the Draft Law, i.e. the implementation of the VAT Group regime, the Draft Law also introduces the concept of normal value ("*valeur normale*"), a concept similar to the arm's length principle applicable in direct tax matters, into the VAT legislation in order to prevent tax fraud and avoidance in transactions entered into between members of the same family or related entities. According to the rules laid down in the Draft Law, the normal value will serve as the taxable basis for VAT purposes, in cases where such normal value is higher than the consideration agreed upon among the parties and where the beneficiary of the supply or the service recipient / service provider (as the case may be) has no (or limited) input VAT deduction right.

NEW CIRCULAR ON INPUT VAT DEDUCTION

On June 11th 2018, the Luxembourg VAT authorities issued a circular letter No. 765-1 (the "**Circular**"), extending the scope of application of the circular letter No. 765, released in 2013, to VAT taxable persons carrying out both economic and non-economic activities.

Through the Circular, the VAT authorities announced that their views on the computation of the deductible input VAT, expressed in the 2013 circular, and applying to VAT taxable persons carrying out VAT taxable and VAT exempt activities (so-called *“**assujettis mixtes**”*) will also apply *mutatis mutandis* to VAT taxable persons carrying out economic activities (falling within the scope of VAT) and non-economic activities (falling outside the scope of VAT) (*“**assujettis partiels**”*).

The Circular is to be read in the context of the Portugal Telecom and the Securenta cases (European Court of Justice, September 6th 2012, C-496/11 and European Court of Justice, March 13th 2008, C-437/06). Pursuant to those cases the deduction system provided for by the Council Directive 2006/112/EC of November 28th 2006 on the common system of value added tax (the “**VAT Directive**”) only covers cases in which the goods and services acquired are used by a taxable person to carry out economic transactions which give right to deduct or do not give right to deduct input VAT (goods and services for mixed use). The methods and criteria for apportioning input VAT between economic and non-economic activities within the meaning of the VAT Directive are in the discretion of the Member States. Exercising that discretion, Member States must have regard to the aims and broad logic of the directive and, on that basis, provide for a method of calculation which objectively reflects the part of the input expenditure actually to be attributed, respectively, to those two types of activity.

A recent judgement rendered by the Luxembourg-City District Court (*Tribunal d’arrondissement de Luxembourg*) pointed out that the Luxembourg legislator has not, to date, enacted any specific statutory provisions clarifying how to determine the potentially deductible portion of input VAT allocated to the economic activities of a taxable person who carries out non-economic activities as well (Luxembourg-City District Court, November 22nd 2017, docket number 177382). Even though the Circular does not, strictly speaking, constitute a binding legal provision for taxpayers, it nevertheless provides useful guidance on how the VAT authorities will determine the potentially deductible portion of input VAT going forward.

The Circular essentially refers to the 2013 circular, which establishes a hierarchy between different methods of calculation of input VAT deduction rights. The preferred method is the “direct allocation method” by way of which every expense should be allocated, based on its nature and purpose, to either the company’s economic activities or the company’s non-economic activities. Expenses relating to activities that do not fall within the scope of VAT should be isolated and should not be taken into account when determining the right to deduct input VAT. Nonetheless, the authorities acknowledge that a direct allocation may not be possible for every type of expense. In that case, taxable persons should use a lump sum pro-rata method (preferably based on objective criteria appropriately reflecting the economic reality, alternatively based on income).

CIRCULAR ON VAT TREATMENT OF VIRTUAL CURRENCIES

On June 11th 2018, the director of the Luxembourg indirect tax authorities (*Administration de l’enregistrement et des domaines*, “**AED**”) issued a circular, which confirms that the position held by the ECJ, in its court ruling *Hedqvist* of October 22nd 2015 (C-264/14), should apply in Luxembourg and that the VAT exemption for transactions involving foreign currencies (provided for in Article 44(1) (c), 7th indent of the Luxembourg VAT law) should not only include traditional currencies but also virtual currencies (e.g. Bitcoins), provided that these virtual currencies have no other purpose than being a means of payment and that they are accepted for that purpose by certain operators.

CIRCULAR ON DEFENSIVE MEASURES TOWARDS NON-COOPERATIVE COUNTRIES AND TERRITORIES

Further to the conclusions reached by the Council of the European Union on December 5th 2017 on the European Union list of non-cooperative countries and territories for tax purposes (hereafter the "**EU List**"), the director of the Luxembourg direct tax authorities (hereafter the "**ACD**") has issued a circular detailing defensive measures that the ACD will take towards transactions involving countries and territories included on said list.

As a general measure, the ACD will put companies having used structures or arrangements involving countries and territories listed in the EU List under enhanced monitoring. Luxembourg resident companies will thus be required to indicate in their tax returns, starting with the fiscal year 2018, whether they have had transactions with related parties (as defined in the article 56 of the Luxembourg income tax law) located in countries and territories listed in the EU List. The details of the transactions in question, as well as the statement of receivables and payables to such companies, will have to be made available to the ACD upon request or in the event of an on-site tax audit.

EU COMMISSION PROPOSAL FOR AMENDMENTS TO THE VAT DIRECTIVE

On May 25th 2018, the European Commission published a proposal for a directive on the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States (the "**Proposal**"). The Proposal aims at amending the currently applicable VAT rules, laid down in the Council Directive 2006/112/EC of November 28th 2006 on the common system of value added tax (the "**VAT Directive**") and is one of the cornerstones of the Commission's action plan on the definitive EU VAT system.

The initial goal of the VAT Directive was to reflect the fundamental principle of taxation in the country of destination, which applies to indirect taxes on consumption. For political and technical reasons, transitional VAT arrangements had been adopted, notably for the cross-border sale of goods, and finally stayed in place for more than 20 years. Besides their complexity, the transitional rules proved however vulnerable to fraud, which led the Commission to propose an overhaul of the system to make it more fraud-resilient.

In the system currently applied in the EU, cross-border movements of goods between businesses are split into two different transactions: an exempt supply in the Member State of departure and a taxed intra-Community acquisition in the Member State of destination. In the future, cross-border trades of goods will be seen as a single taxable supply, subject to VAT in the Member State of destination. As a matter of principle, the seller will be responsible for the collection of VAT. Only where the customer is a so-called certified taxable person (i.e., a reliable taxpayer, recognized as such by the tax administration) will the acquirer of the goods be liable for VAT.

In order to mitigate the administrative burden arising from VAT obligations in different jurisdictions, the change in regime comes along with a simplified solution helping businesses to declare their VAT, namely the creation of a so-called "one stop shop". The one stop shop consists in a centralised online portal allowing businesses to fulfil their VAT obligations (i.e. declare and pay VAT) in respect of all their supplies in each and every Member State. Luxembourg and the other EU Member States have already successfully implemented a similar online platform for businesses providing electronically supplied services after the changes to the rules governing the place of supply of those services in 2015 (please refer to our May 2014 Newsletter).

NO REMISSION FOR VAT IN LUXEMBOURG

On May 18th 2018 (*Case No. 00136*), the Luxembourg Constitutional Court (hereinafter the "**Court**") decided on a referral for preliminary ruling by the Luxembourg City District Court in a case regarding valued added tax (hereinafter "**VAT**"). The dispute concerned an action taken by a taxpayer against the Luxembourg tax authorities regarding the possibility to benefit from a tax remission (*remise gracieuse*) for VAT. The Luxembourg general tax code offers the possibility for a taxpayer to benefit from such remission in direct tax matters only, excluding *de facto* VAT from the benefit of said remission.

In its decision, based on the principles of equality before the law and equality in tax matters, the Court first examined the comparability of the situations of a taxpayer liable for VAT and the situation of a taxpayer liable for direct taxes. Analysing the general characteristics of both taxes, the Court recalled that direct taxation impacts the taxpayer's financial situation, income and wealth, whereas for VAT, the taxpayer only plays the role of an agent, collecting VAT from its clients in order to subsequently continue the collected VAT to the authorities, without however economically bearing the burden of the tax. The Court concluded that both situations are not sufficiently comparable for the principle of equality to apply and thus declared the current rules governing remission constitutional.

DISTINCTION BETWEEN PRIVATE AND BUSINESS ASSETS UNDER LUXEMBOURG TAX LAW

In a recent decision (No. 39382C dated May 29th 2018), the Higher Administrative Court of Luxembourg expanded on the transfer by a taxpayer of business assets to its private wealth.

The transfer and allocation of assets is generally of great significance for individuals undertaking commercial activities in their own name, since private assets are subject to taxes according to the tax rules applicable to individuals (e.g. not subject to municipal business tax) whereas business assets are part of the commercial activity of the taxpayer and subject to the commercial tax rules (e.g. subject to municipal business tax).

In the case at hand, the asset in question was a stone quarry, which was originally exploited as a commercial activity, but was then transferred by inheritance and subsequently gifted to a taxpayer who didn't undertake a commercial activity therein, but solely rented out said quarry to a company in exchange for a rental income. On April 25th 2005, the exploiting company purchased the stone quarry from the taxpayer, thus leading to the question whether said stone quarry had to be considered a business asset or a private asset in the hands of the taxpayer benefiting from the gift. The tax authorities concluded that the stone quarry remained a business asset despite the various inheritances and gifts. As a result, the sale price received for the disposal of the stone quarry should be taxed as a gain resulting from the liquidation of a business rather than a gain on the disposal of a private real estate property (that would have been subject to a lower tax rate).

In order to determine whether an asset should be considered as having exited the business and entered the private wealth of the taxpayer, the Higher Administrative Court applied a formal analysis followed by an analysis of the facts. Under the formal analysis, the Higher Administrative Court analysed the transmission of the quarry in the course of the inheritance and noted that since the stone quarry represented the fundamental asset of the commercial activity of the deceased, the taxpayers *de facto* inherited a commercial enterprise and not merely a single asset. With regard to the ensuing gift of the quarry, the Higher Administrative Court confirmed that such a gift could either be construed as a disposal of a single asset (the asset thus being treated as a private asset in the hands of the beneficiary) or a transfer of a commercial activity (the asset thus being treated as a commercial asset in the hands of the beneficiary). At this stage, the Higher Administrative Court resorted to a factual analysis and concluded that, based on the facts, the quarry was again the sole asset of the commercial enterprise and that the beneficiary of the gift continued to report the rental income from said quarry as a commercial income, the quarry effectively represented a commercial asset, which the taxpayer implicitly accepted by the way he filed his tax returns.

In conclusion, the Higher Administrative Court's decision relied heavily on the specific factual pattern of the case and confirmed that a transfer of business assets to the taxpayer's private assets requires a positive act of removal (i.e. a sale, a distribution or a gift), which should be reported coherently (in the tax filings). Transfers of assets which represent the sole and fundamental assets of a commercial activity require particular attention.

GERMAN CONSTITUTIONAL COURT DECISION ON UNITARY VALUES

On April 10th 2018 the German Constitutional Court (hereafter "**GCC**") ruled that the assessment of property tax in the "old West German states" of Germany, based on unitary values determined in 1964, was unconstitutional as it leads to major difference in treatment without sufficient justification. The unitary values were supposed to be reassessed every six years, but no reassessment has occurred since 1970. Consequently, the discrepancy between the market value of a property and its unitary value, on which the property tax assessment was based, increased. The GCC concluded that the unitary values are unconstitutional as (i) the previous legislation was not taking into account the features of properties, which did not exist in the past (i.e. energy performance, internet network performance), (ii) more than fifty percent of the properties liable to property tax were built after the unitary values were determined, (iii) changes and economic circumstances related to a property after 1964 were not taken into account and (iv) changes in the real estate market were not taken into account (i.e. rental income deriving from the properties). This decision of the GCC requires the regional governments of Germany to pass new legislation by the end of 2019.

As the property tax system in Luxembourg originates from the German tax law and is likewise based on unitary values, which, for Luxembourg, were last determined in 1941, the property tax in Luxembourg also does not reflect the real value of real estate assets and the same reasoning as above could thus be applied even though no clear discrepancy between regions exists in Luxembourg (as is the case in Germany). While this issue has been raised from time to time in the past and a working group has been put in place to explore ways to reform the property tax, it is an issue that has never gained significant traction. It will be interesting to monitor how the various political parties will handle this topic in the months leading up to the national elections of October 2018.

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