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BONN STEICHEN & PARTNERS
LUXEMBOURG LAW FIRM

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CAPITAL MARKETS

AMENDMENT OF THE LAW OF AUGUST 1ST 2001 ON THE CIRCULATION OF SECURITIES

HISTORY

The law of August 1st 2001 (the "**2001 Law**") on the circulation of securities and other financial instruments was already, historically, an important step towards the modernisation of financial sector legislation.

The modernisation was launched and a further significant step was taken in 2013 with the adoption of the law of April 6th 2013 on the dematerialization of securities amending the 2001 Law.

TODAY

As modern technologies are evolving at a dizzying pace, it has not been necessary to wait for long before a new bill ("**PL7363**") was filed to further amend the 2001 Law with the view to take into account these technological developments related to the blockchain.

PURPOSE OF PL7363

The purpose of PL7363 is to extend the scope of the 2001 Law to allow account holders to hold securities accounts and make registrations of securities through secure electronic recording devices including distributed electronic registers or databases such as blockchain.

Secure electronic recording devices are at the centre of operations and may be used by account holders to maintain securities accounts and make registrations, i.e. issues and transfers.

Fungibility within the system remains complete through the use of tokens (which can be defined as digital assets stored in a blockchain, which like a security or dematerialised security, represent the security) which are fungible by nature within the blockchain.

FUTURE

Although there is not yet any text in Luxembourg relating to token or blockchain, the Luxembourg legislator, by filing PL7363, aims to put Luxembourg law at the forefront of technological progress.

CORPORATE

LAW OF AUGUST 31ST 2018 CONCERNING SOCIETAL IMPACT COMPANIES

On September 14th 2018, the Law of August 31st 2018 (hereafter the "**Law**") was published in the Luxembourg Memorial A. The Law entered into force on September 18th 2018 allowing the use of the "**SIS**" sign by companies authorised as societal impact companies, introduced in Luxembourg by the law of December 12th 2016 creating societal impact companies, and also amending some legislative provisions relating to SIS.

SIS are destined to become the main legal vehicle for the development of the social and solidarity economy in Luxembourg. The SIS should benefit both existing social and solidarity economy organisations (mainly in the form of non-profit organisations (*associations sans but lucratif*, hereafter "**asbl**"), foundations and project leaders who wish to launch socially innovative activities. However, as some legislative provisions are exclusively applicable to agreements concluded with asbl or foundations, organisations currently constituted as asbl and foundations that chose to change their legal statute to the SIS legal regime were then deprived of a significant part of their funding.

In order to ensure that SIS whose capital consists 100% of impact shares benefit from the same financial support as asbl and foundations, the Law introduces the following amendments:

1. The amendment of Article L.133-1 of the Labour Code extends the benefit of the derogation from the ban on temporary lending of labour to such SIS. As a result, the SIS is authorised to carry out the activity of making employees hired under an employment contract available to third parties who use these employees and who exercise over them a part of the administrative and hierarchical authority normally reserved for the employer.
2. The amendment of the amended law of February 25th 1979 on housing assistance and the amended law of September 21st 2006 on residential leases extending certain provisions to the SIS, including but not limited to:
   - SIS can rent housing and make it available to low-income households
   - Leases for residential use offered by SIS are not subject to the provisions of the amended law of September 21st 2006 aforementioned, which notably allows them to offer "rental" housing at moderate cost.
3. The amendment of the amended law of July 19th 1991 establishing an Adult Training Service extends the possibility of offering courses for adults to SIS.
4. The amendment of the amended law of January 6th 1996 on development cooperation extends to SIS, the benefit of approval and therefore public support in the field of development cooperation and humanitarian action.
5. The amendment of the amended law of May 31st 1999 establishing a national research fund (hereafter the "**FNR**") in the public sector extends the benefit of FNR support to SIS.

AMENDMENT CONCERNING THE TRADE AND COMPANIES REGISTER

On September 11th 2018, the Luxembourg Grand-Ducal Regulation of August 1st 2018 amending the amended Grand-Ducal Regulation of January 23rd 2003 implementing the amended Law of December 19th 2002 on the trade and companies register and on the accounting records and annual accounts of undertakings (hereafter the "**Regulation**") was published in the Luxembourg Memorial A under number 790. The Regulation entered into force on September 15th 2018 introducing the following main changes:

COMPANY BRANCHES TO BE AUTOMATICALLY DELETED FROM THE TRADE AND COMPANIES REGISTER ("RCS")

The Regulation foresees that branches of companies having their registered office in another Member State of the European Union, whose company has been removed from the register in which it is registered, for reasons other than a change in its legal form, a merger or division transaction or a cross-border transfer from its registered office, are now automatically deleted from the RCS.

NEW PROVISIONS CONCERNING EXCHANGES WITH THE REGISTERS OF OTHER EU MEMBER STATES

The Regulation foresees that, by means of the system of interconnection of central registers, trade and companies (hereafter the "**system of interconnection of registers**"), drawn up in accordance with Directive 2017/1132/EU of the European Parliament and of the Council of June 14th 2017 on certain aspects of company law, the RCS manager shall provide registered persons and entities registered with the RCS with a unique identifier allowing them to be unequivocally identified in the context of communications between foreign registries.

Moreover, information on the opening and termination of any winding-up or insolvency proceedings of the company and on the striking-off of the company from the register shall be now:

- communicated without delay by the RCS manager to the central European electronic platform drawn up in accordance with Directive 2017/1132/EU, and
- received without delay, by means of the system of interconnection of registers, in the case of companies having their registered office in another Member State of the EU and for which a branch is registered in the RCS.

NEW PROVISIONS CONCERNING FEES

The Regulation foresees that requests for electronic consultation of an archive batch and requests for electronic consultation of a complete file are no longer part of the requests invoiced as "administrative costs".

THE LAW ON COMMERCIAL COMPANIES DATED AUGUST 10TH 1915 AS AMENDED|END OF TRANSITORY PERIOD

The law of August 10th 1915 on commercial companies as amended ("**LCC**") had long since evolved at a glacial pace, following European directives over the years; thus the need for an ambitious reform to ensure its modernisation and increase its attractiveness. This reform came into force on August 23rd 2016.

Two guiding principles have driven this reform: "*contractual freedom for shareholders and*

increased security for third parties"; ensuring that priority is given to balanced solutions between the need for increased security for the protection of third parties and the need not to disrupt the freedoms of economic operators present in Luxembourg.

In view of the importance of this reform, the legislator did not wish to impose it from the outset, and so provided a transition period of 24 months, which expired on August 23rd 2018. Since August 23rd 2016, all companies set up after that date have had to apply the new provisions of the LCC. On the other hand, companies established before August 23rd 2016 and that have not updated their articles of association will be subject to a hybrid regime that may be complicated to interpret depending on the circumstances.

Indeed, the new LCC rules have automatically become applicable to all companies since August 23rd 2018, so that in the event of a conflict with the provisions of the articles of association, it will be necessary to analyse the situation in detail. If, as it is often the case, the articles of a corporation faithfully transpose the text of a section of the LCC and that same section has been amended, there is now an obvious contradiction. Practitioners will have to determine on a case by case basis whether the new text of the LCC should prevail over those of the articles.

Less problematic, if there is a reference in a company's articles of incorporation to a specific section of the LCC, this reference will automatically be adapted to the new content of the rule. Finally, it is important not to forget shareholders' agreements and other agreements that could also be subject to contradictions in the interpretation of the rules if they have not been tidied up as required at the end of the transitional period.

EMPLOYMENT

NEW RULES APPLICABLE TO THE SUPERVISION OF EMPLOYEES

The Law of August 1st 2018 establishing the national commission for data protection and the general scheme on data protection[1] (hereinafter "**the Law**"), implements the general data protection regulation (hereinafter "**the GDPR**") that entered into force on May 25th 2018.

As the GDPR is directly applicable in Luxembourg, it settles most of the provisions now applicable with regard to data protection. The Law thus completes the European framework where necessary.

To this extent, article 71 of the Law amended article L.261-1 of the Labour Code regarding supervision of employees in the context of labour relations. The main innovations in this area, applicable as from August 20th 2018, are as follows:

1) <u>Absence of prior authorisation</u>

The legal requirement to seek an authorisation from the national commission for data protection ("**the CNPD**") no longer applies.

As a result, the processing of personal data for the purpose of supervising employees may now be carried out by the employer, if he is the controller, in accordance with the cases mentioned in Article 6, paragraph 1, letters a) to f) of the GDPR and in accordance with the new article L.261-1 of the Labour Code.

According to the previous version of Article L.261-1 of the Labour Code, such a processing was only possible if necessary:

- for the safety and health needs of the employees, or
- for the protection of the company's assets, or
- for the control of the production process relating only to machinery, or
- for the temporary control of the employee's production or services, where such a measure is the only means of determining the exact salary, or
- within the framework of a mobile work organisation in accordance with the Labour Code.

From now on, it is sufficient for the employer to rely on one of the 6 conditions of lawfulness of Article 6 of the GDPR. Processing can therefore be implemented if:

- the data subject has consented to the processing of his/her personal data for one or more specific purposes;
- the processing is necessary for the performance of a contract to which the data subject is a party or for the performance of pre-contractual measures taken at the request of the data subject;
- the processing is necessary to comply with a legal obligation to which the controller is subject;
- the processing is necessary to protect the vital interests of the data subject or of another natural person;
- the processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in the controller;
- the processing is necessary for the legitimate interests pursued by the controller or by a third party, unless the interests or fundamental rights and freedoms of the data subject requiring protection of personal data prevail.

[1] Memorial A n°686 dated August 16th 2018.

In terms of supervision of employees in the context of labour relations, the most appropriate condition of lawfulness will generally be that the processing is necessary for the legitimate interests pursued by the employer. On the contrary, consent does not seem to be an appropriate lawfulness basis in labour relations.

If the processing is considered lawful, it will nevertheless have to be determined whether the supervision is necessary and proportional to the intended purpose (data minimisation principle, Article 5 of the GDPR).

2) **Information of the staff representatives and of the employees**

A collective right to information is now provided for employees. Without prejudice to the information right of the data subject, the employer must also provide certain information to the joint committee or, failing that, the staff delegation or, failing that, the labour mining inspectorate ("*Inspection du travail et des mines*") in advance.

This prior information must include a detailed description of the purpose of the intended processing, the arrangements for implementing the supervision system, and, where appropriate, the duration or criteria for storing the data, and a formal undertaking by the employer that the data collected will not be used for a purpose other than that explicitly provided for in the prior information.

Furthermore, when supervision is implemented:

- for the safety and health needs of the employees,
- for the temporary control of the employee's production or services, where such a measure is the only means of determining the exact salary, or
- within the framework of a mobile work organisation,

it remains subject to co-decision: processing may therefore only be carried out with the agreement of the employees' representatives, except where the processing complies with a legal or regulatory obligation.

3) **Request for a prior opinion to the CNPD**

The staff delegation or, failing that, the concerned employees, may, within 15 days following receipt of prior information, request an opinion from the CNPD regarding the compliance of the processing project for the purposes of supervising the employees in the context of labour relations. The CNPD must deliver its opinion within 1 month of such request.

The request has suspensive effect. The employer will therefore not be able to implement the supervision before the CNPD has delivered its opinion.

It is also provided that the employees concerned have the right to lodge a complaint with the CNPD. Such a complaint is neither a grave nor a legitimate reason for dismissal.

DRAFT LAW ON THE TIME-SAVING ACCOUNT

On June 25th 2018 the Chamber of Deputies of the Grand-Duchy of Luxembourg issued the draft law 7324 (the **"Draft Law"**) implementing a time-saving account. The time-saving account will enable the employee to better manage their working time and overtime, as well as to take time off when considered appropriate.

1) **Beneficiaries**

Any employee bound to an employer by an employment contract and who has given at least two years of service can benefit from a time-saving account.

2) **Implementation**

The implementation of the time-saving account may result:

- from a collective agreement or

from a sectoral or national agreement on inter-professional social dialogue: a mutual agreement is required between the employer and the staff delegation, in addition to a notification of the agreement to the Minister of Labour.

3) Crediting of the time-saving account

The time-saving account is held and compiled in **hours**. The following time can be credited onto the time-saving account:

- additional days of leave granted as part of the setting up of a work organisation plan with reference periods exceeding one month;
- time worked in excess at the end of the reference period or resulting from a flexitime arrangement;
- overtime;
- time off granted in compensation for work performed on Sunday;
- time off granted in compensation when a statutory holiday falls on a Sunday;
- days of leave granted in excess to the statutory minimum to the extent that the corresponding days of leave have not been taken in the current year and have been granted in accordance with an employment contract or collective agreement;
- a maximum of five days per year of paid recreational leave that could not be taken during the calendar year for reasons of illness of the employee, maternity leave or parental leave with a view to be able to take them after the 31st of March of the following year and to avoid them to lapse.

The hourly balance of the time-saving account is limited to 1800 hours.

4) Use

The use of the time-saving account must be granted by the employer upon written request of the employee, and fixed at least one month in advance.
The employer may refuse the request because of operating needs or the legitimate wishes of other employees.

5) Status of the employee during the leave

The leave taken by the use of the rights accumulated on the time-saving account shall be assimilated to actual working time for the determination of the employee's annual leave and seniority.
During the period of use of the employee's rights acquired on the time-saving account, the employee is considered as being on paid leave.
The employer is required to maintain the absent employee's position or, if it is not possible, a similar position.

6) Employer's obligations

The employer must:

- set up a system ensuring the actual and detailed maintenance of the time-saving account, and
- ensure that individual consultation of the employee is guaranteed at all times;
- ensure that the employee can check on a monthly basis the correct provisioning of the time-saving account;
- fully fund his/her liabilities resulting from the crediting by employees to the time-saving account, increased by the social security contributions and adjusted to the cost of living as the case may be.

However, the staff delegation is responsible of the control of the implementation and the correct execution of the time-saving account.

7) The Employment Fund shall guarantee, up to a ceiling equal to twice the reference minimum social wage, the claims resulting from the liquidation of the time-saving account in the event of:

- bankruptcy of the employer;
- judicial opening of collective proceedings based on the insolvency of the employer;
- recording by a court of the permanent closure of the company or establishment of the employer;
- continuation of the business by the bankruptcy trustee.

In addition, claims resulting from the liquidation of the time-saving account shall be guaranteed and covered by the super-privilege which gives priority in terms of payment in case of bankruptcy.

8) <u>Liquidation</u>

The balance of the days of leave appearing on the employee's time-saving account shall be settled by the employer with a payment of a compensatory allowance resulting from:

- termination with immediate effect of the employment contract as a result of death/incapacity of the employer, bankruptcy of the employer, eligibility of the employee to an old-age pension, disability of the employee, expiry of the employee's rights to sickness benefits, external reclassification of the employee, when an employee no longer qualifies as being handicapped and when a handicapped employee is oriented to the labour market;
- termination of the employment contract at the initiative of one of the parties or by mutual agreement;
- death of the employee (the compensatory allowance will be paid to the beneficiaries).

The compensatory allowance must be equal to the monetary conversion of all acquired rights multiplied by the hourly rate in effect at the time of payment.

FINTECH

ANNOUNCEMENT CSSF – OCTOBER 4TH 2018

The Luxembourg financial supervisory authority (“**CSSF”**) is for long time considering innovation as a driver of paramount importance towards the continued development of the financial services and the financial sector.

In this context, besides many other actions undertaken, CSSF announced today the execution of a cooperation agreement together with the Australian Securities & Investments Commission (“**ASIC”**) aimed at providing a framework for cooperation to understand financial innovation in each jurisdiction.

This cooperation agreement will complement the existing and active relationship between ASIC and CSSF and will provide a framework for information sharing between both regulators on financial technology (*fintech*) and regulatory technology (*regtech*).

This is another clear sign that regulators throughout the world are considering innovating sectors like *fintech* or *regtech* as majour due to their significative growth, which shall somehow remain regulated or at least under the control of authorities for the viability of these systems themselves and protection of investors.

INVESTMENT FUNDS

MANAGEMENT COMPANIES AND AIFMS | CSSF CIRCULAR 18/698

On August 23rd 2018, the CSSF issued Circular 18/698 on the authorisation and organisation of investment fund managers and anti-money laundering and counter terrorist financing in relation to transfer agents and investment fund managers (the "Circular"). The Circular immediately entered into effect.

The Circular replaces CSSF Circular 12/546 applicable to Luxembourg management companies and self-managed UCITS. It imposes similar requirements to those applying under 12/546 on Luxembourg alternative investment fund managers as well as enhances the requirements and provisions applicable under the CSSF Circular 12/546 regime. The Circular also applies to branches and representative offices established by Luxembourg investment fund managers in Luxembourg or abroad as well as to transfer agents with respect to anti-money laundering and counter terrorist financing provisions.

The Circular consolidates in writing what was already the practice imposed by the CSSF and provides some clarifications and a number of new requirements. The main changes introduced by the Circular are as follows:

1. Clarification of eligible own funds and requirement to put in place a treasury management policy;
2. Information about establishment of subsidiaries or acquisitions by investment fund managers;
3. Number of mandates and time allocation of directors and conducting officers. List of mandates and time allocation should be filed annually with the CSSF;
4. Clarification on corporate meetings, conducting officers meetings and records of the same;
5. Requirements regarding the minutes of decisions of meetings of the different control functions;
6. Clarifications regarding independence of directors from depositary;
7. Investment fund managers should have at least a minimum of 3 full time employees in Luxembourg;
8. Replacement of conducting officers should be foreseen in case it is needed due to absence of the conducting officer;
9. Procedure to identify and manage IT risks;
10. If a cloud system is used a "cloud officer" should be appointed amongst the employees;
11. All the reports to be filed with the CSSF regarding internal controls are to be filed within 5 months after the end of the relevant fiscal year (instead of one month after the annual general meeting);
12. Clarifications in relation to the organisation of the permanent risk management function, the risk management report and the risk management policy. Investment fund managers should follow the template attached as Annex I to the Circular;
13. Clarification regarding partial delegation of risk management;
14. Clarification in relation to the organisation of the compliance function;
15. A conducting officer has to be in charge of complaints handling;
16. Communication to the CSSF of the annual audited accounts and the management letter within one month of the AGM and at the latest seven months after the end of the fiscal year;
17. AML and CTF measures to identify and measure the AML/CTF risks as well as measures adopted to mitigate them;

18. AML/CFT compliance officer and AML responsible officer should be appointed and be employees of the investment fund managers, be based in Luxembourg and have sufficient time to dedicate to their task and should be communicated in advance to the CSSF;
19. Obligations regarding AML/KYC: appropriate measures to identify and assess the AML risks and measures of vigilance on UCIs' initiators, investment managers, investment advisors, assets of the UCIs and specific obligations when using distributors;
20. Enhanced due diligence on nominees;
21. AML report;
22. AML liability of the investment fund manager is not affected in case of delegation;
23. AML obligations on marketing intermediaries;
24. Obligations regarding EMIR and MMF Regulation;
25. Exchange of information between the investment fund manager and the depositary;
26. Setup of a procedure on the delegations and details on initial and ongoing due diligence;
27. Recommendations on the investment committees (if any) and conditions on the use of advisors; and
28. Rules on the organisation of the distribution and valuation functions.

The Circular implies that the industry will have to make some efforts to conform to the obligations imposed on them.

AIFMD | UPDATED CSSF FAQ

The CSSF's frequently asked questions ("FAQ") on AIFMs was updated on August 14th 2018 with an additional question 23.b) in the section Impact of the PRIIPs Regulation.

The question raised was whether Luxembourg AIFs the units of which are being advised on, offered or sold to retail investors benefit from the exemption provided under Article 32(2) of the PRIIPs Regulation if they have issued a UCITS KIID?

The answer is yes such AIFs may issue a UCITS KIID in order to be exempted from the obligations of the PRIIPs Regulation until December 31st 2019, provided that the following conditions are complied with:

- the UCITS KIID to be issued under the law of December 17th 2010 on undertakings for collective investment in transferable securities, as amended (the Law of 2010) should comply with Articles 159 to 162 of the Law of 2010, as well as with the provisions of Commission Regulation (EU) No. 583/2010;
- the UCITS KIID should be issued for each retail share class of the sub-funds of the relevant Luxembourg AIF;
- the offering document of the Luxembourg AIF should be amended so it reflects the distribution of a UCITS KIID to all retail investors that would invest in the AIF. The offering document should also mention that the UCITS KIID shall be published on the website of the registered or authorised AIFM of the Luxembourg AIF and that it shall be available, upon request, in paper form.

MONEY MARKET FUNDS | CSSF FAQ

The CSSF published its first Frequently Asked Questions ("FAQ") concerning the Money Market Fund Regulation ("**MMFR**") on August 28th 2018. This FAQ explains some of the key aspects of the regulation which are relevant to money market funds ("**MMFs**") and their managers.

The document answers many of the questions surrounding the new regulation with regards to general provisions, obligations concerning investment policies of MMFs, obligations concerning the risk management of MMFs, variation rules and transparency requirements.

As regards general provisions, the CSSF has said that all types of MMFs can have accumulating and/or distributing share classes and that Circular 08/365 which deals with certain techniques and instruments relating to transferable securities and money market instruments no longer applies to MMFs. The CSSF will analyse on a case by case basis whether the changes to be operated at the level of existing funds requires one month prior notice with redemptions free of charge. The CSSF also confirmed that all AIFs authorised under the MMFR have to appoint an authorised AIFM.

The FAQ also covers obligations concerning the investment policies of MMFs, in particular article 17(1)(b) of the MMFR, whereby it clarifies that the CSSF does not authorise a Luxembourg MMF to invest more than 10% of its assets in deposits with the same credit institution as it is economically feasible for the MMF to make deposits in another Member State and there are sufficient viable credit institutions in Luxembourg. The CSSF also confirms that it requires MMFs to provide information on the internal credit quality assessment procedure in the prospectus.

With respect to obligations concerning the risk management of MMFs, the FAQ confirms that one week or one month deposits, as well as reverse repos with a fixed term, can be considered daily maturing assets when they can be withdrawn with one working day prior notice. Non-compliance issues regarding WAL and WAM limits and minimum liquidity thresholds shall fall under the scope of CSSF Circular 02/77 concerning 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 UCIs.

Regarding valuation rules, different sub funds under the same umbrella can use different methods to price the same security.

In terms of transparency requirements, the FAQ clarifies that information regarding maturity breakdown and credit profile of the MMF (article 36(2)) can be provided by a website link in the prospectus, the manager can decide on which day of the week they report the weekly disclosure of article 36(2), information regarding internal credit quality assessment must be provided and that article 36(2) only applies to MMF authorised in accordance with MMFR as at July 21st 2018, not MMFs who benefit from the transitional provision of article 44(1).

AIFMD | UPDATED ESMA Q&A

The European Securities and Markets Authority ("**ESMA**") recently updated its Q&A on Directive 2011/61/EU of the European Parliament and of the Council of June 8th 2011 on Alternative Investment Fund Managers ("**AIFM Directive**") regarding the supervisory responsibilities of competent authorities in host Member States when an alternative investment fund manager provides investment services through a branch established in the host Member State.

ESMA clarified that, under both the UCITS and the AIFM Directives, supervisory powers of competent authorities in relation to branches of UCITS management companies or alternative investment

fund managers (“**AIFMs**”) established in a Member State that is not the home Member State are shared. The competent authority of the Member State in which the branch is located (i.e., the host Member State) is responsible for supervising the branch’s compliance with conduct rules referred to in Article 17(5) of the UCITS Directive and Article 45(2) of the AIFM Directive, while the competent authority of the Member State in which the UCITS management company or the AIFM is established (i.e., the home Member State) is responsible for supervising the other requirements provided under the relevant applicable framework.

ESMA concedes that neither the UCITS Directive nor the AIFM Directive provides for an explicit framework for the allocation of supervisory responsibilities and powers for those cases where UCITS management companies or AIFMs are authorised to carry out investment services set out in Article 6(3) of the UCITS Directive and Article 6(4) of the AIFM Directive and have branches providing those services in other Member States. Still, ESMA’s position is that responsibilities of home and host Member States should be identified similarly to, and consistently with, the general framework established for the provision of activities pursued by UCITS management companies and AIFMs through branches as well as with the MiFID II framework regulating the supervision of the provision of investment services across the EU. Under Article 35(8) of MiFID II, the competent authority of the host Member State is responsible for ensuring that the services provided by the branch of an investment firm or a credit institution in its territory comply with the requirements under Articles 24 (General principles and information to clients) and 25 (Assessment of suitability and appropriateness and reporting to clients) of MiFID II, which also apply to UCITS management companies and AIFMs providing investment services.

BENCHMARKS REGULATION | UPDATED ESMA Q&A

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

One of the new questions considered by ESMA was whether prospectuses should include reference to the register of administrators and benchmarks (the **“REGISTER**”).

For prospectuses approved on or after January 1st 2018, the answer is two-pronged:

- Where the register already includes the relevant administrator by the time a prospectus under Directive 2003/71/EC (relating to prospectuses to be published when securities are offered to the public or admitted to trading) or Directive 2009/65/EC (“**UCITS DIRECTIVE**”) is published, the prospectus should indicate that the administrator is listed in the register.
- Where the register does not include the relevant administrator by the time a prospectus is published, the prospectus should state so and prospectuses under the UCITS Directive should be updated at the first occasion once the relevant administrator is included in the register. However, prospectuses approved under Directive 2003/71/EC are not required under BMR to be systematically updated by means of a supplement once the relevant administrator is included in the register.

For prospectuses approved prior to January 1st 2018 the answer depends on which directive the prospectus was approved under:

- Prospectuses approved under the UCITS Directive should be updated at the first occasion or at the latest within 12 months after January 1st 2018. If by January 1st 2019 the relevant administrator is not included in the register, ESMA considers that these prospectuses should be updated to include a statement to that effect.
- Prospectuses approved under Directive 2003/71/EC are not required under BMR to be systematically updated by means of a supplement once the relevant administrator is included in the register.

ESMA also confirmed that a calculation agent is not to be considered a user of benchmarks if it is appointed by an issuer of securities.

The role of calculation agents is simply to calculate, on behalf of the issuer, the payment due on the basis of pre-determined terms (including the benchmark to be used). They cannot amend the amount and do not decide which benchmark is referred to by the instrument. For this reason, ESMA considers that calculation agents are not users of benchmarks under Article 3(1)(7) of the BMR if the issuer of securities has set the terms of the financial instrument that references the benchmark.

ESMA also considered whether a benchmark can qualify as a 'regulated-data benchmark' if a third party is involved in the process of obtaining the data.

Although Article 3(1)(24)(a) of BMR precludes, in principle, the involvement of *any* third party in the data collection process, ESMA clarified that, pursuant to Article 3(1)(24)(a)(vii), if an administrator obtains regulated data through a third party service provider (such as a data vendor) and has in place arrangements with such service provider that meet the outsourcing requirements in Article 10 of the BMR, the benchmark still qualifies as regulated data benchmark.

NON-UCITS DEPOSITARIES | CIRCULAR CSSF 18/697

On August 23rd 2018, the CSSF published Circular CSSF 18/697 ("**Circular**"), which (i) specifies organizational requirements for depositaries of funds which are not subject to Part I of the Law of December 17th 2010 on undertaking for collective investment (the "**2010 Law**"), (ii) modifies Circular CSSF 16/644 applicable to depositaries of Luxembourg UCITS subject to Part I of the 2010 Law, and (iii) repeals Chapter E of IML Circular 91/75, as amended by Circular CSSF 05/177.

This new circular provides clarification on depositaries of funds other than UCITS (i.e., all forms of Alternative Investment Funds ("**AIF**")). The Circular applies to (i) Luxembourg credit institutions, (ii) Luxembourg investment firms and professional depositaries of assets other than financial instruments and (iii) Luxembourg branches of banks or investment firms established in another EU Member State, that act as depositary for an AIF. The Circular also applies to AIFs themselves as regards their interaction with their depositary.

The Circular complements and clarifies the Law of July 12th 2013 on alternative investment fund managers and delegated regulation 231/2013 ("**Level 2 Regulation**"). Its structure and content tracks closely that of Circular CSSF 16/644 applicable to UCITS.

The Circular first deals with non-bank depositaries i.e. professional depositaries of assets other than financial instruments and investment firms providing guidance and clarifications on how they carry out the function of depositary of an AIF.

Part II of the Circular sets the criteria to be eligible and to be approved as a depositary of an AIF. Acting as depositary of an AIF requires a specific authorization.

Part III of the Circular deals with governance and organization. It is reiterated that a depositary cannot carry out investment management and clarified that such a prohibition applies to all entities in the custody chain. Neither can the depositary accept a delegation of the risk management function but they may be delegated certain support tasks linked to such function. The Circular contains precisions regarding the operating memorandum or service level agreements to be put in place with the various fund actors with whom the depositary will come into contact and sets out clearly the procedures to be put in place in case the depositary becomes aware of irregularities concerning the AIF.

The Circular goes into a lot of detail on the organizational measures that the depositary has to have in place in relation to the assets of the relevant AIF. It includes precisions on segregation of accounts both at the level of the depositary as well as down stream in the custody chain and the due diligence the depositary is expected to carry out on sub depositaries. In this regard it partly anticipates the amendments to be brought to the AIFM Regulation by the Commission Regulation of July 12, 2018 as regards safe-keeping duties of depositaries. There are specific provisions applicable in relation to certain asset classes such as real estate and private equity.

The Circular clarifies that every depositary must have an emergency plan for each of the markets where it has designed a third party as delegate.

There are clarifications regarding the flux of information between the depositary and the AIF and AIFM and the obligation of the depositary to inform the authorities. In particular depositaries of an AIF whose AIFM is not established in Luxembourg must enter into an information sharing agreement with such AIFM.

In the event of termination of a contract with the depositary or of the liquidation of the AIF the Circular makes it clear that the outgoing depositary must keep the cash and securities accounts open until such time as a new depositary is appointed or the liquidation is closed.

The Circular comes into effect on January 1st 2019. Entities already approved as depositary of a UCITS or an AIF at the date of entry into force of the Circular are not obliged to request a new approval on the basis of the Circular but must conform to its provisions.

APPLICATION OF THE UCITS DIRECTIVE | UPDATED ESMA Q&A

The ESMA Q&A on the application of the UCITS Directive was updated on July 23rd 2018 with four new questions and answers, one of them being a new section X on Depositary.

ISSUER CONCENTRATION

The question was raised whether netting and hedging arrangements can be taken into account for the purposes of calculating issuer concentration limits pursuant to Article 52 of the UCITS Directive? ESMA states that only netting arrangements in accordance with the definition and conditions set out in the guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (Ref. CESR /10-788) may be taken into account when calculating issuer concentration limits.

UCITS INVESTING IN OTHER UCITS WITH DIFFERENT INVESTMENT POLICIES

ESMA has clarified that the prospectus of a UCITS should clearly disclose whether in case of fund of fund investments, the target fund(s) have different investment strategies or restrictions. Where the fund rules or articles of incorporation and prospectus (“**Fund Documents**”) of a UCITS expressly rule out certain types of assets or

derivative use without any reservations, UCITS management companies/self-managed investment companies should carry out proportionate due diligence to ensure that fund of fund investments does not result in a circumvention of the investment strategies or restrictions set out in the Fund Documents of the investing UCITS.

Supervision of branches

ESMA has clarified that, under both the UCITS and the AIFM Directive, the supervisory powers of competent authorities in relation to branches of UCITS management companies or alternative investment funds managers ("**AIFMs**") established in a Member State that is not the home Member State are shared. The competent authority of the Member State in which the branch is located (the host Member State) is responsible for supervising the branch's compliance with conduct rules referred to in Article 17(5) of the UCITS Directive and Article 45(2) of the AIFM Directive, while the competent authority of the Member State in which the UCITS management company or the AIFM is established (i.e., the home Member State) is responsible for supervising the other requirements provided under the relevant applicable framework.

Neither the UCITS Directive nor the AIFM Directive provides for an explicit framework for the allocation of supervisory responsibilities and powers for those cases where UCITS management companies or AIFMs are authorised to carry out investment services set out in Article 6(3) of the UCITS Directive and Article 6(4) of the AIFM Directive and have branches providing those services in other Member States. ESMA takes the view that responsibilities of home and host Member States should be identified similarly to, and consistently with, the general framework established for the provision of activities pursued by UCITS management companies and AIFMs through branches as well as with the MiFID II framework regulating the supervision on the provision of investment services across the EU. Under Article 35(8) of MiFID II, the competent authority of the host Member State is responsible for ensuring that the services provided by the branch of an investment firm or a credit institution in its territory comply with the MiFID II requirements under Articles 24 (General principles and information to clients) and 25 (Assessment of suitability and appropriateness and reporting to clients) of MiFID II, which also apply to UCITS management companies and AIFMs providing investment services.

Section X Depositary

Depositaries as counterparties in a transaction of assets that they hold in custody

According to Article 22(7) of the UCITS Directive the depositary (or any third party to which the custody function has been delegated) shall not reuse the assets they hold in custody for their own account. Does this provision imply that a depositary (or delegated third party) should never act as a counterparty in a transaction of assets that they hold in custody (including, but not limited to, transfer, pledge, sale and lending of those assets)?

The answer is no. A depositary (or a delegated third party) should be able to act as a counterparty in a transaction of assets that they hold in custody, provided that (i) the four conditions under Article 22(7)(a) to (d) of the UCITS Directive are complied with, and (ii) conflicts of interest are properly managed and (ii) the transaction is conducted on an arm-length basis.

TAX

VAT LETTING OF A BUILDING QUALIFIES AS INVOLVEMENT IN MANAGEMENT OF SUBSIDIARY

On July 5th 2018, the Court of Justice of the European Union (the "**ECJ**") handed down an important ruling, clarifying that the letting of a building, by a holding company to its subsidiary, amounts to 'involvement in the management' of that subsidiary, which must be considered to be an economic activity, within the meaning of the Council Directive 2006/112/EC of November 28th 2006 on the common system of value added tax (the "**VAT Directive**").

In the case at hand, a French limited liability company, Marle Participations S.à r.l., acquired and sold shares in the context of a group restructuring and deducted in full the VAT charged on various expenditures relating to said operations. The French tax authorities however denied the deduction on the ground that the expenditures contributed to the implementation of capital transactions which fall outside the scope of the right of input VAT deduction.

The ECJ recalled that, while the mere acquisition and holding of shares in a subsidiary is not to be regarded as an economic activity conferring on the holder the status of a taxable person, and potentially entitling it to deduct input VAT, the position will be otherwise where the holding is accompanied by direct or indirect involvement in the management of the subsidiary, through the carrying out of transactions subject to VAT, such as the supply to those companies of administrative, accounting, financial, commercial, information technology and technical services.

According to the ECJ, there is no exhaustive list of services qualifying as 'involvement of a holding company in the management of its subsidiary'. The concept must rather be understood as covering all transactions constituting an economic activity, within the meaning of the VAT Directive, performed by the holding company for the benefit of its subsidiary. The ECJ concluded in particular that the letting of a building by a holding company to its subsidiary amounts to involvement in the management of that subsidiary. Input VAT deduction must thus be granted on the expenditures incurred by the holding company for the purpose of acquiring securities of that subsidiary, on condition that that supply of services is made on a continuing basis, that it is carried out for consideration and that it is taxed, meaning that the letting is not exempt, and that there is a direct link between the service rendered by the supplier and the consideration received from the beneficiary. In line with its previous case law, the ECJ held that expenditures connected with the acquisition of shareholdings in subsidiaries incurred by a holding company which involves itself in the management of those subsidiaries and which, on that basis, carries out an economic activity, belong to its general expenditures so that the VAT paid on those expenditures must, in principle, be deducted in full. However, should the holding company hold shares in multiple subsidiaries and be involved in the management of only some of those subsidiaries, the VAT paid on expenditures connected with the acquisition of the shareholdings may only be deducted in proportion to the expenditures which are inherent to the economic activity.

LUXEMBOURG CIRCULAR ON VIRTUAL CURRENCIES

On July 26th 2018, the Luxembourg tax authority ("**LTA**") issued a circular on the taxation of virtual currencies. The LTA clarifies therein the tax treatment of operations involving virtual currencies as regards to income tax, corporate income tax and net wealth tax.

The LTA starts by refusing the qualification as a currency of digital currencies, arguing the lack of legal tender with a value guaranteed by a central bank. Following warnings from the European Securities and Markets Authority and the *Commission de surveillance du secteur financier*, the LTA qualifies virtual currencies as intangibles for the purpose of direct taxes. In addition, virtual currencies cannot be used as currencies for annual accounts or to report taxable income.

For entities, the LTA confirms that the same rules and guidelines regarding the determination of a commercial activity will apply to the activity of virtual currency mining, the lending of virtual currencies or trading activities involving virtual currencies as for any other kind of activities and that in this context expenses such as transaction fees, electricity or hardware costs in direct relation with the taxable activity can in principle be deducted. For the establishment of the annual accounts, all expenses and income established in virtual currencies have to be converted into a currency for which the exchange rate is published by the European Central Bank. Finally, corporations should include virtual currencies in the determination of their wealth for the purpose of the net wealth tax, following the rules established for other assets.

For individual taxpayers and in the absence of a commercial activity, income exceeding EUR 500 realised from trading or mining of virtual currencies will be taxed as short term capital gains if the taxpayer cannot prove a holding period of more than 6 months. As the burden of proof lies with the taxpayer, taxpayers are required to consistently and continually document their transactions involving virtual currencies. If individual identification of the virtual currency is not possible, the average cost method should be used to determine the income realised upon sale.

MANDATORY DISCLOSURE OF CROSS-BORDER TAX ARRANGEMENTS BY EU INTERMEDIARIES - DAC 6

On June 5th 2018, the latest amendment to the Directive on Administrative Cooperation including a new set of rules on Mandatory Disclosure of Cross-border Tax Arrangements by EU intermediaries ("**DAC6**") was published in the EU official journal, making the proposal of the Commission applicable (please refer to our newsletter from April 2018 for more details on the DAC 6). The directive thus entered into force on June 25th 2018, meaning that arrangements implemented from this date on and falling within the scope of the DAC 6 will have to be reported by intermediaries starting July 1st 2020.

OECD PUBLISHES DISCUSSION DRAFT ON INTRA-GROUP FINANCIAL TRANSACTIONS

On July 3rd 2018, the Organisation for Economic Co-operation and Development ("**OECD**") published a discussion draft that aims to provide extensive guidance on how tax authorities and Multinational Enterprises should assess the arm's length remuneration on intra-group financial transactions. The public discussion draft explores

the possibility of adding a new chapter to the 2017 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, dealing exclusively with intra-group financial transactions, an aspect that so far lacked specific guidance. The OECD invited any stakeholder to comment on the content of the draft by September 7th 2018, with further follow-on discussions to be expected early 2019.

In the discussion draft, the OECD starts by pointing out certain important positions on which it is seeking input from stakeholders, such as on:

- the possibility to determine the maximum amount of debt that should be taken into consideration, based on the amounts an unrelated lender would be willing to lend, allowing the tax authorities to requalify the excess amounts into equity; or
- the remuneration with nothing more than a risk-free return for entities that lack the capability to control the risk associated with the investments they entered into.

With regards to intra-group loans specifically, the discussion draft states that one should take into account different factors affecting the borrower and lender and that in order to determine the creditworthiness of the borrower, it is recommended to consider the credit ratings of the tested target entity as these are often readily available in many lending markets. If no such rating is available, one may use specific commercial tools that have been designed to rate debt borrowings. The belonging to a group should not be completely ignored as an independent lender would have included the fact that the borrower may benefit of implicit group support in its assessment. As a result of this, one should be able to not only determine the appropriate debt-to-equity ratio at the level of the borrower but also an adequate level of remuneration for the funds made available.

Regarding the remuneration of the transactions, the OECD suggests a two-step approach. In the first phase, one should determine a risk-free rate of return on a specific investment by taking into account the prevailing facts and circumstances. As a reference, the OECD recommends taking government issued securities with a similar maturity and issuance date. In a second phase, the risk-free rate of return should be adjusted in order to reflect the effective financial risk assumed by the funder. The OECD also recommends using the comparable uncontrolled price method ("**CUP**") to define the applicable interest rate on the transaction. As an alternative to the CUP, the cost of fund method could be used in situation where a lender used a third-party loan to finance a group member.

In addition to the explanations on intragroup loans, the draft provides a similar analysis and invites the readers to comment on transfer pricing issues regarding other activities such as cash pooling, hedging activities, guarantees and captive insurances.

VAT TREATMENT OF A REDEMPTION OF SHARES IN KIND

On June 13th 2018, the European Court of Justice (the "**ECJ**") handed down a ruling (Case C-421/17) on the VAT treatment of the transfer, by a limited company, to one of its shareholders, of the ownership of immovable property, as consideration for the redemption of shares.

The facts of the case involved a Polish limited company, active in the pharmaceutical business, which carried out a restructuring of its share capital through the redemption of shares held by its shareholder. The consideration due to the shareholder consisted in the transfer, in kind, of ownership of a plot of land, as well as the buildings and equipment erected thereon. The ECJ held that

said transfer constituted a supply of goods for consideration, falling within the scope of VAT, provided that the assets transferred to the shareholder had been allocated to the company's economic activity.

To reach its conclusion, the ECJ recalled the scope of VAT, set out in Article 2 of Council Directive 2006/112/EC of November 28th 2006 on the common system of value added tax and encompassing the (i) supply of goods (ii) for consideration (iii) within the territory of a Member State (iv) by taxable person (v) acting as such.

In the case at hand, it was unquestionable that the transaction led to the transfer of the right of ownership of immovable property (i.e. to a supply of goods) and was carried out by a VAT taxable person (i.e. a manufacturer of pharmaceutical products) within the territory of a Member State (i.e. Poland).

With regards to the consideration for the supply, the ECJ ruled that there was, between the supplier of the immovable property and the beneficiary thereof, a legal relationship in which the company transferred ownership of immovable property to its shareholder in exchange for the shares held by the latter. There was thus reciprocal performance, the one being the consideration for the other.

Finally, the ECJ considered that the final requirement of a taxable supply of goods, namely the context of the supply, was potentially met. Although a VAT taxable person is deemed to act as such, in principle, only if he does so as part of his economic activity, the latter concept is to be understood in a broad sense. Therefore the ECJ concluded that, should it transpire that the goods, whose ownership was transferred by the company to its shareholder in return for the redemption of its own shares, were allocated to the company's economic activity in the broad sense (which was for the referring court to ascertain), the transaction would be subject to VAT.

COMMISSION CONCLUDES THAT LUXEMBOURG DID NOT GRANT STATE AID TO MCDONALD'S

On September 19th 2018, the European Commission ("**Commission**") announced that it had concluded that the treatment of McDonald's profits in Luxembourg did not constitute illegal state aid within the meaning of Article 107 of the Treaty of the Functioning of the European Union. In December 2015, the Commission had launched an investigation into two rulings granted by the Luxembourg tax authorities regarding the tax treatment of McDonald's in Luxembourg.

According to the publicly available documents, McDonald's Corporation (the "**Parent**"), which is a US resident, operated a subsidiary resident in Luxembourg (McDonald's Europe Franchising, the "**Subsidiary**"). The Subsidiary operated a US branch. After obtaining the franchise rights from its Parent, the Subsidiary allocated these rights to the US branch. The Subsidiary received royalties from franchisees operating McDonald's restaurants in Europe, Ukraine and Russia which were allocated to the US branch that held the franchise rights.

The rulings at issue confirmed that, under Luxembourg law, the Subsidiary's US branch constituted a permanent establishment ("**PE**") and was therefore exempt from Luxembourg corporation tax pursuant to the Luxembourg – US double tax treaty. On the other hand, the US branch did not constitute a PE pursuant to domestic US law and therefore was not liable to corporation tax in the US. In the second ruling, the Luxembourg tax authorities agreed with McDonald's that it did not have to provide proof the US branch was effectively subject to tax. According to the Commission, this resulted in double non-taxation of the royalty income attributed to the US branch.

In its press release, the Commission concludes that the so-called double non-taxation of McDonald's royalty income is the result of a mismatch between Luxembourg and US domestic tax laws rather than of a selective advantage granted by the Luxembourg tax authorities. The Commission takes the view that this mismatch nevertheless results from a correct interpretation of the double tax treaty by the Luxembourg tax authorities. Finally, the Commission notes that Luxembourg has taken steps to address these types of outcomes by submitting a draft law to parliament on June 18th 2018 (please refer to our newsletter of July 2018 for more details on the BEPS related amendments to the Luxembourg tax law). In a statement issued on the same day, the Luxembourg Minister of Finance acknowledged the Commission's decision and welcomed the Commission's recognition of the steps taken by Luxembourg to avoid similar cases in the future.

COMMISSION DECISION IN ENGIE FISCAL STATE AID CASE

On September 4th 2018, the European Commission ("**Commission**") released the public version of its state aid decision ordering the recovery of the alleged illegal state aid granted to Engie by Luxembourg. At issue are two tax rulings issued by the Luxembourg tax authorities in 2008 and 2010 confirming the treatment of two financing transactions involving subsidiaries of the Engie Group.

In brief, the tax rulings endorsed the use of convertible loan structures to finance two intragroup transactions. In the first case, Engie Holding (the "**Holding**") indirectly financed the purchase by LNG Supply (the "**Subsidiary**") of natural gas by using a mandatorily convertible loan. At the level of the Subsidiary, the loan was treated as debt, meaning that any increase in its repayment obligation was deductible from its taxable profits. The Subsidiary was thus taxed on a margin, the determination of which was set out in the tax ruling. Under the terms of the convertible loan, no income was received by the Holding until conversion of the loan into shares. At that point, the shares benefited from the participation exemption regime and were not taxed in the hands of the Holding. A substantially similar structure was approved by the Luxembourg tax authorities in 2010 in relation to Engie Treasury Management and *Compagnie Européenne de Financement.*

The Commission concluded that these rulings gave Engie a selective advantage contrary to Article 107 of the Treaty of the Functioning of the European Union. The combined effect of the deductibility of the loans granted to the Subsidiary, and the exemption of the corresponding income under the participation regime resulted in the Subsidiary being taxed on a small amount of its profits.

According to the Commission, the selectivity of the measure lies in the application of an exemption to an income at the level of the Holding which corresponds economically to amounts deducted as expenses at the level of the Subsidiary. This result runs counter to both the general objective of the tax system to tax the profit of all the companies subject to tax in Luxembourg and the objective of the participation exemption which is to relieve double economic taxation.

On this basis, the Commission concluded that the tax rulings issued by Luxembourg gave a selective advantage to the Engie Group contrary to EU state aid rules and ordered Luxembourg to recover the aid, approximating EUR 120 million. Luxembourg has notified it will be appealing the Commission's decision.

ECJ GRAND CHAMBER JUDGMENT ON CROSS-BORDER LOSS RELIEF FOR PERMANENT ESTABLISHMENTS

On June 12th 2018, the Grand Chamber of the European Court of Justice ("**ECJ**") handed down its judgment in Case C-650/16 *A/S Bevola*. The case concerned the compatibility of Danish rules on the deductibility of foreign permanent establishment ("**PE**") losses with the freedom of establishment provided by Article 49 of the Treaty of the Functioning of the European Union.

Under Danish tax law, A/S Bevola, a Danish resident company, could not deduct the losses suffered by its foreign PE located in Finland unless it had opted for the international joint taxation scheme under Danish law which was subject to strict conditions. In the case of a domestic PE (branch), losses incurred in Denmark are deductible regardless of participation in the joint taxation scheme. First, the ECJ held that this difference in treatment between a foreign PE and a domestic PE (i.e. a branch) could discourage a resident company from carrying on its business through a PE situated in another Member State. Such a difference in treatment may amount to a restriction if the two situations are comparable. In this regard, the ECJ held that the objective of the measure is to prevent double taxation of profits and double deduction of losses of Danish companies possessing foreign permanent establishments. In the case of final losses that cannot be deducted from taxable profits in the Member State of the PE, foreign and domestic PEs are comparable with regard to the objective of preventing the double deduction of losses.

The measure, according to the ECJ, could however be justified by overriding reasons of public interest relating to the balanced allocation of powers between Member States, the coherence of the Danish tax system, and the need to prevent the risk of double deduction of losses. When considering the proportionality of the measure in light of these objectives, the ECJ followed the same reasoning as in Case C-446/03 *Marks & Spencer*. The measure is justified because allowing the resident company to opt in and out of the joint taxation scheme from one year to the next would amount to allowing it to choose freely the Member State in which it could book its foreign PE losses. However, in the case of definitive losses, the risk of double deduction of losses no longer exists and therefore the measure at issue goes beyond what is necessary to achieve its objective.

SIMPLIFIED REGISTRATION AND COLLECTION MECHANISMS FOR NON-RESIDENT TAXPAYERS

The OECD recently released a working paper on simplified registration and collection mechanisms aimed at tax authorities and addressing the issue of the effective enforcement of taxation rights on non-resident taxpayers. Countries generally have two options in order to enforce the tax collection toward non-resident taxpayers. They can either oblige a resident taxpayer involved in the transaction to collect the tax by way of withholding tax on the payment to the non-resident or require the non-resident taxpayer to register himself for tax purpose and file a tax return in order to assess his tax liability. As withholding taxes are generally not an effective mechanism to collect taxes in Business-to-Customer ("**B2C**") transactions, OECD countries are engaged in discussions on how to simplify the registration procedures for self-assessments by non-residents. The emphasis on this topic is driven by the increase of B2C transactions pursuant to the digitalisation of the economy and by a need to ensure the effective collection of taxes owed.

The work paper covers direct taxes and is based on the experience of OECD member states in consumption taxes (i.e. VAT) and discusses the possibility to extend this mechanism for non-residents to taxes other than consumption taxes. The process would entail:

- Simplifying the registration and compliance procedure for taxpayers with simplified tax returns;
- Implementing thresholds as most of the tax revenue are generated by a small number of companies in order to reduce the tax collection costs;
- Improving the use of electronic procedures;
- Facilitating the communication between tax administration and taxpayers;
- Improving the information exchange and cooperation between tax administrations.

Those measures would require the adaptation of domestic tax legislation and would result in an increased compliance burden for companies, especially those involved in B2C transactions or in the intermediation between consumers and suppliers, such as managers of online market platforms.

DISTINCTION BETWEEN RENTAL AND COMMERCIAL INCOME UNDER LUXEMBOURG TAX LAW

In a recent decision (No.39731 dated July 10th 2018), the Lower Administrative Court ("*Tribunal administratif*"), once again confirmed the principle that each tax year should be assessed independently.

In the case at hand, an SCI ("*Société Civile Immobilière*"), a type of tax transparent entity that is not automatically deemed to undertake a commercial activity for Luxembourg tax purposes, as opposed to a *Société à responsabilité limitée* or a *Société anonyme* that is always deemed to undertake such a commercial activity, solely held real estate assets from which it earned rental income. That by itself does not constitute a commercial activity leading to the recognition of commercial income, but rather a mere renting activity leading to the recognition of a rental income, which is not subject to municipal business tax. However, as the SCI sold several real estate assets over a short period of time in the previous years, the activity undertaken by the SCI was requalified into a commercial activity for those years as it exceeded the mere management of the SCI's private wealth (please refer to our newsletter dated April 2018 on the limits of private wealth management under Luxembourg tax law). The question was thus in essence, whether the qualification retained for the activity undertaken in the previous years should be binding on the qualification of the activity in the subsequent years.

The Lower Administrative Court rightfully considered, in line with the principles of Luxembourg tax law and the Luxembourg Constitution, that the tax situation of a taxpayer should be analysed on a yearly basis, irrespective of the conclusions reached in the previous or following years, unless the tax authorities previously agreed to give a binding confirmation of the tax treatment of a transaction (e.g. in cases where an Advance Tax Agreement is granted). While this decision of the Lower Administrative Court is a welcome reconfirmation of long standing principles it unfortunately did not discuss the tax treatment resulting from this position, as the end of a commercial activity generally entails the taxation of all unrealized capital gains on the assets that are deemed to be retransferred back into the private assets of the taxpayer.

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