Luxembourg Legal Update

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CLIFFORD CHANCE

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We are pleased to provide you with the latest edition of our Luxembourg Legal Update.

The newsletter provides a compact summary and guidance on the new legal issues which may impact your business, particularly in relation to banking, finance, capital markets, corporate, litigation, employment, funds and investment management and tax law.

Banking, Finance & Capital Markets

EU Developments

EU Short Selling Regulation and Luxembourg Implementing Measures

The EU Short Selling Regulation N°236/2012 of 14 March 2012 as well as four EU implementing measures specifying certain technical aspects of certain key issues came into force on 1 November 2012.

To this end, the CSSF has published, on 31 October 2012, Circular CSSF 12/548 regarding the entry into force of that Regulation giving details on the notification procedures, the disclosure of significant net short or uncovered positions and the exemption for market making activities and primary market operations. The circular also refers to documents and information published by the European Securities and Markets Authority (ESMA) on the practical application of EU Short Selling Regulation, including in particular ESMA's *"Questions and Answers on the implementation of the Regulation on short selling and certain aspects on credit default swaps (1st update)"* (ESMA/2012/666) dated 10 October 2012.

On the same day, the CSSF published a press release on the entry into force of those regulations and the revocation of its decision of 19 September 2008 to prohibit uncovered (naked) short selling in relation to quoted credit institutions and insurance companies.

In early November 2012, the CSSF opened its Short Selling Platform for the notification of significant net short or uncovered positions or, where applicable, for the publication of significant net short positions. The Short Selling Platform is available here.

Finally, the Luxembourg Government has lodged with the Luxembourg Parliament on 7 December 2012 bill N°6513 for a law on short selling of financial instruments. The bill aims to formally appoint the CSSF as authority competent in Luxembourg to supervise the application of the EU Short Selling Regulation and to define its supervision, intervention, investigation and sanction powers necessary for the CSSF to be able to accomplish its mission. The CSSF will also be in charge of the cooperation and exchange of information with the competent foreign authorities as well as ESMA. The CSSF is also appointed to receive the notification required by the Short Selling Regulation on the debt issued by the Grand Duchy of Luxembourg as well as the debt issued by the relevant European institutions established in Luxembourg, namely the European Investment Bank, the European Investment Fund, the European Financial Stability Fund and the European Stability Mechanism.

EMIR: Implementing Technical Standards Published in Official Journal

The following three implementing technical standards on the regulation on over-the-counter (OTC) derivative transactions, central counterparties and trade repositories (EMIR) have been published in the Official Journal:

- Commission Implementing Regulation (EU) 1247/2012 of 19 December 2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories according to Regulation (EU) 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories.

- Commission Implementing Regulation (EU) 1248/2012 of 19 December 2012 laying down implementing technical standards with regard to the format of applications for registration of trade repositories according to Regulation (EU) 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories.
- Commission Implementing Regulation (EU) 1249/2012 of 19 December 2012 laying down implementing technical standards with regard to the format of the records to be maintained by central counterparties according to Regulation (EU) 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories.

The implementing technical standards have entered into force on 10 January 2013. However, the provisions under the implementing technical standards will only take effect once the associated regulatory technical standards enter into force, since the provisions defined in the implementing acts complement provisions defined in the related regulatory technical standards and are not stand-alone obligations.

European Commission Delegated Regulation (EU) 862/2012

Second Amendment to Prospectus Regulation

The European Commission's Delegated Regulation 862/2012 of 4 June 2012 amending its Regulation 809/2004 as regards information on the consent given by the issuer or the person responsible for drawing up the prospectus to financial intermediaries to use the prospectus, information on underlying indexes and the requirement for a report prepared by independent accountants or auditors entered into force on 22 September 2012.

Prospectuses: ESMA Updates Common Positions Agreed by Members

On 28 September and 19 December 2012, ESMA published updated versions of the frequently asked questions (FAQs) on the Prospectus Directive and the European Commission's Prospectus Regulation 809/2004, which set out the common positions agreed by its Members.

Legislation

Law of 21 December 2012

Family Offices

The law on family offices (enacting bill 6366) has entered into force on 31 December 2012.

The new law regulates professional activities of advice or estate related services provided to individuals, families or their investment vehicles. For further information on the relating bill we kindly refer you to the January 2012 edition of our Luxembourg Legal Update.

The CSSF has clarified in a circular letter dated 21 January 2013 that investment advisors, wealth managers, domiciliation agents and company set-up and management professionals who are subject to its supervision and who are by law authorised to exercise family office activities do not have to apply for a top-up licence as a family office professional. The CSSF however invites them to inform the CSSF swiftly on whether or not and if yes to which extent they exercise family office activities. The CSSF has indicated in a press release 13/03 dated 21 January 2013 that professionals who are not yet regulated as a professional authorised to exercise family office activities will have time until 30 June 2013 to comply with the new law and, if they wish to continue their activity beyond that date, to become appropriately licensed.

Law of 21 December 2012

Implementation of Directive 2010/78/EU "Omnibus I"

The Luxembourg Parliament has adopted bill N°6397 implementing the so-called "Omnibus I" Directive 2010/78/EU. For further information on the bill we kindly refer you to the May 2012 edition of our Luxembourg Legal Update.

The law entered into force on 31 December 2012.

It is important to note that the initial bill has been amended in some points, one of which is that investment advisors of investment funds who will become subject to a licence requirement under the Financial Sector Law will have time until 30 June 2013 to comply with the provisions of the Financial Sector Law (rather than 31 December 2012 as initially foreseen in the bill).

Bill N°6523

Revision of Statutory Mortgage Bond Regime

The Luxembourg government has lodged a bill revising the statutory mortgage bond regime with the Parliament. The bill has been published on 11 January 2013. Certain major innovations are proposed by the bill, which are in part inspired by recent changes to the German *Pfandbrief* legislation.

The major innovation will be to strengthen the provisions on the protection of mortgage bond holders in case of collective liquidation of the mortgage bank. The bill in particular introduces a regime providing for suspension of payment and judicial liquidation proceedings for one or several cover pools or compartments of the mortgage bank. This will permit the reorganisation or liquidation of one or several cover pools or compartments separately without such proceedings affecting the functioning of the remaining estate (cover pool(s), compartment(s) and general estate) of the mortgage bank which will be strictly separated from the cover pool or compartment subject to suspension of payment or liquidation proceedings.

Unlike German *Pfandbrief* legislation, the bill does however not abandon the existing special bank principle, i.e. the principle that only mortgage banks are allowed to issue mortgage bonds.

The second major innovation is the introduction of the new category of mutual mortgage bonds. This new mortgage bond category will be added to the existing categories of real estate mortgage bonds, public sector mortgage bonds and moveable asset mortgage bonds. Mutual covered bonds have to be backed by exposures on credit institutions that are members of mutual guarantee systems.

The bill also extends the scope of eligible assets that may serve as cover for public sector mortgage bonds. Hitherto, public sector mortgage bonds may also be backed by exposure on public sector entities from non-OECD countries, provided the relevant country has a certain rating level.

Clifford Chance is intending to report in more detail on the bill shortly.

Bill N°6539

Bill regarding the preservation of companies and the modernisation of the Luxembourg insolvency laws

This new bill mainly provides for measures aiming to prevent financial difficulties of companies.

The first measure consists in the institution of an administrative authority centralising information regarding the financial situation of companies. Such authority will then be able to identify companies that have financial difficulties or are likely to end up in such difficulties in the near future. When it detects such difficulties, this authority is able to suggest certain non-mandatory measures to companies.

A company may also ask for a mediator (*conciliateur*) to be chosen by this administrative authority. The mediator may for example negotiate with the company's creditors, or help to identify the reasons of the company's financial difficulties.

Another informal procedure aims at allowing to reach an amicable agreement (*accord amiable*) with creditors in order to ensure the survival of the company. This agreement is deposited with this administrative authority. The agreement as well as payments made with regard to the agreement are protected in a subsequent insolvency and cannot be voided even if they are made within the hardening period.

There will also be judicial reorganisation measures, which will imply the deferral of all payments during such proceedings.

The bill also provides for an administrative dissolution procedure without liquidation. This simplified procedure, which does not necessitate the intervention of the courts, will be used with regard to companies which have no assets, no employees and which might not even have had any activity for a prolonged period.

Finally, the bill simplifies bankruptcy proceedings in order to facilitate criminal prosecution of the directors of insolvent companies.

It should be noted that financial collateral arrangements will be generally unaffected by the purported changes.

Grand Ducal Regulation dated 29 September 2012

Taxes Levied by the CSSF

The Grand Ducal regulation of 29 September 2012 relating to the fees to be levied by the CSSF has replaced the Grand Ducal regulation of 18 December 2009 relating to the fees to be levied by the CSSF as from 2013. The new regulation is available on the CSSF website.

Grand Ducal Regulation dated 21 December 2012

Physical Transport of Cash

The Grand Ducal regulation contains a new form to be used for declaring cash equal to or amounts exceeding EUR 10,000 when entering, transiting or leaving the Grand Duchy of Luxembourg.

Grand Ducal Regulation dated 14 November 2012

Changes to Insurance and Reinsurance Undertakings Regulation

The regulation amends certain details of the Grand Ducal regulations specifying the modalities of authorisation and exercise of business of insurance and reinsurance undertakings. The changes relate in particular to the calculation of solvency margins and the amount of the guarantee fund an insurance or reinsurance undertaking has to maintain. The amendments have entered into force on 1 January 2013.

CSSF Regulation dated 14 December 2013

Combat Against Money Laundering and Terrorism Financing

CSSF Regulation 12-02 dated 14 December 2012 on the combat against money laundering and counter-terrorism financing (AML/CTF) was published in the Official Journal on 9 January 2013. The new CSSF Regulation applies to all professionals who are subject both to Luxembourg AML/CTF obligations and supervision by the CSSF.

The new regulation contains important specifications on the CSSF's positions on the application of Luxembourg AML/CTF legislation. The main new topics are:

- Which relationships constitute relationships similar to cross-border correspondent banking relationships.
- The obligation of undertakings for collective investment, risk capital investment companies, their management companies or their agents to apply enhanced customer due diligence measures vis-à-vis intermediaries subscribing their parts or shares for client account.
- The minimum content of the AML/CTF policy of a finance professional and more generally the internal organisation requirements for such professional.

The new regulation already takes into account certain of the new recommendations of the Financial Action Task Force (FATF) adopted in February 2012 and to be introduced within the EU by way of a directive.

The CSSF Circular 13/556 dated 16 January 2013 has abrogated with immediate effect two of its main circulars in the area of AML/CTF, namely circulars 08/387 and 10/476, whilst the other CSSF circulars in this area remain in force.

Regulatory Developments

CSSF Circular 12/550

Practical Rules Concerning the Mission of the Approved Statutory Auditors of Payment Institutions

This circular applies to Luxembourg incorporated payment institutions. It specifies the scope of the mandate that such a payment institution has to give to external auditors for the audit of its annual accounting documents and specifies the rules concerning the content of the long form report the external auditor has to establish and that is communicated to the CSSF.

CSSF Circular 12/552

New Central Administration, Internal Governance and Risk Management Requirements for Credit Institutions, Investment Firms and Lending Professionals

This major new circular will enter into force as of 1 July 2013. It will combine the entirety of key application modalities in the area of internal governance currently spread over several CSSF circulars and guidelines existing on an international level in one comprehensive circular.

The circular applies to credit institutions, investment firms, and to some limited extent to professionals carrying out loan transactions.

The existing circulars on central administration, the administrative and account organisation (including outsourcing in the area of IT), internal audit, the compliance function as well as reporting in crisis situations, will therefore no longer be applicable to credit institutions and investment firms after 1 July 2013.

The new circular also implements:

- The "Guidelines on Internal Governance (GL44)" issued by the European Banking Authority (EBA) on 27 September 2011.
- The document "The internal audit function in banks" issued by the Basel Committee on Banking Supervision (BCBS) on 28 June 2012.
- The "Guidelines on the management of concentration risk under the supervisory review process (GL31)" issued by the Committee of European Banking Supervisors (CEBS), the predecessor of the EBA, on 2 September 2010.
- The "Guidelines on Liquidity Cost Benefit Allocation" issued by the CEBS on 27 October 2010.

The new circular nevertheless does not address all aspects covered by the area of internal governance. For example remuneration principles will continue to be covered by the existing circulars implementing the Capital Requirement Directives framework (2006/48/EC and 2006/49/EC). Also, the coverage of the area of risk and risk management is limited to simply implementing the above-mentioned EBA/CEBS Guidelines and setting out basic prudential principles in the area of granting loans and private asset management. The CSSF announces the integration of the multiple existing circulars relating to risk and risk management in a future revised version of the new circular.

You can find a presentation of the basic points of and changes arising under the new circular on the CSSF website (available in French only).

CSSF Circular 12/553

Shareholding Disclosure Requirements

This new circular modifies the regular reporting requirements for Luxembourg credit institutions and Luxembourg branches of non-EU/EEA credit institutions concerning their shareholders. Shareholders must be reported by the credit institution to the CSSF if they hold, directly or indirectly, at least 10% of the capital or voting rights attached to the shares of the credit institution (and no longer 5%).

CSSF Circular 13/554

Evolution of the Use and Control of IT Resources and their Access Tools

On 7 January 2013, the CSSF published a new circular which entered into force with immediate effect and which is applicable to all credit institutions and other professionals of the financial sector subject to the Financial Sector Law. The new circular deals with the use and control of the tools allowing professionals of the financial sector to manage access rights to the IT resources connected to their network and/or to centrally register and administer most of those resources (user accounts, printers, computers, services, etc.).

The CSSF reminds professionals that they always need to have permanent full control over the resources under their responsibility and the corresponding accesses to these resources, primarily for compliance and governance reasons and secondly to protect confidential data subject to professional secrecy. The annex to the circular contains a technical note setting out the detailed requirements of the CSSF in this area, in particular for professionals using access tools integrated into the global access tools system of the group. Any professional wishing to use such a configuration is required to introduce a formal and detailed authorisation request to the CSSF demonstrating that the professional always keeps permanent full control over the resources under its responsibility and over the corresponding accesses to these resources.

CSSF Circular 13/555

Introduction of a Single Customer View with respect to the AGDL Deposit Guarantee

This new circular dated 8 January 2013 applies to Luxembourg banks or Luxembourg branches of non-EU/EEA banks and the Luxembourg *Entreprise des postes et télécommunications* taking deposits or other repayable funds from the public and informs them of the decision of the Luxembourg deposit guarantee scheme AGDL requiring them to put in place and keep up to date a Single Customer View (SCV) data file as of 31 December 2013 at the latest.

As of 31 December 2013, each institution has to be able to communicate the SCV data file to the AGDL within three business days following the day of the request by the AGDL to the institution subject to insolvency proceedings.

The objective of the SCV data file is to provide the AGDL with the total amount of deposits per depositor covered by the deposit protection on the date of the declaration of insolvency of the credit institution, thereby permitting to the AGDL to comply with its own obligations of indemnification of such depositor within the deadlines foreseen by law.

The responsibility for the production and content of the SCV data file remains fully with the bank. Its management is obliged to put in place adequate internal policies and procedures to comply with the new requirements. One of the authorised managers will have to be appointed to be in charge of AGDL matters and his/her name will have to be communicated to the CSSF. The authorised management will have to confirm compliance with the new requirement on a yearly basis to the CSSF.

CSSF Circular 13/557

Entering into force of EMIR

The CSSF has issued a circular dated 23 January 2013 on the entering into force of the EU regulation on over-the-counter (OTC) derivative transactions, central counterparties and trade repositories (EMIR). The circular provides an overview of the regulation, useful website links and action points for counterparties to derivatives contracts. The circular also announces the forthcoming publication on the CSSF website of templates for the notifications and applications for exemption from EMIR when technical standards relevant to the intra-group exemptions available under EMIR will have entered into force and ESMA and the national competent authorities will have developed the most appropriate process for applications.

CSSF Questions and Answers Relating to PFS

Update of Q&A Relating to Lending Licence Requirement

On 15 October 2012, the CSSF updated section 51 relating to the licence requirements for professionals carrying on the activity of granting loans to the public for own account. The amendments relate to the scope of the exemption from this licence requirement for certain investment vehicles subject to specific regulations, namely the extension of such exemption to special purpose vehicles controlled by regulated investment vehicles.

The CSSF indicates that it would, for the question whether loans are granted by an SPV to a restricted group of persons known in advance (which does not trigger the lending licence requirement) also take into consideration the parent company of the SPV. The CSSF also specifies now that only where the application of the lending licence requirement to an envisaged activity cannot be excluded on the basis of the criteria set forth by the CSSF, persons envisaging to carry out such activity are invited to approach the CSSF.

See also Funds & Investment Management section.

CSSF Questions and Answers Relating to the Prospectus Regime

Publication of Revised Version of the Q&A Document

The CSSF has published a revised version dated 12 October 2012 of its Q&A on the prospectus regime. The new Q&A document adapts the old version to the legal, regulatory and other developments in this area. Certain of the former Q&A have been deleted, modified or clarified. In addition, the Q&A document is now structured by reference to the topics covered for the ease of reading. The new Q&A document is available on the CSSF website (in French only).

CSSF Frequently Asked Questions on the Transparency Law

Publication of Revised Version of the FAQ Document

On 25 July 2012, the CSSF has published an updated version of its FAQ Document on the Transparency Law. The updated version is available on the CSSF website. The FAQ document addresses a new question on the impact of the law of 3 July 2012 that has amended the Prospectus Law and the Transparency Law by implementing into national law Directive 2010/73/EU (see in respect of the law of 3 July 2012 the October 2012 edition of our Luxembourg Legal Update) on the obligations of issuers in terms of transparency and makes consequential changes to other FAQs throughout the document. The new question in particular deals with the modification of the nominal value per unit threshold below of which exemptions from periodic publication requirements under the Transparency Law are available, as well as the deletion of the issuer obligation to file a document regrouping all publications of the issuer in an annual period.

CSSF Press Release 12/51

EBA Update on Supervisory Reporting Requirements for Liquidity and the Leverage Ratio

In a press release of 21 December 2012, the CSSF has drawn the attention to the publication by the EBA on 20 December 2012 of feedback documents and amended templates following the consultations on Draft Implementing

Technical Standards (ITS) on supervisory requirements for liquidity coverage, stable funding and the leverage ratio. These documents provide the *current* position of the EBA regarding the supervisory requirements (formats, frequencies, IT solutions) for liquidity and leverage ratios to be reported pursuant to the forthcoming Capital Requirements Regulation (CRR). The CSSF announced that it will continue and broaden its current monitoring exercise ("impact studies") with respect to liquidity coverage and stable funding in light of the need for the EBA to perform impact assessments with respect to the foreseen liquidity and leverage regulations.

CSSF Press Release 13/01

Control of 2012 Financial Information by Issuers Subject to the Transparency Law

The CSSF has published a press release dated 9 January 2012 drawing the attention of issuers subject to the Transparency Law and currently preparing their financial statements for 2012 in accordance with IFRS on certain matters and issues that will be subject to a special control by the CSSF on the occasion of its annual review of such financial statements. This includes for example transparency concerning risk exposure related to financial instruments, notably issued by sovereigns, or non financial assets as well as the valuation of pension plan liabilities and of real estate investments.

Publication of the Annual Report 2011 of the Financial Intelligence Unit

The Financial Intelligence Unit (*Cellule de Renseignement Financier*, CRF) of the State Prosecutor's office to the Luxembourg District Court published its annual report 2011. The document is available (only in French) at the following address: http://www.justice.public.lu/fr/publications/rapport-activites-crf/rapport-crf-2011.pdf.

The report contains examples of types of frauds occurring regularly:

- Many suspicious transaction reports have been linked to scams or attempted scams regarding redemption requests from life insurance contracts. Such requests have subsequently been found to be falsified and not emanating from the policyholder. The recipient account abroad – usually opened under false identities – is immediately debited by a cash withdrawal. In many cases the interception of mail and copies of identity documents of the policyholder allows criminals to produce documentary "evidence" to support the redemption request, while indicating payment details to take possession of the redemption amount.
- A number of suspicious transaction reports were related to the use of customer accounts for transactions with no apparent link to the actual client. Such transactions involved the cashing in of cheques in a foreign currency which proved to be forgeries. Persons had responded to a job offer. The job was the evaluation of the performance of payment services after customer complaints. In order to test the payment services, the candidate is given a cheque – which turned out to be a forgery – and he is supposed to receive the funds.

The report also contains numerous examples of types of suspicious transactions having occurred in 2011. One example is of particular interest as it shows that the Financial Intelligence Unit may remind professionals of the financial sector of their obligation to report suspicious transactions and even initiate court action if it does not respect this obligation. In the case at hand, no action in court has been initiated given that the facts were not recent enough to be considered important and given the absence of a criminal record. The transaction regarded the renting of a holiday home for a total amount of more than EUR 600,000. The person renting the home had a monthly income of less than EUR 5,000 and came from a country known to have a high degree of corruption. The rent has been paid in around 60 bank transfers of which about 50 had a value of less than EUR 10,000 in order for them not to be detected.

CAA Circular 12/10

Update of CAA Circular 03/5 on Technical Bases for Life Insurance Contracts

The new circular 12/10 issued by the CAA on 19 December 2012 is available on the CAA website and adapts the existing circular 03/5 on technical bases for life insurance contracts to take account of the recent prohibition to use gender specific calculation bases for contracts commercialised as of 20 December 2012.

Case Law

District Court, 4 January 2012[1]

Transfer Orders with a Forged Signature

A bank transferred important amounts from a client's accounts to other accounts. The client pretended that he had never instructed the bank to make such transfers and when the bank claimed that it had received signed transfer orders, the client answered that the signatures on these orders are forged.

Burden of Proof

When it came to the burden of proof regarding the genuine or forged nature of a handwriting, the District Court decided that it lay with the person pretending that the handwriting was genuine. Given that the bank did not offer any element enabling the court to verify whether the signatures were genuine, the transfer orders could not be used as evidence.

Obligation to Repay

The contractual relationship between the bank and a client opening a bank account with it in order to deposit money is a deposit agreement. Such an agreement implied the contractual obligation of the bank to return money deposited with it to the client or to a person having a power to receive the money. This obligation was an obligation of result (*obligation de résultat*). It was not possible for the bank to be freed of such obligation by proving that it had not committed a fault. For this reason it was not sufficient for the bank to prove that it had not been possible to notice that the client's signature on the transfer orders had been a forgery to exonerate it from its obligation to repay.

Contractual Exclusion of Liability

The bank referred to a clause of its general conditions which provided that the bank was not responsible for the fraudulent use of a client's signature by a third party. According to the Court, this clause did not simply limit the bank's liability but it excluded it completely in this particular case. However, a debtor of an obligation may not limit the contents of his obligations to the point where it annihilates the obligation which is of the essence of the contract. Contractual clauses which annihilate the obligation which is of the essence of the contract are deemed to be inefficient or nul and void. The obligation of restitution of the depositary was essential to a deposit agreement. A clause liberating the depositary of this obligation was thus deemed to be inefficient.

For this reason, the bank would only have been exonerated from its obligation to recredit the client's account if the payment had been the result of a fault of the client.

District Court, 8 February 2012[2]

Duties of the bank in an advisory mandate

A bank's client invested in certain financial products and incurred losses to the point that the account had a negative balance at the end of the financial operations. The client considered that his bank was liable for the losses as it had discretionary powers when managing the client's investment portfolio.

Discretionary Management or Advisory Services

The District Court characterised the contractual relationship between the bank and its client. It appeared that there had been very regular e-mail contact between the client and the bank and that all operations by the bank had to be approved by the client. The client mentioned some transactions where the bank had sold assets without his prior approval. However, the Court noted that these transactions had been made in a context of market turmoil and that they had been made only to save as much as possible of the value of the client's assets. Furthermore, it appeared from e-mails that the client had been informed prior to these transactions and that he could have stopped them if he had wanted to do so. Given the context of these transactions, the Court decided that they were not constitutive of a discretionary management contract. For these reasons, the relationship between the bank and its client was characterised to be an advisory relationship, where the client took his decisions alone on the basis of suggestions and recommendations of its advisor.

Client's obligation to regularly verify his account statements

The client also considered that the bank had committed a fault as it had not informed him about the evolution of his portfolio in certain months and especially when his portfolio lost large parts of its value. It appeared, however, that the bank had issued account statements every month, that it had been the decision of the client that the statements were kept with the bank on a hold mail basis and that the client did not consult those. According to the Court, the client had an obligation to regularly verify his account statements and if he did not do this, he was negligent. In particular, the financial crisis leading to the client's losses has been such that if the client felt that he did not have the necessary information, he should have asked the bank to provide him with all the necessary elements.

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[1] District Court, 4 January 2012, N°139.409.

[2] District Court, 8 February 2012, N°125.430.

District Court, 15 February 2012[3]

Ancillary Obligation of Information and Advice of a Custodian

A client incurred losses when placing stock market orders regarding financial instruments which were held in an account with a bank. The client wanted to recover some of its losses by invoking the bank's liability because it had not provided him with the adequate information and advice.

Given that the client was trading autonomously, the District Court decided that the contract between the bank and its client was a custody agreement regarding financial instruments.

The District Court decided that even though the bank did not have any power to manage the client's financial instruments, in the context of stock market orders the bank had an ancillary obligation of information and advice. In particular, regarding such operations, the bank had to provide the client with information regarding the financial conditions and the risks of such operations. However, in such context the bank did not have to give specific advice or advise on the decision of the client whether to place a stock market order.

In fact, with regard to a custody agreement, the client managed his portfolio himself and he took the decisions regarding stock market orders. The information and advice given by the bank had the sole purpose to inform the client on the operation. This means that the client took the final decision and assumed the risks.

The nature of the custodian's obligation of information and advice regarding stock market orders is variable and it strongly depends on the qualities and the knowledge of the customer. In presence of a qualified and regular investor the bank's obligation might not exist at all. In addition, the client has an obligation to inform himself and to seek advice. It is not possible for him to stay completely passive and to claim his ignorance later.

In the case at hand, it appeared that the customer was a regular investor whose operations implied some risk and who knew the functioning of the financial market and the risks related to such operations. For this reason, the Court held that the bank did not incur a liability.

The client also argued that he had only bought the financial instruments, because they had been recommended to him by the bank.

The District Court held that, with regard to the fact that the client was an informed investor, even if the bank had recommended the purchase of the financial product, it would only be liable if the advice it gave had been the result of a wrong appreciation of the elements it had or should have had at its disposal. One could not blame the bank for the negative outcome of an investment as any investment was subject to the fluctuations of the market and good advice given today could reveal itself to be bad advice tomorrow due to the evolution of the markets. In addition, the bank was not liable for the efficiency of the information if the client was free to take a decision on the basis of such information. In fact, the person receiving information was free to take it into account or not in his decisional process. In particular, it appeared that the bank had advised the client to sell the product when its value fell under a certain threshold. The client however chose not to follow the banks' advice. For this reason, the bank could not be considered to be liable for the losses suffered by the client.

District Court, 26 June 2012[4]

Theft of Confidential Documents by Employee of Bank

The head risk manager of a bank had resigned due to certain facts (unusual high risks taken by the bank) that, in his opinion, made it impossible for him to work for the bank any longer. Shortly after his resignation he started a lawsuit against his former employer in the labour court in order to receive damages because of misconduct of his employer during the employment contract. In these proceedings, in order to prove the bank's misconduct and that he was not liable of misconduct, he used a number of internal documents of the bank. For this reason, the bank initiated criminal proceedings against the former employee on the grounds of theft and violation of the professional confidentiality obligations.

The District Court noted that there had been theft, as there had been an appropriation of internal documents by the employee without the knowledge and approval of the employer. In fact, even if he had had material use of these documents during his work contract, the ownership of these documents belonged to the employer. Even if the employee only used the documents to make photocopies, he committed a theft of these documents. Such qualification of theft was even appropriate if the employee only made such photocopies in order to use them later in proceedings against the employer.

With regard to professional confidentiality rules in the banking sector, the Court noted that the documents used in the proceedings contained information that had been protected by professional confidentiality. Furthermore, not only the bank as such but also all its employees had to respect the rules regarding professional confidentiality. This obligation only ceased if this was either authorised or

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[3] District Court, 15 February 2012, N°140.306.

[4] District Court, 26 June 2012, N°2270/2012.

imposed by law. Given that this was not the case when an employee violated the professional secrecy obligation in order to collect documents to be used in proceedings against his employer, the Court decided that the former employee had violated professional confidentiality rules.

However, a criminal act could lose its criminal nature in certain circumstances, if there are certain justifications (*faits justificatifs*).

According to French case law referred to by the Court, an employee was allowed to use internal documents of a confidential nature against his employer in his defence in proceedings in labour court. But the use of such documents was only admitted if it was strictly justified by the employee's rights of defence. This is admitted under three conditions:

- The employee had access to the documents due to his position in the normal exercise of his job (an employee has the right to photocopy, scan, print or duplicate work documents or even take the originals, but he does not have the right to search other employees' or his superiors' offices in order to find helpful documents).
- The documents were really useful for his defence.
- The proceedings in labour court against the employer were imminent (it is not necessary that such proceedings exist at the time of the theft, but they have to start "shortly" afterwards).

In addition, if the employer wanted the criminal liability of the employee to be retained by the court, it had to prove that the documents had been taken by the employee in order to be used for a purpose other than his defence in labour court proceedings.

Given that the rights of the defence have a superior value to the right of ownership of the employer, in these conditions even though the employee had committed a theft, he was not criminally liable.

With regard to the violation of the obligation of professional confidentiality, the Court admitted that, even though the justification (*fait justificatif*) of the rights of the defence was not based in the law, but only in case law, an employee was allowed to use confidential documents in court proceedings for his defence in order to avoid a conviction. However, such use had to be justified by the exercise of the rights of the defence and the Court had to check that this was the case. The Court noted that the documents had only been used in the court proceedings against the employer and it assumed that the employee had only intended to use them in such proceedings. In addition, the Court noted that the documents contained information in favour of the employee.

For these reasons, even though there had been theft and violation of professional confidentiality, the employee was acquitted.

District Court, 16 November 2012[5]

Voidability of Enforcement of Pledge

Following the occurrence of events of default in a facilities agreement, a pledge over shares had been enforced. After the insolvency of the pledgor, the bankruptcy receiver started an action in court in order to see the sale of the shares voided. In particular, the bankruptcy receiver argued that if article 20 (1) of the Financial Collateral Law provided that while the rules regarding insolvency proceedings were not applicable to financial collateral arrangements, this was not applicable to enforcement measures of such financial collateral arrangements. In a summary, the bankruptcy receiver argued that the security as such was protected, but that this was not the case of contracts which are execution measures of such arrangements as was the case of the sale of the pledged assets which could thus be voided with regard to the insolvency legislation. In addition, the bankruptcy receiver argued that the enforcement should be voided because the sale had not been made in normal commercial conditions.

The District Court decided that according to article 20 (1) of the Financial Collateral Law, financial collateral arrangements, events leading to their enforcement and the means of evaluation and enforcement determined by contract between the parties according to this law took effect against third parties and the bankruptcy receiver. In addition, article 20 (4) of the law provided that rules regarding insolvency proceedings were not applicable to financial collateral arrangements and did not preclude the enforcement of such arrangements. In the case at hand, the parties had provided for the enforcement by private sale in the pledge agreement. As a consequence, it appeared that the parties had freely agreed on the enforcement measures and this arrangement had taken effect against third parties. The bankruptcy receiver could not demand that such enforcement measures be voided on the basis of rules regarding insolvency proceedings whose application had been expressly excluded by article 20 (4). It also appears from preparatory works to the Financial Collateral Law that the enforcement of financial collateral arrangements was supposed to be protected by the law and that the only means left to the parties was to act for damages after enforcement.

With regard to the argument based on the absence of normal commercial conditions the Court notes that even if such conditions were not met, the sale could not be voided. The prejudiced party could only start an action for damages.

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[5] District Court, 16 November 2012, N°143.752. The decision is subject to appeal.

Corporate, M&A

Legislation

No significant changes entered into force in the general provisions of Luxembourg corporate law during the period covered by the present newsletter. However, the Luxembourg authorities have issued certain regulations which may affect the activities of Luxembourg companies.

CSSF Circular 12/545

Squeeze-out/sell-out procedures

1 October 2012 marked the entry into force of the new law of 21 July 2012 relating to squeeze-out and sell-out procedures for companies whose securities are listed or were listed on a regulated market.

The aim of this law is to implement in Luxembourg a squeeze-out procedure pursuant to which shareholders holding 95% of the share capital and 95% of the voting rights of a Luxembourg company may force minority shareholders to sell their remaining shares in the company, as well as a sell-out procedure offering the right to minority shareholders to require the purchase of their shares by a shareholder holding 95% of the share capital and 95% of the voting rights of the Luxembourg company.

These new procedures are under the supervision of the CSSF, which issued a circular clarifying certain aspects of the new law on 1 October 2012.

Scope of the law

The circular specifies that the new squeeze-out and sell-out procedures only apply to companies whose registered offices are located in Luxembourg. The circular mentions that these new procedures should in practice principally affect Luxembourg *sociétés anonymes* and *sociétés en commandite par actions*.

Moreover, the circular expressly states that the new procedures are only related to securities with voting rights attached thereto. They are not applicable to non-voting shares or beneficiary shares (*parts bénéficiaires*).

The circular also clarifies on which regulated markets such securities must be listed (or must have been listed in the past) in order to benefit from these new procedures. Only regulated markets within the meaning of the MiFID directive (i.e. a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly). In Luxembourg, only the regulated market of the Luxembourg Stock Exchange (*Bourse de Luxembourg*) falls within the scope of the new law. MTF markets are excluded from the benefit of the provisions of this new law.

The circular also mentions that these new procedures are not applicable in case of mandatory takeover bids (*offre public d'acquisition*), thus avoiding interaction between the provisions of the new law and the specific ones relating to the mandatory squeeze-out and sell-out procedures within the framework of mandatory takeover bids provided for in the law of 19 May 2006 on mandatory takeover bids.

Transitory provisions

The general provisions of the law state that the new procedures shall apply to Luxembourg companies whose securities:

- are listed on a Member State regulated market,
- have been delisted on a Member State regulated market for less than 5 years,
- have been subject to a takeover bid, for which a prospectus has been published in accordance with applicable laws or an exemption has been obtained, provided that such takeover bid was not started more than 5 years ago.

The law contains a transitory provision which effectively allows to use these new procedures for Luxembourg companies, which have been delisted after 1 January 1991, provided that these procedures are initiated within a period of three years after the entry into force of the law.

Notification and communication with the CSSF

The law creates new notification and reporting requirements towards the CSSF. The circular also explains that certain of these reporting requirements apply immediately to certain shareholders of Luxembourg companies. Thus, a majority shareholder within the meaning of the new law (i.e. a natural or legal person, who holds, alone or with persons acting in concert with him, directly or indirectly, shares representing 95% of the capital carrying voting rights and 95% of the voting rights in the company) of a Luxembourg company falling within the scope of this new law (hereafter referred to as a "**Majority Shareholder**") has the obligation to provide to such company and the CSSF, as soon as possible and at the latest on 1 December 2012, with the following information:

- the exact percentage of its shareholding in the company,
- its identity, and
- the form of its shareholding (e.g. direct and indirect participation in the company).

Publication of information

➔ *For Majority Shareholder*

Within the framework of the new squeeze-out and sell-out procedures, the Majority Shareholder must publish certain information and ensure that this information is rapidly accessible on a non-discriminatory basis.

If the company's shares are listed on a regulated market, the circular explains that the Majority Shareholder will be deemed to have complied with this obligation if the publication of such information is made in the same manner as information communicated under the Transparency Law (e.g. communication through the OAM (Officially Appointed Mechanism) system).

➔ *For the company subject to the new squeeze-out and sell-out procedures*

The Luxembourg company subject to the new squeeze-out and sell-out procedures must also publish information received within the framework of these procedures and ensure that such information is rapidly accessible on a non-discriminatory basis. The company must publish such information as soon as possible and at the latest within three business days after its receipt.

The circular defines the various ways in such information may be communicated, most notably:

- If the company's shares are listed on a regulated market, the company will be deemed to have complied with this obligation, if the information is published in the same manner as publications under the Transparency Law.
- The information was published in two widely circulated newspapers in the Grand Duchy of Luxembourg and in the Luxembourg official gazette (*Mémorial C*).
- If all the shares of the company are registered shares, the information may be sent by registered letter to each shareholder of the company.

➔ *For minority shareholders*

The circular also specifies the form of notification to be made by minority shareholders within the framework of the new squeeze-out and sell-out procedures.

In case of squeeze-out procedures, minority shareholders may object to the price proposed by the Majority Shareholder during a period of one month following the publication of the price, by sending a registered letter with acknowledgment of receipt to the CSSF explaining the reasons of their objection to the proposed price. Copies of this letter must also be sent by the minority shareholders to the Majority Shareholder and the company, by registered mail with acknowledgment of receipt within one month following publication of the proposed price.

In case of sell-out procedures, minority shareholders must first inform the Majority Shareholder of their intention to benefit from the sell-out procedure by registered letter, with copies of this letter to be sent to the CSSF and the company. Once the proposed price for the repurchase of their shares is published by the Majority Shareholder, they may object to the proposed price to the CSSF explaining the reasons of their objection to the proposed price during a period of one month following the price's publication. Copies of this letter must also be sent by the minority shareholders to the Majority Shareholder and the company.

Case Law

Administrative Court, 24 October 2012[6]

Non-payment of taxes – Liability of a director of a Luxembourg company after the end of his mandate

This case involved a Luxembourg company which had neither made any tax declarations, nor paid any taxes since 2000. In addition, no annual accounts had been prepared and filed for the company during this period. The Luxembourg tax administration, in accordance with Luxembourg tax law, issued several mandatory tax invoices against the company for the period since 2000 and declared the chairman of the board of directors of the company (who was also a shareholder of the company) jointly and personally liable with the company for the payment of these tax invoices, considering that the chairman of the board of directors had committed serious wrongdoing breaching the Companies Law and the articles of association of the company by neither preparing and filing any annual accounts for the company since 2000, nor preparing any tax declaration during this same period.

The chairman of the board of directors contested the decision of the Luxembourg tax administration and argued that in fact the day-to-day management was delegated during this period to a third-party (his brother) who was responsible for the tax filing and the preparation of the annual accounts. Moreover, he argued that his mandates as chairman of the board of directors and as director of the company expired in 2006 and that he was only reappointed

[6] Administrative Court, 24 October 2012, N°29408.

for a new mandate in 2009 and that, therefore, he could not be responsible for the period between 2006 and 2009.

The Administrative Court rejected the arguments of the directors and confirmed the decision taken by the Luxembourg tax administration.

Firstly, the Administrative Court explained that a director is obliged to ensure that the company complies with its legal obligations regarding tax and accounting, even if the day-to-day management or the accounting function has been delegated to another person. As a prudent and diligent person, the director must exercise an effective supervision of the person to whom these roles have been delegated. Moreover, by virtue of the law, directors are responsible for the preparation and filing of the annual accounts of the company and the tax declarations, and the Administrative Court held that failure to comply with these obligations constitutes a serious wrongdoing for the director. For this reason, the director may be declared personally liable when the company has failed to make tax declarations or pay taxes for several years.

Secondly, the Administrative Court held that the director was also responsible for the period between 2006 and 2009, even if his mandate expired in 2006. The Administrative Court stated that a director whose mandate has expired is still in charge, on a provisional basis, of the management of the company until his effective replacement by a new director, and therefore in the present situation the director still had the obligation to prepare and file the relevant annual accounts and tax declarations of the company, in accordance with the law.

Court of Appeal, 22 June 2011[7]

Involuntary Dispossession of Bearer Securities

According to the law of 3 September 1996 regarding the involuntary dispossession of bearer securities the owner of such securities can claim, under certain conditions specified by the law, the issue of new bearer securities replacing the ones he has been dispossessed of.

The Court of Appeal recently had to define the meaning of "involuntary dispossession" within the ambit of the law. In the case at hand, the owner of the securities had given them to her son as she did not have the knowledge necessary to deal with them. In criminal proceedings, it had been decided that in fact the owner had given the securities to her son voluntarily but as a consequence of fraud, embezzlement and breach of trust. The question was thus whether the law regarding the involuntary dispossession of bearer securities was applicable in these circumstances.

According to the Court, which refers to Belgian law and case law and to the preparatory works to the law of 3 September 1996, the law is also applicable if the dispossession is the result of embezzlement, misappropriation or a contract made under the influence of violence.

Court of Appeal, 23 November 2011

Conditions of the Intervention of a Judge in Chambers in the Functioning of a Company

According to the Court of Appeal a court sitting in summary proceedings (*juge des référés*) may only intervene in the running of a company in exceptional circumstances, when its normal operation is no longer possible and when the existence of the company is compromised. A court sitting in summary proceedings may only designate a director of a company if there are particular reasons which motivate such a decision.

In the case at hand, the only factual element that had been reported was a disagreement within the company regarding the date of a meeting during which one shareholder was supposed to inspect the company’s documents. This was not deemed to be sufficient to justify the intervention of a judge in chambers.

[7] Court of Appeal, 22 June 2011, N°35024 & 35440.

Funds & Investment Management

EU Developments

EU Commission Delegated Regulation

AIFM Directive Level 2 Measures

On 19 December 2012, the European Commission has adopted the so-called "Level 2 measures" supplementing the AIFM Directive[8] ("**Delegated Regulation**").

The Delegated Regulation is now subject to a three-month scrutiny period in which each of the European Parliament and Council has the right to object to the entire Delegated Regulation (no longer having the ability to propose amendments). Assuming that no objection is made, the Delegated Regulation will apply at the end of this three-month period and the day following its publication in the Official Journal (anticipated by 22 July 2013). As it is a Commission Regulation, it will have direct effect in Member States, and so does not require implementation at Member State level.

Clifford Chance has prepared a briefing note examining a few of the key issues in the Delegated Regulation.

To access the full briefing note, please click here.

ESMA Consultation Papers

AIFM Directive Technical Standards and Key Concepts

Following an earlier discussion paper issued in February 2012, ESMA has published for consultation on 19 December 2012 its draft regulatory technical standards (RTS) on the determination of types of AIFMs[9] and its draft guidelines on key concepts of the AIFM Directive.

The draft RTS are aimed at ensuring the uniform application of the AIFM Directive across the EU. These standards distinguish between managers of AIFs[10] whose investors have the right to redeem their shares at least annually (open-ended AIFs), and those whose investors have less frequent redemption rights. ESMA's draft guidelines are aimed at clarifying, *inter alia*, the rules applicable to hedge funds, private equity and real estate funds. These proposals help to clarify what entities fall under the remit of the AIFM Directive, thereby creating a level-playing-field by providing for consistent application of the provisions throughout the EU.

Both consultations closed on 1 February 2013 and the RTS and guidelines are expected to be finalised in the first half of 2013.

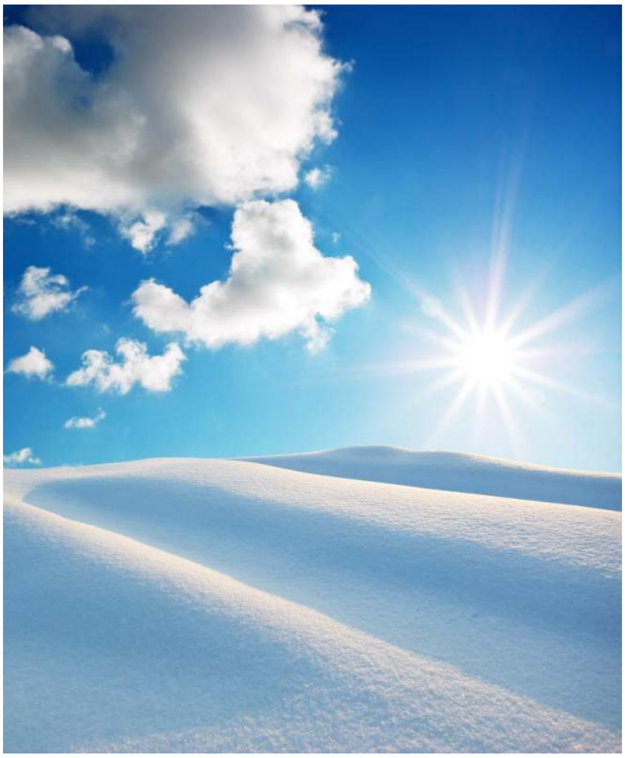
ESMA Guidelines

(Reverse) Repo, ETFs and other UCITS Issues

On 4 December 2012, ESMA published its final guidelines on repurchase and reverse repurchase agreements for UCITS funds (ESMA/2012/722).

Amongst other things, the guidelines state that:

- For repurchase arrangements, UCITS should be able to recall at any time the assets subject to such arrangements.
- For reverse repurchase agreements, UCITS should be able to recall at any time the full amount of cash on either an accrued or a mark-to-market basis, but when cash is recalled on a mark-to-market basis, the mark-to-market value of the reverse repurchase agreements should be used for the calculation of the net asset value of the UCITS.
- ESMA considers fixed-term repurchase and reverse repurchase agreements that do not exceed seven days as arrangements that allow the assets to be recalled at any time by the UCITS.



[8] Directive 2011/61/EU of 8 June 2011 of the European Parliament and the Council on alternative investment fund managers.
[9] Alternative investment fund managers.
[10] Alternative investment funds.

ESMA's guidelines on repurchase and reverse repurchase agreements for UCITS have been incorporated into ESMA’s guidelines on ETFs and other UCITS issues (ESMA/2012/474), which were published in July 2012. The consolidated guidelines, which have now been translated into the official languages of the Member States and published on ESMA's website on 18 December 2012, will enter into force on 18 February 2013. UCITS created after that date will have to comply immediately with the guidelines, whilst existing UCITS may benefit from transitional/grandfathering provisions giving them up to 12 months to comply with ESMA's guidelines (but some guidelines may need to be applied earlier or immediately).

It has to be noted that the publication of the translations of ESMA's guidelines triggers a period of two months (i.e. until 18 February 2013) within which national supervisory authorities have to declare to ESMA whether they intend to comply with the guidelines or otherwise explain the reasons for non-compliance. In Luxembourg, the CSSF indicated in a press release dated 21 December 2012, that a new circular will be elaborated soon to introduce ESMA's guidelines in Luxembourg laws and regulations. It is also expected that ESMA will publish a Q&A document on the guidelines in the late first quarter of this year.

Legislation

Law of 21 December 2012

Implementation of Directive 2010/78/EU "Omnibus I"

The Luxembourg law of 21 December 2012 implementing the Omnibus I Directive[11] in respect of the powers of the three European Supervisory Authorities (i.e. EBA[12], EIOPA[13] and ESMA[14]) has been published in the *Mémorial A* on 28 December 2012 and entered into force on 31 December 2012.

As indicated in the May 2012 edition of our Luxembourg Legal Update, the new law amends, *inter alia*, the scope of the Financial Sector Law to render it applicable to Luxembourg-based investment advisers of investment funds. As a result, Luxembourg-based investment advisers to UCIs and SIFs now fall within the scope of the Financial Sector Law (unless they can benefit from the exemptions provided for in the Financial Sector Law such as the group exemption) and will need to be licensed as investment advisers in accordance with the provisions of article 24 of the Financial Sector Law, the authorisation being delivered by the Ministry of Finance. The new law provides, however, that existing Luxembourg-based investment advisers will have until 30 June 2013 (instead of 31 December 2012 as was initially foreseen in the bill of law) to comply with the new provisions of the Financial Sector Law.

In a press release dated 10 January 2013, the CSSF has required that all the Luxembourg-based investment advisers to UCIs and SIFs that want to continue their activity, contact the CSSF preferably before 1 March 2013, in order to allow the processing of their application for authorisation within the legal timeframe.

Grand-Ducal Decree of 29 September 2012

Fees to be levied by the CSSF

The Grand-Ducal Decree of 29 September 2012 relating to the fees (*taxes*) to be levied by the CSSF applies as of 1 January 2013 and repeals the Grand-Ducal Decree of 18 December 2009 (as amended). Most of the existing fees levied by the CSSF in relation to the instruction and maintenance of the files of UCIs, SIFs, SICARs and their management companies are increased with, in particular, higher annual fees (depending on the number of sub-funds) in umbrella structures. Fixed fees will also be levied by the CSSF for restructuring of UCIs, SIFs, SICARs and management companies (e.g. change of applicable legal regime if permitted, transformation of a stand-alone fund into an umbrella fund, etc.).

The table below provides an overview of the CSSF’s fees applicable as of 1 January 2013 to Luxembourg investment vehicles (and their management companies, if any).

For the avoidance of doubt, Chapter 18 management companies (i.e. multilateral development banks which are permitted by their statute to provide the services of collective portfolio management, such as the European Investment Bank and the European Investment Fund), are not subject to any CSSF's annual or instruction fees.

[11] Directive 2010/78/EU of 24 November 2010 of the European Parliament and the Council.
[12] European Banking Authority.
[13] European Insurance and Occupational Pensions Authority.
[14] European Securities and Markets Authority.

	Fixed rate for instruction (EUR)		Annual fees (EUR)	
Investment Fund	**Stand-alone fund**	**Umbrella fund**	**Stand-alone fund**	**Umbrella fund**
SIFs	3,500.-	7,000.-	3,000.-	6,000.- (1 to 5 SF) 12,000.- (6 to 20 SF) 20,000.- (21 to 50 SF) 30,000.- (≥ 51 SF)
SICARs	3,500.-	7,000.-	3,000.-	6,000.-
UCIs (2010 Law)	3,500.- But 10,000.- for SIAGs (self-managed investment companies which have not designated a management company within the meaning of Article 27 of the UCI Law)	7,000.- But 10,000.- for SIAGs	3,000.-	6,000.- (1 to 5 SF) 12,000.- (6 to 20 SF) 20,000.- (21 to 50 SF) 30,000.- (≥ 51 SF)
EU UCITS and non-EU UCIs	2,650.-	5,000.-	3,950.-	5,000.-
Management Company	**Fixed rate for instruction (EUR)**		**Annual fees (EUR)**	
Chap. 15 ManCo (2010 Law)	10,000.-		20,000.- Additional 2,000.- for every branch established abroad by such ManCo	
Chap. 16 ManCo (2010 Law)	5,000.-		15,000.-	
Chap. 17 ManCo (2010 Law)	5,000.-		15,000.-	

Regulatory Developments

CSSF Regulation N°12-02

Combat Against Money Laundering and Terrorism Financing

CSSF Regulation N°12-02 dated 14 December 2012 on the combat against money laundering and counter-terrorism financing (AML/CTF) has been published in the Official Journal on 9 January 2013 and entered into force shortly thereafter. The new CSSF Regulation applies to all professionals who are subject both to Luxembourg AML/CTF obligations and supervision by the CSSF, including UCIs, SIFs and SICARs[15].

See Banking, Finance and Capital Markets section.

[15] Investment company in risk capital.

CSSF Circular 12/546

Substance Requirements Applicable to UCITS Management Companies/SIAGs and UCI Promotership

On 26 October 2012, the CSSF released Circular 12/546 relating to the authorisation and organisation of Luxembourg management companies subject to Chapter 15 of the UCI Law and SIAGs.

In a separate press release dated 31 October 2012, the CSSF further specifies that it is no longer required to designate a promoter for UCITS taking the form of a SIAG as well as UCITS and other UCIs subject to the UCI Law that are managed by a UCITS management company complying with all the requirements laid down in Circular 12/546.

Circular 12/546 has entered into force with immediate effect. However, existing UCITS management companies and SIAGs (where applicable) will have until 30 June 2013 to comply with the new organisational requirements introduced in relation to the shareholders, management bodies and conducting officers, as well as in the area of the use of own funds, the arrangements concerning the central administration and the delegation rules. The application deadline for filing with the CSSF is 15 April 2013.

Clifford Chance has prepared a briefing note providing an overview of the main changes introduced by Circular 12/546 to the substance and organisational requirements applying to UCITS management companies and SIAGs, including the abolishment of the promoter status and the transitional period running until 30 June 2013.

To access the full briefing note, please click here.

CSSF Press Release 12/46

Open-Ended UCI's Units/Shares no longer allowed as UCITS Eligible Assets under the Trash Ratio

On 22 November 2012, the CSSF has issued a press release concerning the opinion published by ESMA on 20 November 2012 on the interpretation of article 50(2)(a) of the UCITS Directive[16].

According to ESMA's opinion, UCITS may only invest in units or shares of UCIs as defined in article 50(1)(e) of the UCITS Directive. As a result, according to ESMA, units or shares of UCIs which do not fulfil all of the conditions listed in article 50(1)(e) of the UCITS Directive do not constitute eligible investments for UCITS under article 50(2)(a) of the UCITS Directive (i.e. the so-called "trash ratio"), which provides that a UCITS shall not invest more than 10% of its assets in transferable securities or money market instruments other than those referred to in article 50(1) of the UCITS Directive.

In the past and subject to certain conditions, Luxembourg UCITS have been authorised by the CSSF to use the so-called trash ratio in order to invest up to a maximum of 10% of their net assets in certain shares and units issued by open-ended UCIs which did not meet all of the conditions of article 41(1)(e) of the UCI Law (transposing Article 50(1)(e) of the UCITS Directive). In particular, the CSSF has accepted investments by Luxembourg UCITS in shares and units of open-ended regulated hedge funds, real estate funds and commodity funds which were subject to supervision considered by the CSSF as equivalent to that laid down in Community law and complying with the criteria applicable to transferable securities (e.g. liquidity, reliable valuation, etc.).

In light of the ESMA opinion, the CSSF considers that these investments by Luxembourg UCITS will no longer be allowed from now on and any existing position in such investments will need to be realised, taking into account the best interests of the investors, at the latest by 31 December 2013.

Update of CSSF Questions and Answers relating to PFS

On 15 October 2012, the CSSF published on its website an updated version of its document titled "Questions/Answers on the statuses of PFS - Part II".

As regards UCIs, SIFs and SICARs, the CSSF continues to specify that neither article 28-4 (professionals carrying on lending transactions for own account), nor the Financial Sector Law itself, apply to UCIs, SIFs, SICARs, pension funds or any other person exercising an activity, the taking up and pursuit of which are regulated by specific laws. The CSSF also clarifies that the aforementioned non-application of article 28-4 of the Financial Sector Law also applies where these exempted regulated entities grant loans through an SPV they hold at 100% or control (look-through approach).

See also Banking, Finance and Capital Markets section.

Case Law

ECJ, Opinion of the Advocate General in the case C-275/11, 8 November 2012
VAT treatment of investment advisory services performed by a third party

See Tax section.

[16] Directive 2009/65/EC of 13 July 2009 of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to UCITS (recast).

Litigation

Supreme Court, 15 November 2012[17]

Legitimate expectations of citizens – compensation for damage – loss of opportunity

Under Luxembourg law, public authorities have a duty not to mislead legitimate expectations of citizens. They may be held liable towards the harmed person, in case of failure to conduct themselves in a manner that citizens could reasonably expect from them.

The Supreme Court had the opportunity to confirm this principle in a case where a company was the owner of a piece of land on which it contemplated to construct a residential and business complex. The municipality had first declared the land concerned as a constructible area and subsequently granted to the company two building permits for the construction of two buildings being part of the residential and business complex. Subsequently, when the company applied for a building permit for a third building, the municipality had reclassified the land in question as a green area, thus preventing construction of the whole project in relation to the residential and business complex.

The Court of Appeal had decided that, by doing so, the municipality had acted inconsistently, and had hence violated the legitimate expectations of the company regarding the existing legal situation. The Court of Appeal further held that the municipality had failed in its general duty of care and diligence (*devoir général de prudence et de diligence*) and hence had to be held liable towards the company.

Furthermore, the Court of Appeal held that the municipality's fault caused a damage to the company, namely a loss of opportunity to carry out the project. Given that the company was granted permits for two buildings, the Court had held that the company had a very high degree of probability (90%) of being granted the building permit for the third building. The Court of Appeal hence condemned the municipality to compensate the company for up to 90% of the profit that the latter could have made in the project, as evaluated by an expert.

The Supreme Court confirmed the decision rendered by the Court of Appeal.

[17] Supreme Court, 15 November 2012, N°60/12, which confirms Court of Appeal, 11 July 2001, N°24128 and Court of Appeal, 23 March 2011, N°30591.

Court of appeal, 11 January 2012[18]

Enforcement of mortgages by application of the *clause de voie parée*

The *clause de voie parée* is a clause which enables a mortgagee to have the mortgaged property sold by a notary without having to apply for a court decision. This clause therefore avoids proceedings which may be lengthy and expensive. The inclusion of such a clause in a mortgage deed is permitted under Luxembourg law, which is not necessarily the case in other countries.

The case submitted to the Court of Appeal sitting in an appeal against a decision rendered by the summary judge of the District Court of Luxembourg-City[19], was related to a loan agreement entered into between a Luxembourg-based civil property company (*société civile immobilière*) as borrower and a French banking institution as lender. The purpose of the loan agreement was the financing of the acquisition of a property located in Luxembourg. The parties had agreed to subject the loan agreement to French law and the mortgage over the acquired property to Luxembourg law.

Following the termination of the loan by the bank due to the non-payment of several instalments, the bank initiated the enforcement of the mortgage through the *clause de voie parée*. In order to stop this process and thus the sale of the property, the borrower initiated legal proceedings against the lender before the summary judge of the District Court, raising, among other pleas, that the application of the *clause de voie parée* constituted an illicit act (*voie de fait*). The claimant indeed raised that the mechanism of the *clause de voie parée* was contrary to French public order since it is forbidden under French law and that the enforcement process initiated by the lender over the mortgaged property should cease given that the loan agreement was subject to French law.

The summary judge dismissed the application and his decision was confirmed by the judgment rendered by the Court of Appeal on 11 January 2012.

In its decision, the Court of Appeal rules that the summary judge has indeed jurisdiction to stop an illicit act, i.e. an act which is obviously unlawful, meaning that this alleged unlawfulness must not be seriously challenged.

Having confirmed that, the Court of Appeal notes that the parties have agreed to subject the loan agreement to

[18] Court of Appeal, 11 January 2012, N°37263.
[19] District Court (summary proceedings), 11 March 2011, N°135571.

French law and the mortgage, including the related enforcement process, to Luxembourg law. According to the Court, such a choice complies with article 3.1 of the Rome Convention dated 19 June 1980 which provides that contracting parties may choose the law applicable to the whole or a part only of their contract, as well as with article 3 of the Civil Code which provides that properties located in Luxembourg are governed by Luxembourg law.

Furthermore, the Court of Appeal rules that the breach of the public order of a given jurisdiction by the application of a legal provision of another jurisdiction is to be taken into consideration only in the case where the application of the legal provision concerned leads to a breach of the public order of the court seized.

As a result, the Court of Appeal concludes that the alleged breach to the French legal provision of public order forbidding the *clause de voie parée* is not serious enough to conclude that the application of said clause by the French bank is an illicit act having to be stopped by the relevant judge sitting in summary proceedings.

French Supreme Court (*Cour de Cassation*), 26 September 2012[20]

Validity of one-sided jurisdiction clauses

A client had entered into a custody agreement with a Luxembourg-based bank. The account had been opened through the intermediary of a French financial company. Unhappy with the returns from her investment, the client sued the bank (and the financial company) in France.

The bank argued that the French courts lacked jurisdiction to hear the case. For this purpose, they relied on a jurisdiction clause in the deposit agreement that gave exclusive jurisdiction to the Luxembourg courts but allowed the bank to sue the depositor in Luxembourg, in her domicile, or before any competent court.

The French Supreme Court, approving a previous decision of the Court of Appeal of Paris, decided that the clause did not comply with article 23 of the Brussels I Regulation, and was, therefore, ineffective.

In the absence of the clause, applying the Brussels I Regulation, French courts had jurisdiction.

The reasoning of the Court of Appeal was that the clause was in fact only binding upon the client, who could only sue in Luxembourg, but left a choice to the bank on where to sue the client. Therefore, in the eyes of the Court, the clause was *potestative*, meaning a clause where performance depends wholly on the will of one single party. A *potestative* obligation is unenforceable under French law.

On this basis, the court inferred that the clause was contrary to the object and the aim of article 23 of the Brussels I Regulation and could therefore not be relied upon by the bank.

With this decision, the French Supreme Court has created considerable insecurity as to the validity of one-sided jurisdiction clauses. The fact that a Luxembourg bank was at the origin of this decision is a mere coincidence, as this decision makes it more difficult for any party to a cross-border agreement to contractually secure the jurisdiction of their home judge, while at the same time retaining a certain flexibility as to jurisdiction. Nevertheless, Luxembourg banks, who often serve a predominantly foreign client base, will be among those most impacted by this decision.

The decision has attracted criticisms in legal writing, and it remains to be seen whether the European Court of Justice in Luxembourg, with which a decision over the interpretation of Brussels I Regulation ultimately lies, will adopt the same view as the French Supreme Court.

A briefing note on this subject is available on our website.

District Court, 27 March 2012[21]

Mitigation of Damages

After a tenant had left the rented premises, the landlord asked a bailiff to do the inventory. The landlord then demanded the reimbursement of reparation costs due to damage caused by the tenant. In particular, the landlord also claimed the reimbursement of the fees of the bailiff. The tenant refused to pay, because it deemed the cost caused by this unnecessary given that the inventory could have been prepared by the landlord and the tenants together and without the help of a bailiff.

According to the District Court, the landlord had an obligation to mitigate the damages. For this reason, before asking a bailiff to do the inventory, the landlord should have suggested a date to the tenants in order to do the inventory together. If the tenants had refused this, the landlord could have hired a bailiff. Given that there had been no such refusal by the tenants, the Court decided that the tenants did not have to pay the bailiff's fees.

[20] Cour de cassation, 1re civ. 26 September 2012, N°11-26.022.

[21] District Court, 27 March 2012, N°142115.

Employment

Labour Court, 12 November 2012[22]

Employer's refusal to take over additional tax owed by an employee as a consequence of his secondment

A Belgian resident was employed by a Luxembourg company, but worked essentially in Belgium. The employee had been subject to a tax adjustment by the Belgian tax authorities, who claimed a higher amount of tax than the amount which would have been due by application of the Luxembourg tax rate. The employee claimed the reimbursement of the difference from his employer.

In support of its claim, he argued mainly that the employer's refusal to take over this difference was a modification of an essential element of his employment contract, namely his salary. As the employer had not complied with the procedure to be followed in case of a unilateral modification of an essential element of the employment relationship (as provided for in article L.121-7 of the Labour Code), the employee was of the opinion that the employer's refusal to bear the tax differential was nul and void.

The Labour Court held that the reduction in the employee's net salary as a consequence of his secondment abroad and the ensuring application of a foreign tax rate was not attributable to the employer and did hence not constitute a modification of an essential element of the employment contract made by the employer. The court hence dismissed the employee's claim for reimbursement of the tax differential.

Supreme Court, 24 May 2012[23]

Damages awarded to the employee in case of unfair dismissal

Article L. 124-12(1) of the Labour Code provides that, as regards the right of termination of a permanent employment contract, if the labour court determines that the employee's dismissal was unfair, the court awards the employee damages in consideration of the damage suffered due to his dismissal.

Until now, the labour courts had construed this provision as allowing them to only award compensation in lieu of notice, but not moral and material damages to employees unfairly dismissed with immediate effect when they established that the justification for the dismissal would have been sufficient to dismiss the employee with notice.

By a decision dated 24 May 2012, the Supreme Court overturned the decision dated 17 June 2010 of the Court of Appeal which had recognised that the dismissal of the plaintiff was unfair and yet had refused to award him damages for the alleged moral and material damage on the grounds that the employee by his own behaviour had contributed to his dismissal. The Supreme Court established that the Court of Appeal had not construed and applied article L. 124-12 properly.

Court of Appeal, 1 March 2012[24]

The consequences for an employer of being part of a group with respect to economic dismissals

With a decision dated 1 March 2012, the Luxembourg Court of Appeal followed into the French Supreme Court's footsteps one year after the latter blazed a trail with respect to the assessment of economic difficulties in the context of economic dismissals within groups.

An employee had been working as a "project manager - technical lead" for a Luxembourg company since 26 June 2008 before he was dismissed with notice and consequently brought a claim for unfair dismissal. He appealed the labour tribunal's decision that had deemed the dismissal fair, based on the dire economic situation of the Luxembourg company. The Court of Appeal decided the other way, noting that the Luxembourg company did not dispute being part of a group and that the group did not encounter any financial or economic difficulties.

In its decision, the Court of Appeal considered that even though a company may be specialised in a different field or may be established in a country other than the other companies of the group, these elements were not sufficient to preclude subsuming the company under a single line of business within which the economic difficulties have to be assessed.

The Court of Appeal then endorsed the French Supreme Court's stance that a profitable group is not entitled to dismiss employees for economic reasons in one of its ailing companies, even though that company is legally autonomous.

The Court of Appeal concluded that the economic situation of the whole group should have been mentioned in the letter of dismissal and that in the absence of proof of economic difficulties at group level, the dismissal of the employee was unfair.

This position of the Court of Appeal should be put into perspective. Indeed, in the situation at hand, the Luxembourg company did not enjoy any autonomy. A UK

[22] Labour Court of Luxembourg-City, 12 November 2012, N°4029/2012.
[23] Supreme Court, 24 May 2012.
[24] Court of Appeal, 1 March 2012.

company of the group was indeed entirely in charge of the Luxembourg company with respect to its administrative and commercial activities and after the group had decided to stop its financial assistance to the Luxembourg company, all the Luxembourg company's activities transferred to the UK company.

It is worth noting that a previous attempt by a Luxembourg tribunal to decide that the economic situation of the whole group should be taken into consideration in relation to economic dismissals was quashed by the Court of Appeal that had reaffirmed in a decision dated 27 October 2011, its traditional stance by stating that "*the corporate risks are borne by the employer alone who in return is entitled to take the internal measures he deems necessary in the company's interest, even if they result in the termination of employment contracts.*"

It remains to be seen whether the Luxembourg courts will revert to this traditional stance or will fully embrace their new assessment of underlying reasons of economic dismissals within groups.

Tax

Luxembourg 2013 Tax Law Voted

On December 2012, the Luxembourg Parliament adopted the bill N°6497 on new tax measures to be implemented as from 1 January 2013. On 21 December 2012, the Luxembourg *Conseil d'Etat* formally confirmed that no second vote of the Parliament is required for the entry into force of the bill. The bill consequently entered into force on 1 January 2013 (hereafter the "**New Law**").

Even if those measures impact both individuals and companies, it is worth noticing that the impact of the newly enacted measures will be more limited than initially feared by the Luxembourg market place.

Corporate Tax

Minimum Tax

The New Law amends the existing EUR 1,575 minimum flat tax already applicable to some Luxembourg companies and introduces a new minimum progressive tax for all other companies. As from 2013, two regimes of minimal income tax will then coexist. The minimum flat and progressive tax are both only applicable to companies having their statutory seat or their place of effective management in Luxembourg.

Modification to the existing minimum flat tax

Since 2011, some Luxembourg companies have been subject to an annual minimum flat income tax of EUR 1,575 Before the entry into force of the New Law, this tax was only levied on entities:

- whose activities did not require a business license or the agreement of a supervisory authority, and
- whose total fixed financial assets, transferable securities and cash at bank (respectively accounts 23, 50 and 51 of the standard chart of accounts) exceeded 90% of their total balance sheet.

In practice, this minimum flat tax applied to holding and finance companies.

The New Law provides for an increase of the minimum flat tax from EUR 1,575 to EUR 3,210 (including the increase of the unemployment surcharge). In addition, the scope of application of this flat tax is broadened:

- As from 2013, the minimum flat tax also applies to regulated entities. SICARs, securitisation companies subject to the supervision of the CSSF are now potentially subject to the flat tax.
- For the computation of the 90% threshold, receivables due by affiliated companies have to be taken into account (being booked under Account 41 of the standard chart of accounts).

The New Law also clarifies that interest into tax transparent entities (e.g. *sociétés civiles immobilières*) are taken into account for the application of the 90% threshold (based on the commentaries to the bill, "*the interest is deemed to be booked in the account 231 and 233 of the standard chart of account*").

New progressive minimum tax

As from 1 January 2013, all companies not covered by the minimum EUR 3,210 flat tax will be subject to a progressive minimum income tax. This minimum income tax ranges from EUR 535 to EUR 21,400 depending on the total balance sheet amount (e.g. EUR 21,400 for a total balance sheet exceeding EUR 20 million). In a nutshell, the EUR 21,400 minimum income tax applies as from 2013 to Luxembourg companies when their total balance sheet is at least of EUR 20 million and they are not in the scope of the EUR 3,210 flat tax.

On 21 December 2012, the tax authorities formally confirmed that the assets generating income exclusively taxable in another state under a relevant double tax treaty are not taken into account for the computation of the minimum income tax (e.g. German or UK real estate and/or income attributed to a permanent establishment). These foreign assets are excluded for their net asset value.

Nature of the minimum tax payment

This minimum income tax is a Corporate Income Tax advance payment that could be offset against future corporate income tax burden. Following a strict reading of the new provisions, the potential credit should apply to the minimum flat tax and the progressive minimum tax (being both under the new article 174 alinéa 6). However, these taxes would not give rise to any refund claim. In other words, the minimum tax is a final tax if the company is in an ongoing loss position without realising future taxable profits.

Impact on the tax unity regime

Should a Luxembourg tax unity apply, the parent company (or parent Luxembourg branch) will be liable for the sum of the minimum taxes that each company part of the unity would have been subject to if no unity existed. However, the total minimum tax due is limited to EUR 20,000 per annum.

Potential tax credit offset

The New Law specifically denies the offset of investment tax credits, unemployed recruitment credits, lifelong learning and venture-capital credits against the minimum tax.

Interaction with Net Wealth Tax

The Net Wealth Tax burden is currently reduced if the taxpayer allocates part of its profits to a specific reserve for at least 5 years (under the provision of Article 8 (a) of the Net Wealth Tax law). The New Law limits the reduction of Net Wealth Tax to the amount of Corporate Income Tax excluding the minimum tax. In other words, the minimum tax is not taken into account for the reduction of Net Wealth Tax.

Solidarity Tax

The unemployment surcharge (so-called Solidarity Tax) has been increased from 5% to 7% for companies. The aggregated 2013 tax rate applicable to Luxembourg corporations will amount to 29.22% (vs 28.80% presently applicable to companies established in Luxembourg-city).

Investment Tax Credit

The tax credit for additional investments will be reduced from 13% to 12%. The tax credit for global investments will be reduced from 3% to 2% for an investment tranche exceeding EUR 150,000.

Individual Tax

Individual Income Tax rate

A new marginal income bracket taxed at 40% for the portion of income exceeding EUR 100,000 for single individuals and EUR 200,000 for couples is introduced.

Solidarity Tax

The solidarity tax will increase from 4% to 7% for individuals (surcharge assessed on tax). A higher rate (9%) will apply on income tax assessed on income exceeding EUR 150,000 for single individuals and EUR 300,000 for couples.

Taxation of stock options and warrants

On 20 December 2012, the Luxembourg tax authorities published a new Circular LIR N°104/2 on the tax treatment of stock option plans. This new circular replaces a former circular dated 11 January 2002 and modifies the valuation for tax purposes of freely transferable options. The value of the options was previously deemed to correspond to 7.5% of the value of the underlying assets (shares). The new circular provides that the value of the options will now be deemed to correspond to 17.5% of the value of the underlying assets. The new circular applies as from 1 January 2013.

Tax Allowances

The lump sum allowance for travel expenses between the taxpayer's home and his place of work (i.e. 4 distance units being approx. EUR 396) is abolished. Moreover, the flat deduction for a distance exceeding 30 distance units is now limited to EUR 2,574.

As from 2013, the maximum annual allowance for debit interests is reduced from EUR 672 to EUR 336 per member of the taxpayer's household.

Other Legislation

Bill N°6501

Luxembourg Modifies 13 Double Tax Treaties and Protocols

A bill which aims at ratifying 13 recent Double Tax Treaties ("**DTTs**") and protocols has been submitted to the Luxembourg parliament on 20 November 2012. The entry into force of these DTTs and protocols is not known yet as it will depend on the ratification process.

Firstly, the bill modifies existing DTTs with Canada, Italy, Malta, Romania and Switzerland in order to align these DTTs with international standards for an effective exchange of information upon request, as set out by the OECD.

As a reminder, the OECD standards on exchange of information in tax matters provide for information exchange upon request, where the information is "foreseeably relevant" for the administration of the taxes of the requesting party, regardless of bank secrecy and a domestic tax interest.

As discussed in the October 2012 edition of our Luxembourg Legal Update, the standard of "foreseeable relevance" is evolving in order to provide for exchange of information in tax matters to the widest possible extent and at the same time to prohibit fishing expeditions (see the updated article 26 of the OECD model convention dated 17 July 2012). The main evolution is that even though "fishing expeditions" (i.e. speculative requests of information that have no apparent nexus to an open inquiry or investigation) remain clearly not authorised, the commentary now allows for group requests to the extent that the standard of "foreseeable relevance" is met (i.e. the requesting state has to provide a detailed description of the group and the specific facts and circumstances that have led to the request, an explanation of the law and why there is reason to believe that taxpayers have not been compliant with that law supported by a factual basis).

Secondly, the bill purports to amend DTTs with Korea, Kazakhstan, Russia and Poland in order to align these DTTs with international standards for an effective exchange of information upon request. It must be kept in mind that these new protocols also amend other provisions than the article on exchange of information. Our briefing notes dated 20 December 2011 with respect to the DTT with Russia and dated 28 August 2012 with respect to the DTT with Poland can be downloaded from our website.

The bill finally ratifies a new DDT in order to replace the existing DTT concluded by Luxembourg with Germany and ratifying new DTTs with Tajikistan, Seychelles and Macedonia. Our briefing note on the new DTT with Germany dated 13 July 2012 can be downloaded from our website.

The new protocols with Poland and Russia and the new DTT with Germany include a new provision according to which potential local capital gains tax may apply on the disposal of shares in real estate property companies, i.e. potential taxation of the gain in the country where the real estate is located. This change is of importance for many real estate investment structures with local property companies in Germany, Poland or Russia.

EU Developments

Opinion of the Advocate General to the European Court of Justice, 8 November 2012

VAT Treatment of Investment Advisory Services

The Advocate General issued his opinion regarding the VAT treatment of outsourced investment advisory services rendered to a management company of a regulated investment fund and in particular, whether the VAT exemption[25] for management services of regulated investment funds foreseen by the VAT Directive could apply to these services. In his opinion, the Advocate General believes that the VAT exemption could be applicable to outsourced investment advisory services and concludes that "*advisory and information service provided by third party, relating to the management of a special investment fund and the purchase and sale of assets, constitutes an activity of 'management' specific and distinct in nature, provided that the service is found to be autonomous and continuous in respect of the activities actually performed by the recipient of the service, a matter which it is for the national court to clarify*".

Such opinion is important as it is in line with the long standing approach in Luxembourg, which applies an exemption for advisory services. As it has been confirmed in the past, it is common for the ECJ to follow the opinion rendered by the Advocate General such as there is hope that it will be the same. We will keep you informed of the decision of the ECJ, which should be rendered in the first half of 2013.

International developments

OECD – Beneficial Ownership

Further to the release of the public discussion draft on beneficial ownership in April 2011, a revised version of the proposals was released by the OECD on 19 October 2012 (2012 Beneficial Owner Discussion Draft). The final objective of the OECD is to clarify the concept of "beneficial ownership" by amending the Commentary on articles 10, 11 and 12 of the OECD Model.

The changes in the 2012 Beneficial Owner Discussion Draft mainly consist in clarifying the concept of a "constrained right" to use or enjoy a dividend, interest or royalty payment.

The draft released in 2011 provided that the recipient of the payment is the "beneficial owner" where he has the right to use and enjoy the income unconstrained by a contractual or legal obligation to pass on the payment received to another person. In October 2012, the OECD has clarified that the recipient of a payment remains the "beneficial owner" if the obligation to pass on the payment does not "relate" to the payment received. In other words, the beneficiary of a payment would remain the "beneficial owner" if the obligation to pass on the payment is included in contractual or legal obligations "unrelated" to the payment received. At this stage, the OECD has not yet defined the concept of "related" or "unrelated" payment.

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[25] Article 135(1)(g) Council Directive 2006/112 of 28 November 2006.

The OECD requested comments on the 2012 Beneficial Owner Discussion Draft by 15 December 2012. As indicated by the OECD, these comments focus on drafting issues only and will be reviewed in February 2013.

Case Law

Administrative Court, 20 July 2012[26]

Participation Exemption Regime and Usufruct

On 20 July 2012 the Court dealt with the application of the participation exemption regime (article 166 of the Luxembourg Income Tax Law "**LITL**") on payments received by a Luxembourg company which granted, for a limited time, the usufruct of about 52% of shares of an Italian corporation SpA against an annual compensation.

In the case at hand, the Luxembourg tax authorities challenged the qualification of the annual remuneration received by the Luxembourg company and took the view that the said remuneration did not fall under the scope of the participation exemption regime.

The Court disagreed concluding that even if there was a transfer of the usufruct (i.e. transfer of the right to the dividends) such right was in the case at hand only temporarily disposed of and in counterpart, the Luxembourg company received a compensation falling under the scope of article 166 LITL. Moreover, pursuant to article 11 LITL, such compensation was qualified as an income replacement in lieu of the perception of dividends. Finally, to ascertain the application of article 166 LITL, the court ruled in the light of a European Court of Justice case[27] that the transfer of the usufruct of the shares which results in a dismemberment of ownership and participation did not exclude the application of the participation exemption regime on income earned by the bare owner participation (the Luxembourg company), which remains, in principle, the legal owner of the shares, unless the economic ownership within the meaning of § 11 StAnpG was transferred to the usufructuary.

Therefore, the transfer of the right to dividends by the Luxembourg company which originally met all the requirements under the participation exemption regime should still be eligible to it if:

- there is compensation which qualifies as an "income replacement",
- the transfer is limited in time, and
- it remains the legal owner.

[26] Administrative Court, 20 July 2012, N°29234.
[27] ECJ, 22 December 2008, C-48/07.

Administrative Court, 12 July 2012[28]

Carry Forward Losses and Abuse of Law

In a case of 2010, the Administrative Court of Appeal has ruled that the sole fact that a company changes its shareholders or its business does not allow the tax authorities to challenge its tax loss position. The said case law confirmed that the tax authorities are only entitled to dispute the carry forward losses based on the abuse of law principle when they conclude that the sole purpose of a transaction is to avoid taxes.

For the first time, the administrative court ruled in favour of the Luxembourg tax authorities concluding that tax losses cannot be carried forward based on the abuse of law theory. In the case at hand, a new shareholder acquired shares and a receivable in a Luxembourg subsidiary for a consideration of respectively CHF 1. Based on the specific background of the case, the court characterised the acquisition of the receivable for such a low price as abusive and not in line with market conditions. For the court, the transfer of the receivable for CHF 1 had to be assimilated to a debt waiver for the benefit of the subsidiary generating a taxable gain for it (i.e. the new shareholder cannot enjoy the benefit of most of the tax losses of the subsidiary).

For the court, it was sufficiently demonstrated that the only purpose of the transaction was for the company to acquire shares in a company with tax losses. This case is of interest as it opens the door for potential new challenges to the use of tax losses based on the abuse of law principle.

[28] Administrative Court, 12 July 2012, N°28815.

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