Luxembourg Legal Update

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Contents

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, investment management and tax law.

Banking, Finance & Capital Markets

EU Developments

CRR/CRD 4

The Capital Requirements Regulation CRR/CRD 4 package amending the EU's rules on capital requirements for banks and investment firms have been published in the Official Journal on 27 June 2013.

The regulation entered into force on 28 June 2013 and shall apply directly in all Member States from 1 January 2014 subject to certain exceptions of gradual application. The CRD 4 will need to be implemented into national law.

The main purposes of the CRD 4 package is to strengthen EU banks and investment firms and to improve the management of the risks linked to their activities, notably by new financial ratio requirements (e.g. Common Equity Tier 1 ratio of 4.5%, establishment of five new capital buffers, new liquidity requirements, leverage ratios, increased own funds requirements for credit institutions and investments firms that are trading over-the-counter derivatives and securities financing transactions or have exposures to a central counterparty), corporate governance requirements (e.g. limitations to multiple directorships, reputation, knowledge, skills and experience requirements for management body members, remuneration policy) and the strengthening of the sanctions, their extension to natural persons and significantly accrued monitoring powers of the supervisory authorities.

Corrigenda to the CRR/CRD 4 package have been published in the Official Journal thereafter. The corrigenda set out a number of changes to the transposition/application dates for the CRR/CRD 4 package, as well as the deadlines for the submission by the European Banking Authority (EBA) of technical standards to the EU Commission.

The EBA has further published new Q&As on the Single Rulebook concerning the CRR/CRD 4 package, the related technical standards developed by the EBA and adopted by the EU Commission, as well as the EBA guidelines.

MiFID: ESMA Guidelines on Remuneration Policies and Practices

On 11 June 2013, the European Securities and Markets Authority (ESMA) published guidelines on remuneration policies and practices under the Markets in Financial Instruments Directive (MiFID). According thereto, remuneration policies should be aligned with effective conflicts of interest management duties and conduct of business risk management obligations, in order to ensure that clients' interests are not impaired by the remuneration policies and practices adopted by the firm in the short, medium and long term.

The key obligations of the guidelines focus on the governance and design of remuneration practices, and controlling the risks that such practices create. The guidelines define remuneration as all forms of payments or benefits provided directly or indirectly by firms to relevant staff involved in the provision of investment and/or ancillary services to clients. Relevant staff are those who can have a material impact on the service provided, and include:

- client-facing staff
- sales force staff and/or

- other staff indirectly involved in providing investment services whose remuneration may create inappropriate incentives to act against the best interests of clients (this includes persons who oversee the sales force, such as line managers).

The guidelines are also addressed to national securities regulators that supervise and enforce the MiFID requirements. They are expected to comply with these guidelines and will have two months from the date of publication of the translations of the Guidelines to inform ESMA whether they intend to do so or give their reason otherwise. The Guidelines will become applicable to market participants 60 days after the deadline for the "comply or explain" obligation of national securities regulators.

EMIR: New Commission Delegated Regulation – RTS on CCP Colleges

Commission Delegated Regulation (EU) N°876/2013 of 28 May 2013 supplementing the European Market Infrastructure Regulation (EMIR) with regard to regulatory technical standards (RTS) on colleges for central counterparties (CCP) has been published in the Official Journal.

The new delegated regulation defines conditions for determining the most relevant currencies for the participation of central banks of issue in the CCP college, and practical arrangements for the establishment and functioning of colleges. The delegated regulation entered into force on 3 October 2013.

EMIR: ESMA Update of Q&A

On 4 June and 5 August 2013, ESMA published updated versions of the Q&A on the implementation of EMIR. The Q&As aim to ensure that the activities and actions of competent authorities under the regulation are converging along the lines of the responses adopted by ESMA, and to help investors and other market participants by providing clarity on the requirements under EMIR.

EMIR: ESMA Update of EMIR Implementation Timetable

ESMA has published an updated version of its EMIR implementation timetable. The key change in the implementation timeline relates to the registration of the first trade repositories, which was not expected to occur until at least 24 September 2013. ESMA now expects to make those first registration decisions not before 7 November 2013. Consequently, counterparties' reporting to trade repositories is not expected to start before February 2014. ESMA has indicated that the change in the timetable is related to a combination of factors, including issues faced by applicants in ensuring the completeness of their applications.

EMIR: ESMA Guidelines and Recommendations for Establishing Consistent, Efficient and Effective Assessments of Interoperability Arrangements

On 10 June 2013, ESMA published guidelines and recommendations for establishing consistent, efficient and effective assessments of interoperability arrangements which apply to national competent authorities (NCAs) under EMIR. The objective of these guidelines and recommendations is to improve the rigor and uniformity of standards applied in the assessments of interoperability arrangements.

The guidelines and recommendations define what NCAs should analyse in assessing an interoperability arrangement and therefore on what aspects of the interoperable arrangement the relevant CCPs will need to focus their attention. They do not introduce new requirements for CCPs in addition to the ones specified in EMIR or the relevant technical standards. However, they specify how those requirements should be met for the purpose of establishing robust and stable interoperability arrangements.

The guidelines and recommendations focus on the risks that might arise from interoperability arrangements and outline the areas on which CCPs should focus, and which NCAs should verify, to mitigate those risks.

Prospectus Regulation: Delegated Regulation on Disclosure Requirements for Convertible and Exchangeable Debt Securities

EU Commission Delegated Regulation EU 759/2013 amending its Prospectus Regulation as regards the disclosure requirements for convertible and exchangeable debt securities has been published in the Official Journal. The amending regulation has entered into force on 28 August 2013.

Prospectus Directive: ESMA Comparison of Liability Regimes in Member States

ESMA has published a report comparing the national liability regimes in the EU Member States in relation to the Prospectus Directive. The report contains an overview of the different arrangements and frameworks in place in the European Economic Area (EEA) to address administrative, criminal, civil and governmental liability, and provides clarity to market participants about the different regimes in place. It covers the national administrative and criminal sanctioning regimes with respect to infringements of national legislation and rules transposing the Prospectus Directive and of the Prospectus Regulation. Although the report does not cover how the different regimes, or sanctions, are applied, it encompasses national regimes setting out the conditions for the investors' right of restitution for losses from the author of the violation (civil liability) and from the government.

CRA Regulation, UCITS IV Directive and AIFMD: EU Commission Q&A Paper on New CRA Rules

Regulation (EU) N°462/2013 amending the Credit Rating Agencies Regulation and Directive 2013/14/EU amending the UCITS IV Directive and the Alternative Investment Fund Managers Directive (AIFMD) in respect of the excessive reliance on credit ratings have been published in the Official Journal. The new regulation and directive have entered into force on 20 June 2013. Member States will have to implement the directive by 21 December 2014. We kindly refer you to the June 2013 edition of the Luxembourg Legal Update containing an overview of the new developments.

The EU Commission recently published a set of frequently asked questions (FAQs) on the new rules for credit rating agencies.

CRA Regulation: ESMA Guidelines and Recommendations on the Scope of the CRA Regulation

On 17 June 2013, ESMA published guidelines and recommendations on the scope of the CRA Regulation. The guidelines cover the following areas:

- obligation for CRAs to register with ESMA
- credit rating activities and exemptions from registration
- establishing branches outside the EU by registered CRAs
- specific disclosure recommendations for best practice
- enforcement of the scope of the CRA Regulation.

Benchmark Setting: ESMA/EBA Final Principles on Benchmarks

On 6 June 2013, ESMA and the EBA published their final report setting out their principles for benchmark-setting processes in the EU.

These principles are designed to address the problems identified with benchmark-setting processes and provide benchmark users, administrators, calculation agents, publishers and data submitters with a common framework for carrying out these activities. The application of the principles will also help in the transition to any potential future EU legal framework for benchmarks.

Legislation

Revision of Statutory Mortgage Bond Regime

Law of 27 June 2013

The Luxembourg Financial Sector Law provisions on mortgage banks and mortgage bonds have been amended by a law of 27 June 2013 which has entered into force on 5 July 2013. The law provides for a number of changes and innovations further strengthening the legal framework for the issuance of mortgage bonds and creating new opportunities for mortgage banks in Luxembourg.

The law strengthens the protection of holders of mortgage bonds in case of collective proceedings. In particular, by introducing the possibility of suspension of payment and judicial liquidation proceedings for one or several cover pools, the law now permits separate reorganisations per cover pool without affecting the general estate of the mortgage bank or other cover pools, by allowing for a separation between the different pools.

The law also introduces mutual mortgage bonds as a new category of mortgage bonds in addition to the already existing categories of real estate mortgage bonds, public sector mortgage bonds and moveable asset mortgage bonds. Mutual mortgage bonds are mortgage bonds covered by exposures on credit institutions that are members of a mutual institutional guarantee system.

The law finally extends the scope of eligible assets covering public sector mortgage bonds to exposure on non-OECD countries assets (public sector entity, real estate or movable asset exposure), provided the relevant country has a certain rating level.

These and some further innovations are described in a more detailed client briefing Clifford Chance has published on the new law. The main features of the new law have already been summarised in the February 2013 edition of the Luxembourg Legal Update.

Modification of the Insurance Sector Law

Law of 12 July 2013

The Luxembourg parliament has passed a new law revising the Insurance Sector Law on 12 July 2013. The new law has entered into force on 26 July 2013.

The law introduces a new section in the Insurance Sector Law which

- covers certain existing and new professions of the insurance sector
- sets out licensing requirements for certain professionals
- introduces increased financial, reporting and supervision requirements.

The new law in particular introduces the regulatory category of professionals of the insurance sector (*professionel du secteur assurance*, PSA), which encompasses

- management companies of captive insurance companies, of insurance companies in run-off, of reinsurance companies, of pension funds or of insurance portfolios, as well as
- certain types of insurance sector service providers.

Only legal persons may obtain a PSA licence. The minimum corporate capital for a PSA is fixed at EUR 125,000. Some PSA types are subject to statutory professional confidentiality obligations, thus facilitating the outsourcing to them by a Luxembourg insurance company itself being subject to statutory professional confidentiality obligations to such PSA types.

The new law also sets out the requirements that apply to managers (*dirigeants*) of insurance companies, reinsurance companies, PSAs or insurance broker companies. It further includes a section on insurance and reinsurance brokers and agents. The existing regime based on the EC Insurance Intermediation Directive is kept while certain technical details are modified. The law finally extends the scope of AML/CTF legislation to PSA.

The main features of the new law have already been summarised in the May 2012 edition of the Luxembourg Legal Update.

Short Selling of Financial Instruments

Law of 12 July 2013

The new law of 12 July 2013 appoints the CSSF as authority competent in Luxembourg to supervise the application of the EU Short Selling Regulation and defines its supervision, intervention, investigation and sanction powers necessary for the CSSF to be able to accomplish its mission. The CSSF has further been charged with the cooperation and exchange of information with the competent foreign authorities as well as ESMA. The CSSF has also been 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.

The new law has entered into force on 23 July 2013 and has already been summarised in the February 2013 edition of the Luxembourg Legal Update.

Introduction of a New Type of Professional in the Financial Sector Law

AIFMD Implementing Law of 12 July 2013

A new type of professional has been introduced in the Financial Sector Law as part of the Luxembourg AIFMD implementing law of 12 July 2013 in respect of which we refer generally to the Funds and Investment Management section of this Luxembourg Legal Update.

This type of professional covers those professionals whose activity consists of acting as depositary for Luxembourg specialised investment funds, Luxembourg SICARs or alternative investment funds within the meaning of the AIFMD, for whom no right of redemption can be exercised during a 5-year period following the date of initial investments and who, in accordance with their principal investment policy, do not generally invest in assets which have to be kept in custody in accordance with Art. 19 (8) a) of the Luxembourg AIFMD implementing law, or who generally invest in issuers or non- listed companies to potentially acquire control over them in accordance with Art. 24 of such law.

Depositaries of assets other than financial instruments may equally ensure as a delegate the safekeeping of assets other than liquidities or financial instruments for which safekeeping can be ensured where such mission is delegated to them by the unique custodian of an alternative investment fund within the meaning of the AIFMD. Only legal entities are eligible to become a depositary of assets other than financial instruments and need to have an entirely subscribed and paid in company capital of at least EUR 500,000.

On its website, the CSSF published application forms to apply for a licence as a professional depositary of assets other than financial instruments and a relating declaration to be joined by the applicant.

Credit Rating Agencies

Grand-Ducal Regulation of 28 May 2013

A new Grand-Ducal regulation of 28 May 2013 abrogated the Grand-Ducal regulation of 27 May 2010 on credit rating agencies implementing article 22 of the EU Credit Rating Agencies Regulation (CRA) on the appointment of an authority competent for CRA with effect on 9 June 2013.

Modalities of Authorisation and Exercise of Insurance and Reinsurance Intermediaries

Grand-Ducal Regulation of 27 August 2013

A Grand-Ducal regulation of 27 August 2013 entering into force on 14 September 2013 amended the existing Grand-Ducal regulation of 24 November 2005 on the modalities of authorisation and exercise of insurance and reinsurance intermediaries by increasing the level of minimum coverage of the professional liability insurance that a professional has to subscribe to as a condition for its authorisation as an insurance broker. The new coverage levels are EUR 1,250,000 per liability case and EUR 1,900,000 globally per year against previously EUR 1,240,000 per liability case and EUR 1,680,300 globally per year.

Regulatory Developments

Establishment of Secured Means of Electronic Exchange for the Notification and Execution of Court Orders

CSSF Circular 13/566

This circular applies to credit institutions and relates to the implementation of a secured means of electronic exchange for the notification and execution of court orders. The circular reminds that the courts may order, in specific limited circumstances, to inform the courts if a specific accused person has or has had a business relationship with the institution and the details about transactions of such person with the institution.

The technical details to be complied with are contained in an annex to the circular.

The circular has entered into force and has abrogated CSSF Circular 11/514 with immediate effect.

Central Administration, Internal Governance and Risk Management

CSSF Circular 13/568

In its Circular 13/568 of 28 June 2013, the CSSF draws the attention of the professionals of the financial sector to the entry into force, on 1 July 2013, of CSSF Circular 12/552 on central administration, internal governance and risk management. The circular also updates the relevant references in the IML and CSSF circulars, and specifies the points of CSSF Circular 12/552 that the CSSF requires to be covered by the annual long form report to be established by the statutory auditors of Luxembourg incorporated credit institutions or of Luxembourg branches of non-EU/EEA credit institutions pursuant to CSSF Circular 01/27 on the practical rules concerning the role of the statutory auditor. These points concern in particular the administrative, accounting and IT organisation, internal control, outsourcing, credit risk and private wealth management. The new circular has entered into force on 1 July 2013.

Central Administration, Internal Governance and Risk Management

CSSF Q&A Paper on Circular 12/552

On 2 August 2013, the CSSF issued a Q&A paper in relation to Circular 12/552 on internal governance, central administration and risk control, which has entered into force on 1 July 2013. It applies to credit institutions, investment firms and to a limited extent to certain other professionals of the financial sector.

The Q&A clarifies the CSSF's position on certain specific topics raised by the institutions in the framework of their implementing process of the circular and relate, amongst others, to the scope of application of the circular, the concept of independent directors on the board of an institution, the application of the principle of proportionality to the internal control functions (audit, risk, compliance) of an institution (including its branches and subsidiaries), the segregation of an institution's advisory, discretionary and execution-only services and the requirement for consent that an institution needs to obtain for outsourcing, in particular where its client is an investment fund.

Practical rules concerning the mission of the approved statutory auditors of electronic money institutions

CSSF Circular 13/569

The CSSF issued a new Circular 13/569 on the practical rules concerning the mission of the approved statutory auditors of electronic money institutions. This circular applies to Luxembourg incorporated electronic money institutions. It specifies the scope of the mandate that such an electronic money 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.

The provisions of this circular have to be complied with in their entirety for the annual accounts of the accounting year starting after 31 December 2012.

Central Administration, Internal Governance and Risk Management

CSSF Circular 13/571

Following the entry into force of CSSF Circular 12/552 on central administration, internal governance and risk management on 1 July 2013, the CSSF issued on 19 August 2013 its new Circular 13/571 specifying the points of Circular 12/552 that statutory auditors of Luxembourg incorporated investment firms need to cover in their annual long form report. These points concern the administrative, accounting and IT organisation, internal control, outsourcing, credit risk as well as private wealth management of Luxembourg investment firms. Circular 13/571 has entered into force on 19 August 2013.

Own Fund Requirements and Determination of Risk Value in Crisis Situation

CSSF Circular 13/572

This new circular of 4 September 2013 applies to credit institutions and investment firms who calculate, after having obtained CSSF authorisation thereto, their own fund requirements triggered by foreign exchange risk, commodity price variation risk and/or trading book position risk on the basis of an internal risk management model.

The circular implements the EBA Guidelines on Stressed Value at Risk (sVaR) (EBA/GL/2012/2) and the EBA Guidelines on the Incremental Default and Migration Risk Charge (IRC) (EBA/GL/2012/3) in Luxembourg and introduces specifications concerning

- the modalities of calculation of the risk value in a crisis situation and
- the manner in which institutions have to deal with the supplement risks of default and of migration inherent to the positions in the trading book.

The circular entered into force with immediate effect.

Reminder on EMIR

CSSF Press Release 13/26

In a press release of 24 June 2013, the CSSF reminds all concerned entities of the obligations applicable to them under the European Market and Infrastructure Regulation (EMIR).

The EMIR obligations apply to financial and non-financial counterparties. Financial counterparties are banks, investment firms, collective investment undertakings with their management companies, pension funds and insurance undertakings. Non-financial counterparties are very broadly defined as all undertakings other than CCP and financial counterparties and the CSSF specifies that securitisation undertakings hence also qualify as non-financial counterparties.

Financial counterparties are subject to the clearing obligation and the exchange of collateral imposed by EMIR. They also have to comply with the reporting requirements to a trade repository as well as with risk management requirements for OTC derivatives contracts they enter into and which are not cleared by a CCP. For the time being, financial counterparties do not need to submit a report on unconfirmed OTC derivative transactions to the CSSF, but they must have the necessary procedures in place for the recording and the production of a monthly report of these unconfirmed trades. They must be able to produce such reports to the CSSF upon request.

All non-financial counterparties, whether above or below the clearing threshold, have to apply the operational risk management requirements and the reporting obligations to a trade repository. Those non-financial counterparties which are above the clearing threshold are moreover subject to the clearing obligation and the exchange of collateral, one of the risk mitigation techniques for outstanding OTC derivatives contracts.

Non-financial counterparties that enter into positions in OTC derivatives contracts are required to notify the CSSF if they pass the clearing threshold, either going above it or below it. The CSSF has published relating notification forms that can be downloaded from its website.

The CSSF draws the concerned entities' attention to the timing of several upcoming EMIR obligations for which starting dates are already determined and asks that concerned entities start preparing for complying with such obligations. Insofar as some of the start dates are not yet definitive, the CSSF announces that it will publish the final dates as soon as they will be known.

The CSSF reminds that an interim legal entity identifier (LEI) meeting the conditions indicated by the LEI Regulatory Oversight Committee (ROC) is expected to be used for reporting purposes under EMIR.

CSSF Q&A

CSSF Recognition of External Auditors of Financial Sector Entities and Listed Issuers

The CSSF issued a Q&A paper dated 13 August 2013 on the way financial sector entities subject to CSSF supervision and issuers of securities admitted to trading on the Luxembourg Stock Exchange need to authorise the external auditors (*réviseur d'entreprises agréé*) they choose for the legally required control of their accounts by the CSSF. This type of authorisation needs to be obtained as part of the licensing or prospectus approval process and anytime thereafter when the relevant entity wants to change its external auditor. The Q&A paper further describes the types of authorisation proceedings and the procedural steps, lists the items that need to be included in the authorisation request and criteria for the assessment of the appropriateness of the auditor's professional experience.

Reporting by Securitisation Vehicles on Securities Holdings

Circular BCL 2013/232

On 12 October 2012, the Governing Council of the European Central Bank (ECB) has adopted its Regulation ECB/2012/24 concerning statistics on holdings of securities. It completes the existing framework of the statistical activities related to the data collection on securities issuances and holdings by introducing a collection of data on securities with an ISIN code held by securitisation vehicles.

Furthermore, on 26 September 2012, the Governing Council of the ECB adopted guideline ECB/2012/21 concerning the data quality management framework for the Centralised Securities Database, appointing the Luxembourg Central Bank (*Banque centrale du Luxembourg*, BCL) to be responsible for quality control of Luxemburgish resident issuers.

The new circular BCL 2013/232 issued by the BCL on 20 June 2013 practically implements the ECB regulation with respect to Luxembourg securitisation vehicles by introducing reporting on a security by security basis. The reporting frequency is monthly and it has to be provided at the latest 20 working days following the month-end to which it relates. The first reference data will be based on positions held as at the end of December 2013.

The new reporting obligation is added to the existing reporting obligations of securitisation vehicles under Circular BCL 2009/224, setting out the practical modalities for data reporting of securitisation vehicles pursuant to regulation ECB/2008/30 in Luxembourg. The securitisation vehicles currently exempted from providing reports S 2.14 and S 2.15 under Circular BCL 2009/224 will also be exempted from security by security reporting under the new circular.

Reporting by Credit Institutions on Securities Holdings for Client Account

Circular BCL 2013/233

On 12 October 2012 the Governing Council of the ECB adopted its Regulation ECB/2012/24 concerning statistics on holdings of securities. It completes the existing framework of statistical activities related to the data collection on securities issuances and holdings by introducing a collection of data on assets in the form of securities held by credit institutions for the account of their non-residents clients on a security by security basis.

The new circular BCL 2013/233 issued by the BCL on 20 June 2013 practically implements the ECB regulation for credit institutions holding securities for the account of their non-resident clients in Luxembourg.

The regulation imposes the collection of data on a security by security basis for end-of-quarter or end-of-month positions, as well as on financial transactions over the reference month or quarter, or the collection of statistical information necessary to derive such transactions. The BCL opted for the approach already applied by it for the collection of information on holdings for own account, namely the reporting of monthly securities positions, permitting to the BCL to derive valuation effects and financial transactions on securities. The reporting obligation applies to credit institutions as of the December 2013 reference period, with a submission deadline of 25 business days after the end of the reference period.

The BCL nevertheless made use of the option contained in the ECB regulation to exempt credit institutions whose total amount of securities held on behalf of their non-resident clients is less than EUR 10 billion from such reporting. Exempted credit institutions will however have to report all their positions of securities held on behalf of non-resident clients annually on an aggregated basis, with a two month submission deadline after the end of the reference period.

The BCL will inform credit institutions that have to make a monthly reporting by individual mail. For the purpose of enabling it to make such determination, the BCL has asked credit institutions to report their aggregated holdings of securities held for client account on 30 June 2013 by 31 July 2013.

Introduction of a Daily Bank Deposit Reporting

Circular BCL 2013/234

The new circular BCL 2013/234 issued by the BCL on 20 June 2013 applies to credit institutions established in Luxembourg. The circular introduces a daily reporting to the BCL for statistical purposes, complementing the existing monthly and quarterly reporting obligations of credit institutions. The new reporting is aimed to allow a better monitoring of the evolution of bank deposits and hence to anticipate developments that would lead to a situation in which a bank is deprived of part of its refinancing.

The new daily reporting will be mandatory for all credit institutions as from 1 January 2014. For an interim period from 1 October 2013 until 31 December 2013, credit institutions representing more than 80% of total Luxembourg deposits will have to report weekly data from the first working day of the week upon individual mail request by the BCL.

New Circular Letters Concerning the Insurance Sector

The Luxembourg insurance sector regulator, Commassu, has issued the following circulars:

- Circular Letter 13/8 on the management of "separate accounts" by brokers and brokerage firms pursuant to Article 108-2 (2) of the Insurance Sector Law
- Circular Letter 13/10 on the introduction of a new version of the quarterly statements of assets covering technical provisions.

Case Law

Fraudulent Enforcement of Pledge – Call for Payment of a Demand Guarantee Made Fraudulently

District Court, 10 July 2013

Securitisation Undertaking – Continuing Issue of Securities to the Public – Scope of Activities Falling within the Corporate Object – Suspension of Payments

Administrative Court of Appeal, 21 August 2013

Wage Assignment and Bankruptcy of the Debtor

Supreme Court, 20 June 2013

Please refer to the Litigation section of this Luxembourg Legal Update for details of the above.

Corporate and M&A

Legislation

Several changes have come into force in the general provisions of Luxembourg corporate law during the period covered by the present newsletter and these changes are likely to affect the activities of Luxembourg companies.

Implementation of the AIFM Directive

Law of 12 July 2013

The Luxembourg Parliament has finished examining draft bill N°6471 on alternative investment funds managers (AIFM) transposing into Luxembourg law the provisions of the EC Directive 2011/61/UE on Alternative Investment Fund Managers (AIFM directive). The law was adopted on 12 July 2013 and was published in the Mémorial, on 15 July 2013. It entered into force on 15 July 2013.

The main measures of this law relate to the investment fund industry (please refer to the Funds and Investment Management section of this Luxembourg Legal Update for further details). However, the law also

- modernises the existing common limited partnership – SCS (*société en commandite simple*)
- creates a new type of vehicle: the special limited partnership – SCSp (*société en commandite spéciale*) and
- offers new management possibilities for the existing corporate partnership limited by shares – SCA (*société en commandite par actions*) and simplifies this form of company.

Modernisation of the SCS

The law modifies certain provisions of the Luxembourg Companies Law in order to modernise the SCS. The law focuses on greater flexibility, which is inspired by both practice and the existing Anglo-Saxon limited partnership regime. The main changes to the current SCS regime are the following:

- It is no longer compulsory to publish the identity of the limited partner(s) and the amount of their contribution.
- In addition to contributions in cash or in kind, it shall be possible to make contributions in the form of services to the SCS.
- SCS is authorised to issue debt securities.
- Unless the articles of the SCS provide for the contrary, it is possible for an unlimited partner to be also a

limited partner in the same SCS, provided that there is at least one other limited or unlimited partner in the SCS.

- Any SCS should maintain a register containing:
  - complete and conformed copy of the updated articles of association of the partnership
  - a list of the names, professions and addresses of the partners, and the number of partnership interests held by each partner
  - a record of transfers of partnership interests and the date of service or acceptance thereof.
- It is no longer compulsory that the name of an unlimited partner be part of the corporate denomination of the SCS.
- The management of the SCS may be entrusted to one or more managers, who may or may not be unlimited partners. Managers who are not unlimited partners shall only be liable to the partnership in accordance with general law for the execution of the mandate given to them and for any misconduct in the management of the partnership's affairs. The articles of association of the SCS may authorise the managers to delegate their powers to one or more proxyholders who shall only be liable in accordance with general law for the execution of the mandate given to them.
- The law includes a non-exhaustive list of business acts and management actions which can be accomplished by limited partners without them losing their limited liability. The limited partners may notably give advice to the partnership or its management, grant loans or guarantees to the partnership. It is also possible to foresee in the articles of the partnership that certain business acts/management actions shall require the approval of the limited partners.
- The articles of the SCS may freely determine the allocation of profits and losses between the partners.
- The articles of the SCS may freely determine the allocation of the voting rights between the partners and derogate from the "one share-one vote" principle.
- Resolutions of the partners of the SCS may be taken during a physical meeting or by written form (circular resolutions). At least once a year, at a date set up in the articles of association of the SCS (which must be within six months of the end of the financial year of the SCS), the partners are obliged to examine and vote on the annual accounts of the SCS.
- Any amendment to the corporate object of the SCS, the liquidation of the partnership, as well as any change to the nationality or legal form of such partnership must be decided by the partners. The articles of the partnership may freely determine other decisions that do not require the partners' approval.
- Unless provided otherwise in the articles of association of the SCS, ordinary decisions of the partners are validly taken by the majority of the votes cast, irrespective of the number of partners present or represented. However, decisions related to the change of corporate object, change of legal form or nationality or to the liquidation of the SCS, shall require the positive vote of:
  - partners representing ¾ of the partnership interests and
  - of all the unlimited partners.
- The articles of the SCS may foresee some specific procedures and restrictions for the transfer of partnership interests. A partners' approval, inspired by the procedure existing for the Luxembourg SARL for the transfer of shares, may apply to the transfers of partnership interests.

Implementation of an SCSp

Along with the reform of the SCS, the introduction of an SCSp has also been proposed. Such SCSp does not have a legal personality.

The SCSp is a partnership entered into by one or more general partners with unlimited and joint and several liability for all the obligations of the partnership, and one or more limited partners contributing only a specific amount, represented by shares or not.

The regime of the SCSp is quite similar to the new regime applicable to the SCS. Most of the changes described in point 1 above shall also apply to the SCSp. The number of mandatory rules applicable to the SCSp is very limited and the partners are largely free to determine in the articles of the partnership their respective political and economic rights, as well as the rules for the governance of the partnership.

This new vehicle may be used by regulated and non-regulated entities whether or not they qualify as alternative investment funds under the AIFM Directive.

New Management Possibilities for SCA and Simplification of this Form of Company

The law modifies certain provisions of the Companies Law in order to offer new management possibilities for the SCA.

The management of the SCA may be entrusted to one or more managers, unlimited shareholders or not, appointed in accordance with the provisions of the articles of the SCA. Managers who are not unlimited shareholders shall only be liable to the SCA in accordance with general law for the execution of the mandate given to them and for any misconduct in the management of the corporate partnership's affairs.

The articles may authorise the managers to delegate their powers to one or more proxyholders who shall only be liable in accordance with general law for the execution of the mandate given to them.

Unless the articles provide otherwise, each manager may take any actions necessary or useful to realise the corporate object. Any limitations to the powers of the managers resulting from the articles are not valid vis-à-vis third parties, even if they have been published. However, the articles may authorise one or more managers to represent the SCA alone or jointly, and any such clause shall be valid vis-à-vis third parties subject to publication.

The SCA shall be bound by any acts of the managers even if such acts exceed the corporate object, unless it proves that the third party knew that the acts exceeded the corporate object or could not in view of the circumstances have been unaware of it.

Each manager shall represent the SCA vis-à-vis third parties and in legal proceedings, either as plaintiff or defendant. Writs served on behalf of or against the SCA shall be validly served in the name of the SCA alone.

Moreover, the law includes a non-exhaustive list of business acts and management actions which can be accomplished by limited shareholders without them losing their limited liability. The limited shareholders may notably give advice to the SCA or its management, grant loans or guarantees to the SCA. It is also possible to foresee in the articles of the SCA that certain business acts/management actions shall require the approval of the limited shareholders.

The law also simplifies the conditions for establishing an SCA. It is now possible to incorporate an SCA with one unlimited shareholder and only one limited shareholder (whereas previously, in addition to an unlimited shareholder, at least two limited shareholders were required for incorporating a corporate partnership limited by shares). Moreover, it is no longer compulsory that the name of an unlimited shareholder be part of the corporate denomination of the SCA.

Finally, the law offers the possibility for an SCA to not establish a supervisory board in case its annual accounts are audited by an independent approved auditor (*réviseur d'entreprises agréé*).

Regulatory Developments

CSSF Regulation 13/01

Since the enactment of the law of 18 December 2009, the CSSF has been in charge of the supervision of the audit profession and has issued several recommendations and circulars in this respect.

On 20 August 2013, the CSSF issued technical regulation N°13-01 relating to the audit profession (abridging the former regulation N°11-01 on the audit profession) whereby

- it updates the international accounting rules which are applicable in Luxembourg
- clarifies the scope of certain activities of independent approved auditors and provides some guidance to independent approved auditors with respect to these activities and
- updates the code of deontology for the audit profession.

Update of international accounting rules (ISA)

According to regulation N°13-01, the "Introduction" part, the "Objective" part, the "Definition" part and the "Requirements" part of the international accounting rules (ISA) as established by the International Auditing and Assurance Standards Board (IAASB) and published in the "Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements – 2013 Edition" of the International Federation of Accountants (IFAC) are now applicable in Luxembourg with regard to the audit profession as of 1 January 2013.

In addition, the CSSF confirms that the following international accounting rules (ISA) remain applicable in Luxembourg.

200–299 General principles and responsibilities

- ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing
- ISA 210, Agreeing the Terms of Audit Engagements
- ISA 220, Quality Control for an Audit of Financial Statements
- ISA 230, Audit Documentation

- ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
- ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements
- ISA 260, Communication with Those Charged with Governance
- ISA 265, Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

300–499 Risk assessment and response to assessed risks

- ISA 300, Planning an Audit of Financial Statements
- ISA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment
- ISA 320, Materiality in Planning and Performing an Audit
- ISA 330, The Auditor's Responses to Assessed Risks
- ISA 402, Audit Considerations Relating to an Entity Using a Service Organisation
- ISA 450, Evaluation of Misstatements Identified during the Audit

500–599 Audit evidence

- ISA 500, Audit Evidence
- ISA 501, Audit Evidence – Specific Considerations for Selected Items
- ISA 505, External Confirmations
- ISA 510, Initial Audit Engagements – Opening Balances
- ISA 520, Analytical Procedures
- ISA 530, Audit Sampling
- ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
- ISA 550, Related Parties
- ISA 560, Subsequent Events
- ISA 570, Going Concern
- ISA 580, Written Representations

600–699 Using the work of others

- ISA 600, Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)
- ISA 610, Using the Work of Internal Auditors
- ISA 620, Using the Work of an Auditor's Expert

700–799 Audit conclusions and reporting

- ISA 700, Forming an Opinion and Reporting on Financial Statements
- ISA 705, Modifications to the Opinion in the Independent Auditor's Report
- ISA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
- ISA 710, Comparative Information – Corresponding Figures and Comparative Financial Statements
- ISA 720, The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements

800–899 Specialised areas

- ISA 800, Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
- ISA 805, Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
- ISA 810, Engagements to Report on Summary Financial Statements

Clarification of the scope of certain activities of independent approved auditors

The CSSF also clarified the scope of certain activities of independent approved auditors (e.g. the review of contributions in kind to Luxembourg SAs, the establishment of reports on the merger operations of Luxembourg companies, the establishment of reports concerning the liquidation of Luxembourg companies) and provided some guidance to independent approved auditors with regard to these activities.

Thus, regulation N°13-01 confirms that the independent approved auditors auditing the annual accounts of Luxembourg SAs, may review the contributions in kind made to such Luxembourg SAs. It also confirms that the independent approved auditors auditing the annual accounts of Luxembourg SAs may prepare the report on the merger process of such Luxembourg SAs. It finally states that the independent approved auditors auditing the annual accounts of Luxembourg companies must not act as liquidator of these companies. They can only act as auditor to the liquidation (*commissaire à la liquidation*) if necessary.

Update of the code of deontology of the audit profession

The CSSF clarifies the International Standard on Quality Control (ISQC 1) established by the International Auditing and Assurance Standards Board (IAASB) applicable to the audit profession in Luxembourg with respect to the conservation of audit documentation by audit firms and auditors.

The CSSF also confirms the application of the deontology code adopted on 1 January 2011 and subsequently amended in 2013 by the International Ethics Standards Board for Accountants (IESBA) to the audit profession in Luxembourg.

Case Law

Misuse of Company Assets and Debit Position of the Current Account of Unitholder

Court of Appeal 9 March 2011

Actio mandati against Directors Exercised by a Single Shareholder

Court of Appeal, 15 February 2012

Managing Director Liability for Tax and Social Security Obligations until the Publication of his/her Resignation

Administrative Court, 15 May 2013

Disqualification of Directors for Default Tax and Social Security Obligations

Administrative Court, 22 May 2013

Liquidator Liability for Nonsufficient Provisions for Claims (Legal Warranty Period)

Supreme Court, 7 February 2013

Evidence – General Manager of a Company as Witness

Supreme Court, 2 May 2013

Please refer to the Litigation section of this Luxembourg Legal Update for details of the above.

Funds and Investment Management

Legislation

Implementation of the AIFM Directive

Law of 12 July 2013

The Law of 12 July 2013 on alternative investment fund managers (AIFM Law) was voted by the Luxembourg Parliament on 10 July 2013 and entered into force on 15 July 2013.

The main purpose of the AIFM Law is to implement the AIFM Directive[1], which imposes a licensing and regulatory compliance framework for the activities of Alternative investment fund managers (AIFMs) within the EU. for the first time, it allows fully licensed AIFMs to benefit from a "passport" to provide management services to Alternative investment funds (AIFs) and to market these AIFs to professional investors in the EU on the basis of a single authorisation and subject to the conditions laid down in the AIFM Directive[2]. Please note that the concept of "professional investors" refers to any investor that is considered as, or may be treated as, a professional client under Annex II of the MiFID. Concurrently, as in the case of UCITS, the AIFM Directive assimilates EEA Member States (i.e. the 28 Member States of the European Union plus Iceland, Norway and Liechtenstein) to the Member States of the EU.

The AIFM Law also amends, among others, the UCI, the SIF and the SICAR Laws by introducing new product rules imposed by the AIFM Directive (e.g. valuation, annual report and disclosure to investors, depositary and delegation rules) on UCIs, SIFs and SICARs qualifying as so-called "Full-Scope" AIFs. Chapter 15 and Chapter 16 of the UCI Law are also amended in order to introduce the possibility for, and conditions according to which,

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

[2] For the avoidance of doubt, the AIFM Directive passport will initially be available to EU AIFMs managing and marketing EU AIFs in the EU only. However, in July 2015, subject to a positive assessment by ESMA and EU Commission implementing measures, the AIFM Directive passport may become available to non-EU AIFMs and non-EU AIFs.

Luxembourg management companies may be authorised and licensed as AIFMs by the CSSF under the AIFM Law.

According to the AIFM Law, any Luxembourg entity qualifying as an AIFM (being an external AIFM or internally-managed AIF) will need to apply for either registration or authorisation with the CSSF, depending on whether the value of the AIF's assets under management in total is below or above the EUR 100/500 million thresholds laid down in the AIFM Law, unless but only within the limits the relevant AIFM is excluded, exempted or grandfathered under the AIFM Law. The various transitional and grandfathering provisions specific to existing management companies and to UCIs, SIFs, SICARs existing on 22 July 2013 or created after 22 July 2013 but before 22 July 2014 are reflected, as the case may be, in the AIFM, the UCI Law, the SIF and the SICAR Law.

In addition to the above, the adoption of the AIFM Law has been considered as an opportunity to introduce other changes, which are unrelated to the AIFM Directive package, in order to make the Luxembourg alternative investment fund regime more attractive as a whole. The major innovations of the new law that are of particular interest to Luxembourg regulated investment funds are:

- the modernisation of the existing common limited partnership (SCS) regime and the creation of a new type of vehicle, the special limited partnership (SCSp) with no legal personality, both partnership forms being available to all SIFs of the corporate type and SICARs as well as to SICAFs subject to Part II of the UCI Law, regardless whether these vehicles qualify as AIFs or not (please refer to the Corporate and M&A section of this Luxembourg Legal Update for further details)
- the introduction of a new type of professional of the financial sector, which may act as depositary for Luxembourg UCIs, SIFs and SICARs, for whom no right of redemption can be exercised during a 5 year period following the date of initial investments and who, in accordance with their principal investment policy, do not generally invest in assets which have to be kept in custody, or who generally invest in issuers or non-listed companies to potentially acquire control over these companies (please refer to the Banking, Finance and Capital Markets section of this Luxembourg Legal Update for further details)
- the introduction of various tax provisions aiming at, among others, ensuring full tax transparency of the SCS/SCSp (under relaxed conditions) and introducing a reduced tax rate for carried interest income (under conditions) (please refer to the Tax section of this Luxembourg Legal Update for further details).

From a domestic perspective, it is worth mentioning that the remainder of the AIFM Directive will be implemented through potentially additional guidance and measures from the CSSF, which has already published on its website:

- an FAQ document (as updated from time to time) on various AIFMD topics analysed from a Luxembourg perspective, including the scope of the AIFM's activities, the delegation requirements, the depositary aspects, the transitional provisions applicable to Luxembourg AIFMs and AIFs as well as to EU and non-EU AIFMs marketing their AIFs in Luxembourg and a list of the cooperation agreements signed by the CSSF with non-EU authorities as required under the AIFM Directive
- various press releases providing information on the procedure to be followed and applicable timing in order to be registered or authorised (as the case may be) as AIFM by the CSSF
- template forms to be used under the applicable authorisation or registration procedure.

At European level, Luxembourg will also take into account further AIFM Directive implementing regulations adopted by the EU Commission and having direct effect in Member States, such as:

- the EU Commission delegated regulation N°231/2013 of 19 December 2012 supplementing the AIFMD with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision
- the EU Commission implementing regulation N°448/2013 of 15 May 2013 establishing a procedure for determining the Member State of reference of a non-EU AIFM pursuant to the AIFM Directive
- the EU Commission implementing regulation N°447/2013 of 15 May 2013 establishing the procedure for AIFMs, which choose to opt in under the AIFM Directive.

Moreover, the EU Commission published a standard list of issues on the AIFM Directive on its website. Finally, ESMA developed – and will continue to develop – additional guidelines on various issues arising from the AIFM Directive in order to minimise the risk of divergent application across the EU, including without limitation:

- ESMA guidelines of 3 July 2013 on sound remuneration policies (ESMA/2013/232.)

- ESMA guidelines of 13 August 2013 on key concepts of the AIFMD (ESMA/2013/611)
- ESMA draft guidelines of 1 October 2013 on reporting obligations to national competent authorities (ESMA/2013/1339.)
- ESMA draft regulatory technical standards of 13 August 2013 on types of AIFMs (ESMA/2013/1119.).

The main features of the AIFM Law have already been analysed in our previous client briefing issued at the time Bill N°6471 was deposited with the Luxembourg Parliament. This client briefing will be updated with a particular focus on the key changes introduced to the current legal framework of Luxembourg regulated investment vehicles and Luxembourg management companies.

International Developments

IOSCO Principles for the Regulation of ETFs

On 24 June 2013, the International Organisation of Securities Commissions (IOSCO) published its final report on principles for the regulation of exchange traded funds (ETFs), setting out nine principles intended to guide the regulation of ETFs and foster industry best practices in relation to these products.

IOSCO principles address ETFs that are organised as collective investment schemes and do not apply to other, non-collective investment schemes, exchange-traded products. These principles are similar to ESMA guidelines on ETFs and other UCITS issues (please see the EU Developments sub-section on ETFs and other UCITS Issues below), and no significant impact is expected for Luxembourg UCITS funds.

EU Developments

AIFM Directive

ESMA Opinion on Arrangements for Late Transposition

The transposition deadline of the AIFM Directive was 22 July 2013. However, some Member States have not yet transposed this directive, which can create difficult situations for AIFMs wishing to operate cross-border by using the benefit of the so-called AIFMD management and marketing passports.

On 1 August 2013, ESMA published an opinion proposing practical arrangements in relation to the rights of EU AIFMs to market and manage EU AIFs in the EU in the case where one of the Member State concerned by the management and/or marketing activities has not transposed the AIFM Directive.

These practical arrangements, which are based on the jurisprudence of the European Court of Justice (ECJ) on direct effect of provisions contained in the relevant EU directives, are the following:

- Notification of marketing of EU AIFs when the host Member State of the AIFM has not transposed the AIFM Directive: ESMA believes that, if the AIFM Directive has been transposed in the home Member State of the AIFM, the competent authority of the host Member State of the AIFM or the competent authority of the home Member State of the AIFM may not refuse a valid notification under the AIFM Directive on the ground that the AIFM Directive has not yet been transposed in the host Member State. This applies irrespective of whether the marketing is done using the freedom to provide services or by means of a branch.
- Management passport: ESMA believes that AIFMs established in a Member State that has transposed the AIFM Directive should be able to manage an EU AIF via the management passport, both using the freedom to provide services or by means of a branch, in a Member State where the AIFM Directive has not been transposed, irrespective of the provisions currently in place in such jurisdiction since the relevant provisions of the AIFM Directive are of a self-executing nature, and provided the AIFM is authorised to manage that type of AIF in accordance with article 33(1) of the AIFM Directive.

EMIR

Please refer to the Banking, Finance and Capital Market section of this Luxembourg Legal Update for further details.

UCITS V

Plenary Vote of the European Parliament

On 3 July 2013, the EU Parliament voted on the text of the draft UCITS V Directive[3] deposited by the European Commission on 3 July 2012 and amended by the EU Parliament's economic and monetary affairs committee (ECON) in March 2013.

[3] Proposal of the EU Commission of 3 July 2012 for a directive of the EU Parliament and of the Council amending directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions.

A number of proposals that were proposed by the EU Commission or ECON have been rejected by the EU Parliament, including the following:

- the cap on fund manager bonuses at 100% of fixed salary
- the prohibition on performance fees save in the case of UCITS that are marketed exclusively to MiFID professional investors
- the requirement that underperformance of a benchmark should result in deductions from the fund manager's fee equal to the level of performance fee paid for equivalent outperformance.

The EU Parliament has also introduced a number of new provisions as part of UCITS V, including without limitation the following:

- the obligation for UCITS management companies to disclose details of remuneration policies and the basis on which they have been decided in the key investor information document (KIID)
- the obligation for UCITS managers to have malus or clawback arrangements in place to allow them to reduce the variable remuneration component where the UCITS manager or the UCITS fund it manages suffers "subdued or negative financial performance"
- a more detailed list of "identified staff" whose remuneration should be subject to the remuneration requirements, including any employee and any other member of staff at fund or sub-fund level who are decision takers, fund managers and persons who take real investment decisions, persons who have the power to exercise influence on such employees or members of staff, including investment policy advisors and analysts, and senior management.

The UCITS V text is now awaiting the so-called trialogue negotiation agreement. The final vote of UCITS V is expected by end 2013 with entry into force anticipated by end of 2014. By this date, the necessary package of implementing measures should also be adopted.

ETFs and other UCITS Issues

ESMA Updated Q&A

ESMA consolidated guidelines on ETFs and other UCITS issues (ESMA/2012/832.) entered into force on 18 February 2013. On the same day, the CSSF published its Circular 13/559 incorporating the ESMA guidelines into its supervisory practice. In addition, ESMA published a Q&A on 15 March 2013 on the practical application of these guidelines, which has been updated on 11 July 2013, and is intended to be continually edited and updated by ESMA as and when new questions are received.

Clifford Chance has updated its previous client briefing providing an overview of the changes to the relevant Luxembourg regulatory environment brought about by these guidelines and focusing on the actions to be taken by Luxembourg UCITS, in particular as regards the new substantive requirements and the amendments to the various fund documents required by ESMA guidelines.

European Long Term Investment Funds

EU Commission Draft Regulation

On 26 June 2013, the EU Commission published a proposal for a regulation on a new collective investment vehicle, the EU long-term investment funds (ELTIFs), which will only invest in businesses that need money to be committed to them for long periods of time, such as infrastructure and real estate projects.

The overall objective of the new regulation is to create a legislative framework for long-term EU funds and to increase the non-bank finance available for companies investing in the real economy in the EU. To that end, a new ELTIF label will be introduced together with a new EU cross-border passport allowing managers to market their long-term funds to all types of institutional and private investors across Europe, subject to certain conditions designed to protect both investors and the companies and projects they invest in.

The main characteristics of the draft regulation are summarised below. For the avoidance of doubt, article 1 of the regulation makes clear that the requirements it contains are exhaustive, thus leaving no scope for "gold-plating" at national level.

Authorisation Procedure

According to the regulation, the ELTIF designation shall be reserved only to EU investment funds that qualify as EU AIFs and are offered across Europe by an authorised EU AIFM. As a result, both ELTIFs and their managers will be subject to the AIFM Directive rules such as, for example, the obligation to have a depositary and to comply with the valuation and disclosure requirements imposed by that directive.

The regulation provides that the authorisations as ELTIF and manager of ELTIF will be granted by the competent authority of the ELTIF's Member State to those EU AIFs and AIFMs complying with the proposed regulation, which implies that a manager of alternative asset classes who wants to manage or market funds focused on long-term assets without using the proposed ELTIF designation is not obliged to comply with the proposed regulation.

The ELTIF and the EU AIFM shall be informed within two months from the date of submission of a complete application whether authorisation of the ELTIF has been granted.

Investment Policy and Restrictions

According to the regulation, ELTIFs can only invest in certain types of long-term illiquid assets and firms (for example infrastructure, real estate, transport and sustainable energy projects) and at least 70% of the money in the fund has to be invested in these assets with a maximum of 10% of its capital in any single qualifying portfolio undertaking, ELTIF, EU venture capital funds (EuVECA), EU social entrepreneurship funds (EuSEF) or individual real estate assets.

However, the regulation allows for a five year period in which the long-term asset portfolio can be built up. In addition, it allows the manager to invest up to 30% of the ELTIF's capital in liquid securities.

The other main investments restrictions applicable to ELTIFs are the following:

- The aggregate value of units or shares of ELTIFs, EuVECAs and EuSEFs in an ELTIF portfolio shall not exceed 20% of the value of its capital.
- An ELTIF may acquire no more than 25% of the units or shares of a single ELTIF, EuVECA or EuSEF.
- An ELTIF shall not engage in short selling of assets, gain exposure to commodities, enter into securities lending or securities borrowing agreements, and enter into repurchase agreements.
- An ELTIF shall not use financial derivative instruments, except where the underlying instrument consists of interest rates or currencies and it solely serves the purpose of hedging the duration and exchange risks inherent to other investments of the ELTIF (so avoiding their use for speculative reasons).
- An ELTIF will limit leverage to 30% of its capital and will obey the other limits on the borrowing of cash laid down in the proposed regulation.

Targeted Investors

Institutional investors, such as pension funds and insurance companies that need to find assets that pay a steady, reliable income to meet the promises they have made to their savers and policyholders, will be attracted to ELTIFs. However, ELTIFs are also likely to appeal to smaller investors, including retail savers, who can afford to have some of the money invested for a number of years in return for a steady income or a lump sum at the end.

Marketing to retail investors is however subject to specific disclosure requirements (see transparency requirements sub-section below). In addition, the manager of an ELTIF shall be able to market the units or shares of that ELTIF to retail investors provided that all of the following additional requirements are fulfilled:

- The ELTIF's rules or instruments of incorporation provide that all investors benefit from equal treatment and no preferential treatment or specific economic benefits are granted to individual investors or groups of investors.
- The ELTIF is not structured as a partnership.
- Retail investors may, during the subscription period and at least two weeks after subscription of units or shares of the ELTIF, cancel their subscription and have the money returned without penalty.

Redemption Policy

ELTIFs will run for a specified period of time during which investors do not have the right to get their money back. This will have to be clearly explained to investors, along with the advice that they should not put all of their assets into an ELTIF.

Transparency Requirements

The regulation contains various transparency rules where ELTIFs are being advertised to investors. In particular, the prior publication of a prospectus and, in case of marketing to retail investors the publication of a KIID, will be required before the ELTIF is marketed. The prospectus, KIID and any other marketing document shall inform the investors about the special nature of the long-term investment into an ELTIF as well as of all costs attached to the ELTIF.

Next steps

The draft regulation is likely to come into effect in 2015. Since the proposal takes the form of a directly applicable regulation, it will have binding legal force throughout every Member State as soon as it is passed and published in the official journal without need for national governments to take action themselves to implement the said regulation. Level 2 measures and technical standards are also expected to clarify some provisions of the regulation.

Shadow Banking and MMFs

EU Commission Communication and Draft Regulation

On 4 September 2013, the EU Commission published a communication on shadow banking and a proposal for a regulation on Money Market Funds (MMFs).

The communication, which is a follow-up to last year's green paper on shadow banking, sets out the measures already taken to deal with the risks related to shadow banking, such as the rules governing hedge fund activity and reinforcing the relationship between banks and unregulated actors. It also outlines the priorities identified on which the EU Commission intends to take initiatives.

The first of these initiatives – the proposed regulation on MMFs – concerns the provision of a framework for MMFs that are domiciled or sold in the EU in order to improve their liquidity profile and stability:

- As regards liquidity management, the draft regulation provides that MMFs should have at least 10% of their portfolio in assets that mature within a day and another 20% that mature within a week. This requirement is intended to allow MMFs to repay investors who want to withdraw funds at short notice. In order to avoid that a single issuer bears undue weight in the net asset value of an MMF, exposure to a single issuer would be capped at 5% of the MMF's portfolio (in value terms), whilst for standard MMFs, a single issuer could account for 10% of the portfolio.
- As regards stability, the new rules would require constant net asset value MMFs (which require sponsor support in order to stabilise redemptions at par) to establish a predefined capital buffer to be activated to support stable redemptions in times of decreasing value of the MMFs' investment assets.

The new MMFs rules could be agreed in the course of 2014. Since the proposal takes the form of a directly applicable regulation, it is expected that it will be applied toward the end of 2014 throughout the EU. However, before it becomes applicable, the EU Commission's proposal will have to be approved by the Council and the EU Parliament.

In addition to the MMFs rules, the EU Commission indicates in its communication that it also aims to take initiatives regarding:

- the transparency of the shadow banking sector and the collection of detailed, reliable and comprehensive data
- securities law and the risks associated with securities financing transactions (principally securities lending and repurchase transactions)
- the provision of a framework for interactions with banks, including a tightening of the prudential rules applied to banks in their operations with unregulated financial entities to address contagion risk.

The European Commission will also pay particular attention to the supervision arrangements of shadow banking entities/activities in order to ensure that specific risks are adequately addressed. Certain areas such as the set-up of resolution tools for non-bank financial institutions and a structural reform of the banking system will be clarified at later stage.

Regulatory Developments

UCITS Master-Feeder Structures

CSSF FAQ

On 24 June 2013, the CSSF issued a FAQ document on master-feeder structures under the UCITS regime. The FAQ document has been updated on 11 July 2013, and it is intended to be continually edited and updated by the CSSF as and when new questions are received. The CSSF also indicated that it may change its approach or position with regard to some of the issues covered by the FAQ document.

The FAQ document applies to both master and feeder funds domiciled in Luxembourg and address, among other, the following issues:

- the identification and disclosure of matters to be treated as irregularities in the audit reports of master and feeder UCITS

- how and where the combined charges of the master and feeder funds should be disclosed in the feeder's fund's annual report
- how to assess the combined charges of the master and feeder UCITS when the funds have different financial year-ends, how audits should be prepared in this situation, and how the costs of such "ad hoc" audit reports should be allocated
- the languages in which the annual reports of master UCITS are made available
- the possibility and related conditions for a UCITS converting into a feeder of a newly created master UCITS to refer to its past performance
- the absence of look-through requirements at the Luxembourg feeder UCITS level for reporting purposes, neither for the CSSF monthly reporting, nor for the long form reports.

Guidance in relation to Luxembourg EuVECA and EuSEF

CSSF Press Release 13/36

On 2 August 2013, the CSSF published a press release indicating that it is the competent authority for managers established in Luxembourg to whom Regulation N°345/2013 of 17 April 2013 on EuVECA or Regulation N°346/2013 of 17 April 2013 on EuSEF apply and who wish to opt-in under the aforementioned regulations.

In particular, the CSSF points out that:

- Managers who wish to obtain the designation EuVECA or EuSEF in relation to the marketing of their funds are invited to inform the CSSF of their intention and to provide the CSSF in writing with the information that is required in article 14 respectively article15 of the relevant regulations.
- The managers concerned also need to register on the basis of article 3 of the AIFM Law.

Please refer to the June 2013 edition of our Luxembourg Legal Update for further information on the EuVECA and EuSEF regulations.

ALFI Code of Conduct for Luxembourg investment funds

The Association of the Luxembourg Fund Industry (ALFI) published a revised version of its code of conduct for Luxembourg investment funds in July 2013.

The purpose of the ALFI code, which was initially introduced in September 2009, is to provide boards of directors with a framework of high-level principles and best practice recommendations for the governance of Luxembourg investment funds and management companies. This code is "principles" rather than "rules" relying on good judgement rather than prescription. As such, the recommendations recognise that the "right approach" for many issues depends on the circumstances. In brief, two additional principles have been added to the eight principles included in the initial version of the ALFI code:

- a new principle on external governance (i.e. the exercise of shareholder rights)
- a new principle on the remuneration of board members.

The revised version of the code also contains new recommendations on:

- the consideration to be given to the appointment of one or more independent directors within the board of directors of investment funds and management companies
- the role of the chairperson of the board of directors of investment funds and management companies
- the periodic review of its performance and activities by the board of directors of investment funds and management companies.

ALFI considers that it is appropriate to apply the code to all funds (UCITS, Part II UCIs and SIFs, regardless whether they are listed or unlisted) and management companies in order to have a uniform and consistent approach in the marketplace. To improve transparency and demonstrate commitment to high standards of corporate governance, ALFI also recommends that boards of Luxembourg funds, and of management companies where appropriate, confirm adherence to the principles of the code in their annual financial statements.

ALFI Practices and Recommendations on AML

On 11 July 2013, ALFI published its new "Practices and Recommendations aimed at reducing the risk of money laundering and terrorist financing in the Luxembourg fund industry". These have been drafted in cooperation with the Luxembourg Bankers' Association (ABBL), the Association of Luxembourg Compliance Officers (ALCO) and the Association of Luxembourg Risk Managers (ALRiM) and replace the previous ALFI recommendations published in February 2007.

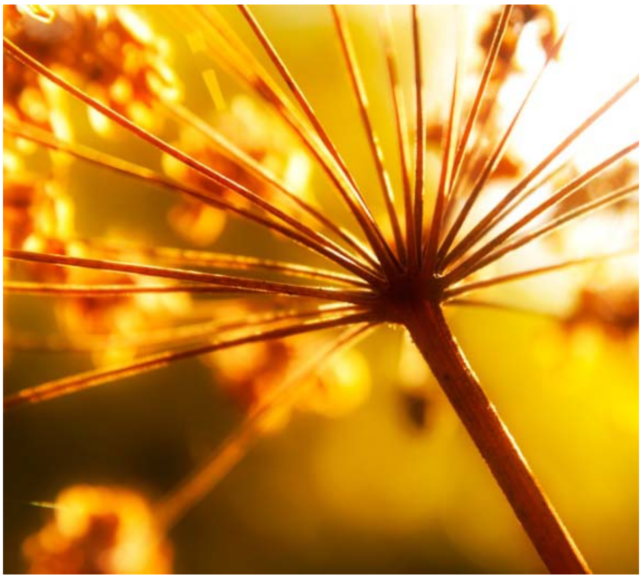
The purpose of the AML Practices and Recommendations is to clarify the application of article 3 of the CSSF Regulation N°12-02[4] concerning customer due diligence measures, in particular documentation and information to be collected, with regard to intermediaries and investors of UCIs in alignment with international standards, including the FATF recommendations as well as the EU Directives 2005/60/EC and 2006/70/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing. In this respect, the AML Practices and Recommendations provide an overview of the responsibilities of the key actors in the fund industry in terms of anti-money laundering and counter-terrorist financing, by distinguishing the two main types of investor relationships and distribution channels for Luxembourg investment funds, i.e. direct investors and distribution via intermediaries. The AML Practices and Recommendations further describe the factors to consider when adopting a risk-based approach with regard to customer, relationship, transaction, distribution channel and geographical risk assessments. They also focus on the use of third parties in foreign jurisdictions, whether as third party introducers or within the framework of an outsourcing.

ALFI/ABBL Guidelines and Recommendations for Depositaries – Oversight Duties and Cash Monitoring for AIFs

Due to the scope and complexity of the AIFM Directive rules and the need to provide further clarifications on certain key aspects, ALFI published on 26 July 2013 the "ABBL and ALFI Guidelines and Recommendations for Depositaries – Oversight Duties and Cash Monitoring for AIFs". They cover and clarify the following oversight duties for depositaries of AIFs:

- to ensure that the sale, issue, re-purchase, redemption and cancellation of shares or units of the AIF are carried out in accordance with the applicable national law and the AIF rules or instruments of incorporation
- to ensure that the value of the shares or units of the AIF is calculated in accordance with the applicable national law and the AIF rules or instruments of incorporation
- to carry out the instructions of the AIFM, unless they conflict with the applicable national law, the AIF rules or instruments of incorporation
- to ensure that in transactions involving the AIF's assets, any consideration is remitted to the AIF within the usual time limits
- to ensure that an AIF's income is applied in accordance with the applicable national law and the AIF rules.

The ALFI and ABBL guidelines and recommendations also cover the cash monitoring obligations of depositaries of AIFs, which require the depositary to have a full overview of the cash position and cash movements of the AIF, including subscription monies.



[4] CSSF Regulation N°12-02 of 14 December 2012 on the fight against money laundering and terrorist financing.

Litigation

Banking, Finance & Capital Markets

Fraudulent Enforcement of Pledge – Call for Payment of a Demand Guarantee Made Fraudulently

District Court, 10 July 2013[5]

A creditor in financial difficulty grants a refinancing loan in replacement of a credit facility to one of its debtors. The initial credit facility was unsecured. This refinancing loan did not imply any transfer of money, however it was secured by a first demand guarantee and a pledge. The refinancing could be drawn until a certain date. It appeared however that certain conditions subsequent had not been met at that date. Three days later, at 4.22 pm, the conditions had still not been met, the creditor notified the debtor that the loan had been granted. 48 minutes later, at 5.10 pm the creditor notified the debtor that the loan had been terminated and demanded immediate and complete repayment of the loan and the interests. The creditor also demanded payment by the guarantor and enforced the pledge.

In these circumstances, the District Court decided that the granting and terminating of the loan were made in bad faith, and that for this reason the call for payment of the demand guarantee had to be considered as patently fraudulent. Additionally, the beneficiary of a pledge falling within the scope of the law on financial collateral arrangements could enforce the pledge under the circumstances and the conditions provided for by the agreement, without the pledgor being able to raise any defences. However, given that the enforcement had been fraudulent, the creditor had to transfer the pledged assets, which were still in his possession, back to the pledgor.

Securitisation Undertaking – Continuing Issue of Securities to the Public – Scope of Activities Falling within the Corporate Object – Suspension of Payments

Administrative Court of Appeal, 21 August 2013[6]

An undertaking had started issuing securities in October 2006. However, it only applied to the CSSF in July 2009 in order to obtain the necessary licence. In 2011, the application had been rejected by the CSSF.

The Administrative Court of Appeal considered that the securities had been issued to the public on a continuing basis. As a matter of fact the securities were issued with a view to individual investors looking for a certain type of investment. Even though the securities were distributed by institutional investors serving as intermediaries, the issue had been made to the public as the law refers to an issue "directed to" (*à destination du*) the public. With regard to the criterion of continuity of the issue, the Court decided that the company had issued securities from time to time as specified in its base prospectus dated August 2007. All of the issues following this date could be seen as part of the program provided for in this prospectus and as such it could be considered that there had been a continuing issue of securities. It is necessary for a securitisation vehicle to obtain a licence before issuing securities to the public on a continuing basis.

The activity of granting loans to other companies is not in line with the corporate object of a securitisation undertaking.

In circumstances where the activities of a securitisation undertaking have started before the application for a licence and where this application has been rejected, such decision entails suspension of any payment by said undertaking and prohibition for such undertaking, under penalty of voidance, to take any measures other than protective measures, except with the authorisation of a supervisory commissioner.

Wage Assignment and Bankruptcy of the Debtor

Supreme Court, 20 June 2013[7]

A bank was granted two wage assignments by a client to which it had granted a loan. It then notified said assignments to the Luxembourg employer of its client. A year and a half later, the client was put under judicial receivership in France, where he was residing, and then put in bankruptcy by a court decision.

The liquidator asked the Luxembourg jurisdictions for the release of the assignment for all the outstanding salaries after the judicial receivership. The District Court granted said request.

The Supreme Court quashed the judgment. To do so, the Court reminds that the notification of a wage assignment

[5] District Court, 10 July 2013, N°120.209, 121.127 & 122.468.
[6] Administrative Court of Appeal, 21 August 2013, N°31952C.

[7] Supreme Court, 20 June 2013, N°48/13.

produces an attributive effect for the benefit of the assignee of the claim, and that the assignment carries out its effects on the outstanding sums in accordance with said claim, even after the launching of the insolvency proceedings.

Corporate and M&A

Misuse of Company Assets and Debit Position of the Current Account of Unitholder

Court of Appeal 9 March 2011[8]

The manager and sole shareholder of a limited liability company (*société à responsabilité limitée*) took EUR 12,500 from the company in order to reimburse a personal loan. He was thus prosecuted for misuse of company assets. For his defence, the manager put forward that he had the right to dispose of the assets of the company withdrawing the sums from the shareholder current account. The Court rejected this argument by putting forward that a situation where a limited liability company grants a loan to its shareholder is not normal (i.e. having a negative shareholder current account). Managers of companies cannot use their undertaking as a bank facility for their personal use. The sole debit position, without justification, of the current account, is sufficient to establish the offence of misuse of the company assets.

Actio mandati against Directors Exercised by a Single Shareholder

Court of Appeal, 15 February 2012[9]

Following the sale by a company of all of its assets, a shareholder jointly sued both the directors and the two auditors of the company for the loss it claimed to have suffered due to that sale. The claimant sued the directors for damages on the grounds that the sale had been done at an undervalue which constitutes a mismanagement fault, the company thus suffering an important loss in its assets, which indirectly caused a decrease of the value of the stake held by the claimant in the company. The auditors were sued for the alleged breach of their obligation of control and supervision.

The District Court held that the claimant's demands were inadmissible against both the directors and the auditors. The District Court considered that, in trying to hold the directors (and the auditors) liable, the claimant attempted to introduce *actio mandati*, which it cannot do as a single shareholder as the Companies Law bars shareholders of companies with a separate legal personality from bringing individual claims on their own behalf. Moreover, the District Court considered that it could not claim to have suffered a separate loss, distinct from the loss suffered by the company itself and that it could thus not claim for damages on the basis of the principles of the general civil liability, as the claimant brought claims solely for the loss of value of its shares, such loss in share value being a damage suffered by the company itself, and not an individual, separate damage experienced by the claimant as shareholder.

The claimant lodged an appeal against the first instance judgment. The Court of Appeal maintained the decision of the District Court. The Court of Appeal hereby confirmed its earlier decision where it was held that no single shareholder had the capacity to claim for a loss suffered by the company[10]. In the present case, the claimant, as a single shareholder, could not act *in lieu* of the company. Indeed, an SA is a distinct legal entity, separate from its shareholders. Therefore, it suffers damage independently of its shareholders and it may bring its own claims for indemnification. In order to bring a claim, a shareholder must have suffered a damage separate from the loss of capital of the company, which is a damage suffered primarily by the company. In the case at hand, the Court of Appeal found this not to be the case, because the shareholder's claim was only based on the loss of the value of the company's shares. A loss of value of the company's shares, which causes a loss of social capital is therefore a damage suffered by the company itself. Unless a shareholder has suffered a separate, individual damage distinct from that of the company, its claim must be rejected.

Managing Director Liability for Tax and Social Security Obligations until the Publication of his/her Resignation

Administrative Court, 15 May 2013[11]

Certain conditions of establishment, good-repute and qualification need to be fulfilled for a business license to be issued to a company or an individual to perform certain

[8] Court of Appeal, 9 March 2011 confirmed by Supreme Court 19 January 2012 N°6/2012.
[9] Court of Appeal, 15 February 2012, Pasicrisie T36, 1/2013, p.71.
[10] Court of Appeal, 30 November 2011.
[11] *Loi du 2 septembre 2011 réglementant l'accès aux professions d'artisan, de commerçant, d'industriel ainsi que certaines professions libérales*.

activities in Luxembourg, in accordance with the law of 2 September 2011.

In the present case, the Minister refused to grant such business licence to a company arguing that the managing director did not fulfil the professional good-repute condition. The applicant managing director was already director of another company that did not pay certain social security contributions. The managing director and his new company lodged an appeal against the Minister's decision considering that the non-payment of the social contributions by the former company only intervened after his resignation on 20 November 2010 as managing director of such company. This resignation was filed with the Luxembourg register of commerce and companies and published in the *Mémorial* on 10 November 2011, the social security administration being informed of such resignation on 7 December 2011.

The Administrative Court[12] confirmed the Minister's refusal to deliver the business license. It considered that, in compliance with provisions of the Companies Law, the resignation of the managing director was not enforceable towards third parties (such as the Social Security Administration and the Minister) until its publication in the *Mémorial*, and that therefore the managing director remained liable for the company's unpaid social security contributions despite his resignation. As a consequence, the Administrative Court noted that the managing director failed to comply with the professional good-repute condition, and then could not obtain the deliverance of a business licence.

Disqualification of Directors for Default Tax and Social Security Obligations

Administrative Court, 22 May 2013[13]

The issue of a business license to a company or an individual to perform certain activities in Luxembourg requires the fulfilment of certain conditions of establishment, good-repute and qualification laid down in the law of 2 September 2011.

The professional good-repute condition is not met where a managing director/officer/executive/head of a legal has failed to comply with social security and tax requirements. In general, the professional good-repute is compromised/jeopardised by any conduct or action by a managing director that affects his professional integrity in such a negative way as to make it impossible to tolerate, in the interest of the concerned economical actors, that said director carries on or continues to carry on the activity for which a business license has been delivered.

In the present case, the Minister of Middle Classes and Tourism (*Ministre des Classes moyennes et du Tourisme*) decided to revoke the business license previously delivered to a company and its managing director after the Customs Administration and the Labour Inspection noted that several breaches of Labour law were committed by the company and its managing director and certain social contributions were not paid to the relevant authorities. The company and its managing director had not complied with their social obligations towards two employees. The Minister therefore considered that the professional good-repute condition was not met anymore in the head of the company and its managing director.

The company and its managing director lodged an appeal against the Minister's decision. The Administrative Court[14] confirmed the decision of the Minister and ruled that the professional good-repute condition was not met anymore by the company and its managing director not complying with the tax and social security contributions obligations.

Liquidator Liability for Nonsufficient Provisions for Claims (Legal Warranty Period)

Supreme Court, 7 February 2013[15]

The Supreme Court recently reversed a decision rendered by the Court of Appeal, which was presented in the June 2013 edition of the Luxembourg Legal Update.

In 1998, a Luxembourg company performed construction works on a house for the benefit of two individuals. The construction of the house was completed in 1999, and the Luxembourg company which performed the work was put into liquidation in April 2003 and the liquidation was completed in December 2003. However in 2007, some construction defaults appeared in the house, and the two individuals brought a case against the liquidated company

[12] Administrative Court, 15 May 2013, N°30214.
[13] *Loi du 2 septembre 2011 réglementant l'accès aux professions d'artisan, de commerçant, d'industriel ainsi que certaines professions libérales*.
[14] Administrative Court, 22 May 2013, N°29991.
[15] Court of Appeal, 1 December 2011, N°35296.

on the basis of the legal warranty period for construction which is ten years. They also made a claim for damages against the liquidator of the liquidated company, considering that the liquidator committed some faults in the liquidation process

- by closing the liquidation before the expiry of the legal warranty period, thus preventing them to have an effective recourse against the liquidated company and
- by not setting aside sufficient funds in the liquidation accounts to cover any amounts which the liquidated company may have to pay arising during the legal warranty period.

Both the District Court and the Court of Appeal[16] rejected the arguments of the plaintiffs and refused to hold the liquidator liable. The Court of Appeal considered that no legal provision prevents a company's liquidator closing the liquidation before the expiry of a legal warranty period, and therefore there is no obligation for the liquidator to wait until the expiration of such legal warranty period before closing the liquidation operation. Moreover, according to the Court of Appeal, a liquidator could be held liable for fault if he forgets to include in the liquidation accounts sufficient provisions to cover those claims of which he was aware. In the present case, considering that the claim only appeared in 2007, i.e. after the closing of the liquidation, the liquidator was not at fault for not setting aside an amount in the liquidation accounts in order to cover this claim.

However, the Supreme Court[17] reversed part of the decision of the Court of Appeal. The Supreme Court first confirmed that no legal provision prevents a company's liquidator from closing the liquidation before the expiry of a legal warranty period, and therefore there is no obligation for the liquidator to wait until the expiration of such legal warranty period before closing the liquidation operation. However, the Supreme Court considered that a liquidator could be held liable for fault if he forgets to include in the liquidation accounts sufficient provisions to cover claims which may appear after the closing of the liquidation but before the expiry of a legal warranty period.

Evidence – General Manager of a Company as Witness

Supreme Court, 2 May 2013[18]

The Supreme Court decided that even in commercial matters where the parties have more freedom in providing evidence that is not in writing, the testimony of a general manager of a company may not be accounted for as evidence when the company is one of the parties to the court proceedings. As a matter of fact, this is related to the principle that a witness has to be a third party to the court proceedings, and this is not the case of a general manager if his company is party to the proceedings.

Contract law

Transfer of Agreement and the Consent of the Transferred Creditor

Court of Appeal, 15 February 2012[19]

Following a decision of 2009 of the Court of Appeal of Luxembourg, it was admitted under Luxembourg law that a party to an agreement could, in principle, freely transfer the agreement binding him to another party, and this without requesting the consent of its co-contracting party.

By a more recent decision, another chamber of the Court of Appeal[20] reversed said case law. In the case at hand, individuals had entered into an architectural agreement with an architectural firm. The individuals had then transferred the project to a company, including the architectural agreement they entered into. The architectural firm had nevertheless summoned the individuals to pay their fees. The individuals opposed to the request putting forward that they had transferred the agreement and the architectural firm had therefore to ask the payment of its fees to the company transferee of the agreement. The District Court granted the argument and non-suited the architectural firm. The Court of Appeal reformed said judgment. The Court ruled that a party could not freely transfer to a third party the agreement binding it, and thus be released from its obligations resulting from said agreement, without the other party expressly accepting to release it from its obligations. The Court adds that the will of the transferred to release the

[16] Court of Appeal, 1 December 2011, N°35296.
[17] Supreme Court, 7 February 2013, N°10/13.

[18] Supreme Court, 2 May 2013, N°3180, 32/13.
[19] Court of Appeal, 4 March 2009, N°32277 – see January 2011 edition of the Luxembourg Legal Update, p. 14.
[20] Court of Appeal 15 February 2012, N°35639.

transferor could not result from the sole authorisation of the transfer.

Validity of a Waiver

Supreme Court, 28 February 2013[21]

A tenancy agreement contained a clause regarding the adaptation of the rent with regard to an official index. However, during the tenancy, the landlord had never applied this clause. The amount of the rent had never been adapted with regard to this clause. After the termination of the tenancy, the landlord requested payment of the adjustments of the rent with regard to the index. The Supreme Court ruled on whether the fact of not applying a clause of a contract and not claiming for the benefit of the rights arising out of a clause before termination of a contract means that the party to the contract had waived its rights arising out of this clause.

According to the Supreme Court a waiver has to be explicit and to demonstrate unequivocally the willingness to waive a right.

Employment law

Implementation of a Whistleblowing Policy subject to the Co-Decision of the Joint Works Council (*comité mixte*)

Administrative Court of Appeal, 22 January 2013[22]

In a case submitted to the Administrative Court of Appeal, two Luxembourg subsidiaries of a foreign company had implemented a whistleblowing policy set by their mother company. This implementation had been made without obtaining a co-decision of the joint works council of these subsidiaries.

Against a complex procedural background, the Administrative Court had to decide whether the implementation of a whistleblowing policy required the co-decision of the joint works council in accordance with article L.423-1 of the Labour Code, which foresees, amongst others, that any modification to "internal rules" (*règlement d'ordre intérieur* – i.e. house rules or internal policies) requires a co-decision from the joint works council.

The Administrative Court of Appeal analysed whether the implementation of the whistleblowing policy was to be considered as being part of the internal rules in the sense of article L.423-1 of the Labour Code. In a first step, the Court confirmed the finding of the lower judges that there was no legal definition of the term "internal rules" and that this term is generally understood to mean "rules determining the behaviour of social partners in the performance of their obligations resulting from the employment contract".

The Court then found that the use of the procedure set up by the whistleblowing policy in the case under review would trigger a mechanism that meets the definition of being a set of rules for determining the behaviour of social partners in the performance of their obligations resulting from the employment contract.

The Court hence ruled that the whistleblowing policy implemented by the two Luxembourg subsidiaries was to be considered as internal rules in accordance with article L.423-1 of the Labour Code and was therefore subject to the co-decision of the joint works council.

[21] Supreme Court, 28 February 2013, N°3082, 14/13.
[22] Administrative Court of Appeal, 22 January 2013, N°30698C and 30711C.

Tax

Abuse of Law

Administrative Court, 21 May 2013[23]

On 21 May 2013, the Lower Administrative Court ruled against the company taxpayer which claimed a tax credit for investment pursuant to Article 152bis of the Luxembourg Income Tax Law (LITL) which was refused pursuant to application of the abuse of law theory.

In the case at hand, a parent company, being under a consolidated tax regime with its subsidiaries, claimed for a tax credit to the extent its subsidiary made capital expenditures to acquire motor vehicles rented to the group. The tax authorities denied such tax credit. In this respect, their refusal was motivated by application of §6 StAnpG and the abuse of law theory. In fact, it was judged that the corporate legal structure of the group and its subsidiary, by having as sole purpose a car rental activity, was incorporated to benefit from tax credits without having any economical motivation.

On the one hand, the Tribunal recalled the role of the abuse of law doctrine by an explicit reference to the German jurisprudence and on the other hand refuted the taxpayer's arguments as an abusive scheme which was put in place through a legal corporate structure in order to unlawfully benefit from a tax credit and therefore reduce its tax charges without being motivated by sufficient economical reasons.

IP Regime

Administrative Court, 27 June 2013[24]

On 27 June 2013, the Lower Administrative Court ruled in favour of the corporate taxpayer which claimed the application of the Intellectual Property (IP) exemption regime. The issue at hand was the creation date before or after 31 December 2007 as such date was essential to claim the benefit of the IP regime. This is the first case law relating to the IP regime.

In the case at hand, a Luxembourg company incorporated in 1994 started to sell its products under a specific trademark and decided to register it in 2008 (further to adoption of the IP Law). In this respect, the tax authorities were of the view that the trademark had been created in 1994, upon commercialisation of the products and not upon its registration and thus decided to deny the application of the IP exemption regime. All of its argumentation was based on the Administrative Circular LIR N°50bis/1 of 5 March 2009.

Per reference to the IP Law, there is no definition of the "date of creation of the IP". In this respect, the judge referred to the commentaries on the Bill to conclude that the key date to take into account was the date of registration of the trademark with an official authority. In addition, the judge recalled the objective of the IP Law and ruled that a trademark which was commercialised prior to 31 December 2007 but registered after would benefit from the IP regime.

Finally, the judge recalled that administrative circulars are only guidelines and could not be used by the tax authorities as a legal basis to request additional and or more strict conditions for application of a specific tax regime.

Participation Exemption Regime and French Civil Companies

Administrative Court of Appeal, 7 August 2013[25]

On 20 July 2012 the Court dealt with the application of the participation exemption regime (article 166 of the Luxembourg Income Tax Law) upon liquidation of companies and in particular, the 12-month holding period requirement.

In the case at hand, a Luxembourg company had a stake of 98% and 98.33% in two French civil companies since 1998. Those companies transferred their seat to Luxembourg and were further transformed into limited liability companies in August/September of 2006. In June 2007, those two companies were liquidated and the parent company claimed for the application of the participation exemption regime to the extent that both requirements were met, i.e. a threshold participation of 10% and a minimal period of at least 12 months. As for the tax authorities, they considered that such exemption could not be granted as the requirements provided by the law were not fully met, especially with respect to the holding period.

[23] Lower Administrative Court, 21 May 2013, 31058.
[24] Lower Administrative Court, 21 May 2013, 31058.
[25] Court of Appeal, 7 August 2013, N°31981C.

The Court ruled in favour of the tax authorities and did not grant the benefit of the participation exemption regime to the parent company on the basis that the holding period was not complete upon liquidation of both subsidiaries. In this respect, the Court considered that the period prior to the transformation of both French civil companies into Luxembourg limited liability companies could not be taken into account as the form of incorporation of these entities was not listed in Article 166 LITL. As such, the starting date being upon transformation, the shareholding participation did not last for at least 12 months.

Value Adjustment Reversal

Administrative Court of Appeal, 4 September 2013[26]

On 4 September 2013, the Administrative Court of Appeal ruled in favour of the taxpayer judging that reversal of non-deducted value adjustment on financial assets should not be a taxable income. The tax payer made some impairment on shares investments in 2003 and 2004. In 2005, further to value adjustment reversals, the tax authorities claimed that such reversals were a taxable income. The Court underlined the link between the non-deducted adjustment and its subsequent reversal being non-taxable. This Luxembourg case could be read together with a recent French case law on the same legal issue. The French court (TA Montreuil 1er Ch. 4 July 2013) took an opposite view considering that a reversal of value adjustment should be taxable even if the initial impairment were not initially deducted. The French final position should be sealed soon upon a decision to be rendered by the French *Conseil d'Etat*.

PPG Holdings – VAT Recovery of Pension Fund Costs

ECJ, 18 July 2013[27]

On 18 July 2013, the European Court of Justice (ECJ) ruled on whether an employer could deduct the VAT costs suffered upon payments of services relating to the management and operation of a pension fund established as a separate legal entity.

In the case at hand, PPG Holdings BV set up a pension fund in order to meet a statutory obligation which provides for the employer the obligation to pay contributions for the benefit of their employees in relation to the pension schemes. In order to manage the assets of the fund and administer the pensions, a PPG subsidiary entered into contracts with suppliers. Pursuant to Article 15(1) of the Netherlands VAT Law, PPG deducted input VAT costs but were disallowed by the Dutch tax authorities.

In this respect, a Dutch referral was asked to the ECJ on (1) whether PPG, as the employer, was entitled to recover the VAT on administrative and certain other services relating to its own employee pension scheme and (2) whether a pension fund could qualify as a "special investment fund" within the Article 135(1)g of the VAT Directive[28] (i.e. Article 44(1)d of the Luxembourg VAT Law) which provides for a VAT exemption upon supply of management services.

With respect to (1) the ECJ ruled that PPG, a taxable person, who has set up a pension fund in the form of a legally and fiscally separate entity in order to safeguard the pension rights of its employees and former employees, should be entitled to deduct input VAT paid on management services provided that the existence of a direct and immediate link is apparent between the acquisition of input services and PPG's taxable activities. As for (2), the ECJ decided that it was not necessary to answer it but made a reference to the Wheels Common Investment Fund Trustees and Other case (C-424/11) in which it was ruled that services to an investment fund pooling the assets of a retirement pension could not benefit from the VAT exemption with respect to management services of investment funds.

[26] Administrative Court of Appeal, 4 September 2013,N°32063C.
[27] ECJ, 18 July 2013, C-26/12.
[28] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

Tax

Legislation

Implementation of the AIFM Directive

Law of 12 July 2013

On 10 July 2013, the Luxembourg Parliament voted Bill N°6471 on alternative investment fund managers (AIFM Law) which implements Directive 2011/61/EU of 8 June 2011 on alternative investment fund managers (AIFMD). Even though the main purpose of the AIFM Law is to implement a special legal regime for fund managers into Luxembourg domestic law, other considerations have to be highlighted.

In this respect, the AIFM Law provides for the following:

- a legislation update for existing investment vehicles
- a new regime for depositaries of assets other than financial instruments
- an update of the legal and tax regime of the Luxembourg limited partnership *(société en commandite simple, SCS)* which has a legal personality and introduces a new special limited partnership *(société en commandite speciale, SCSp)* which has no legal personality
- clarification of the tax treatment of carried interest
- VAT update on the exemption for management services.

Update of the VAT exemption applicable to management of investment vehicles

With respect to the VAT exemption for management services, the wording and scope of Article 44 (1) d of the Luxembourg VAT Law has been revised and updated. From now on, it provides a more specific reference to current qualifying Luxembourg investments vehicles (e.g. UCI, SIF, SICAR, ASSEP, SEPCAV and securitisation companies). In addition, Alternative Investment Funds (AIFs), regulated or not and whether established within the EU or not will now (i.e. extension of the geographical scope) benefit from the VAT exemption.

Modernisation of the SCS and creation of a new SCSp

The AIFM Law provides for an update of the existing SCS and creates a new form of partnership, the SCSp or special partnership. The SCSp regime will have most of the SCS's characteristics but the SCSp will not have a legal personality distinct from its partners. From a Luxembourg tax perspective, these entities are considered as tax transparent and do not conduct any commercial activity per se. In this respect, no municipal business tax (MBT) should be assessed unless a General Partner (GP) of the SCS is a Luxembourg joint-stock company which, further to the *Geprägerechtsprechung* theory will taint the SCS's activity, i.e. deemed to be commercial. From now on, if the GP has an interest of less than 5%, no *Geprägerechtsprechung* should apply.

Carried interest tax regime

The AIFM Law provides that carried interest paid to Luxembourg resident employees of an AIF will be subject to a favourable tax regime (i.e. maximum tax rate of approximately 10%) further to specific conditions and timing periods. Such tax regime will only be temporary as it will be available for 10 years following the beginning of the relevant professional activity in Luxembourg. In addition, such regime will only be applicable to income derived from the distributable profits of the AIF's shares and not to capital gains.

Accounting and Commercial Laws

Bill N°6376

On 9 July 2013, the Luxembourg Parliament adopted draft Bill N°6376 which modifies various provisions relating to accounting standards, annual and consolidated accounts of certain types of companies and which reforms the Luxembourg Accounting Standard Commission (the *Commission des Normes Comptables* or CNC). The main purpose of this Bill is to complete and amend the Law of 10 December 2010 related to the introduction of the

International Financial Reporting Standards (IFRS) which modernised the Accounting Law and the law of 10 August 1915 on the commercial companies.

The major changes deal with the limitation of distributable reserves in case of use by companies of the fair value option, the optional use of substance over form principle, the introduction of the deferred tax and the removal of flexibility to adapt the presentation of the annual accounts together with other minor changes.

Limitation of distributable reserves in case of use of the fair value option

Under the current Accounting Law, applying IFRS for annual accounts together with the fair value accounting method may lead the companies to distribute unrealised gains (i.e. recorded either in the profit and loss accounts or in a re-evaluation reserve). The Bill sticks with the fundamental prudence approach and thus introduces an obligation for the companies to allocate (directly or indirectly through the allocation of the results by the General Meeting of shareholders) most of the unrealised gains into a non-distributable reserve. However, gains almost realised such as unrealised gains on financial instruments integrated in the trading portfolio can still be included in the distributable reserves if deemed to provide benefits within a short period of time and are considered as almost realised.

The new article 72ter provides that unrealised gains cannot be distributed anymore. These provisions apply to all commercial companies whereas the investment companies are excluded from this prohibition.

"Substance over form" principle is now optional

The "substance over form" principle was introduced by the Law of 10 December 2010 implementing the European Directives 2009/49/EC[29] and 2006/46/EC[30]. However, the Bill now provides more flexibility as such principle is now optional. Such turnaround is justified by the fact that the concept was not illustrated within any legal or doctrinal guidance. Absence of clarification led to problematic application in practice even though it was clear that companies should refer to the substance of operations and/or contracts rather than solely to their form. In this respect, companies which would decide not to opt for the "substance over form" principle would nevertheless have to comply with the true and fair view principle of their annual financial statements.

Deferred tax

Clarification has been provided with respect to deferred tax and the fact that companies having opted for the fair value will have the obligation to account for deferred tax liabilities on their balance sheet.

Other changes

The Bill provides for other changes such as the obligation to present the balance sheet and profits and loss accounts in conformity with the standards formats/layouts prescribed by the Grand Ducal Decree of 14 December 2011 (i.e. the electronic filing system). Finally, in order to provide more independency to the CNC, a structural reform is contemplated.

Business Preservation and Modernisation of Bankruptcy Law

Bill N°6539/02

Bill N°6539 on business preservation and modernisation of bankruptcy law has been introduced to the Parliament on 1 February 2013. The Bill aims at modernising bankruptcy law and at preventing bankruptcies through various reorganisation measures for businesses in difficulty. It contains 4 parts:

- the preventive part
- the retroactive part
- the repressive part
- the social part.

On 16 August 2013, the judiciary authorities rendered their opinions on the Bill. From a tax perspective, the Bill adds a no-fault principle, i.e. a full liability without having to be deemed at fault. In this respect, §107, al. 1 of the *Abgabenordnung* (the Fundamental Tax Law) provides that any persons pursuant to §§103 to 108 will be, together with the taxpayer, deemed to be at fault and thus liable to the extent tax debts have been reduced and refunds and or

[29] Directive 2009/49/EC of the European Parliament and of the Council of 18 June 2009 amending Council Directives 78/660/EEC and 83/349/EEC as regards certain disclosure requirements for medium-sized companies and the obligation to draw up consolidated accounts.
[30] Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings.

compensations have been granted further to violations of their obligations.

Luxembourg private foundation (*Fondation patrimoniale*)

On 22 July 2013, Bill N°6595 was submitted to the Parliament and seeks to introduce a new wealth vehicle in the form of a private foundation in order to offer an attractive regime and an alternative estate planning to private clients.

This new regime provides for flexibility as minimum requirements will have to be met in order to establish the foundation. As such, it will be an orphan vehicle with a legal personality and the following substantial requirements (but not limited) will have to be met:

- Register office in Luxembourg
- Minimum contribution of EUR 50,000
- Notarial deed attesting its creation which has to be filed with the Luxembourg Register of Commerce and Companies.

From a tax perspective, the foundation is a fully taxable entity at the ordinary corporate income tax rate (i.e 29.22% in 2013) but will benefit for exemptions on dividends, interest and capital gains arising from securities. With respect to payments made by the foundation to beneficiaries, 50% of payments (including benefit in kind) will be taxable. However, payments made to non-resident beneficiaries will not be subject to withholding taxes.

In addition, the Bill introduces a step-up principle for non-resident individuals who become Luxembourg residents. In this respect, upon migration to Luxembourg, the individuals' assets may be valued at their fair market value which will be considered as the acquisition value upon further sale and realisation of capital gains provided it falls within the scope of Article 100 of the Luxembourg Income Tax Law with respect to substantial participations and convertible loans.

Double Taxation Agreements to enter into force – Law voted

On 14 June 2013, the Luxembourg Parliament adopted Bill N°6501 (Mémorial A – N°114 of 4 July 2013) which ratifies fifteen Double Tax Treaties (DTTs) and Protocols concluded with the following countries:

- Germany DTT replacing the old one
- Kazakhstan DTT
- Laos DTT
- Macedonia DTT
- Seychelles DTT
- Sri Lanka DTT
- Tajikistan DTT
- Canada Protocol
- Italy Protocol
- Malta Protocol
- Poland Protocol
- Romania Protocol
- Russia Protocol
- Switzerland Protocol
- South Korea Protocol.

These DTTs and Protocols should enter into force on 1 January of the year following confirmation by both countries of the implementation of the DTT in domestic law. Some of the Protocols should however enter into force sooner for certain taxes (e.g. Poland and South Korea).

For additional information upon the new DTTs and Protocols, please see the February 2013 edition and the June 2013 edition of the Luxembourg Legal Update.

New Luxembourg-Germany Double Tax Treaty

On 14 June 2013, the Grand Duchy of Luxembourg passed the Law (Mémorial A – N°114 of 4 July 2013) ratifying the new double tax treaty (DTT) with Germany. In principle, the DTT should be applicable the year following the ratification, i.e. from 1 January 2014.

In a nutshell, the new DTT provides that corporate-type funds (i.e. SICAVs, SICARs and SICAFs in Luxembourg and the *Investmentaktiengesellschaft* in Germany) will be fully entitled to treaty benefits whereas contractual-type funds (i.e. funds organised as a *Fonds Commun de Placement* in Luxembourg and as *Sondervermögen* in Germany) will partially be entitled to treaty benefits. With respect to dividends, the withholding tax rate applicable is reduced to 10% or even 5% when paid to corporate shareholders, subject to minimal requirements to be met. The standard tax rate however remains unchanged at 15%. Finally, the new DTT will allow Germany and Luxembourg to tax the capital gains realised upon 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. For an extensive outline of the major changes, our client briefing can be downloaded from our website.

DTT Luxembourg-Japan

On 19 July 2013, Luxembourg and Japan governments exchanged notes relating to the DTT of 5 March 1992 (as amended) and its non-application to the family estate management companies (*Sociétés de gestion de patrimoine familial* – SPFs). In this respect, SPFs would not be able to benefit from the tax provisions, i.e. reduced withholding tax rates or tax exemptions under the DTT. However, a special tax regime would remain applicable further to domestic law. In addition, such exclusion would not preclude an exchange of information with respect to such investment vehicles. The effective date for such notes to enter into force was on 18 August 2013.

DTT Luxembourg-Saudi Arabia

On 7 May 2013, Luxembourg and Saudi Arabia signed their first DTT which bring the total of DTTs signed by Luxembourg to 65. Further to national implementations in both countries, the DTT should enter into force the first day of the second month following the last notification of implementation given by one of the two States. The DTT is based on the OECD Model Convention.

Regulatory Developments

Minimum Corporate Income Tax

Circular L.I.R. N°174/1 of 1 August 2013

As previously discussed in our the February 2013 edition of the Luxembourg Legal Update, the minimum corporate income tax (minimum tax) was amended further to the adoption of Bill N°6497 of 21 December 2012 and has been effective as from 1 January 2013. However, the wording of the Law and its related Parliamentary documents left several points unanswered which drove the Luxembourg tax authorities to issue on 1 August 2013, Circular N°174/1 in order to clarify the scope and application of the minimum tax for both years 2011-2012 together with the year 2013.

In a nutshell, all Luxembourg resident tax companies are subject to the minimum tax regime pursuant to either article 174(6)1 or article 174(6)2 of the Luxembourg Income Tax Law (LITL):

- The minimum flat tax regime which amounts to EUR 3,210 (including the 7% unemployment surcharge) is applicable to all collective entities having their statutory seat or central administration in Luxembourg, regardless of whether they are regulated or not, and whose total holding and financing assets exceed 90% of their total balance sheet (respectively accounts 23, 41, 50 and 51 of the *Plan Comptable Normalisé*[31]).
- The new minimum progressive tax regime which ranges from EUR 535 (for a total balance sheet up to EUR 350,000) to EUR 21,400 (for a total balance sheet exceeding EUR 20 million) will be applicable for all other collective entities, resident of Luxembourg, which do not qualify for the minimum flat tax regime.

Some of the main points of attention of the Circular are the following:

- Companies will have to pay the full minimum tax, i.e. without any pro-rata, even if they are incorporated or dissolved during the fiscal year. Where companies are put into liquidation, taxation will arise further to the date of completion of the liquidation process providing it does not exceed a period of three years. Otherwise, taxation should occur every year on the basis of the balance sheet of the corresponding year.
- Any stake/interest held by Luxembourg companies in transparent entities should be considered as financial assets for the minimum tax computation.
- Assets booked for their adjusted basis which generate or may generate income only taxable in another state further to application of a double tax treaty (DTT) (i.e. immovable properties or Luxembourg entity's permanent establishment located in a foreign treaty country) should be excluded from the computation of the taxable basis for the application of the minimum tax.
- Tax credits remain available for companies but should not decrease the Corporate Income Tax (CIT) below the minimum tax.
- Companies' tax losses should not be affected by the minimum tax, i.e. these would remain available and could be carried forward indefinitely.

Stock Options

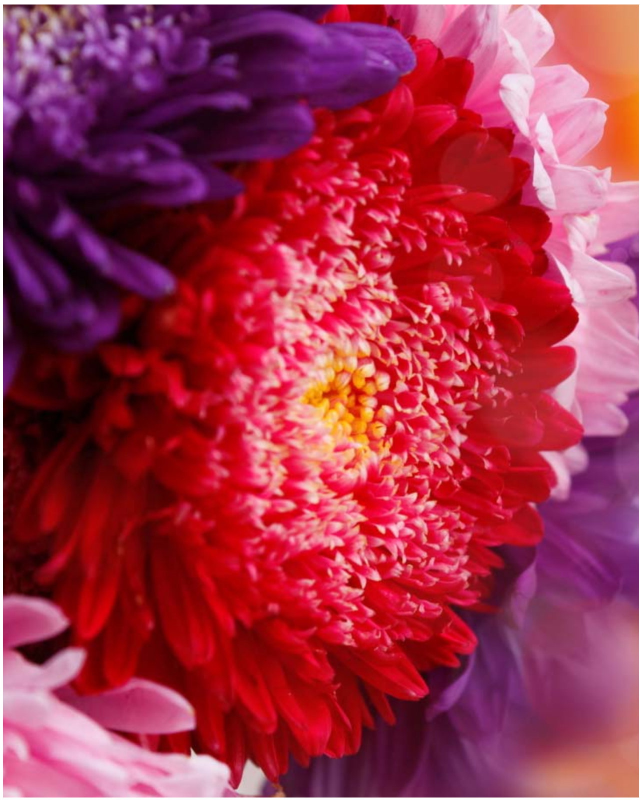
Parliamentary Question N°2549 of 8 February 2013

On 20 December 2012, the Luxembourg tax authorities issued a new circular (Circular L.I.R. N°104/2 of 20 December 2012) regarding the taxation of stock options

[31] Grand Ducal Decree of 10 June 2009, Mémorial A 2009, N°145, p. 2000.

plans effective since 1 January 2013. Further to a parliamentary question addressed to the Luxembourg Minister of Finance, Luc Frieden, on 8 February 2013, further details of this Circular were disclosed on 1 July 2013.

As there is no domestic legislation dealing with stock options it remains essential to refer to the general tax principles and more precisely to the provisions of articles 104 and 108 LITL and to the Circular. Stock options are considered as being part of the employers remuneration package and will be taxed like an ordinary remuneration. However, the taxation event will vary between the transferable *(tradable options)* and the non-transferable *(non-tradable options)* stock options. The Circular clarifies the tax regime applicable.



In respect of the valuation of the benefits, the fair market value of tradable options is determined by several valuation methods being:

- stock exchange listed price
- the Black & Sholes method or any other comparable financial method or
- valuation fixed at 17.5% (instead of the former 7.5%) of the market value of the underlying stock at the moment of the granting of the option.

With respect to the third evaluation method which should have reasonable sound prerequisite, the director of the Luxembourg tax authorities explicitly established three cumulative conditions:

- The stock options cannot exceed 50% of the total annual gross remuneration (options included).
- The option plan can only be applicable to listed persons pursuant to article L211-27(5) of the Luxembourg Labour Code which refers to senior managers.
- The stock option plan has to assure that the option's price does not exceed 60% of the value of the underlying stock.

The third evaluation method and its conditions will only be applicable to option plans in which the underlying stocks are not linked to the "warrant plans" of the company whereas the classic options will not need to meet these requirements.

International Developments

FATCA – Revised Timeline and Guidance for Implementation

The US Department of the Treasury/IRS has published on 12 July 2013 a notice providing revised timelines for implementation of the Foreign Account Tax Compliance Act (FATCA). Withholding on payments of US source income, such as interest payments, will now start on 1 July 2014, i.e. six months later than originally announced, with the grandfathering deadline also extended to 1 July 2014. Withholding for US source principal repayments, gross proceeds and pass-through payments remains scheduled for 1 January 2017. Guidance has also been published concerning the treatment of financial institutions located in jurisdictions that have signed intergovernmental agreements (IGAs) for FATCA implementation but have not yet brought those IGAs into force. Finally, further to such announcement, the Loan Market Association (LMA) has published revised FATCA riders for investment grade facilities, noting the grandfathering extension.

The Luxembourg IGA Model 1 is expected to be signed by the end of the third quarter this year.

The US Internal Revenue Service has released a draft Form 8966 (FATCA Report) including all of the information foreign financial institutions and withholding agents will be required to report regarding their US accounts to comply with their Foreign Account Tax Compliance Act reporting obligations.

Finally, on 19 August 2013, the IRS unveiled its FATCA Registration Portal, an internet-based application that financial institutions may use to register for FATCA purposes. At the same time, an updated version of the Model IGA was released.

OECD – Action Plan on Base Erosion and Profit Shifting

As discussed in our the June 2013 edition of the Luxembourg Legal Update, the OECD has released a report on base erosion and profit shifting and has committed to develop an action plan within a short period of time. In this respect, on 19 July 2013, the OCED published, upon G20 request, its Action Plan on Base Erosion and Profit Shifting which offers a global roadmap that will ensure national governments to collect the tax revenue and provides certainty to businesses to invest. It identifies 15 specific actions that will provide the governments with domestic and international instruments to prevent the tax base erosion tax and thus to avoid businesses to shift their profits overseas in order to pay little or no taxes. To do so, new set of standards to prevent double non-taxation will be developed by updating current domestic and international tax rules such as tax treaties, transfer pricing rules and controlled foreign corporations regimes in order to prevent treaty shopping and align tax with substance together with a greater transparency.

OECD – White Paper on Transfer Pricing Documentation

In line with the OECD's BEPS (see above) which calls for the development of transfer pricing documentation rules that will enhance transparency for the tax administration, the OECD has released a White Paper on Transfer Pricing Documentation. This document is intended to initiate an international discussion in which compliance with transfer pricing documentation requirements could be made simpler and more straight-forward, while at the same time providing tax authorities with more focused and useful information for consideration in connection with transfer pricing risk assessment and transfer pricing audits.

By 1 October 2013, all interested parties will submit their comments, which will be further discussed in a public consultation to be held on 12-13 November 2013.

EU Developments

Financial Transaction Tax – Wider Scope and Application to Pension Funds (Update)

On 14 February 2013, the European Commission published its detailed proposal for an EU Financial Transaction Tax (FTT) to be implemented under the "enhanced cooperation procedure" across France, Germany and nine other EU Member States. If adopted, most equity, debt and derivative transactions in these jurisdictions will be subject to the tax. For more details, please see our client briefings.

On 3 July 2013, the Parliament passed a Resolution which backs the proposition of the EU Commission which provides for a wide scope and rates of 0.1% for trades in stocks and bonds and 0.01% for those in derivatives. Lower rates should apply until 1 January 2017 for trades in sovereign bonds and pension fund industry trades. Finally, a new legal ownership principle was inserted to make tax avoidance more costly, i.e. that acquisition of legal ownership rights would only be certain upon payment of the FTT.

Update

In July, the EU Council Legal Service was asked by several Member States for an opinion on whether the FTT was compatible with the free movement of capital and the enhanced cooperation procedure's conditions. In early September, it rendered its opinion which is in no sense binding but would nevertheless leave grounds for an ECJ's court challenge by opposing Member States such as the UK (which already filed for annulment of the Council decision to authorise ECP, United Kingdom of Great Britain and Northern Ireland v. Council of the European Union, C-209/13). The following are the opinion's key points:

- Imposing the tax on persons resident outside the FTT zone is contrary to the norms of customary international law and violates EU laws.
- Differential treatment of FTT zone entities transacting with participating Member States compared to non-participating Member States is discriminatory and distortive of competition.
- The FTT has equivalent effect to a duty imposed on those transacting with entities in the FTT zone and therefore amount to a restriction of the free movement of capital and the freedom to provide cross-border services.

Council Approves Measures to Tackle VAT Fraud Schemes

On 22 July 2013, the Council of the European Union adopted two directives[32] that will provide the EU Member States with additional tools in order to tackle VAT fraud (i.e. carrousel fraud) with more efficiency. These directives are in line with the meeting organised in May 2013 which highlighted the need to adopt new measures to inhibit tax evasion and tax fraud which lead to considerable budget losses and affects the internal market. In fact, on cross-border transactions, Member States lack sufficient tools to quickly react and prevent VAT fraudulent schemes put in place by suppliers which become more and more creative to avoid any VAT payments.

As such, the two directives will amend directive 2006/112/EC on the EU's common VAT system and provide for:

- A "quick reaction mechanism", i.e. to enable Member States, through an accelerated procedure, to derogate to the provisions of the VAT directive by applying a "reverse charge" to specific supplies of goods and services for a short period of time. Such mechanism enable an immediate reaction of the Member States in cases of sudden and massive VAT frauds.
- A "reverse charge mechanism", i.e. shift the payment liability of VAT from the supplier to the customer upon supplies for certain goods and services. Such a mechanism will be optional and temporary in order to close off certain types of known frauds.

Case law

Abuse of Law

Administrative Court, 21 May 2013

IP Regime

Administrative Court, 27 June 2013

Participation Exemption Regime and French Civil Companies

Administrative Court of Appeal, 7 August 2013

Value Adjustment Reversal

Administrative Court of Appeal, 4 September 2013

PPG Holdings – VAT Recovery of Pension Fund Costs

ECJ, 18 July 2013

Please refer to the Litigation section of this Luxembourg Legal Update for details of the above.

[32] Council Directive 2013/42/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards a Quick Reaction Mechanism against VAT fraud and Council Directive 2013/43/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards an optional and temporary application of the reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud.

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