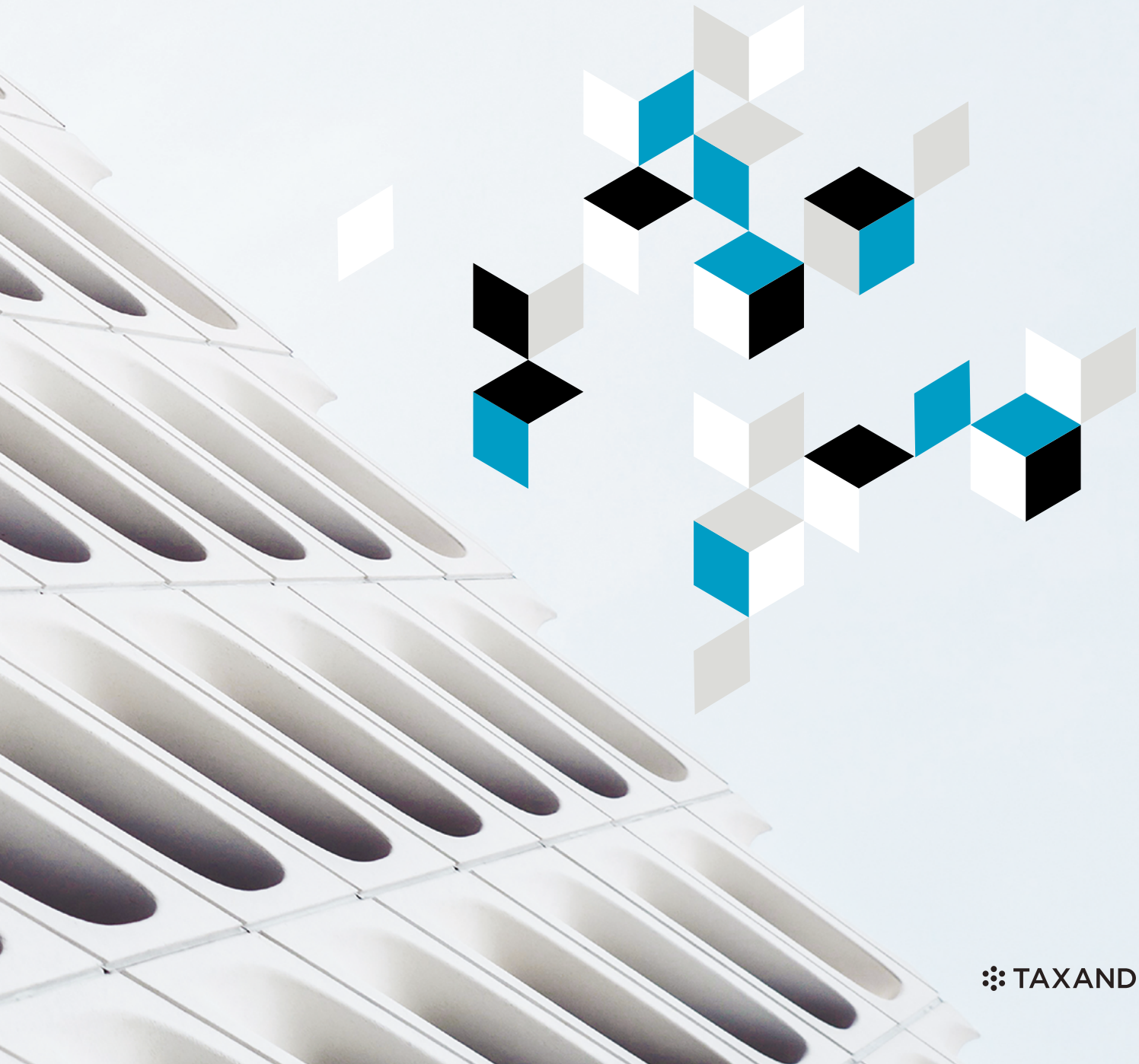
ATOZ

TAX ADVISERS LUXEMBOURG

INSIGHTS

MARCH 2021



TAXAND

CONTENTS

EDITORIAL

Greetings,

It's already been a year since the COVID-19 pandemic hit us. Now, vaccination campaigns throughout the world provide a glimmer of hope, which must be seized in order to prepare for the future. In this context, from a tax and legal point of view, COVID-19 is no longer at the centre of the measures taken, so things are moving forward.

On 22 February 2021, the EU Council updated the EU list of non-cooperative tax jurisdictions, which directly impacts the scope of application of three different Luxembourg tax measures: 1) the corporate income tax deduction of interest and royalty expenses, 2) the requirement to disclose transactions with entities located in non-cooperative jurisdictions in corporate income tax returns and 3) the mandatory disclosure under DAC6. We describe the update of the EU list and its impact in Luxembourg.

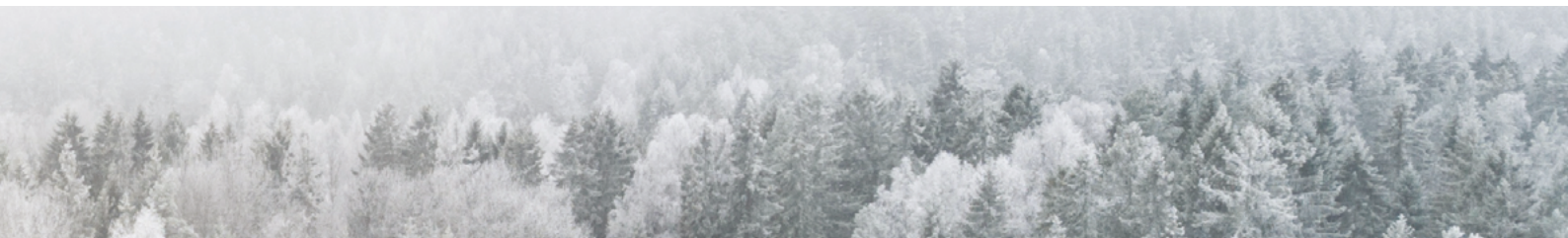
On 8 January 2021, the Luxembourg tax authorities issued a circular in order to provide guidance on the interpretation of the interest deduction limitation rules implemented in accordance with ATAD. We will go through various points which the long-awaited circular sheds light on.

In the 2021 budget law, a new provision dealing with the tax consolidation regime was introduced with effect as from tax year 2020. The new provision confirms that the change of a consolidated group from a vertical form to a horizontal form will not entail any negative tax consequences for the members of the group, provided that, notably, the change is made before the end of 2022. We describe the new rules applicable and their consequences in the future.

From an individual tax and social security perspective, since the COVID-19 pandemic continues to impact the day-to-day work organisation of businesses, the possibility for cross-border workers to work remotely was extended until 30 June 2021. We describe the framework and its implications for cross-border workers.

From a VAT perspective, on 11 March 2021, the CJEU answered the question whether or not services provided by a head office to its branch located in another jurisdiction are to be considered as transactions for VAT when the head office is part of a VAT group. We go through this decision and its implications for businesses with foreign branches whose head offices are part of a VAT group.

In another of its recent decisions, the CJEU examined whether or not the provision of a company car to a non-resident employee used for both business and private purposes constitutes a long-term hiring of a means of transport subject to VAT in the employee's country of residence. We explain this decision and its impact for Luxembourg employers.



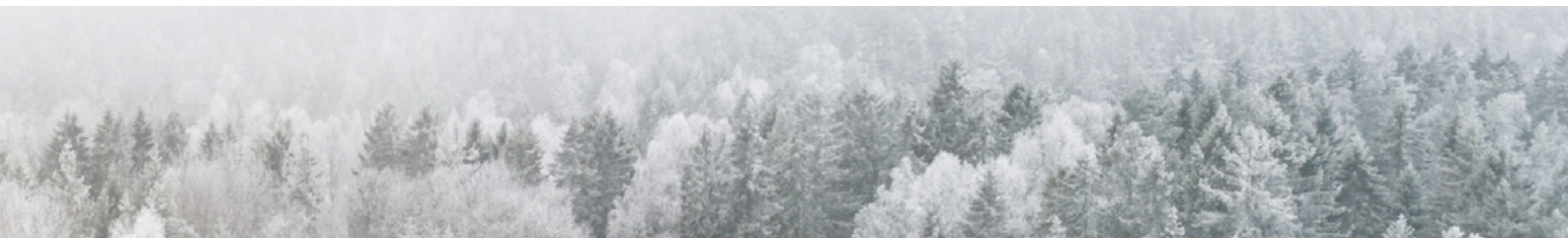
From a legal perspective, the law of 22 January 2021 modernises the legal framework for dematerialised securities by introducing changes to the Luxembourg rules allowing securities accounts and registered securities to be held within or through secure electronic recording systems, including distributed ledgers and databases. We describe the new rules and their implications.

On 22 March 2021, the EU Council adopted the so-called DAC7, which strengthens administrative cooperation to include sales through digital platforms. On 10 March 2021, the EU Commission launched a public consultation to evaluate the need for a new directive on the reporting and exchange of information for tax purposes on e-money and crypto assets. We describe what is expected in a potential future "DAC8" directive.

On the political front, there are still many initiatives in progress, such as Pillar 1/2, EU digital levies, carbon adjustments, etc. It is worth mentioning in particular that on 3 March 2021, the EU Member States mandated the Portuguese Presidency to engage in negotiations with the European Parliament for the swift adoption of the proposed directive on public country-by-country reporting (public "CbCR"), a tool which would require large MNEs to publish a defined set of facts and figures, thereby providing the public with a global picture of the taxes MNEs pay on their corporate income. We will closely follow the legislative procedure related to this proposal which still needs to address a complex set of legal, EU competitiveness and trade issues.

We hope you enjoy reading our insights.

The ATOZ Editorial Team



EU list of non-cooperative tax jurisdictions updated: implications for Luxembourg taxpayers

OUR INSIGHTS AT A GLANCE

- On 22 February 2021, the EU Council updated the EU list of non-cooperative tax jurisdictions.
- The update is an important step as it directly impacts the scope of application of three different Luxembourg tax measures: the measure denying the corporate income tax deduction of interest and royalty expenses due to entities located in non-cooperative tax jurisdictions, the requirement to disclose transactions with entities located in non-cooperative jurisdictions in the corporate income tax return and the mandatory disclosure rules applicable to certain cross-border arrangements (DAC6).
- Luxembourg taxpayers with investments into and from non-cooperative jurisdictions should seek advice from their tax advisers in order to analyse the potential tax impact of the update of the EU list of non-cooperative jurisdictions on their investments and the potential reporting requirements.
- The evolution of the legislation of jurisdictions under the radar of the EU Council should also be closely monitored in order to anticipate an addition to or a removal from the EU list of non-cooperative tax jurisdictions in the future and thus a change in the scope of application of the Luxembourg measures.

On 22 February 2021, the EU Council updated the EU list of non-cooperative tax jurisdictions. The update is an important step as it directly impacts the scope of application of three different Luxembourg tax measures: the measure denying the corporate income tax deduction of interest and royalty expenses due to entities located in non-cooperative tax jurisdictions, the requirement to disclose transactions with entities located in non-cooperative jurisdictions in corporate income tax returns and the mandatory disclosure rules applicable to certain cross-border arrangements (DAC6).

Background

The list of non-cooperative tax jurisdictions is determined at EU level. It is a result of a thorough screening and dialogue process with non-EU countries to assess them against agreed criteria for good governance relating to tax transparency, fair taxation, the implementation of OECD BEPS measures and substance requirements for zero-tax countries. The list is updated twice a year, taking into consideration the evolving deadlines for jurisdictions to deliver on their commitments and the evolution of the listing criteria that the EU uses to establish the list. Given these regular updates, the scope of application of all Luxembourg measures which refer to those jurisdictions will constantly evolve over time.

As of 22 February 2021, following the listing of Dominica and the delisting of Barbados, the EU list now includes the 12 following jurisdictions: American Samoa, Anguilla, Dominica, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, US Virgin Islands and Vanuatu.

Impact on the measure denying the corporate income tax deduction of interest and royalty expenses due to entities located in non-cooperative tax jurisdictions

Based on the Law of 10 February 2021, as from 1 March 2021, interest and royalties due to entities located in non-cooperative tax jurisdictions are no longer tax-deductible for corporate income tax purposes if the following cumulative conditions are met:

- The beneficiary of the interest or royalty is a collective undertaking within the meaning of article

159 Income Tax Law, "ITL" (thus, excluding tax transparent entities); if the beneficiary is not the beneficial owner, then the beneficial owner has to be taken into account;
- The beneficiary of the interest or royalty is an associated enterprise within the meaning of article 56 ITL; and
- The collective undertaking which is the beneficiary of the interest or royalty is established in a country or territory which is on the EU list of non-cooperative tax countries and territories.

Interest and royalties remain tax deductible to the extent that the taxpayer can demonstrate that the operation to which the interest or royalties relate has been put in place for valid economic reasons which reflect economic reality.

The measure applies to interest and royalties due as from 1 March 2021 to entities located in jurisdictions considered as non-cooperative tax jurisdictions based on the latest EU list available as of 1 March 2021, i.e., based on the list which was adopted on 22 February 2021 and published in the Official Journal of the European Union of 26 February 2021: American Samoa, Anguilla, Dominica, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, US Virgin Islands and Vanuatu. However, since the EU list is updated twice a year (generally in February and October), it means that the scope of application of the measure may evolve another time in the course of 2021 following the next update to take place this year (e.g. in October 2021).

What will be the effect of a country being added or removed from the EU list in the future?

- Countries added (e.g. following another update in October 2021) will be taken into account for interest and royalties due as from 1 January of the following year (i.e., 2022 if we assume that an update will take place in October 2021). Therefore, there will be no retroactive nor immediate effect but only an impact as from the following calendar year;
- Countries removed (e.g. following an update in October 2021) will no longer be taken into account for interest and royalties due as from the date of the publication of the relevant EU list in the Official Journal (that would be in October 2021 if we assume that an update will take place in October 2021), which means that the removal will have an immediate effect.

Impact on disclosure requirements based on Circular L.G. - A n° 64 of 7 May 2018

Based on Circular L.G. - A n° 64 of 7 May 2018, the Luxembourg tax authorities systematically review transactions entered into by Luxembourg corporate taxpayers with related parties (within the meaning of article 56 of the Income Tax Law) located in non-cooperative jurisdictions (as listed by the EU) in order to assess whether the terms and conditions of the transactions reflect the arm's length principle. Detailed information on these transactions has to be reported by Luxembourg corporate taxpayers in their corporate tax return.

The Circular states that the blacklisting as of the end of the year concerned is key for determining whether reporting is required or not. Therefore, since another update of the list is expected to happen prior to year-end, the scope of the disclosure requirements under Circular L.G. - A n° 64 of 7 May 2018 for the 2021 corporate tax return remains to be confirmed. As far as the disclosure for the 2020 corporate income tax returns is concerned, reference should be made to the EU list in force as of 7 October 2020 (date of publication in the Official Journal of the European Union of the update preceding the update of today).

Impact on disclosure requirements under DAC6

The listing of a jurisdiction as non-cooperative may also have an impact on the reporting obligations applicable according to the Luxembourg Law of 25 March 2020 implementing Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (DAC6).

Hallmark C.1.b) ii) of the Annex to the Law of 25 March 2020 implementing DAC6 covers deductible cross-border payments made between two or more associated enterprises where the recipient is resident for tax purposes in a jurisdiction which has been assessed as being non-cooperative. This hallmark is not subject to the main benefit test.

The question arises as to the list (in force as of which date?) to be taken into account to assess whether the recipient is resident in a non-cooperative jurisdiction. In this respect, in our view, reference should be made to the list in force at the time the transaction was implemented and the listing or delisting of a jurisdiction after the transaction has been implemented should not have any retroactive effect. In other words, reporting should only be required if the transaction with the entity located in the jurisdiction was implemented at the time when this jurisdiction was blacklisted.

Implications

Luxembourg taxpayers with investments into and from non-cooperative jurisdictions should seek advice from their tax advisers in order to analyse the potential tax impact of the update of the EU list of non-cooperative jurisdictions on their investments and the potential reporting requirements. The evolution of the legislation of jurisdictions under the radar of the EU Council should also be closely monitored in order to anticipate an addition to or a removal from the EU list of non-cooperative tax jurisdictions in the future and thus a change in the scope of application of the Luxembourg measures.

Your contacts for further information:

ROMAIN TIFFON
Partner
romain.tiffon@atoz.lu

SAMANTHA SCHMITZ
Chief Knowledge Officer
samantha.schmitz@atoz.lu

Interest deduction limitation rules: tax authorities release guidelines

OUR INSIGHTS AT A GLANCE

- On 8 January 2021, the Luxembourg tax authorities issued a Circular in order to provide guidance on the interpretation of the interest deduction limitation rules laid down in Article 168bis of the Luxembourg income tax law (through which the EU Directive laying down rules against tax avoidance practices ("ATAD 1") has been transposed into Luxembourg law).
- The interest deduction limitation rules limit the interest deductibility for tax purposes for Luxembourg corporate taxpayers and Luxembourg permanent establishments of foreign taxpayers, unless they qualify as financial undertakings or stand-alone entities. The limitation applies to exceeding borrowing costs (i.e., the amount by which the borrowing costs exceed the interest income in a given year) and corresponds to the higher of EUR 3mio or 30% of the tax EBITDA per fiscal year.
- The IDLR provisions in Luxembourg tax law include a number of definitions which are core to the practical application of the limitations for taxpayers. Their interpretation has been the subject of multiple discussions in the past years as investors, asset managers and advisors have been looking for certainty and a clear assessment of the risks embedded into their existing investment structures.
- The long-awaited Circular sheds light on various points. However, some other key aspects unfortunately remain unclear.

On 8 January 2021, the Luxembourg tax authorities issued a new Circular n°168bis/1 (the "Circular") in order to provide guidance on the interpretation of the interest deduction limitation rules ("IDLR") laid down in Article 168bis of the Luxembourg income tax law ("LITL") (through which the Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices ("ATAD 1") has been transposed into Luxembourg law).

The IDLR have been applicable since 1 January 2019 and shall be interpreted according to the Circular for all tax years from 2019 (the Circular merely has clarifying character with regard to the interpretation of the existing legal provisions).

The IDLR limit the interest deductibility for tax purposes for Luxembourg corporate taxpayers and Luxembourg permanent establishments of foreign taxpayers, unless they qualify as financial undertakings or stand-alone entities. The limitation applies to exceeding borrowing costs (i.e., the amount by which the borrowing costs exceed the interest income in a given year) and corresponds to the higher of EUR 3mio ("Safe Harbour Rule") or 30% of the tax EBITDA per fiscal year.

The IDLR provisions in Luxembourg tax law include a number of definitions which are core to the practical application of the limitations for taxpayers. Their interpretation has been the subject of multiple discussions in the past years as investors, asset managers and advisors have been looking for certainty and a clear assessment of the risks embedded into their existing investment structures.

While the Circular provides clarity on some of these subjects, and also hints at the appropriate computation of the tax EBITDA used to calculate the deductibility threshold, it still leaves certain questions unanswered and will, not unsurprisingly, push the taxpayers to carefully consider its acceptable level of risk.

The concept of borrowing costs and interest income

The Circular specifies that borrowing costs encompass interest expenses on any type of debt, other costs economically equivalent to interest and certain expenses incurred in connection with financing.

Borrowing costs may only concern deductible interest expenses, i.e., non-deductible interest expenses,

regardless of the reason for the non-deductibility (e.g. anti-hybrid rules), do not qualify as borrowing costs.

The Circular provides a non-exhaustive list of borrowing costs, in particular:

- Fixed and variable remuneration on profit participating loans;
- Imputed interest on certain financial instruments such as convertible bonds and zero coupon bonds (including issuance and redemption premiums);
- Amounts paid on alternative financing arrangements such as Islamic finance;
- The finance cost element of finance lease payments on leasing contracts;
- Capitalised interest included in the acquisition costs of assets in the balance sheet or amortisation of capitalised interest;
- Amounts measured by reference to a funding return under transfer pricing rules (e.g. deemed interest deductions in application of transfer pricing rules);
- The notional interest element of derivatives and hedging instruments in relation to an entity's borrowings;
- Certain foreign exchange losses on borrowings and instruments connected with the raising of finance (excluding foreign exchange losses on the principal amount of borrowings);
- Guarantee fees on financing arrangements (in particular mortgage guarantees, and any other type of guarantee connected to a financing operation);
- Fees and similar charges relating to the borrowing of funds.

In light of the notion of borrowing costs set out above, the Circular clarifies that the notion of interest income and other economically equivalent income should be interpreted applying a symmetric and coherent approach. While in a national context borrowing costs incurred by a borrower should likewise be considered as interest income at the level of the lender (and vice versa), difficulties may arise in a cross-border context in case of deviating interpretations between member states.

An interesting attention point is that the Circular clearly states that redemption premiums on convertible loans and bonds are to be treated as interest expenses for the purpose of the IDLR. While under certain accounting frameworks these financing instruments may be treated differently and sometimes be recognized partly as debt and equity, this should not impact the application of the IDLR.

Discounted debt

The Circular does not specifically refer to the acquisition of discounted debt and the distinction between capital gains and interest. The only hint relates to a deduction for impairment of (presumably) irrecoverable receivables which shall not be considered as interest expenses in the hands of the lender. Applying the principle of symmetry, the reversal of such impairment should likewise not constitute interest income.

Absent any further guidance, the question arises whether in application of an economic approach, a capital gain on discounted debt in the hands of an acquirer may or may not qualify as interest income (at least partially), even where a principal repayment would not be considered as an interest expense at the level of the borrower.

Hence, taxpayers need to consider whether it may be appropriate to rely on the general principles touched upon above and consider that capital gains should not be considered as interest income in the hands of the lender. This could lead to a Luxembourg tax exposure where, for example in sizeable securitisation transactions (i.e., where the Safe Harbour Rule is insufficient), such discounted debt has been financed with (profit participating) loans since the fixed and variable interest as well as any types of redemption premiums on loan instruments qualify as borrowing costs subject to the IDLR rules.

Derivatives and hedging instruments

Interest rate swaps and similar derivative or hedging instruments where the interest charges are calculated on the basis of a notional amount and that are in relation to an entity's borrowings are in the scope of the IDLR. Derivatives in relation to the assets of a company should, in principle, not be in the scope of the IDLR (noting that the principle of symmetry may impact the qualification if the borrower considers such derivatives as in relation to the raising of funding).

More complex hedging positions such as a swap covering a net exposure on certain assets and liabilities, or other synthetic positions, should be considered carefully and analysed on a case-by-case basis.

Grandfathering and subsequent modifications

The IDLR include a grandfathering rule pertaining to existing loans to the extent that their terms are not subsequently modified, i.e., in case of a modification on or after 17 June 2016, the benefit of the grandfathering clause would be limited to the original terms of the loan. The subsequent modifications include an extension of the maturity of a loan, a modification of the interest rate or the interest rate computation method or the modification of one or several of the contracting parties if such modifications were not contractually foreseen before 17 June 2016, or a modification of the principal amount.

Tax-neutral reorganisations such as mergers and demergers are out of the scope since the initial conditions of the loan should not be impacted by such transactions.

It appears unclear whether the mere change of the lender would trigger a loss of the grandfathering privilege if the terms and conditions of the loan remain unchanged. Since the Circular applies the limitations to the excess amount of borrowing costs after a change of terms, this could mean that if the borrower pays exactly the same amount of interest on the same amount of loan principal before and after the change of lender, the loan should continue to benefit from the grand-fathering rule.

A mere drawdown under a loan facility granted before 17 June 2016 falls within the scope of the grandfathering rule (provided that the maximum amount has not been subsequently increased).

Stand-alone entity exception

The IDLR provide for a number of carve-outs. For example, securitisation undertakings subject to EU Regulation 2017/2402 are explicitly out of the scope of Article 168bis of the LITL. In this context, it is to be noted that a formal notice of the European Commission dated 14 May 2020 challenged the carve-out of securitisation vehicles falling within the scope of the above EU Securitisation Regulation as financial undertakings. As expected, the Circular does not comment on this issue.

Notwithstanding the above, many securitisation vehicles do in any case not fall within the scope of this EU Regulation and may therefore only benefit from the general carve-out rule applicable to all Luxembourg corporate taxpayers/Luxembourg permanent establishments of foreign entities, if they

1. are not part of a consolidated group for financial accounting purposes;
2. do not have an associated undertaking as defined in Article 164ter, paragraph 2 of the LITL; and
3. do not have a permanent establishment situated in a state other than Luxembourg.

Regarding point 2, the Circular states that it is required to verify the existence of a direct or indirect link of association between the taxpayer and an undertaking within the meaning of articles 159, 160 or 175 of the LITL or a natural person. This link of association must be analysed from an economic point of view.

The reference that the link of association has to be analysed from an economic point of view seems to support the argument that so-called orphan structures may benefit from the stand-alone entity exception. However, this is subject to a case-by-case analysis.

Tax transparent entities

The Circular also covers the case of taxpayers holding interests in tax transparent vehicles, such as (special limited) partnerships. Here, the amounts of interest income and interest expense of the partnership would be allocated to its partners for the purpose of the IDLR based on the participation held into the partnership. Combined with the general approach and tax doctrine on the allocation of profits of tax transparent entities, one would expect that such allocation would be done based on the economic rights of the partners rather than the mere percentage of units or interest held in the partnership. It is regrettable that the Circular does not cover this aspect in more details.

Implications

The long-awaited Circular sheds light on various points. However, some other key aspects unfortunately remain unclear.

In particular, in regard to derivatives and hedging instruments, additional guidance would have been welcome to determine under which circumstances exactly a connection with the raising of funding may be assumed (e.g. a contractual and/or temporal link).

Further, a more concrete clarification with regard to the qualification of capital gains on discounted debt would have been desirable. In light of the Circular, taxpayers which finance discounted debt with debt instruments (e.g., debt funds) may therefore need to review their current structure set-up to identify potential tax exposures and take the necessary steps, if needed.

Finally, the developments made in the Circular regarding the stand-alone entity exception seem to suggest that orphan structures, such as those often used in securitisation transactions, could in certain cases benefit from the carve-out.

Your contacts for further information:

ANTOINE DUPUIS
Partner
antoine.dupuis@atoz.lu

ANDREAS MEDLER
Principal
andreas.medler@atoz.lu

The amended Luxembourg tax consolidation regime: improvements still needed

OUR INSIGHTS AT A GLANCE

- Following the decision of the CJEU regarding the consequences of the change from a "vertical" to a "horizontal" tax consolidation, the Luxembourg legislator introduced a new provision dealing with the tax consolidation regime with effect as from tax year 2020.
- The new provision confirms that such change will not entail any negative tax consequences for the members of the tax consolidated group, provided that certain conditions are met.
- However, this new provision is limited in time as its effects expire with the taxation year 2022.
- As from 2023, the tax neutrality of a change from a "vertical" to a "horizontal" tax consolidation will thus be again at risk.
- New amendments to the tax consolidation regime would be welcome in the interest of legal certainty.

The 2021 budget law dated 19 December 2020 introduced a new provision dealing with the tax consolidation regime with effect as from tax year 2020. The amendments to the regime aim at reflecting the recent decision of the Court of Justice of the European Union ("CJEU") regarding the consequences of the change from a "vertical" to a "horizontal" tax consolidation (see "The modification of a vertical tax consolidation group into a horizontal tax consolidation group does not end the tax consolidation regime" in ATOZ Insights - July 2020). The new provision confirms that such change will not entail any negative tax consequences for the members of the tax consolidated group, provided that certain conditions are met.

Background

On 14 May 2020, the CJEU ruled on the Luxembourg tax consolidation regime and took a very positive decision for Luxembourg corporate taxpayers. The CJEU answered the question whether the strict separation of vertical and horizontal tax consolidations was in line with EU law. In other words, is it EU-compliant to be required to end the vertical tax consolidation before being able to benefit from a horizontal tax consolidation?

In this respect, the CJEU decided that the freedom of establishment should be interpreted as prohibiting a legislation of a Member State which has the effect to force a parent company with its seat in another Member State to dissolve an existing vertical tax consolidation between one of its resident subsidiaries and a certain number of its resident sub-subsidiaries, in order to allow this subsidiary to proceed with a horizontal tax consolidation with other resident subsidiaries of said parent company, when the resident integrating subsidiary remains the same and the dissolution of the vertical tax consolidation before the end of the minimum period of consolidation, provided for by national law, implies the rectification, on an individual basis, of the taxation of the companies concerned.

The CJEU concludes that since a non-resident parent company without a permanent establishment in Luxembourg can only consolidate its Luxembourg resident subsidiaries at the cost of dissolving an existing vertical consolidation, cross-border situations are disadvantaged compared to purely domestic situations. According to the CJEU, such a de facto obligation constitutes an unjustified restriction on the freedom of establishment.

As a result, EU law precludes that when a vertical consolidation is modified into a horizontal consolidation (i.e., addition of sister companies of the integrating company into the consolidated group) the vertical consolidated group must be dissolved with the consequence of retroactive taxation of each member of the group on an individual basis, in case the minimum period of five years has not yet been reached.

The new Luxembourg rule applicable to tax consolidations

The budget law did not amend article 164bis of the LITL, which is the article of reference for the tax consolidation regime. Instead, the new rule is included in a standalone provision of the 2021 Budget law. According to this provision, the change from a "vertical" to a "horizontal" tax consolidation will not entail any negative tax consequences for the members of the consolidated group, provided that certain conditions are met.

The new provision states that when the change from a "vertical" to a "horizontal" tax consolidation results in the dissolution of an existing vertical consolidated group, the change in the tax consolidation regime is made exceptionally without entailing tax consequences for the members of the dissolved integrated group if the following conditions are simultaneously met:

- the integrating parent company of the dissolved consolidated group becomes the integrating subsidiary company of the new consolidated group;
- the change of regime takes place for the tax year 2022 at the latest;
- the change of regime extends the scope of the dissolved consolidated group; and
- the members of the new consolidated group are bound for a period that must cover at least five financial years. For those who were already part of the dissolved consolidated group, the minimum five-year period is made as if the change of regime had not taken place.

Comments on the new Luxembourg rule

Introduction of a temporal limit in contradiction with the CJEU case law

According to the new Luxembourg rule, the period which the change of form from a vertical to a horizontal consolidation can be made within, without the consequences generally provided for in the event of dissolution of a consolidated group before the minimum period of five years has elapsed, expires with the taxation year 2022.

According to the comments on the draft budget law, "*it is considered that this period is sufficient to allow a consolidated group taking the form of a 'vertical consolidation' to verify whether, in its concrete case, it is judicious to change the regime and constitute a consolidated group taking the form of a 'horizontal consolidation', in order to enlarge the scope of the existing consolidated group*". Furthermore, it is specified that, "*After this period, the general principles governing the dissolution of a consolidated group apply*".

It is obvious that such comments ignore, on the one hand, the reality of groups of companies and their needs and, on the other hand, the very conclusions of the CJEU case law which are at the origin of the new provision.

Ignorance of the reality of groups of companies and their needs

Considering that a period expiring on 31 December 2022 is sufficient to allow a consolidated group taking the form of a "vertical consolidation" to verify whether, in its concrete case, it is appropriate to enlarge the scope of the existing consolidated group and apply for a "horizontal consolidation", the legislator ignored, for example, the following realities:

- The extension of a vertical consolidation after 31 December 2022 with a sister company of the integrating company incorporated after 31 December 2022;

- The extension of a vertical consolidation after 31 December 2022 with a sister company of the integrating company acquired by the joint parent company after 31 December 2022;
- The consolidation of a group as a vertical consolidation after 31 December 2022 and its subsequent extension;
- A change in the commercial policy of a group after 31 December 2022 which would justify an extension of the vertical consolidation only after 31 December 2022.

This is even more true as a consolidated group cannot even foresee a future extension by applying for a horizontal consolidation before 31 December 2022 without extending the scope of the consolidated group. Indeed, under the new provision, one condition to make the change in neutrality is that the change extends effectively the scope of the consolidated group.

Ignorance of the conclusions of the CJEU case law which justify the adoption of the new rule

As explained above, the CJEU considers that since a non-resident parent company without a permanent establishment in Luxembourg can only consolidate its resident subsidiaries at the cost of the dissolution of an existing vertical consolidation, cross-border situations are disadvantaged compared to purely domestic situations. Such a de facto obligation therefore constitutes an unjustified restriction on the freedom of establishment.

As the new rule introduces an option expiring with the taxation year 2022, as from 2023, the change of form of a consolidated group from a vertical to a horizontal form will be subject to the same rules as prior to the introduction of this new provision (i.e., article 164bis of the LITL). The commentaries on the draft budget law stating that a non-resident parent company will now be able to, like a resident parent company, freely decide whether to include its resident subsidiaries or sub-subsidiaries, including its domestic permanent establishments, within the scope of an existing tax consolidation is therefore inaccurate. Once the deadline set out in the budget law has passed, a non-resident parent company will no longer be able to freely decide whether to include its resident subsidiaries or sub-subsidiaries, including its domestic permanent establishments, within the scope of the tax consolidation.

According to the commentaries on the draft budget law, “general principles governing the dissolution of a consolidated group will thus apply to individual members” as from 1 January 2023. This statement is not correct either. Article 164bis of the LITL does not provide, in itself, for the dissolution of a consolidated group when modified from a vertical form to a horizontal one. Besides, article 164bis of the LITL interpreted in such way, driving to the dissolution of the group with retroactive taxation of its members on an individual basis, is considered as contrary to the freedom of establishment by the CJEU.

What is next?

The Luxembourg tax consolidation saga is not over yet! As from 2023, it is likely that consolidated groups taking the form of a vertical consolidation will ask for modifications into a horizontal consolidation based on the case law of the CJEU, while the tax authorities will refuse the neutrality of such transformations. We will thus be back to square one…

New amendments to the tax consolidation regime would thus be welcome in the interest of legal certainty.

In this respect, any amendments to the rules applicable to tax consolidations should also provide an opportunity to examine the effect of certain transactions or restructurings carried out by groups of companies which have adopted the tax consolidation regime. In view of the constant evolution of the structure of groups of companies, it would be appropriate for the Luxembourg legislator to expressly confirm, for the sake of legal certainty, the effects of transactions such as mergers, demergers and liquidations on consolidated groups. Finally, it would be also important to clarify the effect of Brexit on existing tax consolidation groups with a UK non-integrating parent company since, under the tax consolidation regime in force, non-integrating companies have to be resident in either the EU or in an EEA country, which is no longer the case of the UK since Brexit.

Luxembourg taxpayers having a tax consolidation group should seek advice from their tax adviser in order to analyse the potential impact of the new rule, notably if they plan to extend the scope of their existing tax consolidation. When requesting the application of the tax consolidation regime for the first time, consideration should also be given to the fact that, if possible, horizontal tax consolidation should be preferred over the vertical one.

Your contacts for further information:

HUGUES HENAFF
Partner
hugues.henaff@atoz.lu

MARIE BENTLEY
Knowledge Director
marie.bentley@atoz.lu

COVID-19: income tax and social security measures for cross-border workers

OUR INSIGHTS AT A GLANCE

- The protocols to the double tax treaties concluded by Luxembourg with Belgium, France and Germany provide rules allowing cross-border workers to perform their activities outside of their employment state while remaining taxable in their employment state, but only for a limited number of days.
- Given that the maximum amount of days can easily be exceeded during the COVID-19 crisis due to travel restrictions and the requirement of "social distancing" resulting in many employees working from home and thus outside of Luxembourg, the Luxembourg Government concluded agreements with the three countries, according to which the days spent outside of Luxembourg due to the current crisis are not taken into account.
- These three agreements were initially concluded for a limited period of time, were then renewed several times and some of them have now been extended again.
- As far as social security is concerned, the Luxembourg Government also concluded agreements to make sure that cross-border workers remain subject to the social security legislation of their employment state and do not become subject to social security in their residence state, even if they spend 25% or more (threshold applicable under the EU social security rules) of their working time in their residence state due to COVID-19.

The protocols to the double tax treaties concluded by Luxembourg with Belgium, France and Germany provide rules allowing cross-border workers to perform their activities outside of their employment state (Luxembourg in most cases) for a maximum amount of days (19 days in Germany, 24 days in Belgium and 29 days in France) while remaining taxable in their employment state.

Given that the maximum amount of days can easily be exceeded during the COVID-19 crisis due to travel restrictions and the requirement of "social distancing" resulting in many employees working from home and thus outside of Luxembourg, the Luxembourg Government concluded agreements with the three countries, according to which the days spent by employees outside of Luxembourg due to the current crisis are not taken into account. These three agreements were initially concluded for a limited period of time and were then renewed several times.

The agreement with Belgium, which was supposed to apply from 11 March 2020 until 31 March 2021, has now been extended until 30 June 2021. The agreement with France, which was supposed to apply from 14 March 2020 until 31 March 2021, has been extended until 30 June 2021. As far as the agreement with Germany is concerned, it is renewed monthly automatically as from 2021. This means that the agreement will remain in force at least until 30 April 2021. However, given the current context, it can be expected that the agreement with Germany will also remain in force at least until 30 June 2021.

As far as social security is concerned, Luxembourg also concluded agreements according to which, until 30 June 2021, any days spent working from home due to COVID-19 will not impact the applicable social security rules. In other words, cross-border workers will remain subject to the social security legislation of their employment state and will not become subject to social security in their residence state, even if they spend 25% or more (threshold applicable under the EU social security rules) of their working time in their residence state due to COVID-19.

While these measures are positive since they avoid potential individual tax and social security implications of working from home during the crisis, businesses should keep in mind that employees working from a country other than the country of residence of their employing company may create a permanent establishment of the company in the residence state of the employee. Indeed, despite the recommendations made by the OECD in its Updated guidance on tax treaties and the impact of the COVID-19 pandemic (according to which the exceptional and temporary change of the location where employees exercise their employment because of the COVID-19 pandemic, such as working from home, should not create new permanent establishments for the employer), since no measure has been taken so far in Luxembourg in this respect, Luxembourg companies should carefully monitor the activities performed by their employees outside of their tax residence state.

Your contact for further information:

SAMANTHA SCHMITZ
Chief Knowledge Officer
samantha.schmitz@atoz.lu

Danske Bank (C-812/19): services provided by the head office part of a VAT group to a foreign branch fall within the scope of VAT

OUR INSIGHTS AT A GLANCE

- On 11 March 2021, the Court of Justice of the European Union gave its decision in *Danske Bank A/S v. Skatteverket* (Case C-812/19).
- Services provided by a head office to its branch located in another jurisdiction are to be considered as transactions falling within the VAT scope when the head office is part of a VAT group.
- Businesses with foreign branches having a head office being part of a VAT group are invited to review the flows of services between those companies to assess the related potential VAT impacts of the Danske Bank case.

On 11 March 2021, the Court of Justice of the European Union (CJEU) gave its decision in *Danske Bank A/S v. Skatteverket* (Case C-812/19).

Factual background

Danske Bank A/S is a bank with its head office in Denmark which carries out its activity notably in Sweden through a branch. The head office belongs to a Danish VAT group which does not include the Swedish branch.

The IT platform of Danske Bank is also used for the activity of its Swedish branch and part of the IT costs are therefore allocated/recharged by the Danish head office to its branch.

Danske Bank was of the opinion that FCE Bank jurisprudence (ECJ, FCE Bank, 23 March 2006, C-210/04) should be applicable. According to this case law, services between a head office and its branch (not performing an independent economic activity) should be considered as performed within the same legal person and should thus be out of the scope of VAT. As a consequence, Danske Bank considered that the allocation of IT costs is not subject to VAT at the level of its Swedish branch.

Conversely, the Swedish Tax Authorities were of the opinion that the Skandia jurisprudence (CJEU, 17 September 2014, Skandia America Corp. (USA), filial Sverige, C-7/13) is applicable. In this regard, they considered that the IT costs are to be recharged by the VAT group (and not by the head office as such) to the Swedish branch. Considering that the head office and the other VAT group members are a single VAT taxable person, the services rendered by the head office cannot be considered as "internal" transactions within the same legal entity. As a main consequence, services rendered by the head office through the VAT group would be in the scope of VAT and subject to the reverse charge mechanism at the level of the branch.

Decision of the CJEU and potential impacts

In its judgment, the CJEU mirrors its position in the Skandia case. Services provided by a head office part of a VAT group to its branch located in another Member State are to be considered as taxable transactions. As the services

are provided by the VAT group, the head office and the branch cannot be considered as being a single VAT taxable person. As a consequence, transactions between the head office being part of a VAT group and foreign branches are considered as falling within the scope of VAT.

Although this decision is not surprising, it alleviates any remaining doubts that could still exist further to the Skandia judgement. Businesses have to review potential VAT impacts on costs allocations between a head office and its branch(es) when one of them is part of a VAT group.

Our VAT experts, Thibaut Boulangé and Silvin Leibengut, are available to discuss the eventual impacts of the Danske Bank case on your activities and to handle any questions you may have.

Your contacts for further information:

THIBAUT BOULANGE
Partner, Head of Indirect Tax
thibaut.boulange@atoz.lu

SILVIN LEIBENGUT
Director
silvin.leibengut@atoz.lu

VAT on company cars: radical change following CJEU QM case

OUR INSIGHTS AT A GLANCE

- In the QM v. Finanzamt Saarbrücken case (C-288/19), the Court of Justice of the European Union ("CJEU") examined whether the provision of a company car to a non-resident employee used for both business and private purposes constitutes a long-term hiring of a means of transport subject to VAT in the employee's country of residence.
- The decision of the CJEU is of particular relevance for Luxembourg employers providing company cars to Luxembourg and/or non-Luxembourg resident employees. This CJEU case may lead to an increase in the VAT costs of leasing transactions, as well as to additional VAT compliance obligations for Luxembourg employers in the country of residence of their employees.

In the QM v. Finanzamt Saarbrücken[1] case (C-288/19), the Court of Justice of the European Union ("CJEU") examined whether the provision of a company car to a non-resident employee used for both business and private purposes constitutes a long-term hiring of a means of transport subject to VAT in the employee's country of residence.

Background and question referred to the CJEU

QM is a Luxembourg investment fund management company. In 2013 and 2014, QM made two company cars available to two employees, who operated in Luxembourg and were residents in Germany. Those cars were used for professional and private purposes. In one case, the car was provided free of charge, while in the second case, the employee bore a certain cost each year, which was deducted from his remuneration.

QM was registered for VAT purposes in Luxembourg under the "simplified tax regime" and therefore could not deduct input VAT on its costs (notably the VAT incurred on leasing costs). Following the publication in 2014 of a circular from the German VAT authorities, QM registered for German VAT purposes and considered the provision of the cars as being subject to German VAT for the years 2013 and 2014.

Although its German VAT returns were accepted, QM decided to challenge this position and to bring an action before the German courts on the ground of a double VAT taxation (input VAT was not deductible in Luxembourg and the leasing was VAT taxable in Germany).

Judgement of the CJEU

According to the CJEU, a distinction should be made between company cars provided to employees (1) free of charge and (2) for consideration.

Company car provided "free of charge"

The CJEU ruled that the provision of a company car to an employee free of charge is not subject to VAT as a long-term hiring of a means of transport. There is indeed no VAT transaction between the employer and the employee since there is no remuneration received directly or indirectly by the employer.

The provision of a company car is considered as free of charge where (i) the employee does not provide payment for the car being made available to him, (ii) he does not give up a part of his remuneration as consideration for it and (iii) his entitlement to use the car is not contingent on the forgoing of other benefits.

The rules applicable to the private use of company assets should be observed, i.e., if input VAT on the acquisition of the cars has been deducted, this input VAT should not be fully recoverable considering the private use of the car.

[1] CJEU, 20 January 2021, C-288/19, QM v. Finanzamt Saarbrücken.

Company car provided "for consideration"

On the contrary, the CJEU stated that the provision of a company car to an employee for consideration (i.e., not free of charge) is subject to VAT, as a long-term hiring of a means of transport, where all the following conditions are met:

- the employee has an uninterrupted right to use the company car for private purposes and to exclude other persons from using it;
- in exchange for rent; and
- for an agreed period of more than 30 days.

Guidelines issued by the Luxembourg VAT authorities

The Luxembourg VAT authorities, with their circular n° 807 issued on 11 February 2021, shed more light on the practical consequences of this CJEU case for Luxembourg companies.

In line with the reasoning of the CJEU, the Luxembourg VAT authorities identify three different scenarios which might occur in relation to the provision of a company car to an employee and analyse the VAT treatment applicable from a Luxembourg VAT standpoint:

- If the employer provides the company car *in return for consideration* (as defined by the CJEU), for an agreed period of more than 30 days and the employee obtains the right to use it and to exclude other persons from using it, this supply shall qualify as a long-term hiring of a means of transport and will be subject to VAT in the employee's country of residence. Therefore, if the employee is resident in another Member State, the employer should register for VAT in the other Member State in order to declare and pay the VAT due. The agreed rent constitutes the VAT taxable basis.
- If the employer provides the company car *without any consideration* (as defined by the CJEU) *but the employer has (fully or partially) deducted the input tax* in Luxembourg on costs relating to the acquisition or leasing of such a car, the rules for the private use of company assets shall apply. Subsequently, the employer should declare the use of the company car made for purposes other than those of his business (i.e., private use) in its Luxembourg VAT returns.
- If the employer provides the company car *free of charge and has not deducted the input tax* in Luxembourg relating to the acquisition or leasing of such a car, this supply falls outside the VAT scope.

Impact assessment

This CJEU case will have negative impacts as it will lead to:

- an increase in the leasing costs for Luxembourg and non-Luxembourg resident employees having a company car "for consideration";
- new VAT burdens on employers, given that the provision of a company car to employees shall be subject to VAT in the employee's country of residence in some circumstances. This may trigger VAT compliance obligations for employers in foreign countries (although some relief could be provided upon the implementation of the new One Stop Shop scheme that should enter into force as from 1 July 2021).

Actions to be taken

We strongly recommend that Luxembourg companies which provide company cars to Luxembourg and non-Luxembourg resident employees carefully review their current internal leasing policy and assess the potential VAT impacts of this CJEU case and the related Luxembourg circular.

We would be pleased to discuss the VAT impact of this CJEU case on your business, as well as to review and develop your VAT strategy.

Your contacts for further information:

THIBAUT BOULANGE
Partner, Head of Indirect Tax
thibaut.boulange@atoz.lu

SILVIN LEIBENGUT
Director
silvin.leibengut@atoz.lu

Adoption of the new mandatory automatic exchange of information rules for digital platforms "DAC7"

OUR INSIGHTS AT A GLANCE

- On 22 March 2021, the EU Council adopted a new Directive, so-called DAC7, amending the Directive 2011/16/EU on administrative cooperation in the field of taxation for the sixth time.
- DAC7 creates a new obligation for digital platform operators to report the income earned by sellers of goods and services who make use of their platforms and for member states to automatically exchange this information.
- The new rules cover digital platforms located both inside and outside the EU and will apply from 1 January 2023 onwards.
- DAC7 also introduces a definition of the "foreseeable relevance" required for an information request, allows information requests on groups of taxpayers, provides a framework for the conduct of joint audits by member states and finally includes royalties in the list of income subject to mandatory automatic exchange of information under DAC.

On 22 March 2021, the EU Council adopted a new Directive, so-called DAC7, which strengthens administrative cooperation to include sales through digital platforms. DAC7 amends the Directive 2011/16/EU on administrative cooperation in the field of taxation ("DAC") for the sixth time to create an obligation for digital platform operators to report the income earned by sellers of goods and services who make use of their platforms and for member states to automatically exchange this information.

DAC7 introduces new reporting obligations for platforms acting as "digital intermediaries" like under the common reporting standard ("CRS") and DAC6 which place obligations respectively on financial or tax intermediaries. The new rules will allow national tax authorities to detect income earned through digital platforms and determine the relevant tax obligations. DAC7 is part of the EU Commission's Tax Package which aims to ensure that the European tax policy supports Europe's economic recovery and long-term growth following the COVID-19 crisis.

The new rules cover digital platforms located both inside and outside the EU and will apply from 1 January 2023 onwards. The reporting obligation should cover both cross-border and non-cross-border activities.

DAC7 also brings clarifications and improvements to the existing rules on administrative cooperation and introduces notably, for that purpose, a definition of the "foreseeable relevance" required for an information request. In addition, the new rules provide a framework for the competent authorities of two or more member states to conduct joint audits. This framework will be operational in all member states from 2024 at the latest.

Finally, DAC7 adds royalties to the list of income subject to mandatory automatic exchange of information under DAC.

Platform operators subject to new mandatory automatic exchange of information

DAC7 extends the scope of the automatic exchange of information with respect to the information to be reported by digital platform operators and is inspired by the Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy issued by the Organisation for Economic Co-operation

and Development ("OECD") on 9 July 2020 (the "OECD Model Rules").

DAC7 provides for:

- an obligation on the reporting platform operators to collect and verify information in line with due diligence procedures;
- an obligation on the reporting platform operators to report information on the reportable sellers which use their platform on which they operate, to sell their goods and provide their services;
- an obligation on the competent authorities to communicate the reported information to the competent authority of the appropriate member state.

Pursuant to DAC7, each member state shall take the necessary measures to require Reporting Platform Operators to carry out new due diligence and reporting obligations by 31 December 2022. They shall apply those provisions as from 1 January 2023.

DAC7 does not cover issues related to digital taxation or minimum effective taxation discussed at OECD level. In this regard, it is expected that the Commission will present a dedicated action plan on business taxation by mid-2021.

Scope of DAC7

a. Who will bear the burden of the new reporting duties?

With DAC7, the EU Commission targets the digital platform economy through platform operators, which makes the traceability and detection of taxable events by tax authorities very difficult.

Under DAC7, 'platform' means any software, including a website or a part thereof and applications, including mobile applications, accessible by users and allowing sellers to be connected to other users for the purpose of carrying out a targeted activity, directly or indirectly, to such users. It also includes any arrangement for the collection and payment of a consideration in respect of the relevant activities. Software that exclusively allows the processing of payments in relation to a targeted activity, users to list or advertise a relevant activity, or the redirecting or transferring of users to a platform, without any further intervention in carrying out a relevant activity, is not a platform under DAC7.

'Sellers' are defined by DAC7 as platform users, either individuals or entities, which are registered at any moment during the reportable period on the platform and carry out, for consideration, activities which include the rental of immovable property, the provision of personal services, the sale of goods (i.e., tangible properties) and the rental of any mode of transport (the "Relevant Activities"). A personal service is a service involving time- or task-based work performed by one or more individuals who act either independently or on behalf of an entity. This service is carried out at the request of a user, either online or physically offline after having been facilitated via a platform.

A 'platform operator' is an entity that contracts with sellers to make available all or part of a platform to such sellers.

The reporting obligation will fall on a "Reporting Platform Operator" described as any platform operator which is:

- either a tax resident in a member state, is incorporated under the laws of a member state or has its place of management (including effective management) or a permanent establishment in a member state (referred to as "EU Platforms");
- neither resident for tax purposes, nor incorporated or managed in a member state, nor has a permanent establishment in a member state, but facilitates the carrying out of a Relevant Activity by reportable sellers or the rental of immovable property located in a member state (referred to as "Foreign Platforms Operators").

For the sake of simplification and mitigation of compliance costs, it would be reasonable to require

platform operators to report income earned by sellers through the use of the digital platform in one single member state.

b. Who will be reportable?

A Reporting Platform Operator will need to collect and report information on any seller other than an excluded seller (i.e., a governmental entity) which, during the reportable period, either carries out a Relevant Activity or is paid or credited consideration in connection with a Relevant Activity, and is resident in a member state or rented out immovable property located in a member state ("Reportable Seller").

A Reportable Seller is considered resident in a member state if, during the reportable period, it had its primary address in a member state, it had a TIN or VAT identification number issued in a member state or, for a seller that is an entity, it had a permanent establishment in a member state. Notwithstanding these criteria, a Reporting Platform Operator shall consider a seller resident in each member state confirmed by an electronic identification service made available by a member state or the EU to ascertain the identity and tax residence of the seller.

Governmental entities, entities (or related entities of entities) the stock of which is regularly traded on an established securities market, and entities for which the platform operator facilitates more than 2,000 Relevant Activities by means of the rental of immovable property in respect of what is called a 'property listing' during the reporting period are nevertheless excluded from any DAC7 reporting. DAC7 defines Property Listing as all immovable property units located at the same street address, owned by the same owner and offered for rent on a platform by the same seller.

DAC7 also sets up a threshold for being considered as a reportable seller. As a result, sellers for which the platform operator facilitates less than 30 Relevant Activities by means of the sale of goods and for which the total amount of consideration paid or credited does not exceed EUR 2,000 during the reporting period are not in the scope of the DAC7 reporting.

New duties for Reporting Platform Operators

a. Due diligence procedures

A Reporting Platform Operator will have to carry out due diligence procedures to identify Reportable Sellers. For that purpose, the Reporting Platform Operator will have to collect information for each seller (individuals and entities) and will then have to determine whether or not the information collected is reliable, using all information and documents available to the Reporting Platform Operator in its records, as well as any electronic interface made available by a member state of the EU free of charge to ascertain, for example, the validity of the TIN and/or VAT identification number.

Where the Reporting Platform Operator has reason to know that any of the information may be inaccurate, it will have to request the seller to correct information items which were found to be incorrect and to provide supporting documents, data or information which is reliable and of independent source, such as a valid government-issued identification document or a recent tax residency certificate.

Where a seller is engaged in a Relevant Activity involving the rental of immovable property, the Reporting Platform Operator will have to collect the address of each property listing and, where issued, respective land registration number.

If a Reportable Seller does not provide the information required to the Reporting Operating Platform after two reminders following the initial request but not prior to the expiration of 60 days, the platform will have to close the account of such seller and prevent the seller from re-registering on the platform for a six-month period or withhold the payment of the consideration to the seller as long as the seller does not provide the information requested.

A Reporting Platform Operator will have to collect the required information, verify its accuracy and have it available by 31 December of the calendar year in respect of which reporting is being completed (the "Reportable Period"). As the DAC7 provisions apply as from 1 January 2023, the first Reportable Period will be the 2023 calendar year and the first due diligence duties will have to be completed by 31 December 2023. In that case, for sellers that were already registered on the platform as of 1 January 2023 or as of the date on which an entity becomes a Reporting Platform Operator, the due diligence procedures are required to be completed by 31 December of the second Reportable Period for the Reporting Platform Operator (i.e., 31 December 2024 in this case).

A Reporting Platform Operator will be allowed to rely on the due diligence procedures conducted in previous Reportable Periods, provided that the required information has been collected or verified within the last 36 months, and it does not have reason to know that the information collected has become unreliable or incorrect.

A Reporting Platform Operator will be allowed to designate another platform operator or a third party to assume the obligations with respect to due diligence procedures, but such obligations shall remain the responsibility of the Reporting Platform Operator. A Reporting Platform Operator will also be allowed to only complete the due diligence procedures for active sellers upon election. The procedure for such election will be determined by each member state when implementing DAC7.

b. Reporting duties

The information, as collected and verified, will have to be reported within one month following the end of the Reportable Period in which the seller is identified as a Reportable Seller (i.e., no later than 31 January 2024 if the seller is identified as a Reportable Seller in 2023).

Reporting will only be made in one member state (i.e., single reporting). A Reporting Platform Operator will report to the competent authority of the member state where it is tax resident, or where it does not have a residence for tax purposes in a member state, in the member state where it is incorporated or has its place of management (including effective management), or where it has a permanent establishment. In the event the platform is linked to more than one member state based on the above criteria, the Reporting Platform Operator will have to elect one member state to report in.

Where there is more than one Reporting Platform Operator, any of those Reporting Platform Operators shall be exempt from reporting the information if it has proof that the same information has been reported by another Reporting Platform Operator.

A Reporting Platform Operator which is a Foreign Platform shall report in the member state it is registered in.

The information to be reported, as listed in DAC7, will provide member states' tax administrations with sufficient information to correctly assess and control gross income earned in their countries from commercial activities performed with the intermediation of digital platforms. This information includes income earned by sellers of goods and services who make use of the platforms. Information about the consideration paid and other amounts will have to be reported based on the quarterly figures of each Reportable Period in which the consideration was paid or credited. The definition of the 'consideration' under DAC7 excludes any fees, commissions or taxes withheld or charged by the Reporting Operating Platform.

The Reporting Platform Operators will have to inform each individual concerned that information will be collected and reported to the competent authorities and to provide all information the data controllers are required to provide under the General Data Protection Regulation ("GDPR") before the information is reported.

Automatic exchange of information reported by Reporting Platform Operators

The information reported by Reporting Platform Operators will have to be exchanged by the competent authorities of the member states where the reporting has been made with the member states where the Reportable Seller is a resident and/or the immovable property is located within two months following the end of the Reportable Period (i.e., by the end of February).

Penalties for non-compliance at national level

Reporting Platform Operators will be subject to penalties applied by member states in the case that the obligations laid down in DAC7 are not respected. The penalties shall be effective, proportionate and dissuasive.

Currently, in Luxembourg the penalties for non-compliance with the CRS and DAC6 regulations amount to a maximum of 250,000 euros.

Other clarifying measures included in DAC7

DAC7 also amends existing provisions on exchange of information and administrative cooperation, notably in order to clarify some requirements.

Exchange of information upon request: conditions of the request

a. Group requests

Considering there is sometimes a need for issuing requests for information that concern groups of taxpayers which cannot be identified individually but are instead described by a common set of characteristics, DAC7 addresses the issue of group requests in the context of a request for information.

In that respect, DAC7 provides for the possibility for tax administrations to make group requests for information. In such a case, the requesting authority has to provide the requested authority with a set of information including a comprehensive description of the characteristics of the group and an explanation of the applicable law and of the facts and circumstances which led to the request.

b. Foreseeable relevance and exhaustiveness

The 'foreseeable relevance' of the information requested by one member state to another conditions whether or not the requested member state shall be required to comply with the request for information, and thus constitutes one of the legal bases of the information order addressed by that member state to a relevant person and of the penalty imposed on that person for failure to comply with the information order.

The aim of DAC7 is to clearly delineate the standard of foreseeable relevance, to ensure effectiveness of the exchanges of information and prevent unjustified refusals of requests, as well as to provide legal clarity and certainty to both tax administrations and taxpayers.

For those purposes, DAC7 provides for a definition of the standard of foreseeable relevance under which "*the requested information is foreseeably relevant where, at the time the request is made, the requesting authority considers that, in accordance with its national law, there is a reasonable possibility that the requested information will be relevant to the tax affairs of one or several taxpayers, whether identified by name or otherwise, and be justified for the purposes of the investigation*".

DAC7 also lays down procedural requirements which the requesting authority must observe. Thus, "with the aim to demonstrate the foreseeable relevance of the requested information, the requesting competent authority shall provide at least the following information to the requested authority:

- the tax purpose for which the information is sought; and
- a specification of the information required for the administration or enforcement of its national law".

DAC7 also details the information which the requesting authority shall provide where a request relates to a group of taxpayers who cannot be identified individually:

- a detailed description of the group;
- an explanation of the applicable law and of the facts based on which there is reason to believe that the taxpayers in the group have not complied with the applicable law;
- an explanation how the requested information would assist in determining compliance by the taxpayers in the group; and
- where relevant facts and circumstances related to the involvement of a third party that actively contributed to the potential non-compliance of the taxpayers in the group with the applicable law.

Automatic exchange of information: extension of the list of income subject to mandatory automatic exchange between member states

According to the EU Commission, information related to income derived from intellectual property should be exchanged between member states as this is predisposed to profit shifting arrangements due to its highly movable underlying assets. As a result, DAC7 adds royalties to the list of income subject to mandatory automatic exchange of information under DAC. Currently, this list contains income from employment, director's fees, life insurance products not covered by other EU legal instruments on exchange of information and other similar measures, pensions, and ownership of and income from immovable property.

Before 1 January 2024, member states shall inform the EU Commission of at least four categories of income listed in respect of which the competent authority of each member state shall, by automatic exchange, communicate information concerning residents in that other member state to the competent authority of any other member state. The information shall concern taxable periods starting on or after 1 January 2025.

Following this amendment, member states will be required to exchange all information available on at least four categories of income with other member states with respect to taxable periods as from 2024.

Joint Audits

DAC7 finally provides for the possibility for a competent authority of one or more member states to request the competent authority of another member state (or other member states) to conduct a joint audit. That request may however be rejected on justified grounds.

In order to ensure legal certainty, joint audits should be conducted in a pre-agreed and coordinated manner, and in accordance with the laws and procedural requirements of the member state where the activities of a joint audit take place. The audited person(s) shall be informed of the outcome of the joint audit, including a copy of the final report within 60 days of its issuance. In order to ensure legal certainty, the final report of a joint audit should reflect the findings the competent authorities concerned agreed on. Moreover, the competent authorities concerned could also agree that the final report of a joint audit includes any issues where an agreement could not be reached.

Your contacts for further information:

KEITH O'DONNELL
Managing Partner
keith.odonnell@atoz.lu

MARIE BENTLEY
Knowledge Director
marie.bentley@atoz.lu

Crypto assets in the focus of upcoming exchange of information (DAC8)

OUR INSIGHTS AT A GLANCE

- Crypto assets have seen an unprecedented rise over the last decade. The EU Commission recognised this trend and would like to ensure through additional exchange of information that investors in crypto assets pay their fair share of tax.
- As part of the Action Plan for Fair and Simple Taxation Supporting the Recovery, on 24 November 2020, the EU Commission published an Inception Impact Assessment concerning a potential future proposal for an EU Council directive amending DAC for the seventh time to strengthen existing rules and expand the exchange of information framework in the field of taxation to include crypto-assets and e-money (called "DAC8").
- At this stage, no draft directive proposal has been published yet. However, stakeholders were invited to provide input by the 21 December 2020 and have now until 2 June 2021 to submit comments in the framework of a public consultation, taking the form of a questionnaire, launched by the EU Commission.

Crypto currencies or crypto assets are digital assets that are exchanged between peers without the need of a third party such as a bank. It enables consumers to digitally connect directly through a transparent process, showing the financial amount, but not the identities of the people conducting the transaction.

Since the creation of Bitcoin in 2008, numerous new crypto currencies with different features have been created over the years. The total market capitalization of the crypto market recently exceeded USD 1 trillion with Bitcoin representing more than 60% of the market capitalization.

The tax treatment of capital gains depends on the tax rules applicable in the residence state of the investors. In Luxembourg, speculative capital gains realized by individuals within a 6-month period following the acquisition of the crypto assets are taxable, whereas capital gains realized after 6 months are not taxable.

The EU Commission seems to believe in the continued success of decentralized crypto assets as DAC8 aims at providing tax administrations with information to identify taxpayers who are investing in and using crypto assets. While most crypto exchanges are already subject to know your client ("KYC") and anti-money laundering ("AML") requirements, DAC8 will elevate exchange of information in the crypto space to a new level.

Administrative cooperation in the field of taxation

In the European Union ("EU"), member states have agreed to cooperate so as to be able to apply their taxes correctly to their taxpayers and combat tax fraud and tax evasion. Administrative cooperation in direct taxation between the competent authorities of the EU member states is based upon Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation ("DAC") which establishes all the necessary procedures, and provides the structure for a platform for the cooperation.

Since its adoption, DAC has been amended several times to include information on financial accounts (DAC2), on tax rulings and advance pricing agreements (DAC3), on country-by-country reports (DAC4), on beneficial ownership (DAC5) and on reportable cross border arrangements (DAC6). On 22 March 2021, the EU Council adopted a directive amending DAC once more to also include information on digital platforms (DAC7).

In this context and as part of the Action Plan for Fair and Simple Taxation Supporting the Recovery, on 24 November 2020, the EU Commission published an Inception Impact Assessment concerning a potential future proposal for an EU Council directive amending DAC for the seventh time to strengthen existing rules and expand the exchange of information framework in the field of taxation to include crypto-assets and e-money (called "DAC8"). At this stage, no draft directive proposal has been published yet. Stakeholders were invited to provide input by the 21 December 2020 and have now until 2 June 2021 to submit comments in the framework of a public consultation, taking the form of a questionnaire, launched by the EU Commission.

Purposes of the Impact Assessment

The EU initiative aims at improving cooperation between national tax authorities in newly developing areas as well as on existing matters.

The main problems that the initiative aims to tackle are double:

1. The lack of information at the level of national tax administrations about the emergent use of crypto-assets and e-money, possibly resulting in revenue losses also for the EU budget. In this respect, the initiative aims at providing tax administrations with information to identify taxpayers who are using new means of exchange, notably crypto-assets and e-money. It will also ensure consistency with ongoing work at EU level (such as the Digital Finance Strategy adopted on 24 September 2020 and the proposal for a Regulation on Markets in Crypto-assets) and at international level on the taxation on crypto-assets and e-money.

2. The disparity in the sanctions applied based on the current provisions and other necessary punctual adjustments/improvements to be made to DAC. The differences between EU member states with regard to the effectiveness of sanctions are still broad and therefore, should be addressed.

Exchange of information in regard to crypto-assets and e-money

The existing provisions of DAC, as amended by DAC2, provide for an obligation for financial intermediaries to report to tax administrations and for an exchange of information between EU member states. There is currently no such obligation for the relevant intermediaries to report crypto-assets and e-money. Overall, the level of tax transparency is very low in relation to these new technologies.

In the light of the exchange of information from financial institutions on financial accounts set up by DAC2, the EU Commission fears that the development of the crypto-assets and e-money leads to the erosion of the integrity of such exchanges as a tool in tackling offshore tax evasion. The compliance of crypto-assets and e-money institutions with the DAC2 exchange requirements is thus assessed and should be tackled by the ongoing Impact Assessment performed by the EU Commission. It should result either as a self-standing provision or as an extension to existing DAC2 provisions, or even both, in order to cover all the unique particularities of these instruments. The idea would be that crypto-assets and e-money are not treated more adversely and with greater burdens that regular financial services, which present similar opportunities for abuse.

As the objective of this initiative is to ensure adequate tax transparency, with a view to ensuring a proper taxation, the ongoing Impact Assessment will need to define crypto-assets in order to determine the material scope of the amendments to DAC as well as to identify the relevant intermediaries for tax, common reporting and due diligence purposes. The Impact Assessment will also consider which assets should be included (i.e., the so-called stablecoins and e-money), what data should be collected and exchanged among national tax administrations. The aim would be to collect only the data necessary to perform the risk analysis and facilitate tax control of the crypto-assets and e-money. The baseline scenario used as benchmark will consider the current national practices and legislation (where existing) on

mandatory transmission of data on crypto-assets and e-money to national tax authorities.

Outlook

Crypto assets have seen an unprecedented rise over the last decade. The EU Commission recognized this trend and would like to ensure through additional exchange of information that investors in crypto assets pay their fair share of tax.

Numerous institutional investors and multinational groups announced their investments in the crypto space which raises awareness, builds trust and, ultimately, should result in a more wide-spread use of crypto assets. Crypto assets became a store of value and a hedge against the inflation of Fiat currencies (USD, EUR, etc.) due to a massive expansion of currency supply by central banks.

Last but not least, the expected creation of central bank digital currencies (that could be combined with a social credit score system[2]), replacing cash, will likely be another trigger for people to look more seriously into crypto assets.

Your contacts for further information:

OLIVER R. HOOR
Partner, Head of Transfer Pricing & the German Desk
oliver.hoor@atoz.lu

MARIE BENTLEY
Knowledge Director
marie.bentley@atoz.lu

[2] https://blogs.imf.org/2020/12/17/what-is-really-new-in-fintech/

Luxembourg: a new hub for fintech businesses and issuers willing to use new technologies for issuing their securities?

OUR INSIGHTS AT A GLANCE

- The law of 22 January 2021 modifying the law of 5 April 1993 on the financial sector and the law of 6 April 2013 on dematerialised securities was adopted (the "Law") with the aim to modernise the legal framework for dematerialised securities.
- The Law forms part of a continued modernisation of the legal framework of financial transactions and is a continuation of the law of 1 March 2019, stating in essence that account keepers may hold securities accounts and register securities within or through secure electronic recording systems, including distributed ledgers or databases.
- This initiative supports the players concerned and, more generally, the attractiveness of the financial place in the digitalisation and use of new technologies in the field of issuance and circulation of dematerialised securities.
- The Law introduces changes regarding issuance accounts and it broadens the scope of entities able to act as central account keepers for debt securities.

The law of 22 January 2021 modifying the law of 5 April 1993 on the financial sector and the law of 6 April 2013 on dematerialised securities was adopted (the "Law") with the aim to modernise the legal framework for dematerialised securities. This Law forms part of a continued modernisation of the legal framework of financial transactions and is a continuation of the law of 1 March 2019, stating in essence that account keepers may hold securities accounts and register securities within or through secure electronic recording systems, including distributed ledgers or databases. This initiative supports the players concerned and, more generally, the financial place in the digitalisation and use of new technologies in the field of issuance and circulation of dematerialised securities.

The Law is an important new step for the Luxembourg financial centre in its desire to meet the challenges and opportunities resulting from the digitalisation of the financial sector in order to enable it to position itself actively in relation to recourse to secure electronic recording mechanisms in the issuance of securities.

Two material changes are introduced.

Issuance accounts

It is necessary to keep a record of the number and type of dematerialised securities. The issuance or conversion of dematerialised securities is carried out by registering the securities in an issuance account held with a settlement institution or a central account holder. The dematerialised securities are represented by an entry in the securities account. The issuance account is not a securities account. The issuance account enables verification that in the securities account there are not more securities in circulation than securities issued.

By means of a clarification of the legal definition of issuance accounts, the Law expressly recognises the ability to use new technologies to secure electronic records, such as distributed ledger technology or electronic databases, as part of the issuance of dematerialised listed and unlisted securities.

As per this definition, an issuance account is an account held with a settlement provider or central bookkeeper which allows for the recording of dematerialised securities by secured electronic recordings (including distributed ledger technology). The Law highlights the technological neutral character of this new framework. This novelty allows for a variety of technologies to be adopted.

Opening of the activity of central account keeper

Before the adoption of the Law, the activity of central account keeper was restricted to certain Luxembourg service providers, provided that a specific license to allow performance of this function is obtained.

For non-listed debt securities, the Law opens access to the activity of central account keeper to investment firms and credit institutions of European Member States.

Since the opening of the role of central account keeper to new players should not give rise to a lower quality of services provided by these new actors, they are required to have adequate control and security systems in place for the issuance accounts in order to ensure the registration of the integral amount of the issued securities, the circulation of securities and the verification of the issuance amounts in the issuance account against the securities accounts of the holders.

Your contacts for further information:

JEREMIE SCHAEFFER
Partner, Head of Asset Management Advisory & Corporate Implementation
jeremie.schaeffer@atoz.lu

HERVÉ PRECIGOUX
Director
herve.precigoux@atoz.lu

CONTACT US

NORBERT BECKER
Chairman
Phone +352 26 940 400
Mobile +352 661 830 400
norbert.becker@atoz.lu

FATAH BOUDJELIDA
Managing Partner-Operations
Phone +352 26 940 283
Mobile +352 661 830 283
fatah.boudjelida@atoz.lu

KEITH O'DONNELL
Managing Partner
Phone +352 26 940 257
Mobile +352 661 830 203
keith.odonnell@atoz.lu

JAMAL AFAKIR
Partner, Head of International & Corporate Tax
Phone +352 26 940 640
Mobile +352 661 830 640
jamal.afakir@atoz.lu

JEREMIE SCHAEFFER
Partner, Head of Asset Management Advisory & Corporate Implementation
Phone +352 26 940 517
Mobile +352 661 830 517
jeremie.schaeffer@atoz.lu

CHRISTOPHE DARCHE
Partner, Head of Corporate Finance
Phone +352 26 940 588
Mobile +352 661 830 588
christophe.darche@atoz.lu

OLIVER R. HOOR
Partner, Head of Transfer Pricing & the German Desk
Phone +352 26 940 646
Mobile +352 661 830 600
oliver.hoor@atoz.lu

THIBAUT BOULANGE
Partner, Head of Indirect Tax
Phone +352 26 940 270
Mobile +352 661 830 182
thibaut.boulange@atoz.lu

JEAN-MICHEL CHAMONARD
Partner
Phone +352 26 940 233
Mobile +352 661 830 233
jean-michel.chamonard@atoz.lu

NICOLAS CUISSET
Partner
Phone +352 26 940 305
Mobile +352 661 830 305
nicolas.cuisset@atoz.lu

PETYA DIMITROVA
Partner
Phone +352 26 940 224
Mobile +352 661 830 224
petya.dimitrova@atoz.lu

ANTOINE DUPUIS
Partner
Phone +352 26 940 207
Mobile +352 661 830 601
antoine.dupuis@atoz.lu

CONTACT US

HUGUES HENAFF

Partner

Phone +352 26 940 516
Mobile +352 661 830 516
hugues.henaff@atoz.lu

OLIVIER REMACLE

Partner

Phone +352 26 940 239
Mobile +352 661 830 230
olivier.remacle@atoz.lu

ROMAIN TIFFON

Partner

Phone +352 26 940 245
Mobile +352 661 830 245
romain.tiffon@atoz.lu

GAEL TOUTAIN

Partner

Phone +352 26 940 306
Mobile +352 661 830 306
gael.toutain@atoz.lu

SAMANTHA SCHMITZ

Chief Knowledge Officer

Phone +352 26 940 235
Mobile +352 661 830 235
samantha.schmitz@atoz.lu

MARIE BENTLEY

Knowledge Director

Phone +352 26 940 903
Mobile +352 661 830 048
marie.bentley@atoz.lu

HOLLY WHATLING

Marketing Director

Phone +352 26 940 916
Mobile +352 661 830 131
holly.whatling@atoz.lu

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ATOZ

TAX ADVISERS LUXEMBOURG

Aerogolf Center 1B, Heienhaff I L-1736 Senningerberg
Phone (+352) 26 940-1

www.atoz.lu

TAXAND