ATOZ

TAX ADVISERS LUXEMBOURG

INSIGHTS

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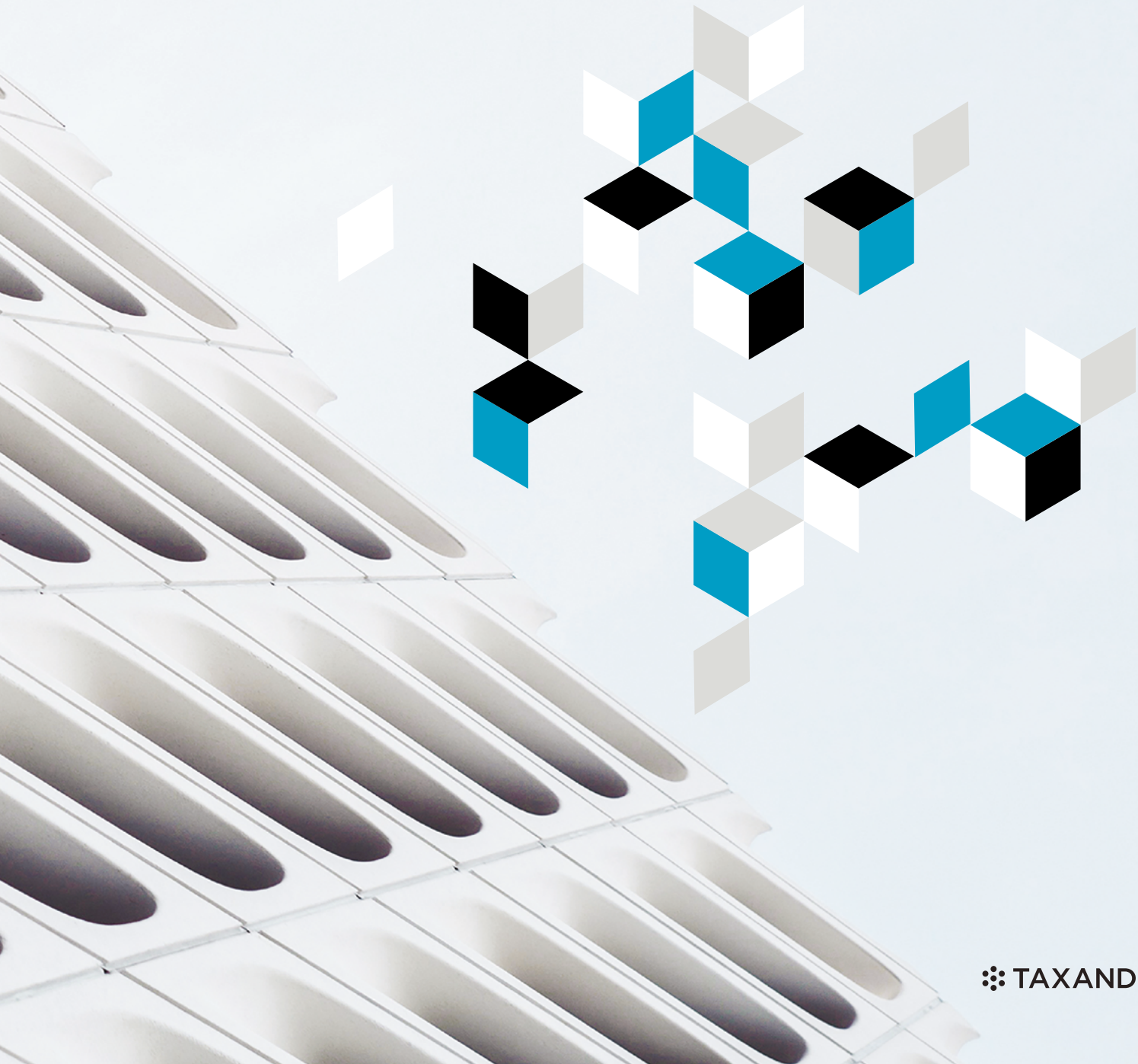

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EDITORIAL

Greetings,

Despite the unprecedented times we are facing, legal life goes on and the Luxembourg government keeps working either to execute its international commitments, or to help Luxembourg taxpayers and entities in facing the COVID-19 crisis.

On 21 March 2020, the DAC6 law was passed by the Luxembourg Parliament, implementing the EU Directive regarding the mandatory exchange of information in the field of taxation in relation to reportable cross-border arrangements. In this edition of ATOZ Insights, we present the new obligations of Luxembourg intermediaries in this area and introduce our IT solution, helping to ensure compliance and coordinate intermediaries, DAC6Connect.

On 4 March 2020, the Luxembourg tax authorities released the first Circular in relation to the various ATAD measures implemented in Luxembourg, dealing with CFC rules. The Luxembourg CFC rules were introduced as of 1 January 2019. Here we detail the guidance and examples provided in the CFC Circular.

On 30 March 2020, a draft law was presented to Parliament in order to amend the Luxembourg corporate income tax law so as to deny, in Luxembourg, the deduction of certain expenses directed to entities established in blacklisted jurisdictions. We explain the proposed new measure and its application.

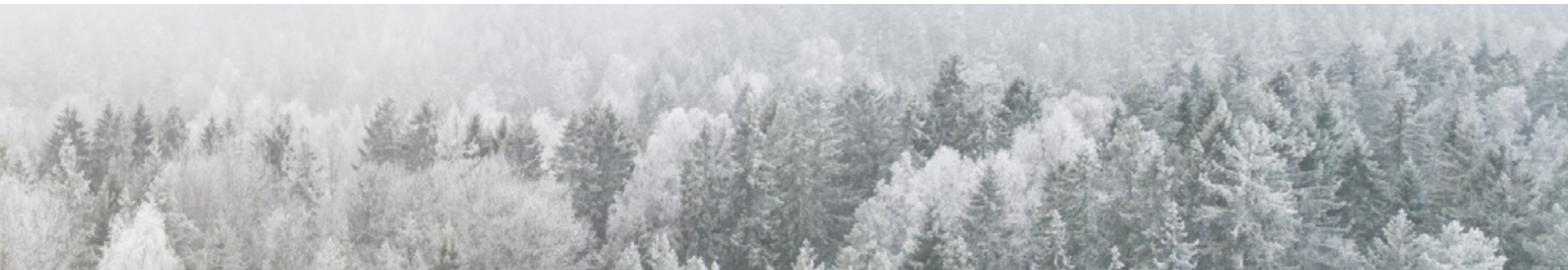
On 20 February 2020, a draft law was presented to Parliament introducing some amendments to the Luxembourg legislation governing CRS and FATCA. The draft law aims to rectify some elements in respect of which the "Global Forum on Transparency and Exchange of Information for Tax Purposes" considered that the Luxembourg legislation was not compliant with the CRS norms. We explain these amendments and their consequences.

Over the past weeks, the Luxembourg Government has been taking measures to deal with the spread of the Coronavirus and guarantee the continuity of the Luxembourg economy. We detail the measures taken for Luxembourg taxpayers, the financial sector, Luxembourg corporate entities, and cross-border workers.

From a case law point of view, we analyse the opinion of the Advocate General of the CJEU on the BlackRock case, in which, the decision to be released by the CJEU may have a significant impact on the VAT position of Luxembourg fund managers. We also analyse the potential impact of the San Domenico Vetraria SpA case in which the CJEU confirmed that the reimbursement of costs in relation to an employee on secondment falls within the scope of VAT.

We hope you enjoy reading our insights.

The ATOZ Editorial Team



DAC6 - Luxembourg implements the New Reporting Obligations of Tax Intermediaries

OUR INSIGHTS AT A GLANCE

- On 21 March 2020, the Luxembourg Parliament passed the law implementing the EU Directive of 25 May 2018 regarding the mandatory exchange of information in the field of taxation in relation to reportable cross-border arrangements ("DAC6")
- As expected, the wording of the law largely resembles the wording of DAC6 and the commentaries to the draft law provide few explanations on how it will be interpreted and applied in practice. Therefore, some of the rather vague terms and concepts used in DAC6 will continue to give rise to uncertainty and will require further interpretation
- The investments and business activities of Luxembourg companies often have a cross-border dimension. In these cases, the question needs to be answered as to whether a particular piece of advice, or involvement in implementation, is reportable
- The new reporting requirements will apply as from 1 July 2020. Nonetheless, cross-border arrangements whose first step was implemented between the date of entry into force of DAC6 (i.e. 25 June 2018) and the date of application of this law (1 July 2020) will also be reportable by 31 August 2020. Thus, as expected, any cross-border arrangement designed and/or promoted since 25 June 2018 is potentially reportable under DAC6, and intermediaries would need to take adequate measures in this respect

On Saturday 21 March 2020, the Luxembourg Parliament passed the law implementing the Council Directive (EU) 2018/822 of 25 May 2018 ("DAC6") regarding the mandatory exchange of information in the field of taxation in relation to reportable cross-border arrangements.

As expected, the wording of the law largely resembles the wording of DAC6 and the commentaries to the draft law provide few explanations on how it will be interpreted and applied in practice. Therefore, some of the rather vague terms and concepts used in DAC6 will continue to give rise to uncertainty and will require further interpretation.

The investments and business activities of Luxembourg companies often have a cross-border dimension. In these cases, the question needs to be answered as to whether a particular piece of advice, or involvement in implementation, is reportable. This article provides a clear and concise overview of the new mandatory disclosure regime and the mechanism that triggers reporting obligations.

What type of arrangements will need to be reported?

Under the law, EU tax intermediaries such as tax advisers, accountants and lawyers who design and/or promote tax planning schemes will have to report potentially aggressive tax planning cross-border arrangements to the tax authorities.

The term "arrangement" may also include a series of arrangements, and an arrangement may comprise of more than one step. Hence, the understanding of the term within the meaning of the law is very broad. An arrangement is considered as cross-border if it concerns either (i) more than one EU Member State, or (ii) an EU Member State and a third country.

Cross-border arrangements may be reportable if they contain at least one of the hallmarks listed in an annex to the law. These hallmarks describe characteristics or features of cross-border arrangements that might present an indication of a potential risk of tax avoidance.

Certain hallmarks must fulfil a Main Benefit Test ("MBT"). The law provides that this test will be satisfied if "it can be established that the main benefit or one of the main benefits which a person may reasonably expect to derive from an arrangement, having regard to all relevant facts and circumstances, is the obtaining of a tax advantage."

The law shall apply to all "direct" taxes of any kind levied by or on behalf of a Member State or the Member State's territorial or administrative subdivisions, including the local authorities, but also by a third country. However, this law shall not apply to value-added tax and customs duties, nor to excise duties covered by other EU legislation on administrative cooperation between Member States. This law shall also not apply to compulsory social security contributions.

What hallmarks are used to determine reportable cross-border arrangements?

Hallmarks are divided into two categories: generic and specific. Generic hallmarks target features that are common to promoted schemes, such as the requirement for confidentiality or the payment of a premium fee. Generic hallmarks can be used to capture new and innovative tax planning arrangements as well as mass-marketed transactions that promoters may easily replicate and sell to a variety of taxpayers.

Specific hallmarks are used to target known vulnerabilities in the tax system and techniques that are commonly used in tax avoidance arrangements such as the use of loss creation, leasing and income conversion schemes.

The law follows the logic of DAC6 and sets out the following five categories of hallmarks:

- general hallmarks linked to the MBT;
- specific hallmarks linked to the MBT;
- specific hallmarks related to cross-border transactions;
- specific hallmarks concerning automatic exchange of information and beneficial ownership; and
- specific hallmarks concerning transfer pricing.

Neither the law nor the commentaries to the draft law provide much explanation on the interpretation of these hallmarks. However, given that the mandatory disclosure regime (DAC6) is inspired by the Final Report on BEPS Action 12 (Mandatory Disclosure Rules) that is also referred to in the commentaries to the draft law, the guidance provided in this Report may be a useful source of interpretation.

What is the Main Benefit Test?

Many of the hallmarks set out in the annex to the law are subject to an additional threshold test. This means that many of the hallmarks only trigger a reporting obligation when an arrangement meets the MBT, reducing the risk of excessive or defensive filings. This should enhance the usefulness of the information collected because the focus will be on arrangements that have a higher probability of truly presenting a risk of tax avoidance.

As mentioned above, the MBT is fulfilled if "it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage." Hence, this test compares the value of the expected tax advantage to any other benefits likely to be obtained from the transaction.

According to the Final Report on BEPS Action 12, the MBT sets a relatively high threshold for disclosure. In practice, arrangements may not meet the MBT if the taxpayer can demonstrate that the value of any tax benefits was incidental when viewed in light of the commercial benefits of the transaction as a whole. Moreover, cross-border arrangements are generally taxpayer and transaction specific and not widely promoted as domestically marketed schemes.

It is interesting to note that DAC6 explicitly states that the tax treatment of a cross-border payment at the level of the recipient cannot alone be a reason for concluding that an arrangement satisfies the MBT. Thus, it does not matter per se (i) if the jurisdiction of the recipient of a payment does not impose any corporate tax or imposes corporate tax at a rate of zero or almost zero or (ii) if the payment benefits from a full exemption or (iii) a preferential tax regime. Likewise, the "converting income scheme" hallmark is subject to the MBT despite investors may benefit from a full tax exemption (suggesting that a tax exemption does not, on its own, suffice for the MBT to be met).

Taxpayers are generally free to choose the option that results in the lowest tax liability including, amongst others, the choice of financing instruments (be it equity or debt) and, in an EU context, the choice of the EU Member State in which an entity is established and managed (also referred to as freedom of establishment). On the contrary, investment managers and multinationals have a fiduciary duty towards their investors to not pay more taxes than legally due (considering all applicable tax laws). Thus, the very fact that there exists an alternative that gives rise to a higher effective tax rate cannot inform the analysis of the MBT unless it can be established that the tax advantage defeats the object or purpose of the applicable tax law.

When there is a series of arrangements, the MBT should be applied in regard to the series of arrangements rather than singling out one specific arrangement. In addition, when a new arrangement is included in a series of arrangement, it should be the series of arrangements that is tested for the purposes of the MBT.

Overall, the MBT comes down to the assessment as to whether an arrangement or a series of arrangements is tax driven (i.e. targeting a tax benefit that is not ancillary to the commercial benefit) or the tax advantage is ancillary to the main benefit of generating on-going income and benefiting from value appreciation at the end of the investment (the latter can be referred to as optimising the tax position in accordance with all applicable tax laws).

Last but not least, the EU Anti-Tax Avoidance Directives ("ATAD I & II") required EU Member States to implement a number of anti-abuse rules in their domestic tax laws as from 2019 including hybrid mismatch rules, interest limitation rules, controlled foreign company ("CFC") rules, a general anti-abuse rule ("GAAR") and exit tax rules. Thus, explicit rules exist in all the areas that have been identified as critical and taxpayers can merely comply with the applicable rules rather than taking advantage of loopholes that may otherwise meet the MBT.

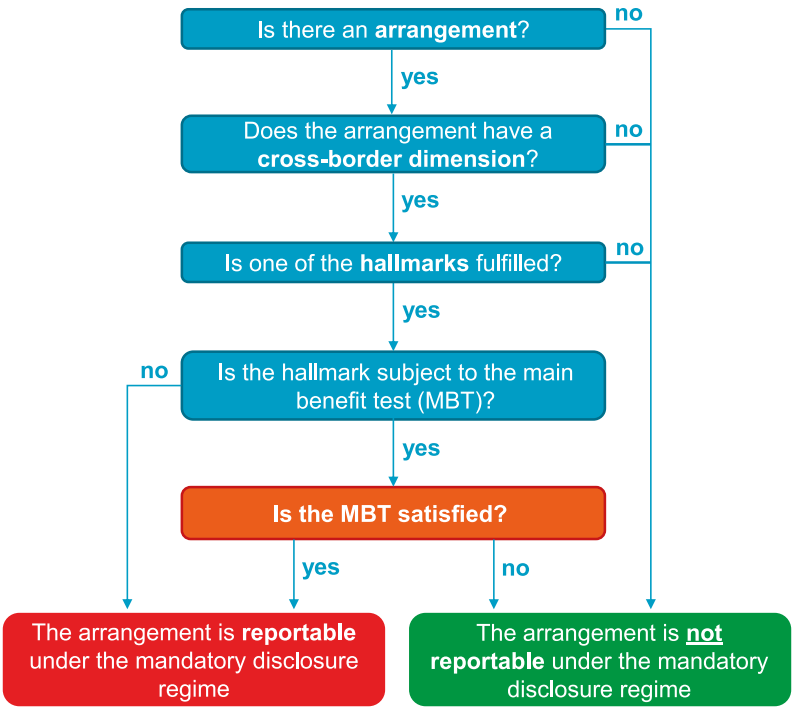
How are reportable cross-border arrangements determined?

When determining whether advice on a particular arrangement is reportable under the mandatory disclosure regime, it is first necessary to analyse whether the arrangement has a cross-border dimension, and then whether one of the hallmarks is present.

When at least one of the hallmarks is fulfilled, it is necessary to verify whether the hallmark is subject to the MBT. If this is not the case, there is an automatic reporting obligation under the mandatory disclosure regime. When the hallmark is subject to the MBT, it is necessary to perform a comprehensive analysis of all relevant facts and circumstances in order to determine whether the main benefit or one of the main benefits was the obtaining of a tax advantage.

Given that many of the hallmarks and the application of the MBT require a good understanding of international tax law and some kind of judgement, the analysis of potential reporting obligations under the mandatory disclosure regime is generally not the role of a person with a risk management profile but requires the involvement of a person with a tax background.

The analysis to be performed is depicted in the checklist below:



Which information will need to be reported?

If a cross-border arrangement is treated as reportable under the law, the information to be communicated to the Luxembourg tax authorities shall contain the following, as applicable:

- the identification of intermediaries and relevant taxpayers;
- details on the hallmarks that make the cross-border arrangement reportable;
- a summary of the content of the reportable cross-border arrangement;
- the date on which the first step in implementing the reportable cross-border arrangement was made or will be made;
- details of the national provisions that form the basis of the reportable cross-border arrangement;
- the value of the reportable cross-border arrangement;
- the identification of the Member State of the relevant taxpayer(s) and any other Member States which are likely to be concerned by the reportable cross-border arrangement; and
- the identification of any other person in the Member State, if any, likely to be affected by the reportable cross-border arrangement.

The information reported under the law to the Luxembourg authorities can be used for taxation purposes, for tax collection purposes and for the verification of the Common Reporting Standard (CRS") reporting duties.

Who will be subject to reporting?

The reporting responsibilities regarding cross-border arrangements generally rest with the intermediary unless such reporting would be a breach of the intermediary's legal professional privilege. In the latter case, the intermediary should notify any other intermediary or, if there is no such intermediary, the relevant taxpayer, that the reporting obligation would then fall on them.

An intermediary is defined as any person that designs, markets, organises or makes available for implementation or manages the implementation of a reportable cross-border arrangement.

The circle of intermediaries further includes any person that knows, or could be reasonably expected to know, that they have undertaken to provide (directly or by means of other persons) aid, assistance or advice with respect to designing, marketing, organising, making available for implementation or managing the implementation of a reportable cross border arrangement.

Accordingly, the definition of intermediaries envisages two distinct types of intermediaries:

(I). Primary intermediaries that are involved in designing, marketing, organising or managing the implementation of an arrangement; and

(II). Secondary intermediaries who provide aid, assistance or advice in relation to the designing, marketing, organising or implementation of reportable cross-border arrangements.

It follows that the understanding of the concept of intermediary is very broad and may include, in particular, tax advisers, lawyers, financial advisers and accountants. However, as the case may be, other service providers such as consultants, banks, insurance companies or investment managers may qualify as intermediaries within the meaning of the MDR.

This broad definition of the term "intermediary" will likely result in overlapping reporting obligations. According to the law, when there is more than one intermediary, the obligation to file information on the reportable cross-border arrangement lies with all intermediaries involved. Intermediaries should only be exempt from their reporting obligations to the extent they can prove that the same arrangement has already been reported by another intermediary. In addition, Luxembourg tax intermediaries are exempt from reporting if they can prove that the same cross-border arrangement has already been reported in another EU Member State.

Thus, it does not suffice to prove that another intermediary has committed to do the reporting: it is necessary to prove the effective reporting by another intermediary. This obviously requires a certain extent of coordination between advisers in order to determine whether or not a cross-border arrangement is reportable and, if so, to ensure that only one intermediary files a report so as to avoid multiple filings in relation to the same arrangement. Here, taxpayers will have at a minimum to coordinate between the different intermediaries involved (in different EU Member States) in a cross-border arrangement.

In practice, it may often not be self-evident whether or not a service provider is an intermediary. This is all the more true in case of secondary intermediaries that are only remotely involved in a transaction. Intermediaries are not, however, expected to do significant extra due diligence to establish whether there is a reportable arrangement. Intermediaries are further not expected to start investigations into arrangements that they are merely aware of.

In these circumstances, the defence for service providers that they did not know and could not reasonably be expected to know that they were part of a reportable arrangement may often be validly put forward since a service provider might only be involved in a particular part of a wider arrangement, such as a bank providing finance or facilitating payments.

The reporting obligations under the law are limited to intermediaries that have a link to the EU based on tax residency, incorporation, etc. Hence, non-EU intermediaries do not have any reporting obligations under the law. In these circumstances, a potential reporting obligation would be shifted to the taxpayer benefiting from the cross-border arrangement.

Likewise, when there is no tax intermediary because, for instance, the taxpayer designs and implements a scheme in-house, the reporting obligation stays with the taxpayer who benefits from the arrangement.

Who will have the right to benefit from the professional secrecy limitation?

According to the law, lawyers subject to the law of 10 August 1991, chartered accountants subject to the law of 10 June 1999 and auditors subject to the law of 23 July 2016 may rely on their professional secrecy and have the right to a waiver from filing information on a reportable cross-border arrangement. Nevertheless, this waiver applies only to the extent that lawyers, chartered accountants and auditors act within the limits of their own profession.

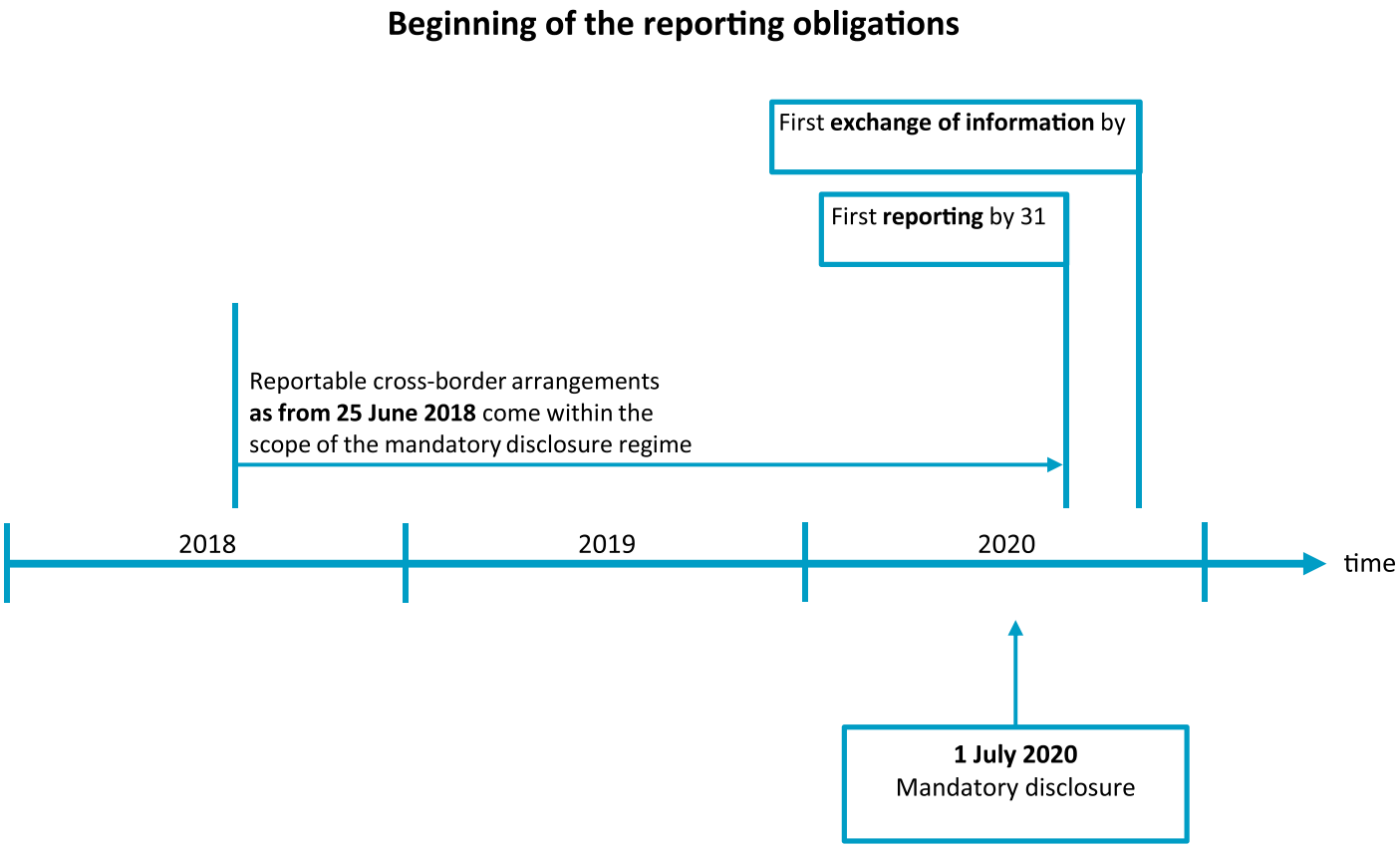
In such circumstances, lawyers, chartered accountants and auditors acting as intermediary in the sense of the law must notify their waiver within 10 days to any other intermediary or, if there is no such intermediary, to the relevant taxpayer. In this case, the obligation to file information on a reportable cross-border arrangement will lie with the other notified intermediary, or, if there is no such intermediary, with the relevant taxpayer.

When will the reporting have to be performed?

Intermediaries, or the relevant taxpayers, will have to report to the Luxembourg tax authorities within the following time limits:

- periodic reporting every 3 months when cross-border arrangements are designed, marketed, ready for implementation or made available for implementation without a need to be substantially customised;
- within 30 days beginning on the day after the reportable cross-border arrangement is made available for implementation, or on the day after the reportable cross-border arrangement is ready for implementation, or when the first step in the implementation of the reportable cross-border arrangement has been made, whichever occurs first;
- within 30 days beginning on the day after aid, assistance or advice is provided by an intermediary, directly or by means of other persons;
- by 31 August 2020 for reportable cross-border arrangements whose first step was implemented between 25 June 2018 and 30 June 2020;
- for each of the years for which the taxpayers use their arrangements, each relevant taxpayer is required to file information about such use in its annual tax return. The local tax authorities will have to automatically exchange the information received within one month from the end of the quarter in which the information was filed. The first information shall be exchanged by 31 October 2020.

The beginning of the reporting obligations is depicted in the following chart:



What are the sanctions for default?

The law introduces fines of up to EUR 250,000 for intermediaries and taxpayers who fail to comply with their reporting obligations in Luxembourg. The maximum amount of the fines corresponds to the amounts applicable in cases of non-compliance with FATCA (the amended law dated 18 December 2015), the CRS, and with the law dated 23 December 2016 on country-by-country reporting.

The Luxembourg tax authorities will verify whether tax intermediaries and taxpayers adopt a process for insuring compliance with the mandatory disclosure regime (article 16 (1) of the law). Such mandatory disclosure regime process should ideally be formalised in a policy that may provide guidance for employees, set out responsibilities and consider practical aspects, such as how the reporting is managed from an operational perspective.

Based on experience, it can be assumed that the Luxembourg tax authorities will levy measured penalties in case of wrongdoing (for example, in case of CRS or FATCA reporting), taking into consideration the level of care taken by the tax intermediaries and taxpayers. When tax intermediaries and taxpayers use their best efforts and dedicate appropriate resources to the implementation of an MDR process (including training of staff) and its systematic application, there should be limited risk of penalties. However, in the absence of any efforts to comply with the MDR, it may be expected that Luxembourg tax authorities will levy penalties.

An appeal against the fine is available to the intermediary or to the relevant taxpayer.

Next steps

The new reporting requirements will apply as from 1 July 2020. Nonetheless, cross-border arrangements whose first step was implemented between the date of entry into force of DAC6 (i.e. 25 June 2018) and the date of application of this law (1 July 2020) will also be reportable by 31 August 2020. Thus, as expected, any cross-border arrangement designed and/or promoted since 25 June 2018 is potentially reportable under DAC6, and intermediaries would need to take adequate measures in this respect.

The analysis of potential reporting obligations under the new mandatory disclosure regime will necessarily become an integral part of each and every tax analysis. This on its own will have the desired deterrence effect as both tax intermediaries and taxpayers will need to carefully consider potential reporting obligations.

With the law being voted, tax intermediaries and taxpayers are now in a position to prepare themselves for the new reporting obligations. In this regard, it would be wise to allocate a person with a good understanding of (international) taxation to the task, develop internal guidelines and processes, train staff involved and analyse potentially reportable cross-border arrangements as from 25 June 2018 to clear the backlog.

Ultimately, despite the fact that we are currently witnessing an unprecedented situation with the global pandemic of COVID-19 that will surely have a severe impact on the world economy and an immediate effect on how business is conducted in an environment of social distancing, taxpayers and intermediaries would be wise to consider 1 July 2020 (the date the MDR enters into force) and 30 August 2020 (filing of reports regarding arrangements that have been implement as from 25 June 2018) as relevant dates.

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Luxembourg tax authorities release Circular on Luxembourg CFC rules

OUR INSIGHTS AT A GLANCE

- On 4 March 2020, the Luxembourg tax authorities released a Circular on the CFC rules introduced as of 1 January 2019 following the implementation of ATAD into Luxembourg law
- The Luxembourg CFC rules provide that a Luxembourg corporate taxpayer or a Luxembourg permanent establishment of a non-Luxembourg tax resident entity will be taxed on the non-distributed income of an entity or permanent establishment which qualifies as a CFC provided that the non-distributed income arises from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage
- The Circular aims at clarifying the scope and the practical application of the new CFCs legislation. Although it brings some useful guidance as to how the rules should be applied in giving some examples, some important questions still remain to be clarified
- In addition, the Circular introduces additional documentation requirements for the taxpayer with respect to its CFCs
- Finally, the Circular emphasises the fact that any restructuring aimed at avoiding the application of the CFCs rules not supported by valid economic reasons will be considered as an abuse of law in the meaning of §6 of the Tax Adaptation Law

On 4 March 2020, the Luxembourg tax authorities released a Circular on the CFC rules (article 164ter of the Income Tax Law) introduced as of 1 January 2019 following the implementation of ATAD into Luxembourg law ("the Circular").

Article 164ter of the Income Tax Law («ITL») provides that a Luxembourg corporate taxpayer (within the meaning of article 159 ITL) or a Luxembourg permanent establishment of a non-Luxembourg tax resident entity (article 160, subparagraph 1 ITL) will be taxed on the non-distributed income of an entity or permanent establishment which qualifies as a CFC provided that the non-distributed income arises from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage.

No CFC rules existed in Luxembourg prior to the introduction of article 164ter ITL. As any new legislation introduced for the first time and for which no case law exists, the CFC rules raise questions regarding their scope and application. The Circular provides useful guidance and examples with respect to the application of some of the key concepts used by the legislator, such as the concept of control, associated enterprises definition and the computation of the applicable 25% threshold for associated enterprises, the effective taxation test and the meaning of distributed income. The Circular does not however provide sufficient clarification on the very important concept of "non-genuine arrangements". In addition, some practical examples on the computation of the Luxembourg tax on the CFC income for the effective taxation test as well as on the Luxembourg tax treatment of the CFC income included in the Luxembourg taxable basis of the taxpayer would have been useful.

It is important to notice that the Circular introduces additional documentation requirements for taxpayers with respect to their CFCs and emphasises the fact that any restructuring aimed at avoiding the application of the CFCs rules not supported by valid economic reasons will be considered as an abuse of law in the meaning of §6 of the Tax Adaptation Law.

CFC definition

A CFC is an entity or a permanent establishment of which the profits are either not subject to tax or exempt from tax in Luxembourg provided that the two cumulative tests are met: the control test and the effective taxation test.

The Circular specifies that a partnership established in another jurisdiction and considered as a permanent establishment of the Luxembourg corporate taxpayer may also qualify as a CFC if the two tests are met.

- **1st condition: The control test**

In the case of an entity, the Luxembourg corporate taxpayer by itself, or together with its associated enterprises:
a) holds a direct or indirect participation of more than 50% of the voting rights; or
b) owns directly or indirectly more than 50% of capital (commenting on «directly OR indirectly», the circular clarifies that both direct and indirect participations have to be added in order to determine whether the 50% requirement is met or not); or
c) is entitled to receive more than 50% of the profits of the entity.

The Circular specifies that the control requirement covers both the legal control (direct or indirect capital ownership and direct or indirect voting rights) and the economic control (entitlement to profits, i.e. dividends, capital gains on the sale of the shares in the CFC, liquidation proceed) and that the control condition can be met at any time in the course of the concerned tax year (thus, the situation is not analysed at a specific point in time, like at tax year-end).

It further specifies that in case the CFC owns some of its own shares, this portion of the participation has to be excluded when determining whether the control test is met or not. The same applies to shares of the CFC held by a subsidiary of the CFC (an illustrative example is provided in this respect).

Several taxpayers may meet the control test at the same time if one of the taxpayers holds more than 50% of the voting rights and another one holds a participation in the capital of more than 50% (without voting right but with an entitlement to more than 50% of the profits). In such case, both taxpayers will be considered as controlling the CFC.

The control test has to be analysed based on the substance over form approach in line with §11 of the Tax Adaptation Law.

Control within the meaning of article 164ter ITL is the direct and indirect control. It is specified that holding of a participation through a partnership is to be considered as a direct participation in proportion of the participation held in the partnership. Here, in order to compute the direct holding percentage, only the participation in the net assets of the partnership is to be considered, irrespective of the economic rights embedded into the partnership agreement.

Finally, the Circular provides that any restructuring aimed at reducing the level of control of the Luxembourg taxpayer over the CFC so as to be out of the scope of the CFC rules without any valid commercial reasons which reflect economic reality will be qualified as an abuse of law to the extent that the conditions of §6 of the Tax Adaptation Law are met.

- **2nd condition: The effective taxation test**

In addition to the control requirement, article 164ter ITL requires that the following additional condition is met: the actual corporate tax paid by the entity or permanent establishment is lower than the difference between:
(a) the corporate tax that would have been charged in Luxembourg; and
(b) the actual corporate tax paid on its profits by the entity or permanent establishment.

It means that the actual tax paid is less than 50% of the tax that would have been due in Luxembourg. The Circular clarifies that the contribution to the unemployment fund is not taken into account. Given the currently applicable corporate income tax rate of 17%, the CFC rule will only apply if the taxation of the profits at the level of the CFC is lower than 8.5% applied on the taxable basis determined under the Luxembourg tax rules.

When assessing the actual tax paid by the CFC, only taxes that are comparable to the Luxembourg corporate income tax are to be considered. If the amount of foreign tax is not in EUR, it has to be converted into EUR using the exchange rate as of the end of the tax year.

It is only the tax effectively paid that is to be taken into account. If the CFC receives a reimbursement of the tax paid or if the assessed tax is not recovered by the local tax authorities, the actual tax of the CFC is to be reduced accordingly.

Upon request, Luxembourg taxpayers will have to provide tax assessments of the CFC, proofs of payment of the tax or any other official document issued by the State of residence or establishment of the CFC to demonstrate the amount of tax effectively paid.

The amount of actual tax of the CFC may however not be available at the time the CFC rules will be applied in Luxembourg. Unfortunately, the Circular does not provide any further clarification as to how the taxpayer is supposed to apply the effective taxation test in this case. In our view and for practical reasons, the effective taxation test should be applied based on the estimated tax of the CFC.

The Circular explains how to compute the Luxembourg tax on the CFC income under the Luxembourg tax rules and states that all taxable income of the CFC has to be taken into account to make this simulation (so, not only the non-distributed income arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage).

Based on the Circular, the Luxembourg tax on the CFC income is to be computed in application of the provisions of the Luxembourg ITL (including the provisions of article 114 ITL on the use of the tax losses). It is however not clear whether article 164ter ITL will need to be applied at the level of the CFC in order to determine the Luxembourg tax on the CFC income.

It is only reinforced that a permanent establishment of the CFC which is exempt from tax in the CFC's jurisdiction is not to be taken into account to compute the actual tax paid by the CFC. This is to avoid to increase the tax rate of the CFC by taking into account the actual tax paid by the permanent establishment which may be highly taxed in its country of establishment. However, the income of a PE that is not exempt in the CFC's jurisdiction and which is included in the taxable basis of the CFC has to be taken into account.

The Circular does not give any example of computation of the Luxembourg tax on the CFC income. We can also wonder how the Luxembourg tax on the income of the CFC of a taxpayer with a specific tax regime in Luxembourg (eg. SICAR) will be computed. Should the specific tax rules of the taxpayer be applied to the CFC income for the purposes of the effective taxation test? In our view, this should be the case as the aim of the computation is to compare the taxation at CFC level with the one which would have been applied in Luxembourg, had the Luxembourg taxpayer received the income directly.

Situations out of the scope of the CFC rules

CFCs with accounting profits of no more than EUR 750,000 based on the commercial balance sheet (determined under accounting standards recognized in Luxembourg, including IFRS) are excluded from the scope of the CFC rules based on article 164ter ITL.

In the same way, CFCs of which the accounting profits amount to no more than 10% of its operating costs for the tax period are excluded from the scope of the CFC rules. The Law specifies that costs of goods sold outside of the residence or establishment State of the CFC as well as payments to associated enterprises are not taken into account in the operating costs. The Circular gives some examples of operating costs to be considered: distribution costs, payroll costs, administrative costs or rents. The Circular further explains that this exemption is intended to exclude CFCs performing low value-adding services such as administrative functions, local marketing and distribution, call centers or data processing.

Finally, here again, the Circular provides that any restructuring aimed at reducing the profits of the CFC so as to be out of the scope of the CFC rules without any valid commercial reasons which reflect economic reality will be qualified as an abuse of law to the extent that the conditions of §6 of the Tax Adaptation Law are met.

Concept of associated enterprise

The control test requires analysing whether the Luxembourg corporate taxpayer by itself or together with its associated enterprises has a minimum direct or indirect participation in the entity.

Article 164ter ITL provides the following definitions of the term "associated enterprises":
a) entities in which a taxpayer directly or indirectly holds a participation of at least 25% in terms of voting rights or capital ownership, or is entitled to receive at least 25% of an entity's profits
b) individuals or entities that directly or indirectly hold a participation in the Luxembourg corporate taxpayer of at

least 25% in terms of voting rights or capital ownership, or are entitled to receive at least 25% of the taxpayer's profits.

If an individual or an entity holds, directly or indirectly, 25% or more in the voting rights or the share capital of a taxpayer and of other entities, all entities including the taxpayer are considered as associated enterprises. In that regard, the term "entity" includes corporate and transparent entities, irrespective of whether they are tax resident in Luxembourg or abroad.

The Circular provides the following additional information on how to analyse the associated enterprise criteria:

- It can be met at any time in the course of the concerned tax year (thus, the situation is not analysed at a specific point in time, such as at tax year-end) and it does not matter for how long.
- For the determination of 25% threshold, the indirect participation has to be added to the direct participation (the indirect participations being obtained by multiplying the holding percentages along the chain with each other according to article 164ter al. 2 ITL).
- For the computation of the 25% threshold, own shares held by the Luxembourg taxpayer or by the CFC have to be excluded. In addition, when determining the shareholding link between the taxpayer and the CFC or an individual, the participation in the taxpayer or in the CFC held by a subsidiary of the taxpayer or the CFC have to be excluded.
- The Circular provides that the concept of associated enterprise within the meaning of article 164ter ITL is a concept which differs from the related party concept within the meaning of article 56 ITL.

Finally, here again, the Circular provides that any restructuring aimed at reducing the association link without any valid commercial reasons which reflect economic reality will be qualified as an abuse of law to the extent that the conditions of §6 of the Tax Adaptation Law are met.

The Circular provides some examples on how to apply the control test and the associated enterprise test.

Undistributed income arising from non-genuine arrangements

Any income distributed by the CFC to the taxpayer during the same tax year (be it an interim dividend distribution during the course of the tax year concerned or a distribution of profits following the allocation of past profits) has to be deducted from the taxable CFC income. One important clarification in the Circular is that the same treatment applies to both ordinary dividend distributions and hidden dividend distributions.

Article 164ter al 3 ITL provides that the CFC income needs to be distributed to the taxpayer in order to be excluded from the CFC taxable income. If the income has been distributed by the CFC to an intermediary entity only it will however be included in the taxable CFC income if it arises from non-genuine arrangements which have been put in place for the essential purposes of obtaining a tax advantage. In this context the Circular adds that if the income has been distributed to a tax transparent entity directly held by the taxpayer, the income is deemed distributed to the taxpayer and therefore excluded.

On the concept of non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage, the Circular only adds to the definition included in article 164ter ITL that the CFCs concerned are the ones which, based on the assets owned, the functions performed and the risks assumed would not be in a position to generate on their own the profits at stake. One could have expected some additional guidance and practical examples on this concept.

Determination of the CFC income to be included and tax treatment applicable

- **First limit**

Amounts to be included are only the ones generated by the assets and risks linked to the significant people functions carried out by the Luxembourg taxpayer. In this respect, the Circular provides that the taxpayer will have to annually prepare an analysis of the significant people functions linked to the assets owned by the CFC which

generate all, or part of, its income and the associated risks and which are instrumental in generating the CFC's income.

The Circular further specifies that the net CFC income to be included in the taxable basis of the taxpayer is to be determined based on the arm's length principle of articles 56 and 56bis ITL and that the CFCs rules are intended to complement the Luxembourg transfer pricing rules.

Here, no further clarification is provided on the concept of significant people functions and the interaction between the Luxembourg transfer pricing rules and the CFCs rules.

However, we understand that the tax authorities are imposing an additional documentation requirement, not required by the law, according to which a transfer pricing analysis following the OECD guidelines has to be performed for each of the CFCs of the taxpayer and which has to be updated on an annual basis. Based on the Circular, even though the taxpayer does not assume any people function generating the CFC's income, a transfer pricing documentation would need to be available and updated on an annual basis.

Should we also understand that if the functions and risks assumed by the taxpayer are properly remunerated under articles 56 and 56bis ITL, no CFC income should be included in addition in the taxable basis of the taxpayer? The Circular does not give a clear answer to this question. However, in our opinion, to the extent that the CFC rules are intended to be anti-abuse rules, if the income generated by the functions, assets and risks is already included in the taxable basis of the taxpayer no further adjustment would need to be performed under the CFC rules. There is no abuse in such a situation and otherwise, a double taxation would arise. This could be demonstrated in a transfer pricing study.

When determining the taxable CFC income, deductible expenses are only the ones in economic connection with the income to be included.

The Circular provides an example on how to compute the CFC income to be included and how to make the computation in case the CFC makes losses. In accordance with article 164ter al. 4 ITL the CFC losses are only deductible against the CFC profits. Further, only the CFC losses realised after the implementation of the CFC rules are to be considered, i.e. as from 1 January 2019. CFC losses can be carried forward on future CFC profits without any time limit.

- **Second limit**

The income to be included in the tax base shall further be computed in proportion to the taxpayer's participation in the CFC (direct and indirect but excluding the participation controlled through associated enterprises). For the computation of the participation level, own shares held by the CFC or shares held by a subsidiary of the CFC have to be excluded.

If the taxpayer holds e.g. 60% of the shares but 70% of the voting rights, 70% of the CFC income will have to be included (because the higher rate is taken into account).

In case the taxpayer having the control over the CFC changes in the course of a specific tax year, the CFC income will be included in proportion to the time period during which the participation was held by the taxpayer in the year concerned.

Even though not specifically mentioned, based on the examples and the text of both article 164ter ITL and the Circular, it seems that the two limits are to be applied successively, i.e. first we have to determine the amount of income generated by the assets and risks linked to the significant people functions carried out by the taxpayer and to that amount we have to apply the second limit of ownership in the CFC.

Once the CFC income to be included is determined in application of the two limits above, the Circular provides that at the level of the taxpayer this income will range in the category of commercial income irrespective of the qualification given to it at the level of the CFC. However, no example or further comment is provided regarding the tax treatment of the income at the level of the taxpayer.

One may expect that the CFC income should be treated as if it was the income of the tax payer and be taxable depending on its nature, i.e. interest income should be fully taxable and taken into account for the determination of the exceeding borrowing costs under article 168bis ITL, dividend income could be exempt under the Luxembourg participation exemption regime, income from securities may be exempt under the Luxembourg SICAR regime if the taxpayer is a SICAR.

Avoidance of double taxation

Article 164ter ITL provides for rules that aim to avoid the double taxation of CFC income (for example, when CFC income is distributed or a participation in a CFC is sold). The Circular provides that these rules do not apply if the dividend or the capital gain is exempt in Luxembourg (e.g. under the Luxembourg participation regime).

Based on articles 134bis and 134ter ITL, the foreign tax in relation to the portion of the income to be included, including withholding tax, is creditable on the Luxembourg tax computed on the included CFC income. The non-creditable amount (in proportion to the participation) is deductible but cannot be reimbursed.

Conclusion

The introduction of CFCs rules is creating substantial complexity for Luxembourg taxpayers. Running a CFC analysis and transfer pricing analysis if CFCs are identified on an annual basis significantly increases the tax compliance burden of taxpayers and very often for no result if the conclusion at the end is that the CFC rules do not apply or no CFC income is to be included in the Luxembourg taxable basis of the Luxembourg taxpayer if he is not involved in any function that may generate income outside of Luxembourg. There is no clarity yet on the tax filing obligations related to the CFC rules, but this is expected to come with the release of the 2019 form 500 F.

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New measure denying the tax deduction of interest and royalties to entities in blacklisted jurisdictions

OUR INSIGHTS AT A GLANCE

- On 30 March 2020, a draft law was presented to Parliament which amends the Luxembourg corporate income tax law so as to deny, in Luxembourg, the deduction of certain expenses directed to entities established in blacklisted jurisdictions
- The measure to be introduced by the draft law will apply as from 1 January 2021. It provides that interest and royalties paid or due by Luxembourg corporate taxpayers will no longer be tax deductible in Luxembourg if the beneficial owner of the interest or royalty is a collective undertaking (within the meaning of article 159 of the Luxembourg corporate income tax law ("ITL")) established in a non-cooperative jurisdiction for tax purposes
- The analysis of the impact of this new measure on structures with entities located in non-cooperative jurisdictions still depends on evolving factors, including a potential amendment of the list of non-cooperative jurisdictions before the new measure enters into force
- Awaiting these clarifications, Luxembourg taxpayers with investments into and from non-cooperative jurisdictions such as the Cayman Islands should seek advice from their tax adviser in order to analyse the potential impact of the new provisions on their investments, shareholders or lenders/bondholders and take action, if necessary

On 30 March 2020, a draft law amending the Luxembourg corporate income tax law so as to deny, in Luxembourg, the deduction of interest and royalty expenses directed to entities in non-cooperative jurisdictions was presented to Parliament.

The draft law amends one of the corporate income tax law provisions (article 168 ITL), meaning that the new measure only deals with the tax deductibility at the level of Luxembourg corporate taxpayers and will not apply to individuals.

Background

On 18 February 2020, the EU Council updated the EU list of non-cooperative tax jurisdictions by adding the Cayman Islands, Palau, Panama and Seychelles.

As of 27 February 2020 (date of the latest update of the list), the list included the 12 following jurisdictions: American Samoa, the Cayman Islands, Fiji, Guam, Oman, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, the US Virgin Islands and Vanuatu.

The EU Council regularly reviews and updates the list, 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 such list.

In parallel, the Council produced a guidance on further coordination of national defensive measures in the tax area towards non-cooperative jurisdictions in December 2019 and invited EU Member States to apply one of the following legislative defensive measures in taxation vis-à-vis the listed jurisdictions as of 1 January 2021, with the aim of encouraging those jurisdictions' compliance with the Code of Conduct screening criteria on fair taxation and transparency:

- non-deductibility of costs
- CFC rules
- withholding tax measures
- limitation of the participation exemption on profit distributions

The Luxembourg Government decided to introduce the first of these measures, i.e. the non-deductibility of costs.

Presentation of the new measure

As from 1 January 2021, interest and royalties paid or due will no longer be tax deductible, if the following cumulative conditions are met:

- the beneficiary of the interest or royalty is a collective undertaking within the meaning of article 159 ITL (which means that tax transparent partnerships are out of scope); 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 list of non-cooperative countries and territories

Interest and royalties will 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.

Interest is defined as follows: «Interest paid or due relating to debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and, in particular, interest from bonds or debentures, including premiums and prizes attaching to such securities. Penalties for late payments shall not be regarded as interest payments.»

Royalty is defined as follows: «Remuneration of any kind paid or due as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.»

These 2 definitions are largely inspired by the definitions included in the EU Interest and Royalty Directive and in the OECD Model Tax Convention.

Timing for application

The new measure will apply to interest and royalties paid or due as from 1 January 2021.

The list of non-cooperative jurisdictions to be taken into account and applied as from 1 January 2021 will be proposed by the Government later on and will be annexed to the above provision. It will reflect the situation as of the date of the proposal based on the latest EU list available at that time.

The commentary to the draft law states that the Luxembourg Government intends to present the list at the time the 2021 budget will be presented to Parliament (which generally occurs each year in October). In this respect, please note that the next update of the EU list is also supposed to take place in October 2020.

Updates of the blacklist

Once a year, the Government will propose an update of the list which will correspond to the latest EU list available in the Official Journal of the EU at the time of the update proposal.

- The countries which will be added will be taken into account for interest and royalties paid or due as from 1 January of the following year (i.e. there will be no retroactive nor immediate effect but only an impact as from the following calendar year)
- The countries which have been removed will no longer be taken into account for interest and royalties paid or due as of the date of the publication of the relevant EU list in the Official Journal (i.e. the removal will apply immediately)

The draft law and the related commentary provide some examples on the effect of adding or removing a specific country from the list.

Implications

Since the EU blacklist evolves over time and some jurisdictions (such as the Cayman Islands) may have already adopted measures which could be assessed as sufficient from an EU

point of view, it is possible that such jurisdictions will no longer be on the list to be presented by the Luxembourg Government and to be taken into account as from 2021.

Therefore, the analysis of the impact of this new measure on structures with entities located in non-cooperative jurisdictions still depends on evolving factors which remain to be clarified. Awaiting these clarifications, Luxembourg taxpayers with investments into and from non-cooperative jurisdictions such as the Cayman Islands should seek advice from their tax adviser in order to analyse the potential impact of the new provisions on their investments, shareholders or lenders/bondholders and take action, if necessary.

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New CRS and FATCA legislation: A real change?

OUR INSIGHTS AT A GLANCE

- On 20 February 2020, a draft law was presented to Parliament which introduces some amendments to the Luxembourg legislation governing CRS ("Common Reporting Standards") and FATCA ("Foreign Account Tax Compliance Act"), the two sets of rules dealing with the Automatic Exchange of Information in Luxembourg
- The changes to be introduced with effect as from next year are of importance since Luxembourg reporting financial institutions will be subject to additional obligations and lump sum penalties in case of non-compliance
- The draft law aims to rectify some elements in respect of which the "Global Forum on Transparency and Exchange of Information for Tax Purposes" considered that the Luxembourg legislation was not compliant with the CRS norms
- The automatic exchange of information is more than ever at the heart of the concerns of regulators in most developed countries. It can be anticipated that the tax authorities will be uncompromising in respect to the compliance with the rule and will henceforth have a scale of penalties at their disposal that they will apply rigorously if the market players do not meet the expected level of compliance

In our November 2019 ATOZ blog (Upcoming FATCA - CRS Issues: What the Alternative Fund Industry Needs to Know), we noted that the Luxembourg tax authorities more frequently controlled the correct application of the FATCA (Foreign Account Tax Compliance Act) and CRS (Common Reporting Standards) rules and financially sanctioned proven breaches with increasingly dissuasive fines, whether for delays or for absence of FATCA and CRS reporting (including «zero-reports» under FATCA). More recently, for some service providers, we also witnessed controls on the related documentation and processes implemented by financial institutions in this respect. Thus, it appears that the tax authorities (Administration des Contributions Directes) request all FATCA - CRS procedures from institutions, as well as the self-certification documentation collected from their clients and counterparties.

In our aforementioned previous blog, we insisted on the fact that compliance with these rules is, both from a reputational and a financial point of view, a major issue for the financial sector, especially for the alternative investment fund sector. We also noted with regret that, despite the years that have elapsed since the implementation of these rules, today they still present some technical or educational challenges for clients and their investors.

The introduced changes

On 20 February 2020, the Luxembourg Government proposed a draft law amending the FATCA and CRS rules as from 1 January 2021. Even though it is still draft legislation at this stage, it seems appropriate to us to take stock of the "changes" introduced in order to analyse the current trends and "state of mind" of the tax authorities that this draft law reflects in terms of exchange of information.

The changes resulting from this draft law can be summarised as follows:

- Even in the absence of reportable accounts, a CRS report must be filed
- The necessary documentation must be kept during a time period of 10 years
- The amounts of lump sum penalties applicable in case of absence of reports are specified
- The powers of control of the tax authorities and the type of documents required are specified

It appears that the real changes resulting from the draft law are only few, apart from the obligation to file zero CRS reports. Still, since 2019, the tax authorities already require financial

institutions to produce such reports. The other amendments provide some details, not on the new obligations applicable to financial institutions, but on the administrative practice in terms of control and on the applicable penalties.

What do these changes tell us about the current environment?

The explanatory statement of the draft law provides useful elements to understand the state of mind of the tax authorities. It states that the draft law aims to rectify some elements in respect of which the "Global Forum on Transparency and Exchange of Information for Tax Purposes" considered that the Luxembourg legislation was not compliant with the CRS norms.

Therefore, the pressure comes from the OECD and this draft law confirms how seriously the authorities consider the assessment of their legislative framework by third parties. It also confirms that the effectiveness of the exchange of information constitutes an objective criterion of assessment of Luxembourg.

The fact that the Luxembourg authorities provide themselves a legislative framework for some provisions / penalties that could have been enacted through a circular is extremely questionable. Obviously, should the draft law be adopted in its current form, the tax authorities will not be able to ignore their commitment and it will be necessary to carry out the controls set out.

One should also keep in mind that these controls have already started and apply to a scope which is much broader than the only reporting, as they apply to the whole "production" chain, starting from the documentation collected from clients. It becomes crucial for the industries affected by those rules to determine the concrete actions to be taken in order to anticipate the strengthening of controls.

Actions to be taken

Most umbrella funds of alternative investment funds are financial institutions within the meaning of FATCA and CRS. The General Partner of funds and the funds themselves are subject to all requirements imposed by these laws, in terms of both reporting (i.e. all the mechanisms used to transmit information to the foreign authorities adhering to the automatic exchange of information) and "due diligence" (i.e. all the documents and information collected by financial institutions on investors and used for the exchange of information).

As mentioned in our previous blog, the collection of self-certification documents by managers is turning out to be difficult and is, still today, often incomplete. The reasons for these difficulties are well-known and stem essentially from the limited knowledge of these regulations and from the fact that some financial institutions do not perform any consistency checks.

As the review/control of these documents becomes absolutely certain in the end, it is necessary to strengthen the documentation procedures at the level of the financial institutions.

What is often perceived as a mere KYC-like collection of documentation turns out to be, in reality, a complete tax analysis that can only be carried out by automatic exchange of information specialists. Since the draft law is expected to come into force in January 2021, 2020 will have to be devoted to the complete review of documents and procedures in anticipation of future controls.

It is crucial that financial institutions meet their due diligence obligations, but also implement the necessary procedures and secure the production of FATCA and CRS reports. Ultimately, all the participants involved in the back, middle and front office functions of these entities must be aware of the existence of these procedures and apply them at their level.

FATCA and CRS reports are indirectly the result of the collection of information during the due diligence process. The accuracy of reports therefore depends on the quality of the information collected, but also on the effective monitoring of information on payment flows to investors. If the documentation is properly collected and the flows are accurately identified, the production of FATCA and CRS reports will become "trivial".

In view of the accumulation of compliance obligations for traditional investment structures, the real challenge is of course to comply with these multiple obligations, while ensuring that the teams in charge in the field can continue to fulfil their other related responsibilities. This is possible, but only as part of a consistent strategy that is recognised as such by all stakeholders.

A typical alternative investment fund structure involves many entities: one or more General Partner(s), one or more fund(s), intermediary holding companies and investment vehicles. It is necessary for management teams to have mapped all the vehicles of their group as well as the reporting obligations of each of these vehicles. This exercise implies the implementation of procedures at the level of the group of financial institutions. These procedures become essential to organise the issue but also as a means of proof to be transmitted to the tax authorities.

Our experience has shown us that managers have registered entities with the IRS (Internal Revenue Service), de facto qualifying these entities as reporting financial institutions. In the event of failure to produce FATCA and CRS reports, these entities may be subject to fines of up to a lump sum of ten thousand euros per missing report. With such a financial challenge, the mapping exercise becomes crucial for the groups concerned.

Holding companies and target companies set up by alternative investment funds are financial institutions by default. However, they may qualify as non-financial entities if certain conditions are met. In this case, for these entities, the draft law does not introduce any change with regard to their current “obligations” and practices.

What adjustments should be made as priority?

The automatic exchange of information is more than ever at the heart of the concerns of regulators in most developed countries. The tax authorities’ reactivity to respond to the OECD pressure in this matter is enlightening.

We consider that it is important to understand the implicit message in the draft law of 20 February. The tax authorities will be uncompromising in respect to the compliance with the rule and will henceforth have a scale of penalties at their disposal that they will apply rigorously if the market players do not meet the expected level of compliance.

In addition, a targeted investment in the consistency and quality of the procedures implemented will not only ensure that an appropriate response to the tax authorities’ controls can be delivered, but will also enable the teams in charge to carry out their multiple missions in the most efficient way, without having to do things as they come along in a constantly changing environment.

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COVID-19: Luxembourg introduces positive measures for businesses and individuals

OUR INSIGHTS AT A GLANCE

- Over the past weeks, the Luxembourg Government has been taking several measures to deal with the spread of the Coronavirus and to guarantee the continuity of the Luxembourg economy
- On 17 March 2020, as part of the implementation of these measures, the Luxembourg tax authorities made several positive announcements for Luxembourg taxpayers
- During the following days, considering the development of the COVID-19 crisis, a number of additional measures and communications were issued to the attention of the financial sector
- On 26 March 2020, a draft law was presented to Parliament which extends certain deadlines relating to accounting obligations of entities of the financial sector, including inter alia SICARs, SIFs, UCIs Part II and RAIFs in order to take into account the exceptional circumstances caused by COVID-19
- One day later, another draft law was released which extends the deadlines for the filling and publication of annual accounts, consolidated accounts and related reports during the state of crisis
- On 7 April 2020, the Government also presented a draft law addressing the extension of deadlines in fiscal, financial and budgetary matters in the context of the state of COVID-19 crisis to Parliament
- Finally, the Luxembourg Government anticipated the potential negative tax implications for cross-border workers who have to work from home during the COVID-19 crisis and managed to reach an agreement with Belgium, France and Germany

Covid-19: Positive tax measures for Luxembourg companies

On 17 March 2020, the Luxembourg tax authorities made several positive announcements for Luxembourg taxpayers. In addition, the Luxembourg Government anticipated the potential negative tax implications for cross-border workers who have to work from home during the COVID-19 crisis and started negotiations with Belgium, France and Germany.

Luxembourg individual and corporate taxpayers who are experiencing liquidity problems due to Covid-19 and have business income, income from agriculture and forestry or income from independent professional services may request:

- a cancellation of the quarterly advances of (corporate) income tax and municipal business tax in relation to the 1st and 2nd quarters of 2020. However, it is not possible to cancel the net wealth tax advances. The form to be used for the request is available here.
- an extension of 4 months of the deadline for the payment of (corporate) income tax, municipal business tax and net wealth tax. This extension is only possible for taxes with a due date as from 1 March 2020, meaning that an extension is not possible if the due date was 29 February 2020 or earlier. The form to be used for the request is available here.

It is important to note that even though the request for cancellation and/or extension has to be (briefly) justified, the cancellation/extension will be accepted automatically by the Luxembourg tax authorities, which means that the tax authorities will not assess how significant the liquidity issues of the taxpayer are.

As a last measure, the deadline for filing the tax returns has been extended to 30 June 2020. This applies to both individual and corporate taxpayers.

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COVID-19: New draft law to extend deadlines in fiscal matters

On 8 April 2020, Luxembourg Parliament released the draft law n°7555 addressing the extension of deadlines in fiscal, financial and budgetary matters in the context of the state of COVID-19 crisis. The draft law follows the newsletter released by the Luxembourg tax authorities on 17 March 2020 which deals with the cancellation of tax advances and the extension of deadlines for the filing of tax returns (for more details, please click here), but has a broader scope.

The purpose of the draft law is to introduce, for a limited period of time, a certain number of deadline extensions for certain legislative provisions in fiscal, financial and budgetary matters. However, the draft law does not cover the deadlines applicable in respect of indirect taxes such as VAT (filing of tax returns and recapitulative statements which are not covered by informal announcements by the Administration de l'Enregistrement, des Domaines et de la TVA, and deadlines for appealing against amending assessment or automatic taxation).

The main provisions related to fiscal matters are:

Tax returns

- The deadline for filing the 2019 income tax, corporate income tax and municipal business tax returns is extended to 30 June 2020 (§167 (3) AO).
- The deadline for opting for the individual taxation (as the collective taxation applies by default to partners and married couples) or for amending or cancelling the choice originally made is extended to 30 June 2020.
- In respect of the 2019 tax year, the deadline until which a beneficial owner can opt for a 20% final withholding tax is extended from 31 March 2020 to 30 June 2020. According to Article 6bis, n°2, 2nd indent of the amended law of 23 December 2005 introducing a final withholding tax on savings income (so-called *RELIBI* Law), beneficial owners of

interest on savings income paid by certain paying agents established outside Luxembourg, can opt for a final withholding tax of 20% instead of being taxed on an assessment base.

Administrative and judicial proceedings

- The 3-month deadline applicable to «réclamations» (§ 228 AO) is suspended from 18 March 2020 until 30 June 2020.
- The 3-month deadline applicable to «recours hiérarchiques formels» (§ 237 AO) is also suspended from 18 March 2020 until 30 June 2020.

These measures follow the Grand Ducal Decree dated 25 March 2020 suspending the deadline prescribed in the proceedings before the constitutional, judicial, administrative courts during the crisis.

Statute of limitation

- Statutes of limitation («délais de prescription») ending on 31 December 2020 will be extended to 31 December 2021. This will apply to any type of statute of limitation and will apply for all taxes payable to the Treasury as well as for all tax receivables, the collection of which is entrusted to the Administration des Contributions Directes.

Privileges and guarantees

- The privileges and guarantees provided for by the provisions of the amended law of 27 November 1933 concerning the collection of direct taxes whose effects cease before 31 December 2020 are extended to 31 December 2021.

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Covid-19: Positive measures for cross-border workers

The protocols to the double tax treaties concluded by Luxembourg with Belgium, France and Germany provide rules allowing cross-border workers to perform their activity 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 could 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 started negotiating with the 3 countries in order to reach an agreement according to which the days spent outside of Luxembourg due to the current crisis would not be taken into account.

Following these negotiations, on 16 March 2020, the Belgian and Luxembourg authorities agreed that the current crisis constitutes a case of force majeure, for which no days are to be counted under the 24-day rule. Therefore, it was decided that, as of 14 March 2020 and until further notice, the presence of a worker at home, in particular to carry out telework, would not be taken into account in the calculation of the 24-day period.

On 19 March 2020, France and Luxembourg reached the same agreement according to which, as of 14 March 2020 and until further notice, the presence of a worker at home, in particular to carry out telework, will not be taken into account in the calculation of the 29-day period.

Finally, on 3 April 2020, Germany and Luxembourg agreed that as of 11 March 2020, any working day spent at home due to the current crisis would be considered as a working day spent in the country in which the employee usually performs his/her activity (i.e. in the employment State). This measure will apply until 30 April 2020 and will be automatically renewed from month to month until it is terminated by one of the 2 countries.

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COVID-19: New measures for Luxembourg investment funds

Considering the development of the COVID-19 crisis, a number of new measures and communications have been issued to the attention of the financial centre over the past days and weeks.

Business continuity plans

On 22 March 2020, the Commission de Surveillance du Secteur Financier ("CSSF") urged all supervised entities to immediately review their current organisational set-up to ensure that:

- the least possible staff has to travel to, and work from, their usual workplace or back-up site. The deployment of staff members to the usual workplace or back-up site should be limited to vital functions that are essential to maintain the critical mission of supervised entities for them to remain operational provided that these functions cannot be performed remotely;
- where staff is not equipped with laptops or other mobile devices, entities implement desktop and other remote access solutions, cloud based or not, as soon as possible.

Previously, the CSSF advised professionals to activate their business continuity plans and to use, where appropriate, other production sites in or outside Luxembourg. To guarantee a rapid and efficient implementation of such measures, no prior authorisation from the CSSF is required. Simultaneously, the European Securities and Markets Authority ("ESMA") is making the same recommendation to all financial market participants to ensure operational continuity in line with regulatory obligations.

Good governance

For good governance purposes, the Grand-Ducal Regulation of 20 March 2020 introduced measures in order to provide mechanisms enabling companies and other legal persons to hold shareholder and board meetings without having to be physically present. These measures apply with immediate effect.

As a result, companies can, despite any contrary provision in their articles of association, whatever the expected number of participants at the general meeting, hold any general meeting without a physical meeting, and can require their shareholders and other participants to participate in the meeting and to exercise their rights exclusively:

- remotely, by a vote in writing or in electronic form, provided that the full text of the resolutions or decisions to be taken has been published or communicated to the participants;
- through a proxy appointed by the company; or
- by video conference or other means of telecommunication allowing identification of the participants.

The same rule applies to meetings of management bodies such as boards of directors, boards of managers and supervisory boards. Such meetings may be held, and resolutions may be passed by way of:

- written circular resolutions; or
- video conference or any other means of telecommunications allowing the identification of participants.

This emergency system will thus allow the bodies of any company or legal person to be able to hold their meetings without requiring the physical presence of their members while guaranteeing their effective participation and the exercise of their rights. Participants through such means will be considered present for the purposes of determining the quorum and majorities.

Furthermore, concerning the holding of annual general meetings, companies and other legal persons may, notwithstanding any contrary provision in their articles of association, convene them on a date which falls:

- 6 months after the end of their financial year; or
- until 30 June 2020.

On 21 April 2020, the Luxembourg Parliament released a new draft law extending the effects of the Grand-Ducal Regulation dated 20 March 2020 to shareholder and board meetings held after the end of the state of crisis when the notice convening the meeting was sent at the latest on the date of the end of the state of crisis.

The Grand-Ducal Regulation of 20 March 2020 does not deal with the fiscal consequence of holding meetings remotely. From a tax point of view, this may indeed shift the place of effective management of a company outside Luxembourg. Thus, a Luxembourg company may become taxable in the jurisdiction in which the place of effective management is located (in accordance with an applicable tax treaty).

As this situation may last for several months (also depending on the evolution of the COVID-19 outbreak in different jurisdictions), it should be considered to organise board of director meetings in Luxembourg with the physical presence of Luxembourg resident directors on Luxembourg soil (the board of director meeting could be held via conference call or video conference). Non-Luxembourg resident directors may dial-in but should ideally not intervene and instead provide a proxy to the Luxembourg resident directors that can represent the non-resident directors. In some cases, short-term changes in regard to the composition of the board of directors might be considered such as appointing additional Luxembourg directors to a board of directors. Unfortunately, this is not a purely Luxembourg-specific question.

However, on 3 April 2020, the OECD Secretariat released an analysis of potential tax issues linked to telework, individuals that are stranded in a country that is not their country of residence and travel restrictions. The main topics considered in the OECD paper include the potential impact on the tax residency of companies, potential permanent establishment issues and tax issues of cross-border workers. According to the OECD, it is unlikely that the COVID-19 situation will create any changes to an entity's residence status under a tax treaty. A temporary change in location of the chief executive officers and other senior executives is considered as an extraordinary and temporary situation due to the COVID-19 crisis and such change of location should not trigger a change in residence (in particular, when the corporate tie-breaker rule is applied). According to the OECD, all relevant facts and circumstances should be examined to determine the "usual" and "ordinary" place of effective management, and not only those that pertain to an exceptional and temporary period such as the COVID-19 crisis.

While this OECD guidance is positive with respect to the extraordinary situation in the COVID-19 environment, taxpayers should also consider how substance was organised before the pandemic crisis. Given that it cannot be expected that tax authorities will become more relaxed with respect to substance after the COVID-19 crisis (in view of all the costs linked to the emergency packages implemented by countries around the globe), if there are areas of improvement taxpayers would be wise to consider adjustments.

Reporting and management

ESMA recommends issuers to disclose any relevant significant information concerning the impacts of COVID-19 on their fundamentals, prospects or financial situation in accordance with their transparency obligations under the Market Abuse Regulation as soon as possible. In addition, issuers should provide transparency on the actual and potential impacts of COVID-19, to the extent possible based on both a qualitative and quantitative assessment of their business activities, financial situation and economic performance in their 2019 year-end financial report if these have not yet been

finalised or otherwise in their interim financial reporting disclosures. Finally, asset managers should continue to apply the requirements on risk management and react accordingly.

ESMA has also issued a decision temporarily requiring the holders of net short positions in shares traded on a European Union ("EU") regulated market to notify the relevant national competent authority ("NCA") if the position reaches or exceeds 0.1% of the issued share capital. As no competent authorities have adopted sufficient measures to increase their visibility of the evolution of net short positions activity through the establishment of lower reporting thresholds, ESMA considered that lowering the reporting thresholds should ensure that all national competent authorities across the EU and ESMA have the best possible data set available to monitor the market trends and enable themselves and ESMA to take further measures, if necessary.

Finally, the CSSF granted an extension of four additional weeks for the submission of the 2019 Survey related to the fight against money laundering and terrorist financing. Consequently, the new deadline for the submission of the Survey was close of business on 10 April 2020. The Survey was launched on 3 February 2020 and answers had to mandatorily be submitted through the CSSF eDesk portal by 15 March 2020. In case of failure to submit the Survey by close of business on 10 April 2020, the CSSF will consider that the professional is in breach of the article 5(1) of the Law of 12 November 2004 on the fight against money laundering and terrorist financing. The CSSF will thus be in a position to apply the relevant sanctions.

Swing pricing

In the context of the COVID-19 pandemic, the developments in the financial markets and questions from the industry in relation to the application of the swing pricing mechanism by the investment funds, the CSSF provided clarifications to the industry in the form of an updated CSSF Q&A relating to the "Swing Pricing" mechanism.

Due to the current exceptional market circumstances involved by the COVID-19, the CSSF allows the board of directors of the UCI or, if applicable, the management company, to increase the swing factor beyond the maximum level mentioned in the UCI prospectus, on a temporary basis. This decision must again be duly justified and consider the best interest of the investors.

Call taping under MiFID II

ESMA has issued a public statement to clarify issues regarding the application of the MiFID II requirements on the recording of telephone conversations.

According to MiFID II, firms must keep mandatory records, amongst others, recording of telephone conversations relating to, at least, transactions concluded when dealing on own account and the provision of client order services that relate to the reception, transmission and execution of orders. Alternatively, when such measures cannot be put in place, firms are required to adopt alternative arrangements to ensure full compliance with existing regulatory requirements such as the use of recordable electronic communications as an alternative to telephone conversations.

ESMA recognises that, considering the exceptional circumstances created by the COVID-19 outbreak, some scenarios may emerge where, notwithstanding steps taken by the firm, the recording of relevant conversations may not be practicable (for example due to the sudden remote working of a significant amount of staff, or the lack of access to electronic communication tools by clients).

Therefore, if, under these exceptional scenarios, firms are unable to record voice communications, ESMA expects them

to consider what alternative steps they could take to mitigate the risks related to the lack of recording. Alternative steps include the use of written minutes or notes of telephone conversations when providing services to clients. Clients must be prior informed of the impossibility to record the call and that written minutes or notes of the call will be taken instead. In these scenarios, firms should also ensure enhanced monitoring and ex-post review of relevant orders and transactions. However, ESMA requires that firms implement all possible actions to ensure that the above measures remain temporary and that recording of telephone conversations is restored as soon as possible.

New tick size regime for systematic internalisers

ESMA expects competent authorities not to prioritise their supervisory actions in relation to the new tick-size regime introduced in MiFIR towards systematic internalisers, as of 26 March 2020 and until 26 June 2020, and to generally apply their risk-based supervisory powers in their day-to-day enforcement of applicable legislation in this area in a proportionate manner.

Securities Finance Transactions Reporting

ESMA postpones the reporting obligations related to securities financing transactions under the Securities Financing Transactions Regulation and under the Markets in Financial Instruments Regulation.

The new regulatory obligations under Regulation (EU) 2015/2365 (SFTR) requires reporting of all Securities Financing Transactions ("SFTs") to a registered Trade Repository ("TR"). TRs centrally collect and maintain the records of SFTs and they play a central role in enhancing the transparency of SFTs markets and reducing risks to financial stability. SFTR envisages a phased-in approach as regards the counterparties subject to the reporting obligation. Reporting obligations for credit institutions, investment firms, and relevant third country entities become applicable as of 13 April 2020.

ESMA requires competent authorities not to prioritise their supervisory actions towards entities subject to Securities Finance Transactions reporting obligations as of 13 April 2020 and until 13 July 2020.

As a result, ESMA does not consider it necessary to register any TR ahead of 13 April 2020. However, ESMA expects TR to be registered sufficiently ahead of the next phase of the reporting regime, i.e. 13 July 2020, for credit institutions, investment firms, central counterparties and central securities depositories, and relevant third-country entities to start reporting as of this date.

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COVID-19: Accounting obligations and reports - regulatory and corporate aspects

Regulatory aspects

On 26 March 2020, a draft law n°7540 was submitted to the Luxembourg Parliament ("Draft Law n°7540") , which relates to the extension of certain deadlines relating to accounting obligations of entities of the financial sector, including inter alia SICARs, SIFs, UCIs Part II and RAIFs in order to take into account the exceptional circumstances caused by COVID-19.

Within this scope, the Draft Law n°7540 intends to extend the following:

- SICARs – The deadline so as to make the annual reports together with the report of the réviseur d'entreprises (statutory auditor) available to investors is extended from 6 months to 9 months, as from the end of the period to which these reports relate;
- SIFs – The deadline so as to make the annual report available to investors is extended from 6 months to 9 months, as from the end of the period to which the report relates;
- UCIs Part II – The deadlines so as to publish (i) the annual report is extended from 6 months to 9 months, as from the end of the period to which it relates; and (ii) the half-yearly report is extended from 3 months to 6 months, as from the end of the period to which the report relates; and
- RAIFs – The deadline so as to make the annual report available to investors is extended from 6 months to 9 months, as from the end of the period to which the report relates.

However, such extensions are only applicable to reports whose deadlines have not been reached as at 18 March 2020 and which relate to a period ending as at the date of end of the state of crisis declared on 18 March 2020. Such measures introduced by the Draft Law n°7540 are also applicable to the deadlines falling between 18 March 2020 and the entry into force of the Draft Law.

In this context, on 26 March 2020, the CSSF amended its FAQ relating to COVID-19, in order to specify that deadlines for, inter alia, the following documents relating to SICARs, SIFs, UCI Part II and AIFM, may be extended provided that the CSSF is informed thereof:

- the annual reporting O 4.1./ O.4.2 (UCI) on the basis of Circular IML 97/136 to be submitted to the CSSF within 6 months (for non-UCITS) as from the reference date – this deadline may be extended until **30 June 2020**;
- the monthly reporting O 1.2. (UCIs with formal guarantee) to be submitted to the CSSF within 10 days following the end of the month – this deadline may be extended until **30 June 2020**;
- the quarterly reporting G.2.1. (SIAG/FIAAG) on the basis of Circular CSSF 18/698 to be submitted to the CSSF within 20 calendar days following the end of the preceding month – this deadline may be extended until **31 August 2020**;
- the quarterly reporting G.2.1. (AIFMs) on the basis of Circular CSSF 15/633 to be submitted to the CSSF within 20 calendar days following the end of the preceding month – this deadline may be extended to **40 calendar days** following the end of the preceding month;
- the management letter on the basis of Circular CSSF 02/81 to be submitted to the CSSF within 6 months (for non-UCITS) as from the reference date – an additional period of **3 months** may be granted;
- the semi-annual reporting K3.1 (SICAR) on the basis of Circular CSSF 08/376 to be submitted within 45 calendar days following the reference date – this reporting may be suspended until further notice;
- the closing documents to be provided annually by AIFMs pursuant to sub-points (3) to (15) of point (3) of Annex 2 to

Circular CSSF 18/698 to be submitted within 5 months following the closing date of the AIFM's financial year – for the AIFMs which closed their financial year on 31 December 2019, this deadline may be extended until 31 August 2020; for the AIFMs whose financial year closed after 31 December 2019, this deadline may also be extended by **3 months**;

- the management letter to be submitted by AIFMs within the month following the ordinary general meeting that approved the annual accounts and at the latest seven months after the closing date of the AIFM's financial year – an additional period of 1 month may be granted;
- the quarterly reporting of authorised AIFMs with the list of managed AIFs – this deadline is extended until **30 June 2020**.

The legality of these extensions of deadlines should however be assessed following the comments of the State Council to the draft law according to which, under the Luxembourg Constitution, the Grand-Duke only is allowed to take exceptional regulations which derogate from the law during the state of crisis.

Corporate law aspects

On 27 March 2020, a draft law n°7541 was submitted to the Luxembourg Parliament ("Draft Law n°7541"), which relates to the extension of the deadlines relating to the filling and publication of annual accounts, consolidated accounts and related reports during the state of crisis.

Within this scope, the Draft Law n°7541 intends to:

- extend the following deadlines as set out in the Luxembourg law of 19 December 2002 relating to the trade and companies register ("RCS") as well as the accounting and the annual accounts of enterprises, as amended ("2002 Law"), for a period of 3 months:

  - the deadline for the filling with the RCS of the annual accounts and the balance of accounts referred to in the Luxembourg standardised chart of accounts;
  - the deadline for the publication with the Recueil Electronique des Sociétés et Associations of the annual accounts as well as the related reports;
  - the deadline for the publication of the non-financial statement in the form of a separate report, or so as to make such statement publicly available on the enterprise's website;
  - the deadline for the publication of the statement relating to the corporate governance in the form of a separate report, or so as to make such statement publicly available on the enterprise's website;
  - the deadline for the publication with the Recueil Electronique des Sociétés et Associations of the report relating to payments made to the benefit of governments;

- extend the following deadlines as set out in the Luxembourg law of 10 August 1915 on commercial companies, as amended ("1915 Law"), for a period of 3 months:

  - the deadline for the publication of the consolidated accounts and the related reports;
  - the deadline for the publication of the consolidated non-financial statement in the form of a separate report, or so as to make such statement publicly available on the parent enterprise's website;
  - the deadline for the publication with the Recueil Electronique des Sociétés et Associations of the report relating to payments made to the benefit of governments;

According to the Draft Law n°7541, general annual meetings of companies may be convened within a period of nine months after the end of the financial year. In this respect, the Draft Law n°7541 goes further than the Grand Ducal Regulation dated 20 March 2020 which requires companies with a financial year ending on 31 December 2019 to hold their annual general meetings at the latest on 30 June 2020. On 21 April 2020, the Luxembourg Parliament released a new draft law allowing the holding of such annual general meetings remotely.

Since the Draft Law n°7541 allows to file and publish accounts and reports until 31 October 2020 as a result of the 3 month deadlines extensions, it is indeed necessary to neutralize the effect of the Grand Ducal Regulation that would otherwise unintentionally but significantly restrict the effectiveness of the extensions granted by the Draft Law n°7541. With this modification, companies closing their accounts on 31 December 2019 may hold their annual general meetings until 30 September 2020 (and not anymore 30 June 2020) and file and publish their accounts and reports until 31 October 2020.

- extend, for a period of 3 months, the deadlines relating to the failure by the managers and directors so as to (i) submit to the general meeting within 6 months after the end of the financial year, the annual accounts, the consolidated accounts, the management report, the certificate of the person entrusted with the audit and (ii) publish such documents in violation of the requirements of articles 461-8, 710- 23, 813-4 and 1770-1 of the 1915 Law and article 79 of the 2002 Law.

As a result, any business having its financial exercise closing as at 31 December 2019 and that shall in principle file its annual accounts with the RCS at the latest on 31 July 2020 will be granted an additional period of 3 months. Therefore, such company will benefit from an extended deadline until 31 October 2020. However, the Draft Law n°7541 only applies to annual accounts, consolidated accounts as well as related reports which relate to a period ending as at the date of end of the state of crisis declared on 18 March 2020 and whose deadlines for the filling and publication have not been reached as at 18 March 2020.

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Read all our COVID-19-related articles on our website here: https://www.atoz.lu/COVID-19

VAT exemption of management services: The BlackRock case

OUR INSIGHTS AT A GLANCE

- BlackRock Investment Management (UK) Ltd engaged a US company to provide them with investment management services in relation to funds that are eligible to receive VAT exempt management services and funds that are not eligible for such exemption
- In the framework of a litigation with the UK authorities in order to determine whether a single supply of management services received from the US company should benefit, even partly, from the VAT exemption applicable to fund management services, the UK courts raised a prejudicial question to the CJEU
- In his opinion dated 11 March 2020, the Advocate General considered that a single supply of services rendered for the ultimate benefit of funds eligible and not eligible to receive VAT exempt management services should not benefit, even partially, from this VAT exemption
- The judgement to be released by the CJEU in this case will need to be closely monitored as it may have a significant impact on the VAT position of Luxembourg fund managers

Background

BlackRock Investment Management (UK) Ltd ("BlackRock") is a UK company managing both special investment funds ("SIFs" - funds eligible to receive VAT exempt management services) and other funds (non-SIFs - funds non-eligible for VAT exemption and; therefore, receiving VAT taxable management services). In the case at hand, only a minority of the investment funds managed by BlackRock qualified as SIFs.

In the frame of its management activity, BlackRock engaged the US company BlackRock Financial Management Inc. ("BFMI") to provide investment management services in relation to the two categories of funds managed. These services were rendered from the US through the IT platform "Aladdin" to BlackRock in relation to the management of both SIFs and non-SIFs.

Given that part of the services received from BFMI were used in the framework of the management of SIFs, BlackRock considered that part of the services received from the US should benefit from the VAT exemption applicable to fund management services (based on article 135(1) (g) of VAT Directive). According to BlackRock, the dual use of the single service received from BFMI must not jeopardise the application of VAT exemption to the portion of Aladdin costs linked to the management of SIFs.

UK courts denied the application of the VAT exemption on the services received from BFMI in relation to the management of the SIFs and the Upper Tribunal (Tax and Chancery Chamber) decided to stay the proceedings and to refer a question to the Court of Justice of the European Union ("CJEU").

Question referred to the CJEU

'On the proper interpretation of Article 135(1)(g) of [Directive 2006/112], where a single supply of management services within the meaning of that Article is made by a third-party provider to a fund manager and is used by that fund manager both in the management of [SIFs] and in the management of other funds…:

(a). Is that single supply to be subject to a single rate of tax?

If so, how is that single rate to be determined? or

(b). Is the consideration for that single supply to be apportioned in accordance with the use of the management services (for example, by reference to the amounts of the funds under management in the SIFs and [other funds] respectively) so as to treat part of the single supply as exempt and part as taxable?'

Advocate General's opinion

On 11 March 2020, the Advocate General ("AG") Pikamäe released his opinion on the answer to be provided by the CJEU. The AG started the analysis by recalling the jurisprudence of the CJEU in relation to the concept of single supply and considered that the various services received from BFMI (e.g. market analysis, monitoring performance, risk assessment, monitoring regulatory compliance and implementing transactions) should be treated as a single supply made of various elements.

Turning to the question referred to the CJEU, the AG then examined whether the taxable basis of the single supply could be split in order to receive different VAT treatments on the grounds that a portion of that supply is used for the management of SIFs which could benefit from the fund management VAT exemption if it was considered separately.

In this respect, the AG considered that a single supply such as the service rendered by BFMI for the ultimate benefit of both SIFs and other funds should not benefit, even partially, from this VAT exemption on the grounds that:

- the application of that VAT exemption would not be in line with the objective of that exemption which is to ensure that the common system of VAT is neutral as regards to the choice between direct investment in securities and investment through SIFs by excluding the cost of VAT;
- there is no objective, transparent and foreseeable criterion to make a split of the single supply in order to determine the proportion in which BlackRock uses the Aladdin services for the management of SIFs;
- the apportionment pro rata based on the value of assets under management suggested by BlackRock would not be consistent with the objective of the VAT exemption as the VAT applicable to the single supply would vary continuously depending on the value of the SIFs and the other funds and as it may then result in extending the application of the VAT exemption to the other funds.

However, the AG also mentioned that in case detailed data which enables the tax authority to identify precisely and objectively the services provided specifically for SIFs could be provided by the supplier of the fund management services or the recipient of those services in the case of a reverse charge, then these services could still benefit from the VAT exemption.

The judgement to be released by the CJEU in this case will need to be closely monitored as it may have a significant impact on the VAT position of Luxembourg fund managers. In any case, considering a single service as partly VAT taxable and partly VAT exempt could create a risk to have the VAT exempt part of the services jeopardised.

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VAT on employee secondment: The CJEU confirms that the reimbursement of costs is subject to VAT

OUR INSIGHTS AT A GLANCE

- The Italian VAT law foresees that "the lending or secondment of staff in respect to whom only the related cost is reimbursed shall not be regarded as relevant for the purposes of VAT"
- In the San Domenico Vetraria SpA case, the Court of Justice of the European Union ("CJEU") was asked whether such provision was compatible with the EU VAT Directive and concluded that it was
- As the supply of staff between members of a VAT group does not fall within the scope of VAT and no VAT needs to be charged on the reimbursement of the costs requested by the employer, the outcome of this case law has no impact on secondment of staff within the framework of a VAT group, which remains a solid option to mitigate tax exposures

Background and question referred to the CJEU

In this case, the Italian company Avir seconded one of its directors to its subsidiary company, San Domenico Vetraria. Avir issued invoices with VAT to San Domenico corresponding to the reimbursements of the (salary) costs incurred for the seconded director. In its VAT returns, San Domenico considered that the input VAT was deductible and exercised its VAT deduction right on these amounts.

The Italian VAT law foresees that "the lending or secondment of staff in respect to whom only the related cost is reimbursed shall not be regarded as relevant for the purposes of VAT". In other words, and based on the Italian VAT law, the reimbursement of salary costs should not be seen as a service falling within the scope of VAT and should therefore not be subject to any VAT. On that basis, the Italian VAT authorities were of the opinion that San Domenico was not entitled to recover the input VAT on the invoices issued by Avir as VAT should not have been charged.

Noticing that the provision of labour is subject to VAT in Italy (in contrast to the reimbursement of costs linked to seconded staff), the Italian Supreme Court of Cassation raised the question of the compatibility of the above-mentioned Italian provision with the EU VAT Directive.

Position of the CJEU and potential impacts

Noticing that there is a direct link between the service supplied (the secondment) and the consideration received (the payment made to Avir) and irrespective of the amount of the payment, the CJEU ruled that this transaction is a supply of services falling within the scope of VAT. On that basis, the CJEU concluded that the Italian legislation is contrary to the EU VAT Directive.

The Luxembourg VAT law does not include any similar provision based on which the reimbursement of staff costs would fall outside the scope of VAT. As a general rule, payments made in consideration of seconded staff are considered as VAT taxable from a Luxembourg VAT perspective.

The outcome of this case has no impact on the specific situation of secondment of staff within the framework of a VAT group. The supply of staff between members of a VAT group does not fall within the scope of VAT and no VAT needs to be charged on the reimbursement of the costs requested by the employer. The VAT grouping constitutes a robust alternative to mitigate VAT exposures and to, notably, avoid a VAT leakage on the costs related to an employee seconded to a member of the VAT group.

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