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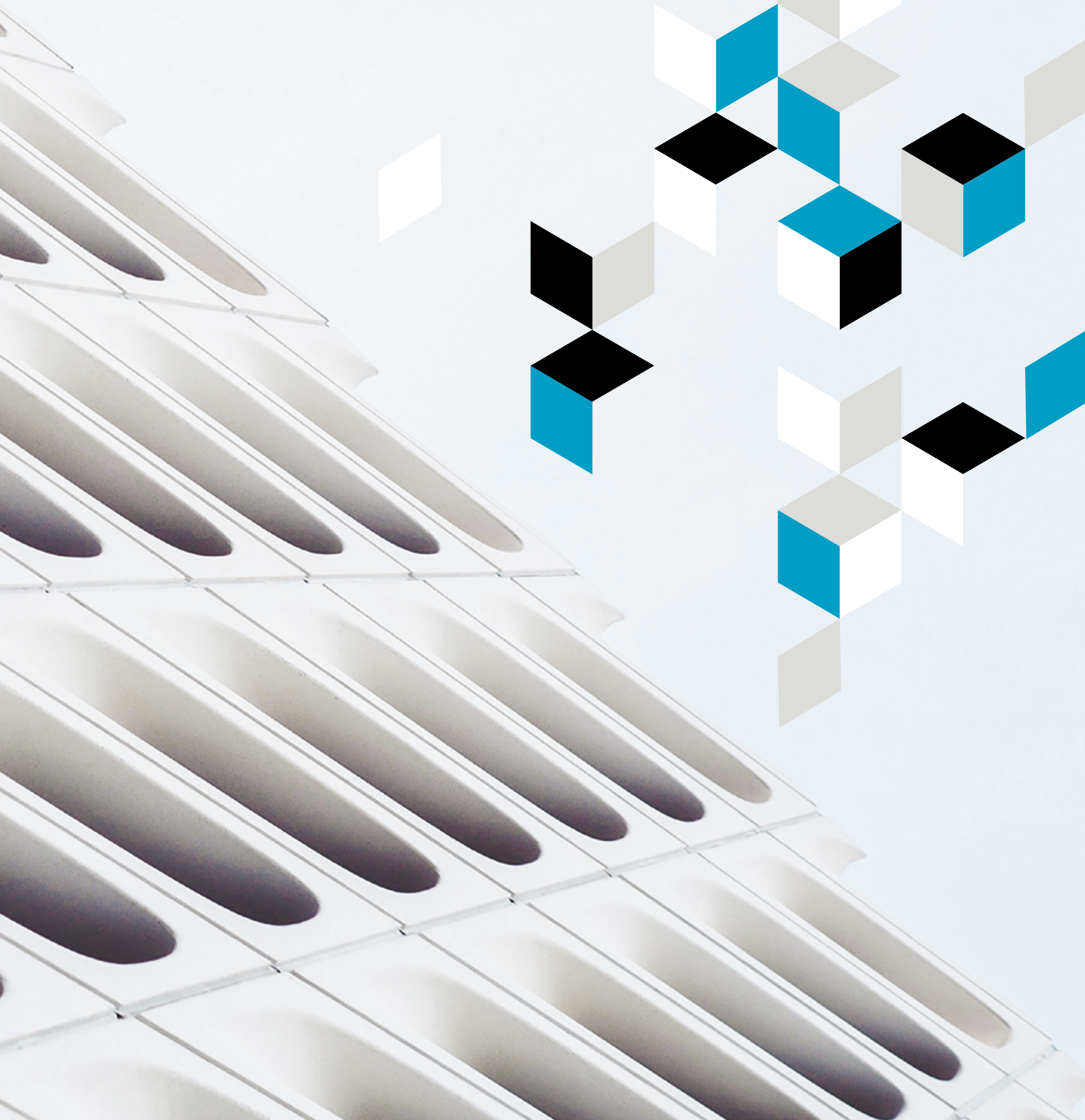
TAX ADVISERS LUXEMBOURG

INSIGHTS

DECEMBER 2022



TAXAND

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EDITORIAL

Greetings!

As every year in Luxembourg, the fall season announces the publication of the draft budget law which in turn foreshadows the winter Holiday Season. And this time has come.

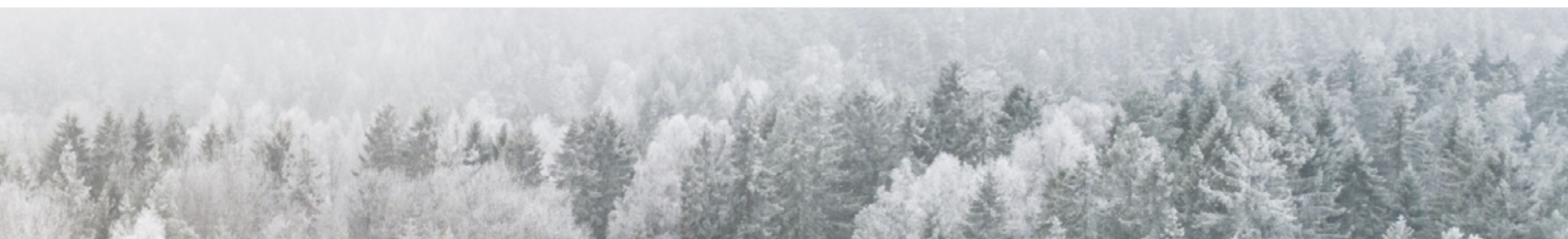
On 12 October 2022, the 2023 draft budget law was presented to Parliament. As expected, due to the current period of crisis and uncertainty, the proposed tax measures only amend existing tax provisions to modify or clarify their scope of application, such as, for example, the clarification about the reverse hybrid rule. We describe below the clarifications proposed in the 2023 draft budget law.

On 10 October 2022, another draft law was presented to the Luxembourg parliament with the aim of carrying out the long-awaited reform of the Luxembourg property tax. This reform is based on three major axes: a modernisation of the property tax itself and the introduction of two new taxes encouraging property owners to mobilise building land and uninhabited dwellings, to combat the increasing housing shortage in Luxembourg. We will explain these rules and the timing for their application.

At European level, the updated list of non-cooperative jurisdictions for tax purposes was published on 12 October 2022. This list directly impacts the scope of the Luxembourg corporate income tax deduction of interest and royalty expenses due to entities located in non-cooperative tax jurisdictions, the requirement to disclose transactions with entities located in non-cooperative jurisdictions and the DAC 6 rules. We provide an overview of the impacts of the updated list in Luxembourg.

The EU Commission is also working on various new initiatives: On 12 October 2022, the EU Commission closed a public consultation regarding a proposal for a Council Directive to tackle tax advisers and other professionals rendering tax advice that facilitate tax evasion and aggressive tax planning. We provide an overview of the questionnaire and analyse to which extent there is a real need for this initiative. Moreover, on 17 October 2022, the European Commission announced the launch of a public consultation on the so-called BEFIT, a new framework for EU corporate taxation. The initiative would introduce a common set of rules for EU companies to calculate their taxable base while ensuring a more effective allocation of profits between EU countries, based on a formula. BEFIT strongly resembles the previous Common Consolidated Corporate Tax Base proposal, which has been withdrawn. We analyse this initiative and its consequences on the EU corporate tax landscape.

From a VAT point of view, a Luxembourg draft law published on 26 October 2022 implements anti-inflation measures aiming to help households and businesses and one of the proposed measures is a Luxembourg VAT rates decrease. We describe this measure and its impact on consumers and businesses.



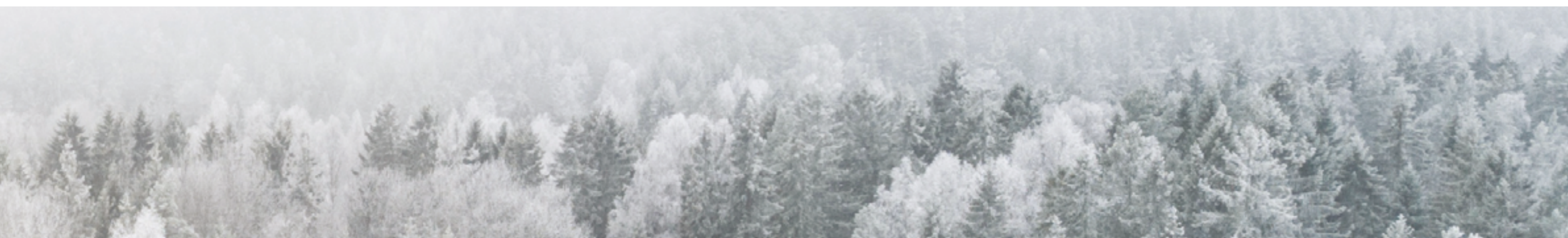
In a recent case, the CJEU clarified the notion of “granting of credit” for the purpose of determining the scope of VAT exempt financing activities. In this respect, the CJEU ruled that the acquisition by a securitisation vehicle of future proceeds from receivables of an originator should be assimilated to a VAT exempt financing activity. We explain the decision of the Court and its consequences in Luxembourg.

On 29 April 2022, the Luxembourg District Court made a referral to the CJEU for a preliminary ruling in the case on the VAT treatment of activities carried out by a natural person as a member of the board of directors of a public limited company. The CJEU will have to arbitrate between two opposing positions on this complex question. We explain what is at stake in this case.

On 5 October 2022, the Council of the European Union endorsed and published the final compromise text of the Regulation on Markets in Crypto-Assets which is meant to “protect investors and preserve financial stability, while allowing innovation and fostering the attractiveness of the crypto-asset sector”. Few days later, the European Parliament Committee on Economic and Monetary Affairs also approved a provisional deal on the Transfer of Funds Regulation that would require exchanges to report any crypto transactions to authorities. We describe these new regulations, which represent a significant milestone in the development of the crypto industry in Europe.

We hope you enjoy reading our insights.

The ATOZ Editorial Team



Budget 2023 - Tax measures

OUR INSIGHTS AT A GLANCE

- On 12 October 2022, the 2023 budget draft law was presented to Parliament.
- As expected during this period of crisis and uncertainty, only some targeted tax measures will be introduced as from 2023 as well as some amendments of existing tax measures to clarify or amend their scope of application.
- We provide an overview of the main tax changes to be introduced.
- However, the proposed measures may still evolve throughout the legislative process.

On 12 October 2022, the 2023 budget draft law (the "**Draft Law**") was presented to Parliament. As expected during this period of crisis and uncertainty, only some targeted tax measures will be introduced as from 2023. In addition, some existing measures will be amended in order to clarify or amend their scope of application. We provide an overview of the main tax changes to be introduced. However, the proposed measures may still evolve throughout the legislative process.

Reverse hybrid rule: scope of application clarified

With retroactive effect as from tax year 2022, the Draft Law amends the wording of article 168quater of the Luxembourg Income Tax Law ("**LITL**") in order to clarify the scope of application of the reverse hybrid rule.

A reverse hybrid is an entity that is treated as tax transparent under the laws of the jurisdiction where it is established but as a separate entity (i.e. opaque) under the laws of the jurisdiction(s) of the investor(s).

Based on the reverse hybrid rule of Article 168quater of the LITL (in force since tax year 2022), Luxembourg tax transparent entities are subject to corporate income tax ("**CIT**") on the portion of their net income that is not otherwise taxed under this law or the laws of any other jurisdiction, where one or more non-resident associated enterprises which hold in aggregate a direct or indirect interest of 50% or more of the voting rights, capital interests or entitlement to profit in such entity, are located in a jurisdiction or jurisdictions which regard the Luxembourg entity as opaque.

The Draft Law clarifies that the reverse hybrid rule will only apply if the non-taxation of the income realised by the investor through the Luxembourg entity is due to the difference in the qualification (as transparent vs. opaque) of the Luxembourg entity. The commentary to the draft law specifies further that the income realised by an investor benefiting from a subjective exemption in its state of residence will therefore be out of the scope of the reverse hybrid rule.

This clarification is very welcome and also in line with the way the rules on hybrid entities and hybrid instruments are applied. Even though the commentary only refers to the case of a non-taxation of the income due to a subjective exemption of the investor, other situations of income exemptions not due to a difference in the qualification of the Luxembourg entity (as transparent vs. opaque) should also be out of the scope of the reverse hybrid rules, such as when investors are located in a jurisdiction with no concept of tax transparency/tax opacity.

New deadline for filing tax returns: 31 December

Based on the Draft Law, the new deadline for filing individual and corporate tax returns will be 31 December instead of currently 31 March.

The change will apply for the first time in relation to:

- the 2022 income tax return, the 2022 corporate income tax return and the 2022 municipal business tax return, which will have to be filed on 31 December 2023 at the latest; and to
- the 2023 net wealth tax return (based on the net wealth as of 1 January 2023), which will also have to be filed on 31 December 2023 at the latest.

§ 167 of the general tax law will be amended accordingly.

As far as individuals are concerned, the provisions of the LITL dealing with the request to be made by partners (Article 3*bis* of the LITL), married resident taxpayers (Article 3*ter* of the LITL) and married non-resident taxpayers (157*ter* of the LITL) when opting for the individual vs. joint taxation will be amended. As from tax year 2022, the deadline for filing these requests will no longer be 31 March but 31 December instead.

The extension of these filing deadlines is good news. However, the Draft Law also repeals the provision included in § 167 of the general tax law which gives the tax authorities the possibility to allow extensions of the filing deadlines in specific cases.

Profit sharing bonus (prime participative): specific measure introduced for tax consolidation

The profit-sharing bonus regime (*prime participative*, Article 115-13a of the LITL) introduced last year will be amended to take into account the situation of employers which belong to a tax consolidated group within the meaning of article 164bis of the LITL.

Based on the regime currently in force, the total amount of profit-sharing bonus paid by the employer to its employees cannot exceed 5% of the accounting profits of the employer as of the end of the accounting year preceding the allocation of the profit-sharing bonus. The purpose of the amendment to be introduced by the Draft Law is to grant, on an annual basis, the possibility to compute the 5% threshold based on the positive algebraic sum of the results of the members of the consolidated group to which the employer belongs, provided that a tax consolidation existed during the year during which the profit-sharing bonus is granted as well as during the year immediately preceding that year.

The conditions for the application of the profit-sharing bonus regime regarding the type of income to be realised by the employer and the requirement to maintain regular accounts during the tax year when the bonus is granted as well as during the immediately preceding year, will have to be met by each member of the consolidated group. A joint request of all members of the consolidated group will have to be filed by the integrating entity.

Impatriate regime improved

To attract more talents to Luxembourg, with effect as from 1 January 2023, the Draft Law will amend Article 115-13b of the LITL so as to extend the scope of application of the impatriate regime. The minimum annual remuneration required for an impatriate to benefit from the regime will be reduced from EUR 100,000 to EUR 75,000.

Real estate taxation measures

The application of the 4% accelerated depreciation for buildings used for rental housing will be limited to two buildings or parts of buildings used for rental housing, acquired or constituted after 31 December 2022 during the entire taxpayer's tax liability period in Luxembourg. This modification will be implemented by way of a Grand-Ducal regulation. This is a further restriction of this deduction that was widely considered to be too favourable in the context of increasing housing prices.

The definition of the annual rental value of a dwelling will be amended so as to make sure that the valuation of the dwelling takes place as soon as the owner can freely dispose of it.

Tax credits for individuals

The maximum amount of tax credit for single parents will be increased from EUR 1,500 to EUR 2,505. In addition, the maximum income up to which taxpayers can benefit from this credit will be increased from EUR 35,000 to EUR 60,000.

Following the increase in the qualified and unqualified minimum social wage as planned for 2023, the income brackets will be increased in order to maintain the social minimum wage tax credit at its current level.

RELIBI: Definition of paying agent clarified

The Draft Law amends the definition of "paying agent" under the Law of 23 December 2005 on the 20% final withholding tax (*Retenue à la source libératoire*, "**RELIBI**") applicable under certain conditions to interest paid to Luxembourg resident individuals. Under the new definition to be introduced, in order to be fall within the definition of a paying agent under the RELIBI Law, the paying agent has to make the payment as part of its normal economic activity. The amendment merely endorses what is already current practice.

VAT

With effect as from 1 January 2023, new photovoltaic installations will benefit from the super-reduced 3% VAT rate and the reduced 8% VAT rate will apply to the repair of household appliances and to the sale, rental, and repair of bicycles, including e-bikes.

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The Luxembourg property tax reform: too slow to address efficiently the housing challenges!

OUR INSIGHTS AT A GLANCE

- On 10 October 2022, a draft law was presented to the Luxembourg parliament with the aim of carrying out the awaited reform of the Luxembourg property tax.
- This draft law aims at modernising the property tax and at introducing two new taxes to combat the increasing housing shortage in Luxembourg.
- The draft law introduces, for property tax purposes, a new valuation model of properties that is supposed to be more objective, transparent and fair.
- The draft law also introduces a tax on the mobilisation of land, whose purpose is to encourage the effective construction of housing on the land dedicated to this end.
- In parallel, the introduction of a national tax on the non-occupation of housing intends to mobilise existing unoccupied housing.
- The deadlines for the implementation of the reform do not correspond to the emergency experienced by people wishing to find housing in Luxembourg.

In the Grand Duchy of Luxembourg, property tax is one of the oldest taxes, and its reform, which has been part of the political discussion for years, is also one of the longest awaited. The situation of the housing market in Luxembourg is well known: the housing shortage is a challenge and the price of building land rose by 137% between 2010 and 2021. This performance is better than that of the Euro Stoxx 50 (+90%), the DAX 30 (+129%) and the CAC 40 (+40%) over the same period, before tax.

The OECD's economic review of Luxembourg, published in July 2019, concluded that housing market pressures include limited use of building land and complex zoning regulations which have pushed up prices and encouraged land speculation. In response, one of the recommendations was to increase the opportunity cost of unused land by reforming periodic taxes on real estate ownership.

On 10 October 2022, a draft law n°8082 was finally presented to the Luxembourg parliament with the aim of carrying out the awaited reform of the Luxembourg property tax. The three major axes of this draft law are based on a modernisation of the property tax and the introduction of two new taxes encouraging property owners to mobilise building land (tax on the mobilisation of land) and uninhabited dwellings (tax on the non-occupation of housing) to combat the increasing housing shortage in Luxembourg. This reform is in line with the philosophy of the OECD's comments. The draft law on property tax, land mobilisation tax and non-occupancy tax also executes and complements the broad lines set out in the coalition agreement 2018-2023.

Here's how the reform looks like:

New property tax (Impôt Foncier, "IFON") computation method

The main objectives of the property tax reform are to eliminate the inequalities generated by the current IFON and to create a new valuation model that will be more objective, transparent and fair. The aim of the property tax reform is not to increase tax revenues, but rather to introduce fair and equitable taxation that does not expose itself to accusations of unequal treatment. The property tax reform targets "the antiquated nature of the current property tax system". For that purpose, the ambition of the draft law is to revalue all lands ensuring that, in determining the tax base, the proportions of real land value between these lands are respected so that the system is considered as fair, and the tax respects the principle of proportionality and equality before the law.

The proposed new formula for valuing lands is based on a recognition of factors that are widely recognised as determining the value of a property, namely (1) the building potential, (2) the land use patterns, (3) the geographical location, (4) the development phasing (immediate availability for construction or not), (5) the available surface area, (6) the number of facilities and services available in the neighborhood and (7) the general level of property prices. To keep up to date the data needed for the evaluation of the land, the data will be re-evaluated periodically - at least every 3 years.

The most important parameter defining the value of a land is its geographical location, and more specifically its distance from Luxembourg City. Indeed, studies conducted by the *Observatoire de l'Habitat* have long confirmed that land prices decrease exponentially in proportion to the distance to the capital. It is emphasised that it was decided to consider the travel time to Luxembourg City, and not the travel distance, as this is the main factor in the choice of the location.

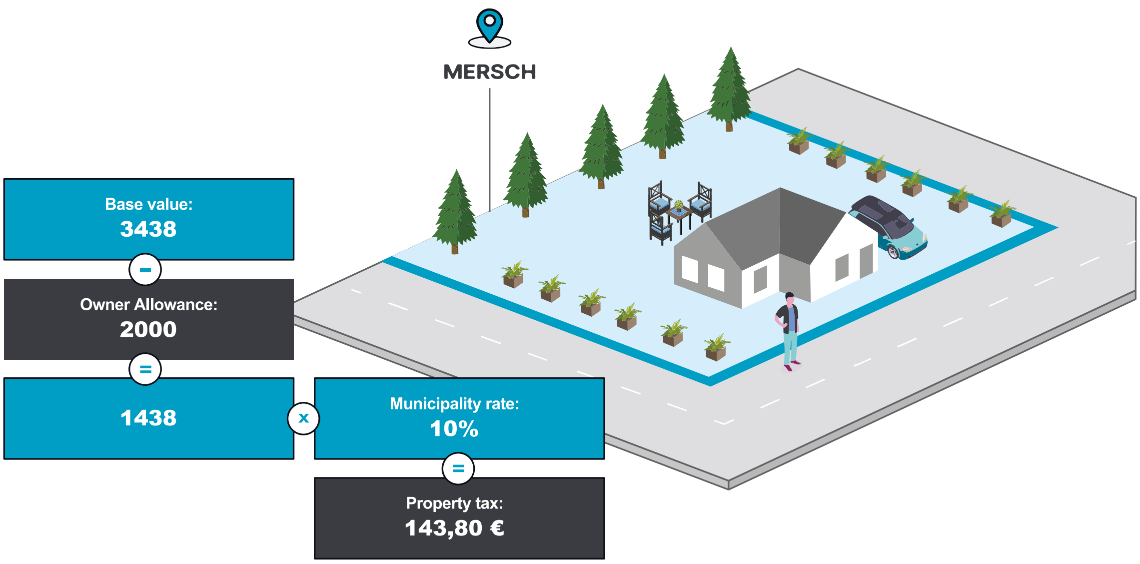
The property tax formula will be a simple multiplication between a unitary value representing the value of a parcel (and no longer an evaluation dating from 1941) and a tax rate set by the municipality where the land is located. Such rate can vary between 9% and 11%.

$$\mathbf{IFON = (V_f - A_{com}) \cdot t_{com}}$$

The reformed property tax also introduces a tax reduction on the main residence. As a result, every individual taxpayer will be entitled to a flat-rate allowance of two thousand euros on the basic value of the property on which he has registered his principal abode. However, no allowance will apply if it brings the base value of a property below 500 euros for the taxpayer concerned. Unless exempt, taxpayers will thus always be subject to a minimum IFON on their property of at least 45 to 55 euros (i.e., 500 x 9-11%).

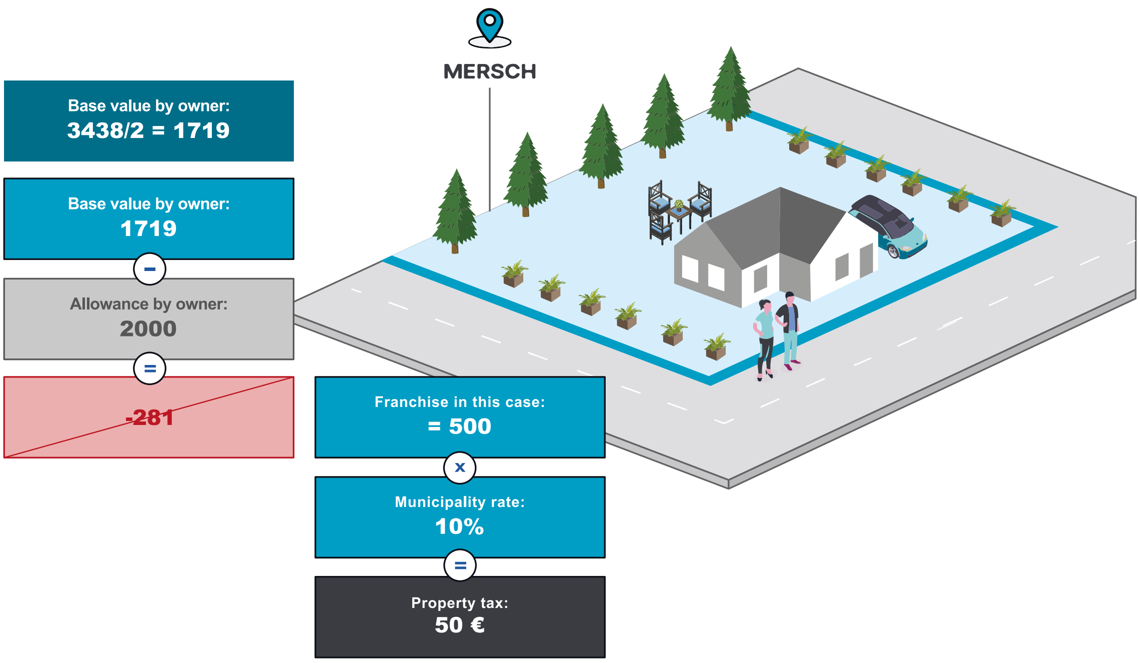
Example:

1 resident-owner : land of 6 acres in Mersch



Source: www.gouvernement.lu

2 resident-owners : land of 6 acres in Mersch



If the tax allowance for the usual residence is welcome, the way it is implemented is surprising. Indeed, the aim of the reform is to implement a fair system with a tax respecting the principles of proportionality and equality in front of the law. However, as the allowance is allocated by taxpayer (i.e., by owner) and not by property, the fairness of the system is not obvious. Indeed, as a result of this system, two owners, resident in their home built on a property valuated at 3438 euros, will pay less (IFON: 500 x10% x 2 owners = 100) tax in total than a single resident-owner who would reside on the exact same property (IFON: 1438 x 10% = 143,80 euros). In this respect, it seems that the Government applies the same philosophy as the one applicable for the already criticised tax classes rates (i.e., classes 1, 1a and 2) resulting in higher taxes due by single taxpayers/owners compared to the one due by married taxpayers. In addition, in such example, if one of the 2 owners must leave the residence because of a separation/divorce for example, then the total tax payable rises to 221.9 euros (i.e., 50 + 171.9). Similarly, in a more theoretical case, if there are 3 resident-owners in the house, the total IFON due would amount to 150 euros (3438/3 – 2000 would be less than 500 euros so the tax due would be 50X3 = 150 euros). Nothing justifies that the IFON amount varies depending on the number of the property's owners. As it is the same land with the same building, the amount of tax should be the same. The property tax is a tax on a land/property and thus the personal situation of the owners should not impact the amount of tax due in total.

As a result, wouldn't it be fairer to apply the tax allowance for residential buildings on the total value of the land/property and not to allocate the allowance to each owner individually? Currently, the level of property tax to be paid depends on the base value of the land, if necessary, broken down between several owners, and then allowances are applied. To better respect the principle of equality and fairness, it should not be the value of the land that is broken down between several owners, but the amount of tax due. The allowance would thus be granted depending on whether the property is assigned to the residence of the owner(s) but would not vary based on the number of owners. In the example above, the IFON due on a house allocated to the residence of at least one of its owners should amount 143,8 euros in every case (i.e. (3438 – 2000) x10%) and such tax should then be shared amongst the owners proportionally to their ownership rights.

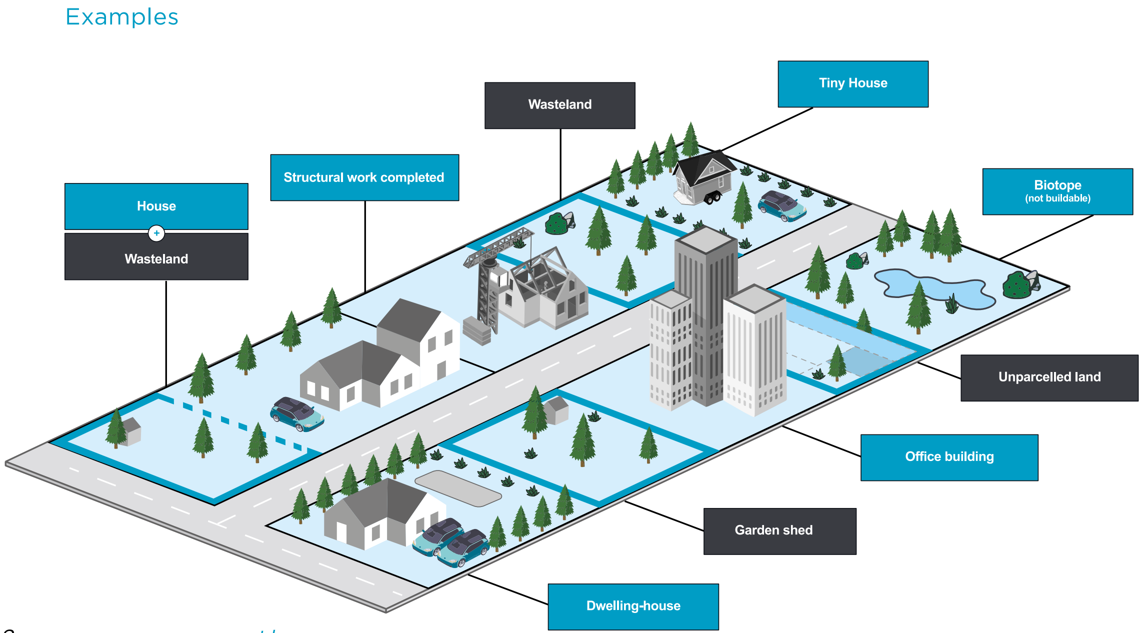
To enable citizens to estimate the property tax they will have to pay after the reform, the Government has set up a simulator: grondsteier-rechner.lu

Introduction of two new taxes:

Another challenge of this reform is the fight against the notorious housing shortage in Luxembourg. In a recent contribution, we stated that "[a] low level of property tax reduces the financial burden on property investors who decide to keep properties unused". It was also clear to us that there was a need to "improve the effectiveness of the non-occupation tax to stimulate the rental market and, in the case of long-term vacancies, to encourage the sale of such properties" and to "incentivise (or reduce the barriers to) the sale of vacant buildings or land", which are now the stated objectives of the new national tax on the non-occupation of housing and on the mobilisation of land.

- **Introduction of a tax on the mobilisation of land (Impôt à la mobilisation de terrains, "IMOB")**

The draft law introduces a tax on the mobilisation of land, whose purpose is to encourage the effective construction of housing on the land dedicated to this end. Contrary to the IFON, the tax on the mobilisation of land will be a national tax to achieve a uniform situation in the country. The IMOB revenue will accrue entirely to the State. The tax will be brought into play wherever it is possible to build, irrespective of property relations and cadastral boundaries.



Source: www.gouvernement.lu

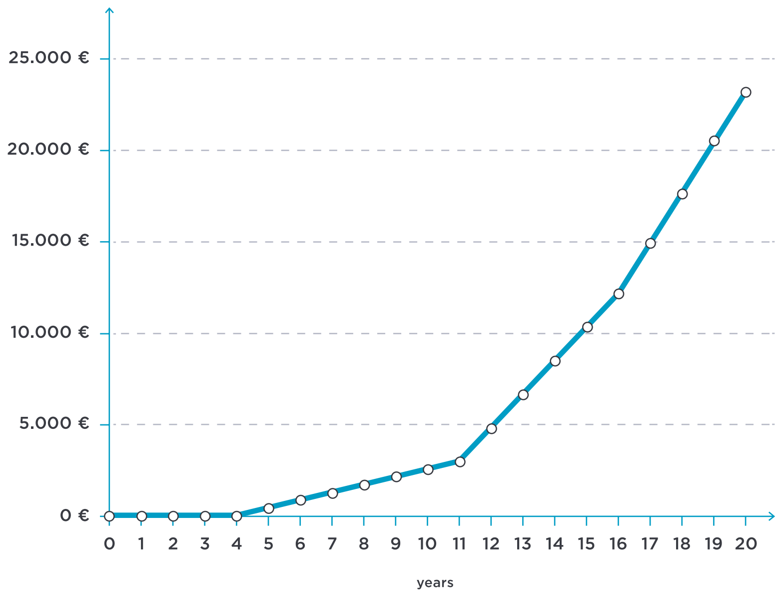
The IMOB is an innovation and is based on the establishment of a national register of undeveloped land, which lists all land available for construction under the general development plans (PAG). A distinction is made in this regard between lands that are immediately constructible, and lands that require the completion of prior roadworks and public and collective infrastructures. If a property is of a size or configuration that does not lead itself to the construction of dwellings in compliance with the regulations, it shall not be taxed. Similarly, no tax is levied on land that already has buildings on it and that cannot accommodate additional buildings. However, land which has sufficient residual surface area to erect a new building, even if it is not to erect a new building, even in the presence of an existing building, will be taxed if the available space is not used.

The tax on the mobilisation of land will be calculated on the same basis as the IFON but the Government plans to introduce a flat-rate allowance of 3400 euros for each child under the age of 25. This measure should allow a reasonable size of land for each child to be released from taxation, to enable the future construction of a single-family home. A taxpayer that is under the age of 25 will benefit from the same flat-rate allowance.

IMOB = (Vf – Amob) x Tmob

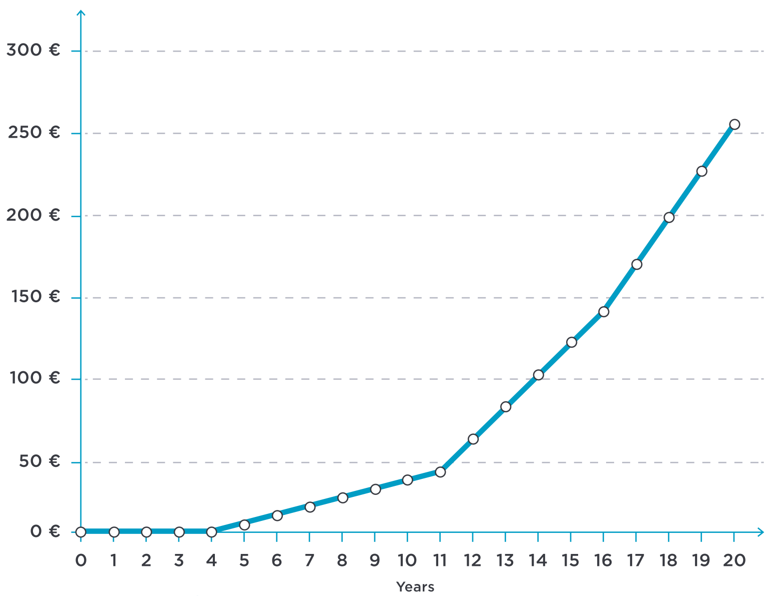
The rate of the land mobilisation tax will be progressive and will increase sharply in order to motivate recalcitrant owners to take care of their land. For example, the national rates of the tax on the mobilization of lands that are immediately constructible varies from 0% to 450% depending on the duration of registration of the land in the national register of undeveloped land at the reference date of the tax year. National rates of the tax on the mobilisation of lands that are not immediately constructible varies from 0% to 150%. Those rates are in addition inflated by 50% or 100% if the land is located in a priority locality under the terms of the spatial planning policy.

Land of 6 acres in Mersch



years	IFON	IMOB
0	344 €	0 €
1	344 €	0 €
2	344 €	0 €
3	344 €	0 €
4	344 €	0 €
5	344 €	258 €
6	344 €	516 €
7	344 €	774 €
8	344 €	1.031 €
9	344 €	1.289 €
10	344 €	2.579 €
11	344 €	3.868 €
12	344 €	5.157 €
13	344 €	6.446 €
14	344 €	7.736 €
15	344 €	10.314 €
16	344 €	12.893 €
17	344 €	15.471 €
18	344 €	18.050 €
19	344 €	20.628 €
20	344 €	23.207 €

Land of 6 acres in Mersch,
owner with 1 child (‹25 years old)



Years	IFON	IMOB
0	344 €	0 €
1	344 €	0 €
2	344 €	0 €
3	344 €	0 €
4	344 €	0 €
5	344 €	3 €
6	344 €	6 €
7	344 €	9 €
8	344 €	11 €
9	344 €	14 €
10	344 €	29 €
11	344 €	43 €
12	344 €	57 €
13	344 €	71 €
14	344 €	86 €
15	344 €	114 €
16	344 €	143 €
17	344 €	171 €
18	344 €	200 €
19	344 €	228 €
20	344 €	257 €

Source: www.gouvernement.lu

On the one hand, the longer it takes to build, the higher the rate will be. On the other hand, a 0% rate applies during the first 5 to 8 years depending on whether the land is immediately constructible or not. Thus, the progressive evolution of the rates over the years increases the incentive to build over time but also gives the opportunity for the holders of the rights in rem in the land to carry out construction planning. If a transitional period is appreciated, we can nevertheless regret that if the national register of undeveloped land is effective in 2025 for the entry into force of the draft reform and its application as from 2026, the first tax would only be collected in 2031 at the earliest. That transitional period should be way shorter: the holders of the rights in rem in the land can indeed start to carry out construction planning as from today.

The flat-rate allowance of 3400 euros for each child under the age of 25 is also a positive measure that raises questions. The maximum of tax may indeed become due if the land is not mobilised as soon as the children of the taxpayers turn 25, since the applicable rate depends on the duration of registration of the land in the national register of undeveloped land at the reference date of the tax year. We believe that a transitional period starting at the age of 25 of a child would be welcome in this respect. Indeed, at 25, not everybody is settled professionally and financially in a position to build a house. Without a transitional period, we may end up with families that kept land for their children, finally forced to sell when they turn 25 because the tax due is very high and their children have just finished their studies for example. Those families could be penalised twice: first the tax due will probably be the maximum from the first year (if the land is in the register of undeveloped land for at least 20 years) and secondly, they may be forced to sell quickly at a lower price because they do not have the savings to pay such an high amount of tax. This result would be contrary to the aim of the tax allowance which is to allow a family to keep land for their children.

- **Introduction of a national tax on the non-occupation of housing (*impôt national sur la non-occupation de logements*, "INOL")**

By introducing the INOL, complementary to the reform of the IFON and the IMOB, the Government intends to mobilise existing unoccupied housing. The municipal tax on unoccupied dwellings, introduced in 2008 on an optional basis as part of the Housing Pact 1.0, failed to produce the expected results and thus will be replaced by this new compulsory national tax.

According to the draft law, a dwelling is considered unoccupied if no natural person is registered in it for a period of six months. For the purpose of the INOL, a dwelling is defined as a set of premises intended for inhabitation, forming a single unit and consisting of at least a living room, a kitchenette and a bathroom with toilet and having direct access to the outside or to common areas.

The municipality must establish that a dwelling is not occupied and to that aim, dwellings are presumed to be unoccupied, according to the draft law, when no natural person is registered in the population register at the address of the dwellings for a period of six consecutive months. Dwellings which have a decrepit external appearance giving rise to a presumption of lack of maintenance; or which are not furnished with the furniture essential to their use as dwellings; or for which the consumption of drinking water or energy services recorded over a period of at least six consecutive months is lower than a minimum consumption level; or for which no tax for the public collection of waste has been paid, may also be presumed to be unoccupied for the purpose of the INOL.

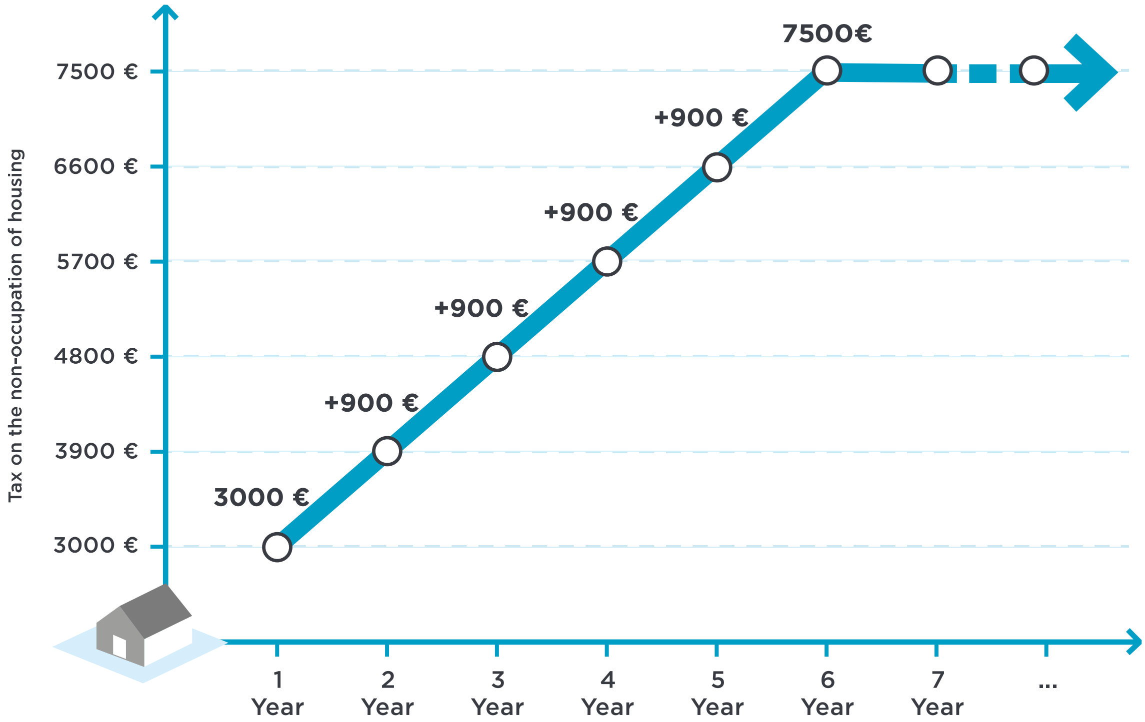
Nevertheless, such presumptions can be overturned by the taxpayer who can justify the occupation of a dwelling, or the non-occupation of a dwelling for legitimate reasons or beyond the control of the taxpayer or in case of "force majeure". A legitimate reason for non-occupation is a project of repair, improvement, construction or fitting out for the purpose of occupation, which may not exceed two years from the start of the work, provided that the person concerned produces a building permit or a detailed estimate and actually undertakes the work within three months of the justification and ensures that the work is carried out continuously thereafter. The two-year period may be extended in exceptional cases and as deemed necessary in view of a written and duly motivated request submitted by the taxpayer.

The INOL formula will be:

$$INOL = Vc + (Vc \times 0{,}3 \times a)$$

Vc is the central value for unoccupied housing which is a lump sum per dwelling set at 3000 euros. " a " is the number of years following the first year for which the tax is due (N) and may not exceed 5. As a result, the INOL to be levied by the Luxembourg tax authorities for the benefit of the State will amount to 3.000 euros per dwelling for the first year (INOL of year N = 3000 + (3000 x 0,3 x 0)). The tax will increase by 900 euros per year up to a maximum of 7.500 euros (INOL of year N+5 = 3000 + (3000 x 0,3 x 5)). If the property remains unoccupied, this amount will be due annually.

In this respect, it is questionable whether this measure will have the desired effect. Will a monthly tax burden from 250 euros (3000 / 12) to 625 euros (7500/12) per month really



make the owner react and encourage him to sell or rent, taking into account the capital gain he is currently making on his property? At the very least, we can ask ourselves this question and it seems that the Government itself does not anticipate any change in behavior since it indicates that "The revenue from this national tax will amount to some 14 million per year".

The INOL raises also a question of fairness and equality because the amount of the tax is not proportionate to the size of the dwelling, as it is for example the case in Belgium. The amount of INOL proposed in the draft law should be a minimum, for the smallest dwellings, and should increase in proportion to the size and the housing capacity of the unoccupied dwellings.

Who is subject to the taxes and who is exempted?

For purpose of the IFON, the IMOB and the INOL, the taxpayers are in principle the owners of the taxable property or in the case of division of ownership, the usufructuary[1], the holder of the right to build ("droit de superficie"), or the holder of the right of emphyteusis on 1 January of the tax year concerned. In undivided ownership as well as in matrimonial communities, the tax due by each taxpayer is fixed in proportion to his respective share, as shown in the cadastral documentation. In the absence of any indication in the cadastral documentation, the taxpayers are presumed to be liable for tax in equal shares. In co-ownership, the tax due by each taxpayer is fixed in proportion to his share in the common parts, as resulting from the descriptive statement of division of the building or, failing that, the cadastral documentation. In the absence of any indication in the cadastral documentation, taxpayers are presumed to be liable according to equal shares.

The draft law exempts some public institutions from the IFON. As a result, are exempt from property tax: 1° the State, 2° the municipalities ; 3° the syndicates of municipalities; 4° public promoters within the meaning of Article 16 of the amended Act of 25 February 1979 on housing assistance ;5° foundations and non-profit associations recognised as being of public

[1] In relation to the IMOB and all man-made usufructs (that are not legal usufructs) established before the law came into force, the usufructuary and the bare owner share the tax burden equally. As usufruct contracts concluded after the entry into force of the law are concluded with full knowledge of the facts, they can anticipate the tax burden by providing for contractual clauses.

utility, within the meaning of the amended law of 21 April 1928 on non-profit associations and foundations; 6° legal persons governed by public international law and 7° approved sports federations and their affiliated clubs. The draft law does not grant any exemption from the IMOB and the INOL to the public institutions. The Government wishes to treat all the private and public actors such as the State, the municipalities, the public institutions on an equal footing in order not to create an infringement of competition law, as both categories of actors operate in a common market, namely housing.

In relation to the IMOB, the exercise of the right to build for the usufructuary remains difficult in practice, while construction on land already containing a house may require a subdivision. Strictly speaking, the surviving spouse's usufructs relates to the house, but not to the land to be subdivided, so it is questionable whether the surviving spouse is entitled to apply for a subdivision. It is uncertain whether the action of subdividing land is compatible with the obligation of the usufructuary to maintain the substance of the asset. For that reason, the draft law exempts the usufructuary and the bare owner from the tax on the mobilisation of land when the usufruct is constituted by the law, based on article 767-1 of the Civil Code. Except for the legal usufructs, no other exemption will be granted in relation to the IMOB.

In relation to the INOL, the draft law does not provide for any exemption.

Entry into force of the draft reform

This reform is welcome but unfortunately its implementation timeline does not take into consideration the emergency experienced by people wishing to find housing in Luxembourg. Indeed, the law will enter into force on the first day of the first month of September following the completion of 24 months from the publication of the law. So, if the law is voted and published before 1st September 2023, the law will enter into force in September 2025. However, if the draft law is voted and published after 1 September 2023, the entry into force of the law will be postponed to September 2026.

In addition, articles 2 to 12 of the draft law, according to which the IFON and the IMOB are collected, will be applicable only from the 1st of January of the calendar year which follows the year during which the law entered into force. It means that the taxes will be applicable as from 1st January 2026 if the law enters into force in September 2025 or 1st January 2027 if the law enters into force in September 2026.

Moreover, provisions related to the INOL will enter into force on the 1st day of the first month of January following the accomplishment of 36 months after the publication of the law. It means that if the law is published in 2023, it will apply as from 1 January 2027 (i.e., 36 months after a publication in December 2023 brings us to December 2026 and the following 1st day of January is 1st January 2027). If the law is published after 31 December 2023, the INOL will apply as from 1 January 2028 (i.e., 36 months after the publication on the 1 January 2024 brings us to January 2027 and the following 1st day of January is 1 January 2028).

The deadlines for the implementation of the reform do not correspond to the emergency experienced by people wishing to find housing in Luxembourg. We imagine that constraints linked to the administrative and IT implementation of the reform justify this delay. The bill n° 8066 which creates a National Register of Buildings and Dwellings (the tool which will notably allow the identification of unoccupied dwellings) confirms this by giving the municipalities, “given the scale of the task”, 3 full years (from the 1st January following the entry into force of the law) to initialise the municipal register, the data that will be used to feed the national register. However, the argument does not work: the Grand Duchy has demonstrated its ability to mobilise about COVID as a matter of urgency.

Sure, it was a health emergency, but behind the housing crisis there is also a social emergency that has deserved an appropriate response for several years.

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EU List of non-cooperative tax jurisdictions for tax purposes updated

OUR INSIGHTS AT A GLANCE

- On 4 October 2022, the EU Finance Ministers decided to add Anguilla, The Bahamas and Turks and Caicos Islands to the EU list of non-cooperative jurisdictions for tax purposes.
- The new list was published in the Official Journal of the European Union on 12 October 2022, which is the date as from which the new list came into force.
- The update of the list is an important step as it directly impacts the scope of application of three different Luxembourg tax measures: the measure denying the corporate income tax deduction of interest and royalty expenses due to entities located in non-cooperative tax jurisdictions, the requirement to disclose transactions with entities located in non-cooperative jurisdictions and the mandatory disclosure rules applicable to certain cross-border arrangements (DAC6).

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The EU list of non-cooperative jurisdictions for tax purposes

The list of non-cooperative tax jurisdictions (the "**Blacklist**") is determined at EU level. It is a result of a thorough screening and dialogue process with non-EU countries to assess them against agreed criteria for good governance relating to tax transparency, fair taxation, the implementation of OECD BEPS measures and substance requirements for zero-tax countries.

The Blacklist is updated twice a year, taking into consideration the evolving deadlines for jurisdictions to deliver on their commitments and the evolution of the listing criteria that the EU uses to establish the list. Given these regular updates, the scope of application of all Luxembourg measures which refer to those jurisdictions will constantly evolve over time.

As of 12 October 2022 (date of publication of the Blacklist in the Official Journal of the European Union), following the listing of Anguilla, The Bahamas and Turks and Caicos Islands, the Blacklist now includes the 12 following jurisdictions (the "**Blacklisted Jurisdictions**"): American Samoa, Anguilla, The Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, Turks and Caicos Islands, US Virgin Islands and Vanuatu.

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

Based on Article 168 n°5 of the Luxembourg Income Tax Law ("**ITL**"), since 1 March 2021, under certain conditions, interest and royalties due to entities located in Blacklisted Jurisdictions are not deductible for corporate income tax purposes.

As a matter of principle, additions of countries to the Blacklist have only an effect as from the next calendar year whereas a removal of a country out of the Blacklist may have an immediate effect under certain circumstances. The new Blacklist, including the 12 countries, is the list to refer to for interest and royalties due as from 1 January 2023 (i.e. there will be no retroactive nor immediate effect but only an impact as from next year). It means that the deduction of interest and royalties due to the 3 newly added jurisdictions (Anguilla, The Bahamas and Turks and Caicos Islands) may only be denied based on Article 168-5 of the ITL as from 1 January 2023.

For a detailed explanation of the scope of the measure provided by Article 168-5 of the ITL, its conditions and its timing aspects, please read our article **New guidelines on Luxembourg defensive measures against non-cooperative jurisdictions for tax purposes** in our July 2022 ATOZ Insights.

Impact on disclosure requirements based on Circular L.I.R. n° 168/2 of 31 May 2022

Based on Section 4 of Circular L.I.R. n° 168/2 of 31 May 2022, the Luxembourg tax authorities systematically review transactions entered into by Luxembourg corporate taxpayers with related parties (within the meaning of article 56 of the Income Tax Law) located in Blacklisted Jurisdictions in order to assess whether the terms and conditions of the transactions reflect the arm's length principle. Detailed information on these transactions has to be reported by Luxembourg corporate taxpayers in their corporate tax return.

The Circular states that the blacklisting as of the end of the year concerned is key for determining whether reporting is required or not. Therefore, when determining whether a specific transaction has to be reported in the 2022 corporate income tax return under Circular L.I.R. n° 168/2 of 31 May 2022, reference will have to be made to the newly released October 2022 list.

As far as the disclosure for the 2021 corporate income tax returns is concerned, reference should be made to the EU list in force as of 12 October 2021 (date of publication in the Official Journal of the European Union of the October 2021 update).

Impact on disclosure requirements under DAC6

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

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

The question arises as to the list (in force as of which date?) to be taken into account to assess whether the recipient is resident in a non-cooperative jurisdiction. In this respect, the FAQ released by the Luxembourg tax authorities on DAC6 provides that "non-cooperative jurisdictions within the meaning of Hallmark C.1. are those which appear on the list (as published in the Official Journal of the European Union) on the date of the triggering event of the reporting obligation."

Therefore, reference should be made to the list in force at the time the arrangement was implemented and the listing or delisting of a jurisdiction after the arrangement has been implemented should not have any retroactive effect. In other words, reporting should only be required if the arrangement with the entity located in the jurisdiction was implemented at the time when this jurisdiction was on the Blacklist. As a consequence, only those arrangements implemented with Anguilla, The Bahamas or Turks and Caicos Islands on or after 12 October 2022 (but only as long as these jurisdictions remain on the Blacklist), may have to be reported under Hallmark C.1.b) ii).

Implications

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

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SAFE - The new EU initiative targeting tax advisers

OUR INSIGHTS AT A GLANCE

- On 6 July 2022, the EU Commission launched a public consultation regarding a proposal for a Council Directive to tackle tax advisers and other professionals rendering tax advice (collectively referred to as “enablers”) that facilitate tax evasion and aggressive tax planning.
- Interested parties had until 12 October 2022 to provide their feedback in a questionnaire referred to as “EU Survey: Proposal for a Council Directive to tackle the role of enablers that facilitate tax evasion and aggressive tax planning in the European Union (Securing the Activity Framework of Enablers - SAFE)”.
- We provide an overview of the questionnaire and analyse to which extent there is a real need for this initiative.

On 6 July 2022, the EU Commission launched a public consultation regarding a proposal for a Council Directive to tackle tax advisers and other professionals rendering tax advice (collectively referred to as “enablers”) that facilitate tax evasion and aggressive tax planning. Interested parties had until 12 October 2022 to provide their feedback in a questionnaire referred to as “EU Survey: Proposal for a Council Directive to tackle the role of enablers that facilitate tax evasion and aggressive tax planning in the European Union (Securing the Activity Framework of Enablers - SAFE)”. We provide an overview of the questionnaire and analyse to which extent there is a real need for this initiative.

Background

The European and international tax landscape has undergone a dramatic transformation over the last years. Following the OECD Base Erosion and Profit Shifting (“BEPS”) Project, the EU Commission adopted several EU Directives that aimed to tackle perceived tax evasion and tax avoidance.

The two Anti-Tax Avoidance Directives (“ATAD” and “ATAD II”) provided for a number of strict anti-abuse provisions that had to be transposed into the domestic tax laws of EU Member States. The 5th amendment of the Directive on Administrative Cooperation in the field of (direct) taxation (“DAC 6”) resulted in the introduction of the mandatory disclosure regime (“MDR”) that requires reporting on potentially aggressive tax planning schemes. End of 2021, the EU Commission further released a draft Directive regarding the misuse of EU shell entities[2] (“ATAD III”, also referred to as the “Unshell Directive”).

Other important changes to the international tax landscape have been advanced by the OECD. The Multilateral Instrument (“MLI”) resulted in the implementation of various anti-abuse provisions such as the Principal Purposes Test (“PPT”) in covered bilateral tax treaties. In 2017 and 2020, the OECD Transfer Pricing Guidelines have been revised in accordance with the guidance developed as part of the OECD’s (follow up) work on BEPS Actions 8 – 10 and 13.

Hence, the tax authorities of EU Member States have already a comprehensive arsenal of anti-abuse rules that allow them to tackle any kind of abusive situation as well as reporting requirements that should allow them to be aware of any residual abuse.

[2] Shell entities are entities lacking a minimum level of substance for tax purposes.

Nevertheless, despite all these changes, the EU Commission takes the view that tax advisers are still designing, marketing and assisting in the creation of tax schemes in non-EU countries that erode the tax base of EU Member States.[3] The purpose of the current initiative is to establish procedures and compliance measures to be adhered to by tax advisors and other professionals that render tax advisory services in order to prevent them from setting up complex structures in non-EU countriesthat erode the tax base of Member States through tax evasion and aggressive tax planning.

Tax evasion and aggressive tax planning

The questionnaire states that "*Complex structures, which typically include cross-border arrangements that could result in tax evasion or aggressive tax planning may be designed by some intermediaries that provide tax advisory services*". However, is this really true?

Tax evasion involves intentional, fraudulent conduct aimed at the evasion of taxes by illegal means. In these cases, taxpayers deliberately misrepresent or conceal the true state of their affairs from the tax authorities in order to reduce their tax liability. Examples of tax evasion include dishonest tax reporting[4], faked transactions to reduce tax payments and transfer pricing manipulations. Tax evasion involves a violation of law, is a criminal offence and may, therefore, be tackled by enforcement of the existing law (once discovered by the competent tax authorities).

While taxpayers engaging in tax evasion face severe penalties and potentially imprisonment, tax advisers involved in tax evasion will likely be punished by the withdrawal of their professional license and charged with a crime. These severe consequences deter, exceptions aside, taxpayers and tax advisers from being involved in practices that may be interpreted as tax evasion.
The term "aggressive tax planning" has been defined in the Commission Recommendation of 6 December 2012 on Aggressive Tax Planning (2012/772/EU) as follows: "Aggressive tax planning consists in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability. Aggressive tax planning can take a multitude of forms. Its consequences include double deductions (e.g. the same loss is deducted both in the State of source and residence) and double non-taxation (e.g. income which is not taxed in the source State is exempt in the State of residence)."

Accordingly, aggressive tax planning is present in the following two situations:

(i) Taxpayers take advantage of the technicalities of a tax system; or
(ii) Taxpayers take advantage of mismatches between two or more tax systems.

Both situations have in common that the tax treatment would not be consistent with the intention of the legislator.

However, the tax treatment of an arrangement is consistent with the intent of the legislator when the tax treatment of the arrangement relies on the application of explicit tax law (which is the expression of the intent of the legislator) or, in a cross-border context, does not take advantage of mismatches in the tax system of two or more jurisdictions.

The transposition of the two EU Anti-Tax Avoidance Directives[5] resulted in the adoption of the following anti-abuse legislation by EU Member States:

a) interest limitation rules;
b) controlled foreign company (CFC) rules;
c) exit tax rules;
d) general Anti-Abuse Rule (GAAR); and

[3] The EU Commission states in its document Call for evidence for an impact assessment (https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13488-Tax-evasion-aggressive-tax-planning-in-the-EU-tackling-the-role-of-enablers_en.) that while the Unshell Directive will ensure that EU shell entities are unable to benefit from any tax advantages, a follow-up initiative is still needed to respond to the challenges linked to non-EU shell entities.
[4] For instance, the non-declaration or underreporting of income or the overstating of expenses.
[5] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market ("ATAD"), Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries ("ATAD II").

e) hybrid mismatch rules.

The specific anti-abuse rules (a) – c)) target perceived vulnerabilities of domestic tax laws and resulted in a substantial harmonisation of the tax laws of EU Member States.

As regards aggressive tax planning, the GAAR allows tax authorities to tackle non-genuine arrangements which take advantage of technicalities of the applicable tax law, whereas the hybrid mismatch rules eliminate mismatch outcomes (double deduction and deduction without inclusion outcomes) that are the result of mismatches in the tax systems of two or more jurisdictions.

Tax benefits available under applicable tax treaties may be challenged in accordance with anti-abuse provisions such as the PPT, eliminating the possibility of taxpayers to engage in aggressive tax planning.

The revised OECD Transfer Pricing Guidelines include new guidance that aims to align transfer pricing outcomes with value creation. Moreover, the amended guidance provides tax authorities with additional room to challenge the transfer pricing of intra-group transactions and to disregard or re-characterise certain intra-group transactions.

Consequently, the transposition of the Anti-Tax Avoidance Directives, the modification of the bilateral tax treaty network and the revision of the OECD Transfer Pricing Guidelines virtually removed the possibility of using aggressive tax planning strategies and provided the tax administrations with far-reaching powers to challenge taxpayers.

The public consultation

- **Opening comments**

Following the release of its *Call for evidence for an impact assessment* (a document which explains the new initiative), the EU Commission launched a public consultation and invited interested parties to share their views by 12 October 2022 in a questionnaire.[6] The questionnaire is divided into three sections relating to (i) problem definition, (ii) ways to tackle the role of "enablers" in facilitating tax evasion and aggressive tax planning and (iii) enforcement of the measure.

Most of the questions require respondents to either (strongly) agree or (strongly) disagree with a statement. As such, the questionnaire leads the respondents around a certain narrative and limits the possibility to answer freely. This tactic has already been deployed in the public consultation regarding ATAD III and allows the EU Commission to twist the interpretation of the responses.

Moreover, while the document Call for evidence for an impact assessment identifies as an issue the setting up of complex tax structures "in non-EU countries", the questionnaire is drafted much more broadly (i.e. no distinction is made between EU and non-EU structures).

- **Problem definition**

The first part of the questionnaire focuses on problem definition. While the author welcomes public consultations, the nature and organization of this raise several issues.

For example, interested parties had to specify to which extent they agree with the following statements:

- "Despite all measures taken by the EU and Member States in this area, tax evasion and aggressive tax planning continue to be a substantial problem in the European Union.[7]"
- "The issue of tax evasion or aggressive tax planning has continued to increase recently.[8]"
- "Enablers play an important role in facilitating tax evasion and aggressive tax planning.[9]"

[6] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13488-Tax-evasion-aggressive-tax-planning-in-the-EU-tackling-the-role-of-enablers_en.
[7] See 3.1. of the questionnaire.
[8] See 3.3. of the questionnaire.
[9] See 3.5. of the questionnaire.

However, the EU toolbox to fight aggressive tax planning has been recently enhanced and new tools came into effect in 2019 and 2020. Therefore, respondents have most probably not any empirical data in this respect. Nonetheless, it seems safe to assume that the introduction of comprehensive anti-abuse rules in domestic tax laws, bilateral tax treaties and the OECD Transfer Pricing Guidelines should significantly reduce the magnitude of perceived aggressive tax planning as taxpayers may merely comply with explicit tax legislation. Hence, it is apparent that the EU Commission does not know if there even is an issue but asks interested parties for their "gut feeling" if there is a need for further action. This raises immediately the question as to whether the EU Commission has authority to intervene. The pretextual legal basis for the initiative would be Article 115 of the Treaty on the Functioning of the European Union ("TFEU") on the approximation of laws of the Member States, which directly affect the establishment or functioning of the internal market. It is difficult to understand how one concludes on the existence of a problem by asking a self-selecting but otherwise unqualified random selection of members of the public.

Furthermore, while the questionnaire is addressed to all "stakeholders", many of the questions can only be answered by people with a strong knowledge of international taxation. For example, the question regarding the criteria to be considered when assessing the existence of aggressive tax planning, including:

- The main business rationale/purpose behind the company structure;
- Other business rationale/purpose behind the company structure;
- Minimum economic substance of the entities used in the structure;
- Tax advantage obtained;
- Use of preferential tax regimes/tax treaties/ mismatches in national legislations across countries involved in the structure;
- Other (to be specified).

The EU Commission requested an assessment of each of these criteria to understand how relevant they are. However, these highly technical questions should be answered by commission experts; they do not lend themselves to public surveys.

- **Options considered**

The EU Commission considers a range of policy options which may lead to a legislative initiative, including:

- Option 1: Requirement for all tax advisers to carry out dedicated due diligence procedures
  This option would involve a prohibition on tax advisers (and other professionals rendering tax advisory services) from assisting in the creation of arrangements abroad that facilitate tax evasion or aggressive tax planning and a requirement to verify whether the arrangement or scheme leads to tax evasion or aggressive tax planning.
- Option 2: Prohibition to facilitate tax evasion and aggressive tax planning combined with due diligence procedures and a requirement for tax advisers to register in the EU
  The second option would aim to make sure that only registered tax advisers could provide tax advisory services to EU taxpayers or residents. In cases of non-compliance, tax advisers may be removed from the registry.
- Option 3: Code of conduct for all tax advisers
  This option would involve the requirement for all tax advisers to follow a code of conduct that obliges tax advisers to ensure that they do not facilitate tax evasion or aggressive tax planning.

Finally, a new measure might be introduced requiring EU taxpayers (both individuals and legal persons) to declare in their annual tax returns any participation above 25% of shares, voting rights, ownership interest, bearer shareholdings or control via other means (the level commonly used in the EU AML legislation) in a non-listed company located outside of the EU.

On each of these options, the EU Commission asked for an assessment and/or how effective the measure would be.

- **Enforcement of the measure**

With regard to the enforcement of the potential measure, respondents had to specify whether they (strongly) agree or (strongly) disagree with the statement that "monetary penalties are an adequate means to appropriately sanction and deter tax advisers from facilitating tax evasion and aggressive tax planning".

Moreover, respondents that either “strongly agreed” or “agreed” with this statement had to determine the type of monetary penalties that would be adequate to deter tax advisers helping their clients to evade or avoid taxes. Here, respondents could choose between “a proportion of their fees”, “a proportion of amounts evaded on behalf of their clients”, “an absolute fixed number” or “other” to be specified by the respondents.

Other measures focusing on tax evasion and tax avoidance

- **Opening comments**

The new initiative of the EU Commission is not the only initiative focusing on transparency regarding potentially aggressive tax planning. Rather, the MDR already requires tax intermediaries to analyse cross-border arrangements and to report potentially aggressive tax planning schemes.

Moreover, the Draft Unshell Directive focuses on the substance of companies that are resident for tax purposes in EU Member States. If adopted, this Directive would require EU Member States to introduce both new reporting obligations and anti-abuse rules targeting shell entities.

Following a concise overview of the MDR and the Draft Unshell Directive, the overlap with existing anti-abuse legislation and the new initiative of the EU Commission will be analysed.

- **The Mandatory Disclosure Regime (DAC6)**

Under the MDR, tax intermediaries such as tax advisers, accountants and lawyers that design, promote or provide assistance in regard to certain cross-border arrangements have to report these to the tax authorities. Since the implementation of the MDR, the analysis of potential reporting obligations has become an integral part of each and every tax analysis.

The MDR operates through a system of hallmarks that may trigger reporting obligations and the main benefit test (“MBT”) that functions as a threshold requirement for many of these hallmarks. As such, the MBT should filter out irrelevant reporting and 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.

When determining whether advice on a particular arrangement is reportable under the MDR, it first has to be analysed whether the arrangement has a cross-border dimension. This would be the case when an arrangement concerns either more than one EU Member State or 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 the Appendix to the DAC6 Directive. These hallmarks describe characteristics or features of cross-border arrangements that might present an indication of a potential risk of tax avoidance.

When at least one of the hallmarks is fulfilled, it has to be verified whether the hallmark is subject to the MBT. If this is not the case, there is an automatic reporting obligation under the MDR. 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.

- **The Unshell Directive (ATAD III)**

The Draft Directive would apply to all undertakings that are considered tax resident and are eligible to receive a tax residence certificate in a Member State regardless of their legal forms. The determination of shell entities under the proposed reporting regime involves a series of tests and may, in some cases, require a comprehensive analysis.

However, only entities that meet certain gateway criteria would have to report in their tax returns on specific indicators of minimum substance. When an entity satisfies all these indicators, there would be a presumption that the entity has minimum substance. Otherwise, there would a rebuttable presumption that the entity is a shell entity.

The proposed reporting regime further places an obligation on the Member States to exchange, in a timely manner, comprehensive information on entities subject to reporting and on entities that rebut the presumption of a lack of substance or are exempt from obligations under the Draft Directive.

The classification as a shell entity would have far-reaching (tax) consequences in the residence state of the entity and the other Member States involved.

- **Overlapping scopes and obligations**

Whenever a taxpayer obtains a tax benefit, it has to be analysed whether such benefit might be challenged in accordance with existing anti-abuse legislation. Tax benefits derived from aggressive tax planning may be denied in accordance with general and specific anti-abuse provisions under domestic tax law and bilateral tax treaties.

Tax advisors (and other tax intermediaries) further have to analyse potential reporting obligations under the MDR and anticipate potential reporting obligations under the Unshell Directive. While the MDR focuses on transactions (i.e. cross-border arrangements), the Unshell Directive focuses on the substance of entities resident in EU Member States.

However, when analysing potential reporting obligations under the MDR, it may also be necessary to analyse whether the entities involved have appropriate substance. More precisely, when a cross-border arrangement meets a hallmark that is subject to the MBT, the analysis as to whether the MBT is met requires an analysis of the substance of the entities involved.

When an entity is classified as a wholly artificial arrangement, the MBT would very likely be met and reporting will need to be made to the local tax authorities that share this information in a central database that is accessible to the tax authorities of all EU Member States. Accordingly, both reporting regimes have a certain overlap.

Whatever the outcome of the new initiative will be, it may only have a very limited effect in practice, as tax advisers already have to ensure that their advice may not be interpreted as aggressive tax planning (which can be tackled under existing anti-abuse legislation).

Conclusion

The current initiative of the EU Commission targets tax advisers and other professionals that render tax advisory services which have been labelled collectively as "enablers". However, in an ever-changing international tax environment, taxpayers must rely on the advice of experts to ensure compliance with all applicable laws. Asset managers and multinationals further have a fiduciary duty towards their investors to explore opportunities to manage their overall tax liability within the limits of the law.

The existing anti-abuse legislation and reporting obligations under the MDR tackle aggressive tax planning analysis already efficiently. Thus, the question arises as to what meaningful purpose an additional measure might serve.

Considering the above, the question arises as to whether the EU Commission has a legal basis for this initiative. Direct tax legislation falls within the ambit of Article 115 of the TFEU which stipulates that legal measures under that article shall be vested the legal form of a Directive. However, the EU's competences are governed and limited by the principles of subsidiarity and proportionality. As the new initiative does not seem to serve any real need, it is more than questionable if this initiative adheres to these principles.

Ultimately, it remains to be seen where we go from here. As we have seen lately some push back from EU Member States regarding the Draft Unshell Directive, questioning the Commission's authority for action, the current initiative may also give rise to some controversial discussions.

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BEFIT - EU Commission wants to introduce a common set of tax rules for EU companies

OUR INSIGHTS AT A GLANCE

- On 17 October 2022, the European Commission announced the launch of a public consultation on **Business in Europe: Framework for Income Taxation ("BEFIT")**, a new framework for EU corporate taxation.
- BEFIT is one of the initiatives announced by the European Commission in its May 2021 communication on Business Taxation for the 21st Century.
- The initiative would introduce a common set of rules for EU companies to calculate their taxable base and an allocation of profits between EU countries, based on a formula.
- Stakeholders are invited to provide input by the 26 January 2023 deadline on whether a new EU corporate tax framework is needed and on the most suitable options for implementing such framework.
- BEFIT's proposal adoption by the Commission is planned for the third quarter 2023.

On 17 October 2022, the European Commission announced the launch of a public consultation on **Business in Europe: Framework for Income Taxation ("BEFIT")**, a new framework for EU corporate taxation. BEFIT is one of the initiatives announced by the European Commission in its May 2021 communication on Business Taxation for the 21st Century. The initiative would, according to the Commission, "*introduce a common set of rules for EU companies to calculate their taxable base while ensuring a more effective allocation of profits between EU countries, based on a formula.*" BEFIT strongly resembles the previous Common Consolidated Corporate Tax Base ("CCCTB") proposal, which has been withdrawn.

According to the Commission, the initiative aims to address the complexity and high costs that businesses, notably those with cross border activities, face as a result of having to comply with 27 different corporate tax systems when doing business across the EU.

The Commission considers that the lack of a common corporate tax system undermines the competitiveness of the single market, as a result of distortions in investment and financing decisions (which may also be driven by tax optimisation strategies rather than primarily commercial considerations) and higher compliance costs for businesses active in more than one Member State as a result of having to comply with many different tax systems.

The Commission further states that this situation creates a competitive disadvantage for the single market compared to large non-EU markets, so the Commission. Stakeholders are invited to provide input by 26 January 2023 on whether a new EU corporate tax framework is needed, what its objectives would be and on the most suitable options for implementing such EU tax framework.

Is there a need to act?

The document *Call for evidence for an impact assessment* presents the different options envisaged by the Commission and the public consultation questionnaire provides further insights on the different options envisaged by the European Commission.

- **First option: Status quo scenario - No action at the EU level**

The baseline scenario used as a benchmark assumes that the current national rules on corporate taxation remain unchanged. This would imply maintaining the current lack of a common corporate tax system in the single market.

While the European Commission presents the absence of any action as an envisaged option it is rather unlikely that the European Commission will finally decide not to move forward with this new initiative. This is even expressly mentioned by the Commission itself in the public consultation paper according to which the European Commission intends to table a legislative proposal for a new corporate tax system in 2023.

- **Second option: EU action - Changing the existing domestic tax laws by means of a directive**

EU action would provide the key features of a common tax base together with an allocation of profits to Member States based on a formula. According to the European Commission, such a formula should ensure a balanced distribution of corporate tax revenues across Member States that better takes into account the realities of today's economy and global developments when allocating the tax base to Member States.

Given the nature of what the Commission identifies as a problem (cross-border commercial activities facing tax-related complexities, legislative fragmentation of national corporate tax systems, and reduced competitiveness of the EU single market), the Commission is of the view that EU action in the form of a directive, and not a soft law approach, seems appropriate.

What would an EU action mean?

While we are at the very first stage of the project where many aspects remain to be defined and clarified, what is already quite clear is that the BEFIT proposal has the potential of becoming a clear threat to the national sovereignty of the Member States.

Should such proposal be adopted, the room for manoeuvre of Member States in corporate tax matters would be reduced drastically, especially if the scope of application of the BEFIT rules is broad. Tax is a key aspect of national sovereignty as tax revenues provide governments with the means they need to function and tax laws reflect the structure of economies and the choices made in terms of tax policy.

One limit which EU Member States have to take into account when they adopt tax legislation is the respect of the EU fundamental freedoms. The European Commission can also take action if there is a need to make the internal market work properly. However, BEFIT seems to go far beyond those limits and it is questionable whether performing such a huge tax reform at EU level at this point is really justified and thus in line with the principles of subsidiarity and proportionality.

We have to keep in mind that the international tax landscape has been completely changing since the time the original CCCTB proposal emerged. Over the last decade, 15 BEPS Actions have been adopted at OECD level. The EU Commission was spearheading the implementation of various anti-BEPS measures through the Anti-Tax Avoidance Directives ("ATAD") 1 & 2, sometimes gold-plating the recommendations of the OECD. Finally, tax transparency has been elevated to a new level through the various amendments of the Directive on Administrative Cooperation ("DAC" 1-7).

Additional tax law changes on a European and global level are currently discussed, including amongst others, Pillars 1 and 2 (taxation of the digital economy and global minimum taxation), the Unshell Directive Proposal (ATAD 3) and the Directive Proposal to mitigate the debt bias (DEBRA).

In light of the above, BEFIT might not contribute much in the fight against aggressive tax planning practices (that may already be efficiently tackled with the existing toolbox of anti-abuse legislation). Another purported purpose of BEFIT is simplification. However, it is rather questionable if replacing 27 different tax systems (which have evolved and been clarified over decades) by a completely new set of rules that might be interpreted differently in different member states and has the potential to result in chronic legal uncertainty for years to come (after a decade of maximum legal uncertainty). While the Court of Justice of the European Union ("CJEU") would be there to guide the national legislators and tax authorities in the way they have to implement and apply the new EU tax rules at national level in line with EU law, it will take many years until the new EU tax system will become clearer (often it takes 10 years or longer until a problematic domestic tax rule is successfully challenged before the CJEU). In the meantime, there will be a lot of tax uncertainty for taxpayers and an increased complexity and administrative burden for both taxpayers and tax authorities when applying these new tax rules.

If action is taken, what are the options?

If an EU Action is envisaged, the EU Commission considers several policy options to establish the key features of a common tax base. The public consultation questionnaire requests the position of stakeholders on whether the system should be compulsory without threshold, compulsory as from a certain threshold or compulsory as from a certain threshold but with a possibility for companies below the threshold to opt in. When analysing the different options, stakeholders should consider the most appropriate/effective option from the point of view of both the taxpayer and the tax authorities.

- **On the scope of the proposal**

Regarding the scope of application of BEFIT, the following options are considered:

- Option 1: Only groups with consolidated global revenues exceeding EUR 750 million; or
- Option 2: A broader scope, with a lower revenue threshold, which, according to the Commission, could be of interest to SMEs with cross-border activities or even to SMEs with plans to operate cross-border in the near future, with an optin possibility. In this respect, the public consultation questionnaire makes the following suggestions: groups with over EUR 50 million or over EUR 250 million of consolidated global revenues, all groups regardless of the revenues or standalone companies, regardless of their revenues.

According to the Call for evidence for an impact assessment, sectoral carveouts would, in either case, be limited. In the public consultation questionnaire, the view of stakeholders is requested on whether excluding companies active in specific sectors of activity would be a good idea and on the issue of companies active in a mix of sectors.

Defining the scope of application of BEFIT is an important issue to solve. On the one hand, limiting the scope of new rules may make sense as it is important to only introduce changes where a real need can be identified. On the other hand, having two different tax systems applying in parallel can also be very problematic because it means that a company may be subject to one tax system or the other, depending on how its business is performing (if a certain threshold in terms of turnover is reached) and the tax system applicable to this company may change from one year to another.

- **On the tax base calculation**

  - Option 1: Groups in scope would be required to use standardised financial statements and the income reported therein would be subject to a limited list of tax adjustments; or
  - Option 2: Setting up of a comprehensive corporate tax system, with detailed rules for all aspects of profit and tax determination.

On the first option, the Commission asks stakeholders to determine what should constitute key adjustments to financial accounts and to assess some suggested adjustments (such as depreciation of fixed assets, exemption of received profit distributions, general anti-abuse rules, CFC rules, etc.). Here, as we already noticed regarding the questionnaire on the SAFE initiative, it is quite clear that while the questionnaire is addressed to all "stakeholders", these questions can only be answered by people with a strong knowledge of international taxation. It is about defining the rules of a new tax system which would have huge implications for many (if not all) companies.

On the second option, the European commission admits that "Member States would have to run two comprehensive sets of corporate tax rules in parallel, i.e. BEFIT and their national rules (this would not be the case under option 1, where BEFIT rules for tax determination would be simplified)." But this is not only true regarding the tax base computation: there would be two tax systems applying in parallel in any case if BEFIT has a limited (no matter how broad) scope of application.

Finally, the questionnaire considers the possibility of a cross-border loss relief and asks stakeholders on whether it should be part of the system and, if yes, what would be the implications. If stakeholders disagree, they should elaborate on ways of disallowing cross-border loss relief in a consolidation system. To answer this question, stakeholders can write a maximum of 500 characters, so basically 1-2 sentences maximum. However, these questions are highly technical and highly complex and one may wonder how the Commission can have such a naïve view about how a tax system is elaborated.

- **On the formula to allocate taxable profits to the Member States in which groups in scope maintain a taxable presence**

It is envisaged that the consolidated tax base of the BEFIT Group will be apportioned to the different EU countries in which the group operates, using a formula. An international consensus, reached for the first time, on the use of a profit allocation formula in Pillar 1, could help pave the way for the use of a formula in BEFIT. The Pillar 1 formula only uses one factor, while the more complex BEFIT would use at least three factors. Formulary apportionment is a mechanism for allocating the tax base among eligible jurisdictions (EU countries) on the basis of a set of pre-determined weighted factors. This formula would replace the arm's length principle as the relevant standard for the allocation of profits between associated enterprises. Stakeholders are requested to present their view on whether using such formula would be a good idea.

Then, when a formula is used, the most frequent factors for allocating profit are tangible assets, staff numbers, payroll and sales by destination. The higher these are in an EU country, the greater the share of profit would be allocated to this country. An alternative would be to also include intangible assets in the formula. As neither the categories of intangible assets recognised for accounting purposes nor the methods for evaluating them are harmonised across the EU, they could be taken into account using a proxy. This could include R&D expenses and marketing and advertising costs, combined with a nexus requirement (to be fulfilled by the company allocated a share of profits deriving from those intangibles).

Stakeholders are requested to take position on the following options:

- **Option 1:** A formula excluding intangible assets and considering only tangible assets, labour, and sales by destination; or
- **Option 2:** A formula incorporating intangible assets as a factor in the formula, in addition to the factors in the alternative option. Here, stakeholders should explain how the value of intangible assets should be taken into account (e.g. accounting value, proxy, or some other way) and indicate whether they have any suggestions for the content of the intangible assets factors (reference to R&D or marketing and advertising in a given EU country?).

Several options are considered regarding the weight of each factor. In the sample formula below, all four factors mentioned above are included and equally weighted (¼). The share of profit of group member F would be determined as follows (N.B. G refers to the whole group):

$$\begin{aligned} Share\ F = Consolidated\ Taxe\ Base * [&\frac{1}{4}\left(\frac{Sales\ by\ destination\ F}{Sales\ by\ destination\ G}\right) \\ &+ \frac{1}{4}\left(0.5\,\frac{Payroll\ F}{Payroll\ G} + 0.5\,\frac{No\ of\ employees\ F}{No\ of\ employees\ G}\right) + \frac{1}{4}\left(\frac{Tangible\ assets\ F}{Tangible\ assets\ G}\right) \\ &+ \frac{1}{4}\left(\frac{Intangible\ assets\ proxy\ F}{Intangible\ asstes\ G}\right)] \end{aligned}$$

In this formula, the EU country of destination (market jurisdiction) is less represented than the EU country of origin, as only one quarter of all factors, i.e. sales by destination, allocates profits to the market jurisdiction. To compensate for this, a possibility could be to apply an increased weighting to sales by destination (e.g. a double weighting, giving two fifths of the overall weighting to sales by destination and three fifths to origin). Stakeholders are requested to provide their view on whether sales by destination should be given a higher weighting in the formula (and if yes how) and on the sectors of activity in respect of which a sector-specific formula would be needed.

- **On the allocation of profits related to entities outside the EU**

Under BEFIT, the arm's length principle would continue to apply to pricing transactions between companies of the BEFIT Group and companies of the same group that are tax-resident outside the EU (i.e. outside the BEFIT Group); and/or their associated companies in the EU or a country outside the EU.

According to the Commission, the planned initiative could as such simplify the methods for applying transfer pricing rules, to give taxpayers greater legal certainty but without deviating from the arm's length principle.

Two options are envisaged:

- Option 1: A simplified approach to the administration of transfer pricing rules, based on mac-roeconomic industry benchmarks. The aim would not be to replace the arm's length principle. In fact, businesses would still need to carry out the necessary transfer pricing analysis. The envisaged rules would only provide guidance on tax authorities' risk approach to businesses' transactions with related entities outside the consolidated group; or
- Option 2: Keep the current approach to the application of transfer pricing rules.

- **On administration aspects**

Finally, the administration aspect of BEFIT is still under careful consideration, as one of the objectives of the initiative is to reduce compliance and administrative costs. However, the European Commission admits that "some additional compliance and administrative costs could arise in certain circumstances." Stakeholders can comment on whether they think that the BEFIT initiative will bring additional compliance costs, either as a taxpayer or as a tax administration.

As far as the reduction of administrative burden is concerned, the European Commission sees filing simplifications regarding tax returns, tax audits and dispute resolution. Stakeholders can indicate which of these simplifications they consider most useful.

Next steps and outlook

Stakeholders have until 26 January 2023 to provide their input on whether a new EU corporate tax framework is needed and on the most suitable options for implementing such framework.

BEFIT's proposal adoption by the Commission is planned for the third quarter 2023 so that one may wonder why the Commission is organising a public consultation when the outcome seems to be clear already. Maybe the Commission wants to give the public the perception that these measures have a democratic dimension even though it remains unclear how a self-selecting group of respondents can give credibility to this extremely complex tax initiative.

While it is quite clear that a Directive proposal will be released next year, a number of factors speak against the subsequent adoption of the BEFIT proposal:

- Firstly, the project looks very much like a remake of the CCCTB which Member States never managed to agree on.
- Secondly, international tax developments over the last decade (ATAD 1 & 2, DAC 6, …) virtually removed the original purpose of the CCCTB.
- Thirdly, the complexity of the new tax system will result in significant administrative burden and costs on the part of the taxpayers and the tax authorities, and has the potential to create chronic legal uncertainty (also considering the interaction with other tax systems such as Pillar 2).
- Fourthly, it can be questioned as to whether the EU Commission has a legal basis for this initiative as BEFIT violates both the principle of subsidiarity and the principle of proportionality.
- Last but not least, the BEFIT initiative would largely remove the member state's sovereignty in tax matters and render public finance a coincidence of formulary apportionment.

Ultimately, it remains to be seen whether the governments of EU member states will unanimously give up their sovereignty in tax matters.

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Decrease of the Luxembourg VAT rates for 2023

OUR INSIGHTS AT A GLANCE

- The law of 26 October 2022 implementing anti-inflation measures to help both households and businesses introduces among others a 1% decrease of the Luxembourg VAT rates from 1st January 2023 to 31 December 2023.
- This temporary reduction of the Luxembourg VAT rates should have a positive impact on consumers and businesses.

On 20 September 2022, the Luxembourg Prime Minister announced that the Government, the trade unions and the employer representatives reached a gentlemen agreement on an anti-inflation package of more than EUR 1,000,000,000 aiming to help households and businesses.

Following the publication of the law of 26 October 2022, the following Luxembourg VAT rates will be decreased by 1% for the period from 1st January 2023 to 31 December 2023:

- The standard rate of 17% will be lowered to 16%. This standard rate is applicable to goods and services not benefiting from any other reduced VAT rate;
- The intermediary rate of 14% (which applies notably to the management and the safe-keeping of securities) will be lowered to 13%;
- The rate of 8% (which applies notably to the provision of gas and electricity) will be lowered to 7%.

The super-reduced VAT rate of 3% will remain unchanged.

This temporary reduction of the Luxembourg VAT rates should have a positive impact on final consumers and businesses with no or limited VAT recovery right. Nevertheless, there is no obligation for Luxembourg suppliers to reduce their prices if they were agreed VAT included.

Luxembourg VAT taxable persons must closely follow-up on this topic to have their accounting and invoice generation systems updated to these new VAT rates. The utmost attention should also be paid to the rules applicable to the chargeable event, i.e. the determination of the applicable VAT rate considering the effective supply and the issuance of the related invoice.

Our VAT experts, Thibaut Boulangé and Lionel Van der Noot, are available to discuss the actions to be taken in this framework.

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CJEU: The notion of granting of credit and the activities of securitisation vehicles

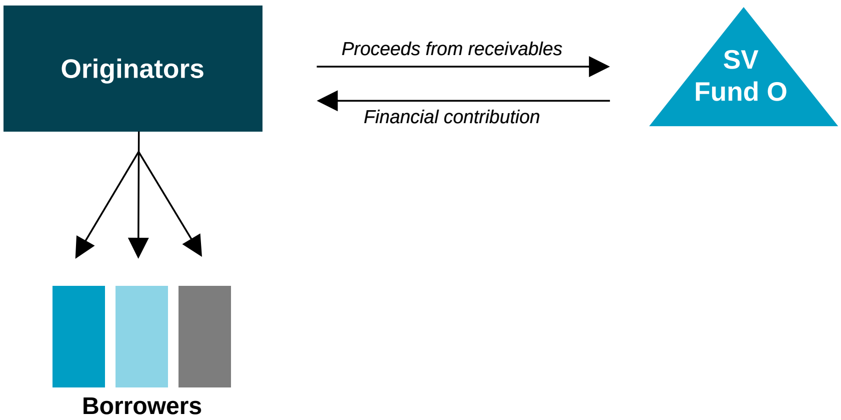
OUR INSIGHTS AT A GLANCE

- In a recent case, the CJEU ruled that the acquisition by a securitisation vehicle ("SV") of future proceeds from receivables of an originator should be assimilated to a VAT exempt financing activity (i.e. "granting of credit").
- VAT savings may be achieved by SVs financing originators established outside the EU, as input VAT incurred in relation to such operations is recoverable.
- SVs operating in Luxembourg shall monitor their VAT obligations (registration, filing of VAT returns) and review their VAT recovery rights.

Background and question referred to the EU Court

On 6 October 2022, the Court of Justice of the European Union ("CJEU") issued its decision in case *O. Fundusz*[10] in which the VAT treatment applicable to sub-participation agreements to be entered into between SV Fund O (as the Sub-participant) and banks / investment funds (as the Originators) was analysed.

Under these agreements, Fund O - a non-standardised securitisation vehicle ("SV") - would acquire, from the Originator, the (future) proceeds from specific receivables, in exchange for a contractually agreed financial contribution to be paid at the time of the sub-participation agreements' signing. The debt securities remain, however, in the assets of the Originators.



Before entering into the agreements, Fund O requested the Polish Minister for Finance to issue a tax ruling on the VAT treatment applicable to the envisaged operations. Several divergent decisions were issued by the involved Polish Authorities and, thus, the Polish Supreme Administrative Court decided to stay the proceedings in order to refer the case to the CJEU.

[10] CJEU, C-250/21, 6 October 2022, *Szef Krajowej Administracji Skarbowej v. O. Fundusz Inwestycyjny Zamknięty reprezentowany przez O S.A.*, [ECLI:EU:C:2022:757]

Position of the CJEU

The CJEU first examined whether the services provided by Fund O under the sub-participation agreement should be seen as effected for consideration (and, therefore, falling within the scope of VAT).

As Fund O undertook to make a financial contribution available to the Originator in exchange of receiving the (future) proceeds from the receivables specified in the agreement, the CJEU concluded that such services were provided for consideration.

The Court also held that it is irrelevant whether the consideration takes the form of a commission or of a specific fee. In the case at hand, the Court ruled that the consideration to be earned by Fund O should be the difference between the estimated value of the proceeds from the receivables and the amount of the financial contribution paid.

In a second phase, the CJEU analysed if the services provided by Fund O could benefit from the VAT exemption set out for the "granting of credit". For such purpose, and based on previous case-law in this concern, the Court recalled the following:

- the granting of credit consists, inter alia, in the provision of capital against remuneration;
- the fact that the operation is remunerated by other forms of consideration than the payment of interest cannot prevent it from being classified as the "granting of credit".

Given the above, the CJEU concluded that the making available of capital (the contractually agreed financial contribution paid to the Originator) in return for remuneration (the difference between the estimated value of the proceeds and the contribution paid), should be considered as falling within the notion of "granting of credit" and should therefore be VAT exempt.

Luxembourg VAT impacts

SVs financing Originators established within the EU should not be entitled to recover input VAT incurred[11] on their costs related to that specific EU financing activity. Indeed, EU financing is a VAT exempt activity not entitling to a VAT recovery right. In such a case, SVs may have to register for Luxembourg VAT under the simplified regime, notably if they receive taxable services from non-Luxembourg based service providers.

Conversely, SVs financing Originators established outside the EU shall be able to recover input VAT incurred in relation to this non-EU financing. The granting of financing to non-EU counterparts is VAT exempt but grants a VAT recovery right. It shall be recalled that, since 1 January 2021, the UK is considered a non-EU country for EU VAT purposes. A VAT registration under the complete format will be required in that case.

Outcome

This judgement may have a positive impact on the VAT deduction right of SVs engaged in sub-participation agreements with non-EU originators. We recommend Luxembourg SVs to review the nature and sources of their revenues (i.e. EU and / or non-EU) in order to determine if they are:

1) entitled to recover part or all of the input VAT incurred on their costs;
2) compliant with respect to the Luxembourg VAT registration obligations (i.e. if they have the obligation to VAT register and, if yes, whether under the simplified or the complete format).

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[11] Either invoiced by national suppliers or self-assessed under the reverse-charge mechanism.

Directors' fees: VAT or no VAT?

OUR INSIGHTS AT A GLANCE

- On 29 April 2022, the Luxembourg District Court made a referral to the Court of Justice of the European Union for a preliminary ruling in the case on the VAT treatment of activities carried out by a natural person as a member of the board of directors of a public limited company.
- Following that referral, the CJEU will have to determine whether directors' fees are subject to VAT or fall outside of the VAT scope.
- In case the CJEU were to conclude that director's percentage fees do not fall within the scope of the VAT, the Luxembourg current VAT treatment would be fundamentally altered.

Introduction

Fifty years (and counting) after the implementation of VAT in the EU, the VAT treatment of services rendered by members of management boards (hereafter, the "**Directors**") still differs greatly across the EU Member States, remaining one controversial and unharmonised area in the field of VAT.

In practice, the discrepancy across the EU Member States poses a number of challenges both for Directors and businesses, first and foremost complying with different administrative obligations depending on the jurisdiction in which the services are rendered and / or received.

Background – two opposing views on a complex question

- **Mr. TP and the "theory of the organ"**

Mr. TP, a physical person, is a Luxembourg lawyer and member of the board of directors of several Luxembourg companies. As a member of the management board, Mr. TP earned percentage fees ("tantièmes") in consideration for his services. According to Mr. TP, the services rendered as a member of the board of directors did not constitute an "economic activity" carried out independently for VAT purposes and therefore did not fall within the scope of VAT. As such, he did not charge any VAT for his services.

The EU VAT directive and the Luxembourg VAT law are clear on the fact that, to fall within the scope of the VAT, an economic activity must be conducted "independently". The lack of independence of the director would induce that his/her mandate would not fall within the scope of the VAT, justifying the non-application of the VAT on the related percentage fees.

In the case *IO*[12], the CJEU provided some guidelines to determine whether the activity of Directors of a supervisory board is carried out independently. The independence criteria should be met if the Directors of such supervisory board render their services in their own name, on their own behalf and under their own responsibility, and if they personally bear the economic risk linked to such activity.

Mr. TP is of the opinion that the condition of independence is not met based notably on the following elements:

(i) a Director does not hold any personal liability towards third parties for the results of his work (except in rare cases of wrongdoing). The economic risk associated with the activity of the board members is therefore borne by the company.

(ii) the board collectively discusses the possible options

[12] Case C-420/18 dated 13 June 2019

and takes decisions. As a consequence, the management service is provided to the company by the board as a whole and not by its individual members. This position reflects the 'theory of the organ', according to which the activity of director is exercised as a member of a collective organ representing the company, and therefore the management service is performed by such collective organ towards the company and not by the members of the organ taken individually.
(iii) the percentage fees are granted by the general assembly of shareholders and not agreed by the Director himself and his client.

- **The VAT authorities and the notion of "economic activity"**

In line with the Circular letter n°781 published in 2016, the Luxembourg VAT authorities consider that the activity of Mr. TP is an economic activity subject to VAT on the basis that the services of a Director are provided for consideration and on a permanent basis. As to the condition of independence, the AEDT (*Administration de l'enregistrement, des domaines et de la TVA*) considers that there is no subordination link between Mr. TP and the companies for which he is part of the management board on the basis, notably, that:

(i) Directors are free to determine their working conditions (autonomous organisation of their time),
(ii) the remuneration of a Director depends, at least in part, on the success of the business. An employee would not bear a similar risk, and
(iii) Directors can be civilly liable towards both the company and third parties for their actions, while employees would not.

Question referred to the EU Court

The District Court of Luxembourg, on 29 April 2022 has requested a preliminary ruling to the CJEU and referred two questions with respect to the VAT status of Directors. The Court will therefore have to assess whether Mr TP performs an "economic activity" carried out "independently".

Potential impacts for Luxembourg and EU based Directors

In case the CJEU were to conclude that director's percentage fees do not fall within the scope of VAT as Directors are not independent, the Luxembourg VAT environment would experience a true Copernican revolution. In such a case:

(i) Luxembourg Directors (at least those acting as natural persons) would no longer be considered as VAT taxable persons and would be relieved from the obligations to register for VAT, to file VAT returns, etc.,
(ii) VAT would no longer be chargeable on directors' percentage fees. Such a change would benefit to companies with no or limited VAT recovery right for which VAT charged or self-assessed on directors' fees constitutes a final cost.

The VAT status of Directors varies significantly across the EU Member States. In Belgium, by virtue of the "theory of the organ", natural persons acting as directors are not deemed to act independently from the company in which they carry out their mandates. As such, Director fees fall outside of the scope of Belgian VAT. In Germany, natural persons being board members may be considered as VAT taxable persons if they are considered as independent (to be determined based on factual elements such as acting on one's responsibility, entrepreneurial risk and initiative, fixed working hours, holiday entitlement, etc.). From a French perspective, the normal exercise of the management, administration or control functions should not be subject to VAT. The potential consequences of the TP case are therefore not limited to Luxembourg and it is very likely that the position of the CJEU will harmonise the VAT treatment of Directors across the EU.

Conclusion

The TP Case represents a good opportunity to shed a light on the VAT status of Directors' fees and on the VAT treatment of the "services" they provide. The position of the Court is eagerly awaited and will have to be closely monitored.

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Markets in Crypto-Assets and Transfer of Funds bills approved by the EU Council and Parliament officials: two combined elements for a major step further on the regulation of the crypto industry

OUR INSIGHTS AT A GLANCE

- On 5 October 2022, the Council of the European Union endorsed and published the final compromise text of the Regulation on Markets in Crypto-Assets to protect investors and preserve financial stability, while allowing innovation and fostering the attractiveness of the crypto-asset sector.
- The Regulation on Markets in Crypto-Assets lays down uniform requirements for the offering and placing on the market of crypto-assets.
- On 10 October, the Transfer of Funds Regulation which lays down rules on the information on payers and payees, accompanying transfers of funds for the purposes of preventing, detecting and investigating money laundering and terrorist financing was approved.
- The Transfer of Funds Regulation is not meant to apply to traditional payment systems only but to cover the transfers of crypto assets and is raising serious concerns in the industry.
- The entry into force of the two regulatory frameworks will represent a significant milestone in the development of the crypto industry in Europe.

Markets in Crypto-Assets and Transfer of Funds bills approved by the EU Council and Parliament officials: two combined elements for a major step further on the regulation of the crypto industry

On 5 October 2022, the Council of the European Union endorsed and published the final compromise text of the Regulation on Markets in Crypto-Assets ("**MiCA**"), which has been subsequently approved on 10 October by the European Parliament Committee on Economic and Monetary Affairs ("**ECON**") in a vote of 28 in favour and 1 against.

The draft regulation still has to be approved by the European Parliament but is likely to enter into force in 2024.

As per the EU Council press release[13], MiCA is meant to "*protect investors and preserve financial stability, while allowing innovation and fostering the attractiveness of the crypto-asset sector*".

This is of peculiar importance for the EU, which cannot miss the boat of a global market now worth USD 895B[14], but must find the right balance in a very contrasted context where recent scandals (Terra Luna, Celsius…) do not prevent major players such as BlackRock and Fidelity from launching ETFs focused on blockchain and crypto technologies. As of now, almost 50% of all blockchain and crypto funds are based in the US.

▪ A comprehensive regulation?

Pursuant to article 1 of the draft regulation, MiCA "*lays down uniform requirements for the offering and placing on the market of crypto-assets*[15] *other than asset-referenced tokens and e-money tokens, and requirements for crypto-*

[13] https://www.consilium.europa.eu/en/press/press-releases/2022/06/30/digital-finance-agreement-reached-on-european-crypto-assets-regulation-mica/pdf
[14] https://coinmarketcap.com
[15] Defined as a digital representation of a value or a right which may be transferred and stored electronically, using distributed ledger technology or similar technology

asset service providers" among the 27 EU member states.

The realms covered by the 380-page regulation are quite broad:

- transparency and disclosure requirements for the issuance, offering to the public and the admission to trading of crypto-assets on a trading platform for crypto-assets;
- authorisation and supervision of crypto-asset service providers, issuers of asset-referenced tokens and issuers of electronic money tokens;
- operation, organisation and governance of issuers of asset-referenced tokens, issuers of electronic money tokens and crypto-asset service providers;
- protection of holders of crypto-assets in the issuance, offering to the public and admission to trading;
- protection of clients of crypto-assets service providers;
- measures to prevent insider dealing, unlawful disclosure of inside information and market manipulation related to crypto-assets, in order to ensure the integrity of crypto-asset markets.

Yet, there are many outstanding questions left unanswered and market participants are divided on the effective impacts of the regulation.

- **Crypto-assets under MiCA**

MiCA introduces three sub-categories of crypto-assets that should be subject to different requirements depending on the risks they entail:

1) "electronic money tokens" or "e-money tokens" are crypto-assets that aim at stabilising their value by referencing only one official currency. Like electronic money, such crypto-assets may be used for making payments;
2) "asset-referenced tokens" aim at maintaining a stable value by referencing to any other value or right, or combination thereof, including one or several official currencies. This sub-category is intentionally generic to cover all other crypto-assets than e-money tokens whose value is backed by assets;
3) the third sub-category relates to all other crypto-assets that are not "asset-referenced tokens" or "e-money tokens", which covers a wide variety of crypto-assets, including utility tokens.

The regulation does not apply to the following crypto-assets:

- crypto-assets that are unique and not fungible with other crypto-assets, including digital art and collectibles, whose value is attributable to each crypto-asset's unique characteristics and the utility it gives to the token holder;
- crypto-assets representing services or physical assets that are unique and not fungible, such as product guarantees or real estate.

As provided in the draft regulation, "*while these crypto-assets might be traded in market places and be accumulated speculatively, they are not readily interchangeable and the relative value of one crypto-asset in relation to another, each being unique, cannot be ascertained by means of comparison to an existing market or equivalent asset. Such features limit the extent to which these crypto-assets can have a financial use, thus limiting risks to users and the system, and justifying the exemption*".

However, it is particularly interesting to note that "*the issuance of crypto-assets as non-fungible tokens in a large series or collection should be considered as an indicator of their fungibility. The sole attribution of a unique identifier to a crypto-asset is not sufficient to classify it as a unique or not fungible*".

Finally, one should keep in mind that "*the exclusion of crypto-assets that are unique and not fungible from this Regulation is without prejudice to qualification of such crypto-assets as financial instruments*".

- **Investors protection**

MiCA will protect consumers against some of the risks associated with the investment in crypto-assets, as those have been highlighted at different occasions by the Luxembourg regulator:

- Crypto-asset service providers will have to respect strong requirements to protect consumers wallets and become liable in case of loss of the wallets;
- Specific measures will be implemented to prevent or detect market abuse, taking into account notably the use of social media or the use of smart contracts for order executions and the concentration of mining pools;
- Minimum capital requirements will be set for crypto-asset service providers;
- Actors in the crypto-assets market will be required to declare information on principal adverse environmental and climate related impact of the consensus mechanism used to issue the crypto-asset.

- **What's next?**

On 10 October as well, members of the ECON also approved a provisional deal on the Transfer of Funds Regulation ("**TFR**"), which lays down "*rules on the information on payers and payees, accompanying transfers of funds, in any currency, for the purposes of preventing, detecting and investigating money laundering and terrorist financing, where at least one of the payment service providers involved in the transfer of funds is established in the Union*".

The TFR is not meant to apply to traditional payment systems only but to cover the transfers of crypto assets as well, and is raising serious concerns in the industry. In March, Coinbase CEO tweeted that the bill would require exchanges to report any crypto transactions to authorities, therefore treating "*crypto, and every person who holds crypto, differently from fiat*"[16], and Ledger posted an article on "*why the EU's transfer of funds regulation (TFR) is a threat to financial freedom?*"[17].

Anyway, the entry into force of the two regulatory frameworks will represent a significant milestone in the development of the crypto industry in Europe and will be closely looked at by international lawmakers in a context of global and intense competition in the sector.

Ahead of these promised challenges, market participants must question their own model and operations and start making any required adjustments now.

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[16] https://twitter.com/brian_armstrong/status/1509202822503428099
[17] https://www.ledger.com/blog-why-the-eus-transfer-of-funds-tfr-regulation-is-a-threat-to-financial-freedom

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