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TAX ADVISERS LUXEMBOURG

INSIGHTS

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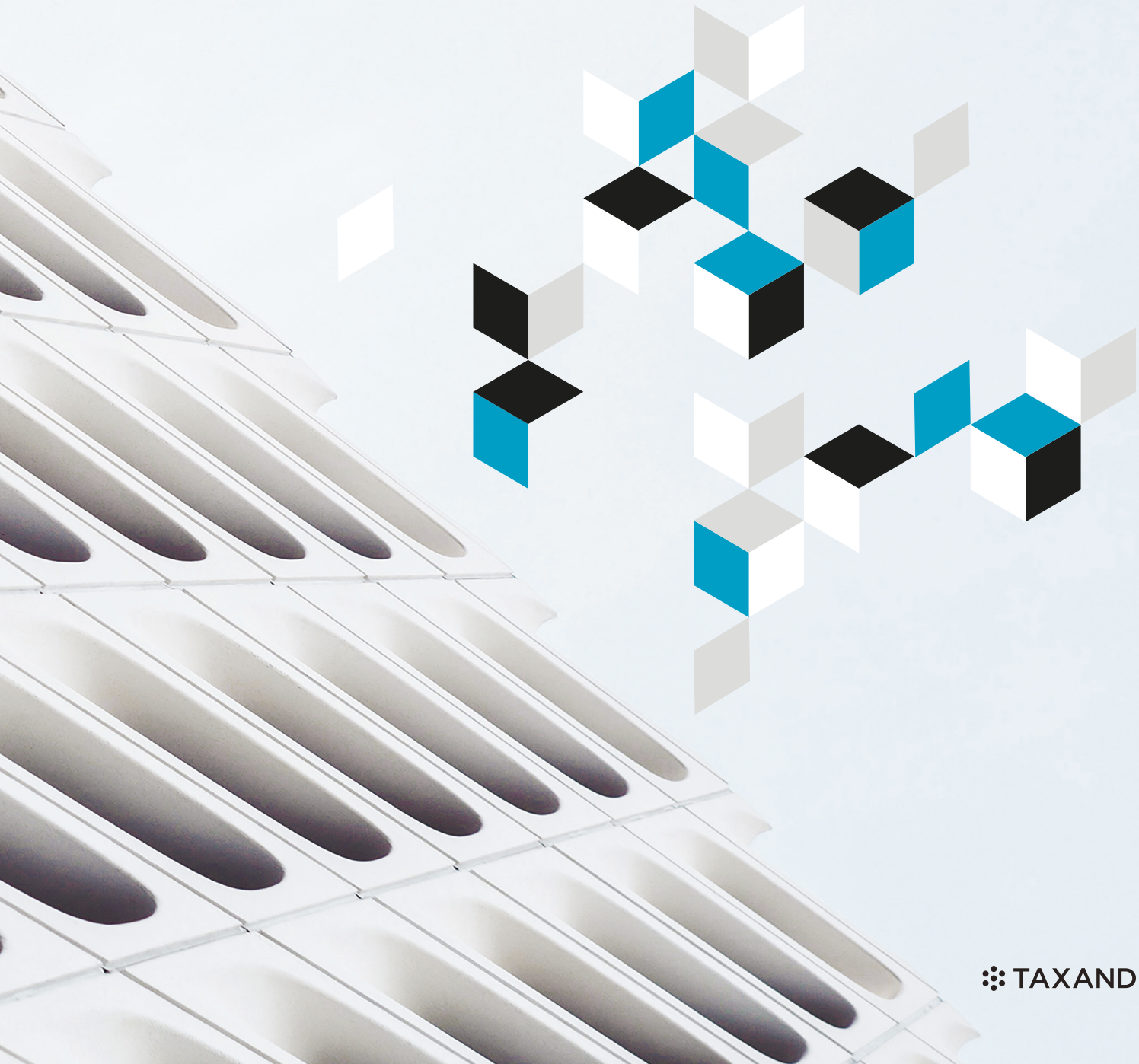

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EDITORIAL

Greetings,

After many years of reforms encouraged by the OECD's BEPS Action plan, it seems as if Luxembourg is now on the home stretch of the BEPS reform marathon.

In December, the Luxembourg parliament passed the last of the BEPS-inspired reforms in the pipeline: ATAD 2 and tax dispute resolution mechanisms. The adoption of the DAC 6 law, which has not been passed at the time of writing of the present Insights, should follow very soon. In these Insights, we describe the implications of the new Luxembourg rules implementing the EU Anti-Tax Avoidance Directive regarding hybrid mismatches with third countries (ATAD 2). We then provide an overview of the new Luxembourg procedure to resolve situations of double taxation between Luxembourg and one or more EU Member States based on the EU Directive on tax dispute resolution mechanisms. We also present the future new obligations of Luxembourg intermediaries in relation to the rules on mandatory automatic exchange of information in the field of taxation with reference to reportable cross-border arrangements (DAC 6).

In the run-up to the year-end events, the Luxembourg legislator also passed the 2020 budget law which introduces a handful of tax measures. The most significant tax measure of the 2020 budget states that tax rulings granted prior to 1 January 2015 will no longer be valid as from the end of tax year 2019. We present the implications of this measure.

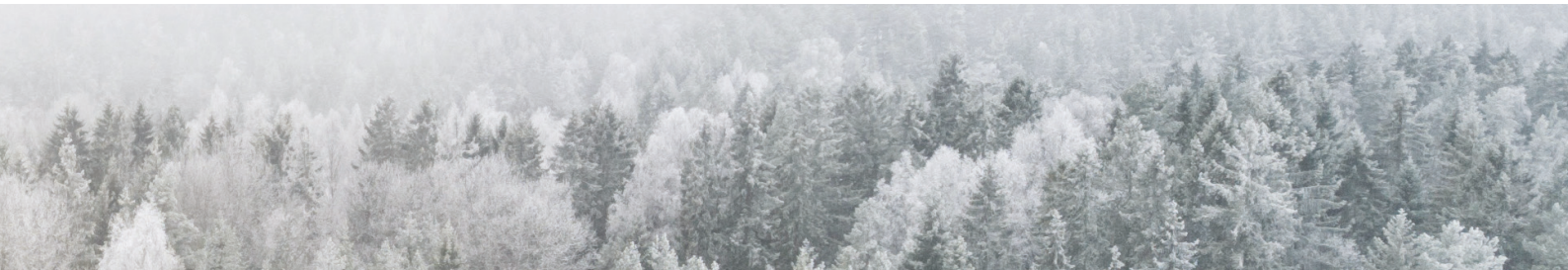
At the international level, the OECD made proposals that aim at addressing the specific tax challenges created by the digitalisation of the economy. The proposals seek to answer how taxing rights on income generated from cross-border activities in the digital age should be allocated among jurisdictions and how to address ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation. Should they be adopted, these proposals may lead to changes far beyond the digital economy and may impact all kinds of industries and businesses. We describe the main features of the OECD proposals.

From a VAT point of view, Luxembourg implemented the EU Quick Fixes on harmonisation and simplification of VAT for cross-border trade. We describe the aim of these Quick Fixes. We also take the opportunity in this issue of Insights to describe the rules applicable for the VAT deduction on overhead costs through the analysis of the recent decision of the CJEU in the Cambridge University case.

Lastly, in our final article, we provide you with a summary of the Luxembourg key corporate implementation developments in 2019 and 2020.

We hope you enjoy reading our insights.

The ATOZ Editorial Team



Luxembourg implements ATAD 2

OUR INSIGHTS AT A GLANCE

- On 19 December 2019, the Luxembourg legislator passed the law implementing ATAD 2, the directive which provides for a comprehensive framework to tackle hybrid mismatches.
- These new rules will replace the existing hybrid mismatch rules which have been introduced as part of the 2019 tax reform implementing ATAD and extend their scope to transactions involving non-EU countries.
- Luxembourg has made the right choices, adopting all available implementation options which limit the scope of the new rules for the benefit of Luxembourg taxpayers and avoid unintended collateral damage for the Luxembourg fund industry.
- The hybrid mismatch rules are characterised by an extreme complexity which requires a good understanding of the overall investment structure and the foreign tax treatment of payments, entities, financial instruments, etc.
- Given that the burden of proof regarding the non-application of the hybrid mismatch rules is on the taxpayer, a hybrid mismatch analysis will become an integral and necessary part of each and every tax analysis.

On 19 December 2019, the Luxembourg legislator passed the law implementing EU Directive 2017/952 of 29 May 2017 (the "Anti-Tax Avoidance Directive 2" or "ATAD 2") which provides for a comprehensive framework to tackle hybrid mismatches. These new rules will replace the existing hybrid mismatch rules which had been introduced as part of the 2019 tax reform implementing EU Directive 2016/1164 of 28 January 2016 (the "Anti-Tax Avoidance Directive" or "ATAD") and extend their scope to transactions involving non-EU countries.

Hybrid mismatches typically result from a different tax treatment of an entity or financial instrument under the laws of two or more jurisdictions and may result in deduction without inclusion outcomes or double deductions.

The hybrid mismatch rules target a number of different situations including direct hybrid mismatches between associated enterprises, structured arrangements between third parties, imported hybrid mismatches and tax residency mismatches. Payments that may come within the scope of the hybrid mismatch rules may include payments under financial instruments and, in some cases, other deductible payments such as royalties, rents and payments for services.

While the primary objective of the hybrid mismatch rules is the elimination of double non-taxation, these rules should also not result in economic double taxation. The latter is ensured through a number of carve-outs and limitations that cancel the application of the hybrid mismatch rules.

ATAD 2 follows the recommendations of the OECD in regard to Base Erosion and Profit Shifting ("BEPS") Action 2 that aim at neutralising the effects of hybrid mismatch arrangements through the application of linking rules that align the tax treatment in two or more jurisdictions. ATAD 2 explicitly states that the explanations and examples in the Final Report on Action 2 may be a source of interpretation to the extent they are consistent with the provisions of the Directive.

1. Hybrid mismatch rules

1.1. Scope of the hybrid mismatch rules

- **Relevant hybrid mismatches**

Article 168ter of the Luxembourg Income Tax Law (LITL) addresses four categories of hybrid mismatches:

- hybrid mismatches that result from payments under a financial instrument, including hybrid transfer;
- hybrid mismatches that are a consequence of differences in the allocation of payments made to a hybrid entity or permanent establishment ("PE"), including as a result of payment to a disregarded PE;
- hybrid mismatches that result from payments made by a hybrid entity to its owner or deemed payments between the head office and PE or between two or more PEs; and
- double deduction outcomes resulting from payments made by a hybrid entity or PE.

Article 168ter of the LITL generally applies in case of mismatch outcomes which include deductions without inclusions and double deductions.

However, mismatch outcomes shall not be treated as hybrid mismatches unless they arise:

- between associated enterprises,
- between a taxpayer and an associated enterprise,
- between the head office and PE,
- between two or more PEs of the same entity, or
- under a structured arrangement (in this case, even unrelated parties may come within the scope of the anti-hybrid mismatch rules).

Article 168ter of the LITL further provides for rules that target imported hybrid mismatches that shift the effect of a hybrid mismatch between parties in third countries into the jurisdiction of EU Member States through the use of a non-hybrid instrument.

Finally, Article 168ter of the LITL provides for rules that neutralise double deduction outcomes in case of tax residence mismatches (i.e. when an entity is resident for tax purposes in two or more jurisdictions).

- **Associated enterprises**

The scope of hybrid mismatch arrangements is generally limited to transactions between associated enterprises with a participation of at least 50% in terms of voting rights or capital ownership, or entitlement to receive at least 50% of an entity's profit (that is the related party test). With regard to hybrid mismatches involving hybrid financial instruments, the threshold requirement of 50% is reduced to 25%.

In certain circumstances, the shareholding percentages of otherwise unrelated parties should be aggregated for the purposes of the related party test. More precisely, a person who acts together with another person in respect of voting rights or capital ownership of an entity shall be treated as holding a participation in all of the voting rights or capital ownership of that entity that are held by the other person.

The purpose of the "acting together" concept is to prevent taxpayers from avoiding the related party test being met by transferring their voting interest or equity interest to another person, who continues to act under their direction in relation to those interests. The other situation targeted by the acting together concept is where a taxpayer or a group of taxpayers who individually hold minority stakes in an entity, enter into arrangements that would allow them to act together (or under the direction of a single controlling mind) to enter into a hybrid mismatch arrangement with respect to one of them.

According to the commentaries to the draft law, investors in a fund generally do not have effective control over the investments made by the fund; the fund is required to invest the contributions in accordance with the fund's investment policy. Therefore, the law provides for a safe harbour rule according to which an investor (be it an individual or an entity) that directly or indirectly owns less than 10% of the shares or units in the fund and that is entitled to less than 10% of the fund's profits is considered not to act together with other investors, unless proven otherwise.

Hence, in an investment fund context, the ownership of stakes below 10% should generally not be added when considering a potential aggregation of interests as a consequence of the "acting together" concept. Moreover, when investors in a fund own 10% or more of the shares or fund units, or are entitled to 10% or more of the fund's profits, a case-by-case analysis has to be performed to determine whether two or more investors are acting together in a given case.

- **Limits of the hybrid mismatch rules**

The purpose of Article 168ter of the LITL is the neutralisation of mismatch outcomes that occur in certain hybrid mismatch situations. At the same time, the hybrid mismatch rules should not create economic double taxation. The scope of the hybrid mismatch rules is limited as follows:

Deductible payments

The hybrid mismatch rules are exclusively targeted at "deductible payments". Thus, non-deductible payments such as interest expenses incurred in relation to tax exempt income do not come within the scope of Article 168ter of the LITL.

Timing differences

Jurisdictions may use different tax periods and have different rules for recognising when items of income or expenditure have been derived or incurred. However, timing differences should generally not be treated as giving rise to mismatches in tax outcomes as long as the income is included within a reasonable timeframe. A payment under a financial instrument is deemed to be included within a reasonable period of time if the payment is included by the payee within 12 months of the end of the payer's tax period.

ATAD 2 and the effect of other EU Directives

When the provisions of another EU Directive, such as the Parent-Subsidiary Directive, lead to the neutralisation of the mismatch in tax outcomes, the hybrid mismatch rules should not apply. Notably, under Article 166 (2a) of the LITL (i.e. the domestic implementation of the Parent-Subsidiary Directive, as amended), a dividend payment only benefits from the participation exemption regime to the extent the payment was not deductible at the level of the EU subsidiary.

Inclusion of income

A deduction without inclusion outcome assumes that a deductible payment is not included in any jurisdiction where that payment or deemed payment is received or is treated as being received under the laws of any other jurisdiction. On the contrary, no mismatch outcome exists if the payment is included in the taxable income in at least one jurisdiction. Thus, the inclusion in any jurisdiction is sufficient to cancel the application of the hybrid mismatch rules.

Tax status of the payee

A payment should not be treated as giving rise to a hybrid mismatch if that mismatch outcome would have arisen in any event due to

the tax-exempt status of the payee under the laws of the payee jurisdiction (for example, tax exempt investment funds, pensions funds and sovereign wealth funds). This includes payments to a taxpayer that is resident in a jurisdiction that does not levy corporate income tax and payments to a taxpayer in a pure territorial regime where the income is excluded or exempt as foreign source income. Furthermore, as regards financial instruments, a payment should not be considered as giving rise to a mismatch outcome that is solely due to the fact that the instrument is subject to the terms of a special regime. Thus, in these circumstances, the hybrid mismatch rules should not apply.

Dual inclusion income

With regard to certain hybrid mismatches, Article 168ter of the LITL only applies if and to the extent such deductions are set off against income that is not dual inclusion income (i.e. any item of income that is included under the laws of both jurisdictions where the mismatch outcome has arisen). Thus, the deduction of payments from dual-inclusion income does not trigger the application of the hybrid mismatch rules.

Transfer pricing adjustments

Differences in tax outcomes that are solely attributable to transfer pricing adjustments do not fall within the scope of the hybrid mismatch rules. Therefore, downward adjustments that are treated as deductible expenses by a taxpayer should not trigger the application of the hybrid mismatch rules even if no corresponding transfer pricing adjustment is made in the other jurisdiction.

Allocation of taxing rights under tax treaties

Any adjustment required under the hybrid mismatch rules should in principle not affect the allocation of taxing rights between jurisdictions established under a tax treaty, confirming that tax treaty law generally takes precedence over the domestic tax laws of the Contracting States.

1.2. Tax treatment of hybrid mismatches

Article 168ter of the LITL aims at neutralising the effects of hybrid mismatches. With regard to deduction without inclusion and double deduction outcomes, the new hybrid mismatch rules provide for linking rules that align the tax treatment of an instrument or an entity in one jurisdiction with the tax treatment in the counterparty jurisdiction.

More precisely, Article 168ter (3) of the LITL sets out a primary rule and a secondary (or defensive) rule for the neutralisation of mismatch outcomes. This mechanism should prevent more than one country from applying the hybrid mismatch rules to the same arrangement and also avoids double taxation.

According to the primary rule, the deduction of a payment is denied to the extent that it is not included in the taxable income of the recipient or is also deductible in the counterparty jurisdiction. When the primary rule is not applied, the counterparty jurisdiction may apply a defensive rule, requiring the deductible payment to be included in the income or denying the duplicate deduction, depending on the nature of the mismatch.

When a hybrid mismatch involves a third state, ATAD 2 places the responsibility to neutralise the effects of hybrid mismatches, including imported hybrid mismatches into the EU Member States.

Imported hybrid mismatches shift the effect of a hybrid mismatch between parties in third countries (be it intra-group or structured arrangements) into the jurisdiction of EU Member States through the use of a non-hybrid instrument. To counter such imported mismatches, Article 168ter (3) No. 3 of the LITL provides that payments are not deductible for tax purposes to the extent that such payments directly or indirectly fund deductible expenditure giving rise to a hybrid mismatch through a transaction or a series of transactions between associated enterprises or entered into as part of a structured arrangement.

When a Luxembourg corporate taxpayer is deemed to be resident for tax purposes in one or more foreign jurisdictions, payments, expenses or losses that are also deductible in the other jurisdiction(s) should not be tax deductible in Luxembourg to the extent that such other jurisdiction(s) allow(s) such payments, expenses or losses to be set off against income that is not dual-inclusion income. However, tax residency mismatches should hardly ever occur in Luxembourg as tax treaties concluded by Luxembourg eliminate tax residency mismatches through the tie-breaker rule.

To the extent that a hybrid transfer is designed to produce a relief for tax withheld at source on a payment derived from a financial instrument, with the relief being available for more than one of the parties involved, the law also limits the benefit of such relief in proportion to the net taxable income regarding such payment.

The adjustment should, however, be no more than what is necessary to neutralise the hybrid mismatch and not result in economic double taxation. When, for example, the payee jurisdiction only provides taxpayers with a partial exemption or a reduced rate on a payment under a hybrid financial instrument, the amount of the deduction that is denied should generally be no more than the amount of mismatch in tax outcomes between the payer and the payee jurisdiction.

1.3. Burden of proof

According to Article 168ter (6) of the LITL, the taxpayer has the burden of proof that the hybrid mismatch rules are not applicable. Taxpayers must, upon request, provide the tax authorities with a statement of the issuer of the financial instrument or any other relevant element such as a tax return, a tax certificate or any document issued by the foreign tax authorities in order to demonstrate that the hybrid mismatch rules provided under Article 168ter (3) – (5) of the LITL are not applicable.

The commentary to the draft law specifies that taxpayers need to produce reasonable evidence that allows the tax authorities to verify whether or not the hybrid mismatch rules apply. With regard to the

elements of foreign tax treatment of potential hybrid mismatches, taxpayers have to provide comprehensive, objective and verifiable information.

2. Reverse hybrid mismatch rules

2.1. Scope of the reverse hybrid mismatch rule

A reverse hybrid is an entity that is treated as 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). As a consequence, the income of a reverse hybrid may be neither taxable in its establishment jurisdiction (as the income is deemed to be allocated to the investor) nor in the residence state of the investor(s) (where the income of the opaque entity is generally not included in the taxable income of the investor(s)).

The reverse hybrid mismatch rule aims at eliminating double non-taxation outcomes through the treatment of reverse hybrids as resident taxpayers. Article 168quater of the LITL will apply as from tax year 2022 to all entities within the meaning of Article 175 of the LITL that are established in Luxembourg (in particular, partnerships). Given that these entities are treated as fiscally transparent from a Luxembourg tax perspective, their income is generally allocated to the owners.

However, the reverse hybrid mismatch rule may only apply when one or more investor(s) (that are resident in a jurisdiction or jurisdictions that regard the Luxembourg entity as opaque) have effective control over the Luxembourg entity. This would be the case when the entity is owned by one or several associated enterprises within the meaning of Article 168ter (1) No. 17 of the LITL which directly or indirectly hold a participation of at least 50% in terms of voting rights or capital ownership or is entitled to receive at least 50% of an entity's profit.

2.2. Tax treatment of reverse hybrid mismatches

2.2.1. Corporate income tax

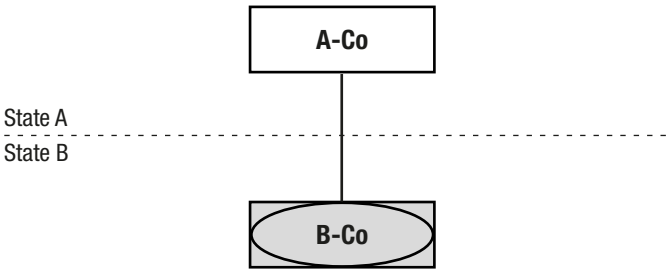
When the reverse hybrid mismatch rule applies, the entity is deemed to be a resident taxpayer and its net income is subject to corporate income tax to the extent this income is not subject to (corporate) income tax at the level of the investors, be it in Luxembourg or abroad.

Accordingly, the reverse hybrid mismatch rules will not apply if and to the extent the income derived through the Luxembourg entity is taxable in Luxembourg as domestic income of non-resident taxpayers. This may, for example, be the case when a Luxembourg partnership performs a commercial activity that results in the constitution of a PE of its non-resident partner(s).

Therefore, the inclusion of income for Luxembourg corporate income taxes should be limited to amounts that otherwise would result in double non-taxation rather than taxing all of the income of the reverse hybrid.

Example: Reverse hybrid mismatch

An investor resident in State A (A-Co) invests in an entity resident in State B (B-Co). While B-Co is treated as a transparent entity from the perspective of State B, under the domestic tax law of State A, B-Co is treated as an opaque entity.



In State B, the income of B-Co is not taxed as the income is allocated for income tax purposes to the owner of B-Co. In State A, the income of B-Co is not taxable as B-Co is classified as an opaque entity. Thus, the income of the reverse hybrid is neither taxable in State A nor in State B.

In these circumstances (assuming that Luxembourg is State B), Article 168quater (1) of the LITL should result in B-Co being treated as a resident taxpayer and subject to corporate income tax ("CIT") to the extent the net income is not taxed otherwise under the Luxembourg income tax law or the law of any other jurisdiction.

With regard to payments to a reverse hybrid entity, the reverse hybrid mismatch rule will ensure that arrangements that would otherwise give rise to a mismatch outcome within the meaning of Article 168ter (1) No. 2 of the LITL will not be subject to any further adjustment under the hybrid mismatch rules. This is because Article 168quater eliminates the deduction without inclusion outcome that may otherwise trigger non-deductibility in accordance with the hybrid mismatch rules.

Article 168quater of the LITL provides for a carve-out for collective investment vehicles ("CIV") that are often established in the legal form of a partnership (for example, a "*société en commandite simple*", "SCS") or a contractual fund without legal personality ("*fonds commun de placement*" or "FCP"). A CIV is defined as an investment fund or a vehicle that is widely held, holds a diversified portfolio of securities and is subject to investor-protection regulation in the country in which it is established.

The commentaries to the draft law specify that the definition of a CIV includes the following types of entities:

- Undertakings for collective investment ("UCIs") within the meaning of the Law of 17 December 2010 (i.e. both undertakings for collective investment in transferable securities, "UCITS", within the meaning of part 1 of the UCI Law of 17 December 2010 and non-UCITS or alternative investment funds within the meaning of part 2 of the UCI Law);
- Specialised Investment Funds ("SIFs") within the meaning of the Law of 13 February 2007;

- Reserved Alternative Investment Funds ("RAIFs") within the meaning of the Law of 23 July 2016; and
- Other alternative investment funds within the meaning of Law of 12 July 2013 on alternative investment fund managers which do not already fall into one of the previous categories to the extent that they are widely held, hold a diversified portfolio of securities (so as to limit market risks) and are subject to investor protection obligations.

2.2.2. Municipal business tax

The reverse hybrid mismatch rule has no impact on Luxembourg municipal business taxation. Instead, the tax treatment of a Luxembourg partnership depends significantly on the activities performed. Notwithstanding the fact that partnerships are deemed to be transparent for Luxembourg direct tax purposes, Luxembourg partnerships are subject to municipal business tax on profits derived from carrying out a commercial activity within the meaning of Article 14 (1) of the LITL through a PE situated in Luxembourg.

Likewise, where a general partner of a Luxembourg (special) limited partnership is a Luxembourg company owning a stake of at least 5% in the partnership, the latter is deemed to generate commercial income.

The commercial income realised by Luxembourg partnerships is subject to Luxembourg municipal business tax at the level of the partnership.

2.2.3. Net wealth tax

With regard to net wealth tax, the law provides for a specific exemption for entities that are treated as opaque in accordance with the reverse hybrid mismatch rule. Thus, reverse hybrids are not subject to net wealth tax regardless of whether the entity is treated as a taxpayer for corporate income tax purposes.

2.3. Burden of proof

The burden of proof that the reverse hybrid mismatch rule does not apply is on the taxpayers. According to Article 168quater (3) of the LITL, taxpayers have to provide, upon request, relevant documentation (tax returns, certificates issued by foreign tax authorities, etc.) demonstrating that the reverse hybrid mismatch rule does not apply.

The commentary to the draft law also specifies that taxpayers need to produce reasonable evidence that allows the tax authorities to verify whether or not the hybrid mismatch rules apply. With regard to the elements of foreign tax treatment of potential hybrid mismatches, taxpayers have to provide comprehensive, objective and verifiable information.

1. To sum up

As from 2020, the Luxembourg legislator implements the comprehensive hybrid mismatch rules provided under ATAD 2 that extend the scope of the existing hybrid mismatch rules to hybrid mismatches involving third states and, in addition, include a reverse hybrid mismatch rule which will apply as from 2022.

However, Luxembourg has made the right choices, adopting all available implementation options which limit the scope of the new rules for the benefit of Luxembourg taxpayers and avoid unintended collateral damage for the Luxembourg fund industry.

The hybrid mismatch rules are characterised by an extreme complexity which requires a good understanding of the overall investment structure and the foreign tax treatment of payments, entities, financial instruments, etc. Given that the burden of proof regarding the non-application of the hybrid mismatch rules is on the taxpayer, a hybrid mismatch analysis will become an integral and necessary part of each and every tax analysis.

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Luxembourg implements DAC 6 – How to interpret the Main Benefit Test?

OUR INSIGHTS AT A GLANCE

- The draft law implementing the EU Directive on mandatory exchange of information in the field of taxation in relation to reportable cross-border arrangements ("DAC 6") was presented to Parliament on 8 August 2019.
- As expected, the wording of the law largely resembles the wording of DAC 6 and the commentaries to the draft law provide only few explanations on how it will be interpreted and applied in practice. Therefore, some of the rather vague terms and concepts used in DAC 6 will continue to give rise to uncertainty and require interpretation.
- This article analyses the main benefit test which is a threshold requirement that operates in conjunction with many of the hallmarks that, when present, may create reporting obligations under the new mandatory disclosure regime.
- The analysis of potential reporting obligations under the new mandatory disclosure regime will become an integral and necessary part of each and every tax analysis. This on its own will have the desired deterrence effect as both tax intermediaries and taxpayers will need to carefully consider potential reporting obligations.
- Ultimately, the mandatory disclosure regime may also be viewed as an opportunity to consider and emphasise the commercial reasons and business rationale driving international investments and business activities.

The draft law implementing Directive (EU) 2018/822 of 25 May 2018 as regards mandatory exchange of information in the field of taxation in relation to reportable cross-border arrangements ("DAC 6") was presented to Parliament on 8 August 2019. This article analyses the main benefit test ("MBT") which is a threshold requirement that operates in conjunction with many of the hallmarks that, when present, may create reporting obligations under the new mandatory disclosure regime ("MDR").

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 will have to report these to the tax authorities.

The purpose of the MDR is to provide tax authorities with comprehensive and relevant information about potentially aggressive tax planning strategies. Such information should enable tax authorities to react promptly against harmful tax practices (closing loopholes by enacting legislation, undertaking adequate risk assessments and carrying out tax audits, etc.).

It is common knowledge that the investments and business activities of Luxembourg companies often have a cross-border dimension. In all these cases, the question needs to be answered as to whether a particular piece of advice, or involvement in implementation, is reportable under the MDR.

1. How to determine reportable cross-border arrangements?

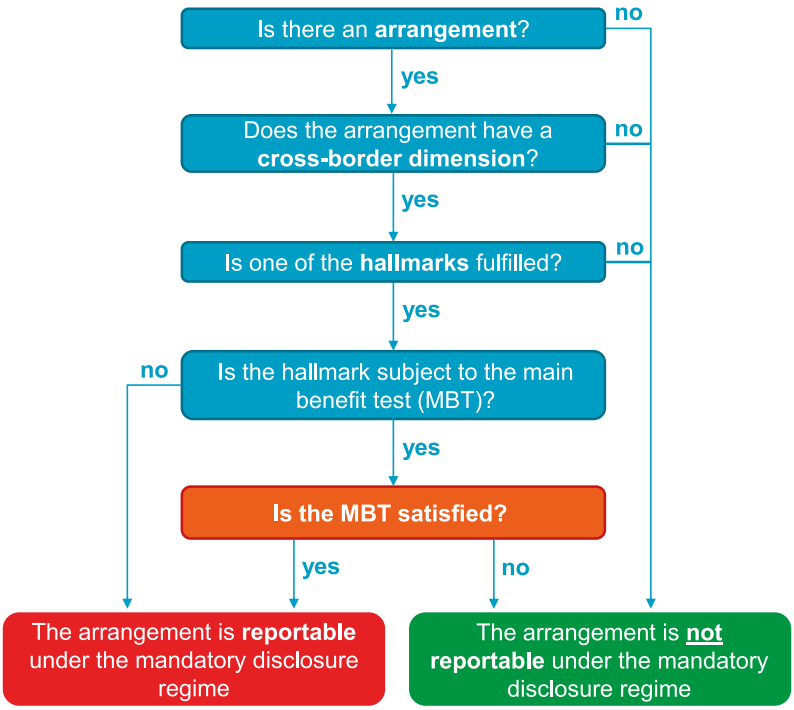
The MDR operates through a system of hallmarks that may trigger reporting obligations and the MBT that functions as a threshold requirement for many of these hallmarks. As such, the MBT should filter out irrelevant reporting and enhance the usefulness of the information collected because the focus will be on arrangements that have a higher probability of truly presenting a risk of tax avoidance.

The term arrangement may also include a series of arrangements and an arrangement may comprise more than one step. Hence, the understanding of the term "arrangement" within the meaning of the law is very broad. When determining whether advice on a particular arrangement is reportable under the MDR, an analysis of whether the arrangement has a cross-border dimension must first be performed. 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 draft law. 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, whether the hallmark(s) is/are subject to the MBT must be verified. If the hallmark is not subject to the MBT, there is an automatic reporting obligation under the MDR. If 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 analysis to be performed is depicted in the checklist below:



2. How to apply the Main Benefit Test?

The MBT is fulfilled if "it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage". Hence, this test compares the value of the expected tax advantage(s) with any other benefits likely to be obtained from the transaction. This requires an objective analysis of all benefits obtained from an arrangement. According to the Final Report on BEPS Action 12, the MBT sets a relatively high threshold for disclosure.

It is interesting to note that the draft law explicitly states that the tax treatment of a cross-border payment at the level of the recipient cannot alone be a reason for concluding that an arrangement satisfies the MBT. Thus, it does not matter *per se* (i) if the jurisdiction of the recipient of a payment does not impose any corporate tax or imposes corporate tax at a rate of zero or almost zero or (ii) if the payment benefits from a full exemption or (iii) a preferential tax regime.

The analysis of the MBT can further not be seen in isolation from anti-abuse legislation such as the General Anti-abuse Rule ("GAAR") that had to be implemented by EU Member States in accordance with the EU Anti-Tax Avoidance Directive ("ATAD") and the principal purposes test ("PPT") that has been implemented in bilateral tax treaties through the multilateral instrument ("MLI"). In other words, when it is concluded that the main benefit or one of the main benefits of an arrangement was a tax benefit, this assessment may also have an impact on the potential analysis of the GAAR or the PPT.

3. Considerations regarding international investments

With regard to the application of disclosure rules to international investment structures, the Final Report on BEPS Action 12 states that several countries with MDR indicated that, in practice, they receive comparatively fewer disclosures of cross-border schemes. The reason for this lower number of disclosures is considered to be partly a consequence of the way international schemes are structured and the approach taken by these regimes in formulating the requirements for disclosure of a reportable scheme.

Here, the Final Report on Action 12 mentions that cross-border schemes typically generate multiple tax benefits for different parties in different jurisdictions and the domestic tax benefits that arise under a cross-border scheme may seem unremarkable when viewed in

isolation from the rest of the arrangement as a whole.

For those hallmarks that need to meet the MBT as a threshold condition for disclosure, it is stated that the MDR can be difficult to apply in the context of cross-border arrangements that trigger tax consequences in a number of different jurisdictions. In practice, such arrangements may not meet the MBT if the taxpayer can demonstrate that the value of any (domestic) tax benefits was incidental when viewed in light of the commercial benefits of the transaction as a whole.

The Final Report on Action 12 acknowledges that cross-border investments often involve a broader commercial transaction such as an acquisition, refinancing or restructuring. Such arrangements are customised so that they are taxpayer and transaction specific and may not be widely promoted in the same way as a domestically marketed scheme. It is stated that for these reasons it may be difficult to address these bespoke schemes with generic hallmarks that target promoted schemes, which can be easily replicated and sold to a number of different taxpayers.

In view of the high threshold standard presented by the MBT, the Final Report on Action 12 even recommends not to include it as a threshold condition. Instead, it is recommended to include hallmarks that focus on the kinds of BEPS techniques that are known to give rise to tax policy or revenue concerns without including a threshold requirement.

4. Developing a reasonable approach towards the MBT

The Final Report on BEPS Action 12 provides useful guidance with regard to the interpretation of the MBT. Nevertheless, the somewhat vague wording of the MBT may make it unpractical to apply this test in practice.

While the analysis of reporting obligations under the MDR requires a good understanding of Luxembourg and international tax law (i.e. is a specific hallmark or the MBT met), tax intermediaries are not tax specialists, *per se*. Therefore, it is important to develop a reasonable approach that can be systematically applied by all tax intermediaries and which produces clear-cut results, taking away the ambiguity from the MBT.

Based on the wording of the MBT and the purpose of the MDR, practitioners might consider analysing five questions. Three of these questions are primary questions that are directly linked to the MBT (questions a – c), whereas the remaining two questions complement the analysis through a focus on logical aspects (questions d and e).

a) Is it reasonable to consider that the investment would have been made in the absence of the tax benefit?

When it can be reasonably established that an arrangement or investment would have been entered into or made in the absence of a particular tax benefit, the arrangement or investment should generally not be considered as having been made for the purpose of obtaining a tax advantage. Instead, a tax benefit may result from the optimisation of the overall tax position within the limits of all applicable tax laws. In these circumstances, the tax benefits are ancillary to the main purpose of generating income, creating value and benefiting from an increase in value.

b) Are the commercial and other benefits more significant than the tax advantage?

This question is related to the first question and compares the value of all commercial and other benefits to the aggregate amount of tax advantages. However, in practice it may not be clear what amounts are to be compared given that various commercial and tax benefits may arise in several jurisdictions. This analysis therefore requires a good understanding of international tax law.

In the absence of any clear guidance in this respect, it seems reasonable to make a broad approximation of the aggregate commercial and tax benefits. When investments are focusing on the generation of income, tax benefits should generally only be a fraction of the amount of income.

In stark contrast, if obtaining a tax benefit is a main benefit, the pre-tax profit may be expected to be insignificant compared to the tax benefit. In these circumstances, the arrangement is tax driven and taxpayers aim at obtaining a tax advantage (for example, benefiting from a tax feature such as the allocation of losses in the case of certain loss creation schemes) rather than realising a return on their investments. In other words, taxpayers engage in the scheme to obtain tax advantages rather than merely optimising the tax position of an arrangement that is intended to generate income.

c) Are there genuine commercial reasons for an investment other than benefiting from a tax advantage?

This question considers the commercial rationale and business purpose of an arrangement or a series of arrangements and is linked to the potential application of the GAAR. The GAAR applies when an arrangement or a series of arrangements has been put in place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law. For the purposes of the GAAR, an arrangement or a series of arrangements shall be regarded as non-genuine to the extent they are not put in place for valid commercial reasons which reflect economic reality.

Thus, the existence of commercial reasons and business purpose may exclude the application of the GAAR. Despite the fact that the scope of the MDR is broader than that of the GAAR, the answer to this question will be helpful to rule out a potential application of the GAAR and informs the analysis of the MBT.

d) Does the arrangement merely rely on the application of tax law (i.e. there are explicit rules) as opposed to taking advantage of loopholes or mismatches between two or more tax systems?

The mandatory disclosure regime aims at providing early information on potentially aggressive cross-border tax planning arrangements.

In the Preamble (No. 2) of the Commission Recommendation of 6 December 2012 on aggressive tax planning, the latter has been defined 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)."

This definition suggests that aggressive tax planning relies on loopholes and mismatches between different tax systems that result in double deductions or double non-taxation. This definition of aggressive tax planning would significantly limit the scope of the reporting obligations under the MDR.

However, even if one considers a broader meaning of aggressive tax planning, the mere application of tax law that explicitly governs an arrangement should not meet the MBT (for example, the application of a tax exemption under a participation exemption regime or the tax treatment of interest expenses in accordance with the arm's length principle and interest deduction limitation rules). Here, the tax treatment of the arrangement is in line with the policy intent of the legislation upon which the arrangement relies. However, this question might be difficult to answer by non-tax experts.

e) Is the arrangement or a series of arrangements known to the tax authorities involved?

When an arrangement or a series of arrangements is known to the tax authorities directly concerned by the arrangement(s), it can be assumed that the tax authorities and the legislator have all necessary information at their disposal to thoroughly analyse the arrangement. Thus, when the answer to this question is yes, the reporting of these arrangements might not provide useful information to the tax authorities.

5. Implications

The new MDR enters into force on 1 July 2020 and applies to cross-border arrangements whose first step was implemented on or after 25 June 2018 (to be reported by 30 August 2020). It can be anticipated that the analysis of potential reporting obligations under the MDR will become an integral part of each and every tax analysis. This on its own will have the desired deterrence effect as both tax intermediaries and taxpayers will need to carefully consider potential reporting obligations.

When the MBT applies, it should set a relatively high threshold for disclosure, filtering out irrelevant disclosure which would otherwise dilute the relevance of the information received by the tax authorities. The approach set out in this article may help both tax intermediaries and taxpayers to consider all relevant aspects and to arrive at thorough conclusions.

Furthermore, the MBT analysis should not be done in isolation since several anti-abuse provisions such as the GAAR and the PPT include concepts that are fairly similar to those deployed by the MBT.
It is interesting to note that reporting under the MDR generally does not mean that taxpayers are engaging in illegal conduct or that the tax treatment of a cross-border arrangement will be challenged. However, one can assume that reported cross-border arrangements will be more in the focus of the tax authorities involved.

Ultimately, the MDR may also be viewed as an opportunity for investors to consider and emphasise the commercial reasons and business rationale driving international investments and business activities.

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Luxembourg implements EU Directive on tax dispute resolution mechanisms in the EU

OUR INSIGHTS AT A GLANCE

- On 11 December 2019, the law on double taxation dispute resolution mechanisms was passed by the Luxembourg parliament. This law implements in Luxembourg the Directive on tax dispute resolution mechanisms in the European Union, according to which EU Member States have to efficiently resolve double taxations.
- Double taxation disputes are related to impositions by two (or more) Member States of taxes in respect to the same taxable income or capital when this gives rise to either an additional tax charge, increase in tax liabilities or cancellation or reduction of losses, all of which could be used to offset taxable profits.
- The law puts in place a 3-step double taxation dispute resolution mechanism, which forces the competent authorities of Luxembourg to resolve all disputes affecting the tax position of businesses and citizens which originate from tax treaties.
- The law applies to any complaint with respect to questions related to the tax year starting on or after 1 January 2018. If the relevant competent authorities agree, the law will also be applicable to any complaint that was submitted prior to 1 January 2018.

On 11 December 2019, the law on double taxation dispute resolution mechanisms (the "Law") was passed by the Luxembourg parliament. The Law implements, in Luxembourg, Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union (the "Directive"), according to which EU Member States have to efficiently resolve double taxations. This mechanism is commonly called the mutual agreement procedure ("MAP").

Objective of the Law

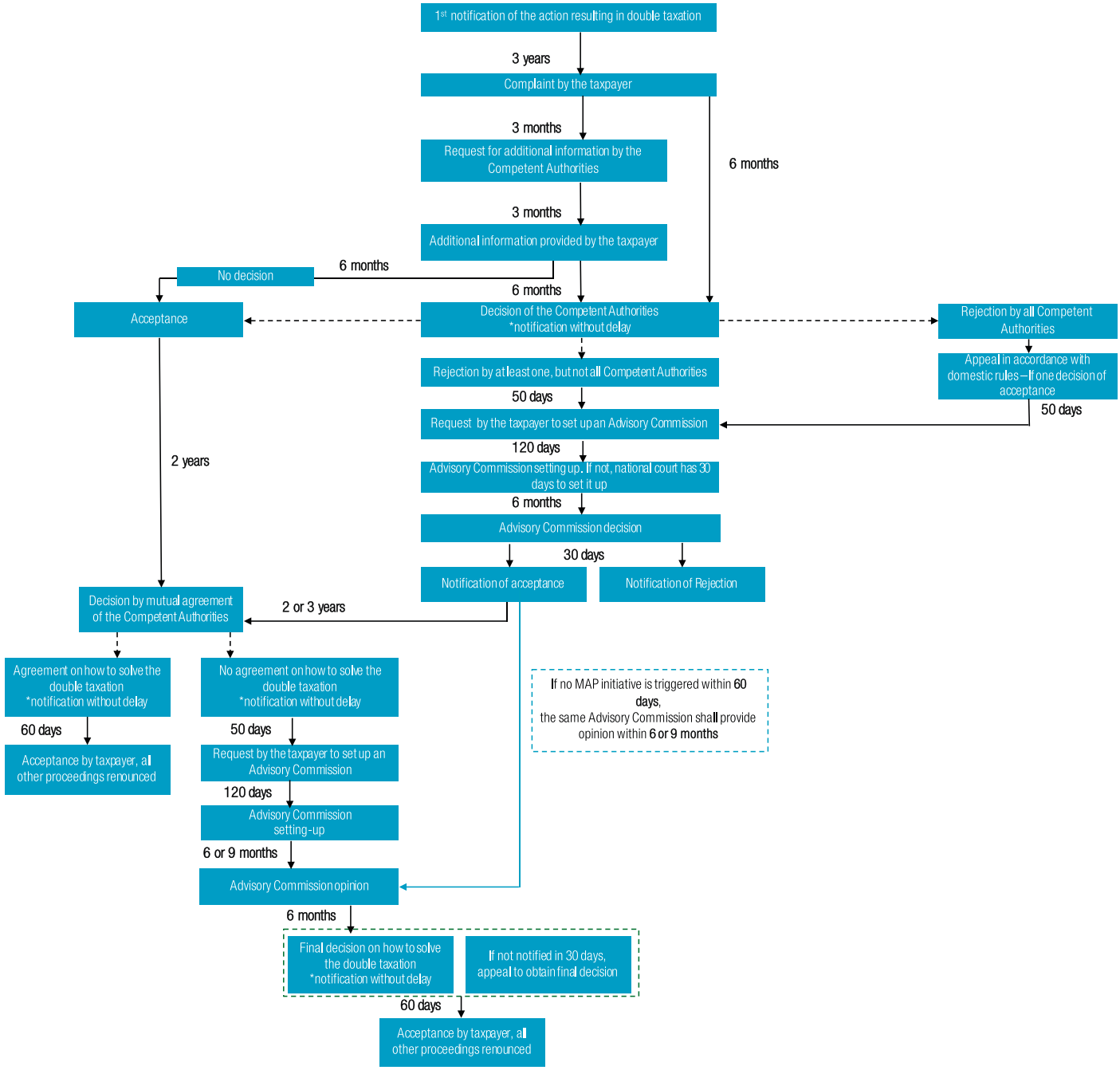
The Law establishes rules that aim at resolving situations of double taxation between Luxembourg and one or more EU Member States where such disputes arise from the interpretation and application of agreements and conventions that provide for the elimination of double taxation of income and, where applicable, capital (the "Double Taxation Dispute").

Double Taxation Disputes are related to impositions by two (or more) Member States of taxes in respect to the same taxable income or capital when this gives rise to either an additional tax charge, increase in tax liabilities or cancellation or reduction of losses, all of which could be used to offset taxable profits. Despite the fact that, under various double tax treaties, Luxembourg is also obliged to resolve any difficulties or doubts arising as to the interpretation or application of such treaties by mutual agreement, the Law does not deal with the procedure to be applied for non-EU countries. The latter is dealt with by a circular dated 28 August 2017.

Double taxation dispute resolution mechanisms

The Law establishes a 3-step Double Taxation Dispute resolution mechanism, which forces the competent authorities of Luxembourg to resolve all disputes affecting the tax position of businesses and citizens which originate from tax treaties. For that purpose, it introduces notably:

- A recourse for taxpayers to national courts to move the procedure forward;
- An obligation to notify taxpayers and publish abstracts of the arbitration decisions;
- An enforceable timeline. In this respect, a shorter timeframe would have been welcome in order to improve the effectiveness of the mechanisms put in place by the Law. An average period of 5 to 7 years to obtain a final decision by the Luxembourg competent authorities to solve double taxation is indeed a little bit long.



Interaction with national procedures

It is possible for a taxpayer to lodge a complaint against the administrative decision on which the Double Taxation Dispute is based, in accordance with simultaneously both the Law and the provisions of the Luxembourg general tax law, or the judicial proceeding. In such cases, the relevant time limits set up by the Law shall be suspended. They shall begin again from the date on which the decision of the tax authorities became final or from the date on which the judgment of the administrative tribunal or of the Administrative Court became final, or on the date on which the procedure was definitively closed by other means, or when the procedure was suspended. Where a taxpayer lodges a complaint in accordance with the Law, any other proceeding dealing with the same Double Taxation Dispute initiated under another convention, such as the European Convention on Arbitration or a double tax treaty, shall terminate.

The taxpayer always has the option to use the mechanism set up by the Law even when the measure on which a Double Taxation Dispute is based has become final under national law. In that case, the mutual agreement or the final decision resulting for the MAP are treated by the Law as a "new fact" within the meaning of paragraph 222 of the General Tax Law ("GTL"). Paragraph 222 GTL allows the tax authorities to issue a corrective tax assessment due to the occurrence of a "new fact". This will allow the rectification of the measure on which a Double Taxation Dispute is based, notwithstanding the expiry of the statute of limitation, and regardless of whether the mutual agreement or the final decision is likely to result in a higher or lower amount of taxation than that resulting from the measure on which a Double Taxation Dispute is based.

However, if a judgment on the Double Taxation Dispute that has already been rendered by the Tribunal or the Administrative Court acquires the force of *res judicata*, the MAP is closed as from the date of the notification of the decision by the Luxembourg tax authorities to the relevant competent foreign tax authorities, unless either an agreement has been found previously by the competent authorities or an opinion of the Advisory Commission has been given beforehand.

The fact that an MAP is initiated under the Law does not prevent the Luxembourg authorities from opening or continuing administrative or criminal proceedings aimed at applying administrative and criminal penalties. In cases where penalties have been imposed for the offences of absence of declaration, fraud or tax evasion, the competent authority of Luxembourg may refuse access to the MAP.

Implementation timeline

The Law will apply to any complaint with respect to questions related to tax years starting on or after 1 January 2018. Luxembourg chose the option to apply the Directive with regard to any complaint that was submitted prior to 1 January 2018. The Law states in this respect that the competent authorities of Luxembourg and the competent authorities of any other relevant jurisdiction may agree, on a case-by-case basis, to apply the Law to any complaint submitted prior to the entry into force of the Law or to income or capital earned in the course of tax years starting before 1 January 2018.

For a detailed overview of the provisions introduced by the Directive and the 3-step process it introduces, please click here (https://www.atoz.lu/media/insights-june-2017 and https://www.atoz.lu/media/insights-december-2017) and read the dedicated article in our June 2017 and December 2017 ATOZ Insights.

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Tax rulings granted prior to 2015 no longer valid

OUR INSIGHTS AT A GLANCE

- On 19 December 2019, the 2020 budget law was passed by the Luxembourg parliament. One of the tax measures of the 2020 budget law is that the tax rulings/advanced tax agreements ("ATA") which were granted before the new tax ruling procedure was introduced (i.e. prior to 1 January 2015) will no longer be valid as from the end of tax year 2019.
- If a taxpayer would like to get a new ATA for taxation years subsequent to 2019, the taxpayer will have to file a new request, in accordance with the procedure in force.
- Since the result of the new measure introduced is that ATAs granted prior to 1 January 2015 will only be valid until the end of tax year 2019, taxpayers should start assessing the potential impact of these changes on existing investment structures as soon as possible and closely monitor whether the introduction of a new tax ruling request is required.

On 19 December 2019, the 2020 budget law was passed by the Luxembourg Parliament. One of the tax measures of the 2020 budget law aims to limit the period of validity of advanced tax agreements ("ATA") which were granted before the current ATA procedure (the "Current ATA Procedure") was introduced by the law of 19 December 2014 (i.e. tax rulings granted prior to 1 January 2015).

As ATAs granted to taxpayers bind the tax authorities in the tax assessment process, the Luxembourg Government wants to ensure legal consistency between the old and the Current ATA Procedure for issuing ATAs. For that purpose, the foreseen measure is intended to ensure that a maximum period of validity, like the 5-year taxation period referred to in the Current ATA Procedure, also applies to ATAs granted before 1 January 2015.

As a result, taxpayers will be able to rely on an ATA issued before 1 January 2015 for the last time in the context of the 2019 tax returns, to the extent that the ATA still complies with the law in force.

Practical implications

For corporate income tax ("CIT") and municipal business tax ("MBT") purposes, the 2019 tax returns are prepared based on the financial statements covering the period ending in the course of 2019 (on 31 December 2019 if the company has a financial year in line with the calendar year but potentially on a much earlier date if the company has a non-calendar financial year). For net wealth tax ("NWT") purposes, the 2019 tax return is prepared based on the unitary value as of 1 January 2019, which is, in most cases, determined based on the accounting period ending on 31 December 2018.

This means that taxpayers have a very limited period of time to assess the impact of the 2020 budget measure and react appropriately if necessary. This is especially true for NWT purposes as well as for taxpayers with a non-calendar financial year.

Filing of a new ATA request

The 2020 budget law provides that if a taxpayer would like to obtain a new ATA for taxation years subsequent to 2019, the taxpayer will have to file a new application, in accordance with the procedure set out by the law of 19 December 2014 and the Grand-Ducal Regulation of 23 December 2014.

The Grand-Ducal regulation provides that ATA requests have to include the following information:

(1) Detailed description of the taxpayer requesting the ATA, of the other parties involved, together with a detailed description of their activities;

(2) Detailed description of the contemplated operation(s) which has/have not yet taken effect;
(3) Detailed and motivated analysis of the related legal issues; and
(4) Confirmation that the information provided to analyse the request is complete and accurate.

According to (2), ATA requests have to be filed before the transaction has produced its effects. However, as commented by the State Council when reviewing the text of the 2020 budget draft law, in the context of a new request for an ATA aiming to replace an ATA which is no longer valid, this specific condition should not apply. Indeed, this condition could otherwise never be met as the transaction has already produced at least some of its effect at the time of the new ATA request.

If the ATA request deals with corporate tax issues, the request will first be submitted for opinion to the ATA Commission (*Commission des décisions anticipées*). The ATA Commission will then provide its opinion to the tax inspector in charge, who will take the final decision.

A fee applies to all ATA requests filed which deal with company taxation issues. The amount of the fee is determined by the tax authorities upon receipt of the ATA request and ranges between EUR 3,000 and EUR 10,000, depending on the complexity of the ATA request and the amount of work required. The fee is payable within one month.

The ATA is valid for a time period of maximum five tax years and has a binding effect on the tax authorities, except in the following situations:

- The situation or operations described are not accurate;
- The situation or operations performed differ from the ones described in the ATA request;
- It appears that the ATA is not, or no longer, in line with Luxembourg, EU or international tax law.

Implications

Since the result of the new measure introduced is that ATAs granted prior to 1 January 2015 will only be valid until the end of tax year 2019, taxpayers should start assessing the potential impact of these changes on existing investment structures as soon as possible, and closely monitor whether the introduction of a new ATA request is required.

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New rules for the digital economy (and other economies too...)

OUR INSIGHTS AT A GLANCE

- The OECD has published a proposal to tax Multinational Enterprises wherever they have significant B2C relations creating a new taxation right and new profit allocation rules.
- The OECD has also published a proposal referred to as the "Global Anti-Base Erosion" or "GloBE" proposal to develop rules that would provide jurisdictions with a right to "tax back" income and payments that are not subject to a minimum taxation in other jurisdictions.
- Why should you care about the OECD work addressing the tax challenges of the digital economy?
  - It is a high-profile topic from both a political and social perspective;
  - The administrative action may lead to changes far beyond digital economy and may impact all kinds of industries and businesses. The original proposals started off dealing with digital tax targeting big tech companies, but then bled into broader areas, and therefore could capture non-digital and non-business activities such as sovereign wealth or pension funds.

On 9 October 2019, the Organisation for Economic Co-operation and Development ("OECD") published a proposal to tax Multinational Enterprises ("MNE") wherever they have significant B2C relations (the "Unified Approach Proposal"). The Unified Approach Proposal is the result of ongoing discussions at the OECD level and aims notably to answer the question of how to allocate taxing rights on income generated from cross-border activities in the digital age among different jurisdictions.

About 1 month later, the OECD published a second proposal referred to as the "Global Anti-Base Erosion" or "GloBE" proposal. It focuses on remaining Base Erosion and Profit Shifting ("BEPS") issues and seeks to develop rules that would provide jurisdictions with a right to "tax back" income and payments that are not subject to a minimum taxation in other jurisdictions.

The two proposals are the result of ongoing work at the OECD level that aims notably at addressing the tax challenges of the digitalisation of the economy. In this context, the Proposals aim to answer two questions: how taxing rights on income generated from cross-border activities in the digital age should be allocated among jurisdictions (Pillar 1) and how to address ongoing risks arising from structures that allow MNEs to shift profits to jurisdictions in which they are subject to no or very low taxation (Pillar 2).

BACKGROUND OF THE PROPOSALS

The tax challenges of the digitalisation of the economy were identified as one of the main areas of focus of the BEPS Action Plan, leading to the 2015 BEPS Action 1 Report. In March 2017, the G20 Finance Ministers mandated the Task Force on the Digital Economy ("TFDE"), through the Inclusive Framework on BEPS, to deliver an interim report on the implications of digitalisation on taxation by April 2018 and a final report in 2020.

The Tax Challenges Arising from Digitalisation – Interim Report dated March 2018 (the "Interim Report") provided an in-depth analysis of new and changing business models that enabled the identification of three characteristics frequently observed in certain highly digitalised business models: scale without mass, heavy reliance on intangible assets, and the importance of data, user participation and their synergies with intangible assets.

Since then, continuing discussions and proposals were articulated around two pillars which could form the basis for consensus: Pillar One focuses on the allocation of taxing rights by suggesting modifications to the rules on profit allocation and nexus and; Pillar Two focuses more on unresolved BEPS issues.

On 13 February 2019, the OECD released a consultation document "Addressing the Tax Challenges of the Digitalisation of the Economy" setting out three proposals to revise existing profit allocation and nexus rules (Pillar One). These proposals were based on the concepts of "user participation," "marketing intangibles" and "significant economic presence" (the "Three Proposals"). The consultation document also set out a fourth one: a global anti-base erosion proposal to allow countries to tax profits where income is otherwise subject to no or very low taxation in another country (Pillar Two). The proposal is also intended as a backstop to Pillar One for situations where the relevant profit is booked in a tax rate environment below the minimum rate.

However, the ongoing work of the OECD on Pillar One, including the public consultation process as well as input received from various stakeholders, has highlighted important questions that needed to be addressed and the broader challenges that the Three Proposals posed in relation to existing tax rules. It has also revealed some

more fundamental issues of the existing international tax framework, which have not been resolved with the BEPS package. In addition, as each of the Three Proposals was significantly different in scope, calculation method and justification, no consensus could be reached on one of the Three Proposals.

Commonalities of the Three Proposals were thus highlighted in order to facilitate a consensus solution on Pillar One. These proposals do indeed have the same primary objective: to recognise the value created by a business activity or participation in user/market jurisdictions which is not recognised in the current framework for allocating profits.

As a result, the Unified Approach Proposal under Pillar One has been developed to respond to the main dissatisfaction relating to how the existing profit allocation and nexus rules take into account the increasing ability of businesses, in certain situations, to participate in the economic life of a jurisdiction without an associated or meaningful physical presence. With this Unified Approach Proposal, the OECD also wants to prevent the risk that more jurisdictions, unhappy with the taxation outcomes produced by the current international tax system, will adopt uncoordinated unilateral tax measures that could provoke significantly increasing compliance burdens, double taxation and uncertainty.

ABOUT PILLAR 1

Why is the Unified Approach Proposal important?

The Unified Approach Proposal seeks to create a new model for allocating profits to different main jurisdictions. The idea to tax the digital economy is shifting slowly towards new taxation rights and new profit allocation rules that may affect more than just tech companies.

- **Impact for the global economy and relations between States**

The model addresses clear unease at how profits are mixed in the digital economy. However, the proposals have morphed over time into a proposal to shift profit from producer States to consumer States. This will have consequences for the relations between States with an economy that produces high value goods and services and States with large consumer populations. The irony is that the proposal will thus shift profits out of countries pushing for the adoption of a digital tax to large consumer States.

- **Impact for businesses**

Most businesses are prepared to pay a fair level of tax but seek to pay tax on profits in one location in a manner that is clear and manageable from a compliance perspective.

The Unified Approach Proposal does acknowledge the risk of double taxation but is relatively silent on the potential compliance cost and overall complexity. However, we expect that the OECD will understand the practical issues the Unified Approach Proposal raises and that any final proposals in the future does not create a disproportionate cost of compliance, which for even medium-size businesses, could act as a barrier to cross-border trade and potentially increase the concentration of economic power in large companies.

What is the Unified approach Proposal?

The Unified Approach Proposal, drafted at a relatively general level, aims at designing a solution that will generate support from all stakeholders. In this respect, the OECD recognises that certain aspects still require further work and that several implementation- and administration-related questions still need to be addressed. Nevertheless, the Unified Approach Proposal has been presented as a viable option.

1. Scope of the Unified Approach Proposal

The Unified Approach Proposal covers highly digital business models but also reaches further as it is focused on consumer-facing businesses, broadly defined (e.g. businesses that generate revenue from supplying consumer products or providing digital services that have a consumer-facing element). This would include highly digitalised businesses which interact remotely with users, who may or may not be their primary customers, as well as other businesses that market their products to consumers and may use digital technology to develop a consumer base.

At this stage, further discussion should take place to articulate and clarify the scope. Further considerations should also be given as to whether some specific sectors (e.g. financial services) should be carved out, considering the tax policy rationale as well as other practicalities. Discussion on scope and carve-outs should also include consideration of size limitations, such as, for example, the EUR 750m revenue threshold used for country-by-country reporting requirements.

2. New nexus rule for taxpayers in the scope of the Unified Approach Proposal

Currently, a non-resident company is taxable on its business profits only if it has a permanent establishment in a jurisdiction. It is, however, assumed that large businesses will conduct more and more consumer-facing and/or user-facing activities from a remote location, with no or minimal physical presence in the market. The new nexus rule aims thus at targeting all cases where a business has sustained and significant involvement in the economy of a market jurisdiction, such as through consumer interaction and engagement, irrespective of its level of physical presence in that jurisdiction.

The primary indicator of sustained and significant involvement in that jurisdiction would be a revenue threshold in the market (the amount of which could be adapted to the size of the market) which would take into account certain activities, such as online advertising services, which are directed at non-paying users in locations that are different from those in which the relevant revenues are booked. This new nexus would be introduced through a standalone rule – on top of the permanent establishment rule – to limit any unintended

spill-over effect on other existing rules. Notably, a revenue threshold would not only create nexus for business models involving distance selling to consumers but would also apply to groups that sell in a market through a distributor.

3. New profit allocation rule going beyond the arm's length principle

Once it has been determined that a country has the right to tax the profits of a non-resident enterprise, the next question is how much profit the Unified Approach Proposal allocates to that jurisdiction.

This question is currently addressed by Article 7 (Business Profits) of both the OECD and United Nations Model Tax Conventions. However, given that the new taxing right would create a nexus for an MNE group even in the absence of a physical presence, the existing rules to allocate profits do not fit into this new nexus in cases where no functions are performed, no assets are used, and no risks are assumed in the market jurisdictions. Therefore, new profit allocation rules going beyond the arm's length principle and limitations on taxing rights determined by reference to a physical presence (two principles generally accepted as cornerstones of the current rules) are required.

Without giving any details on the new allocation criteria, the intention of the Unified Approach Proposal is to create a new profit allocation rule applicable to taxpayers within the scope, and irrespective of whether they have an in-country marketing or distribution presence (permanent establishment or separate subsidiary) or sell via unrelated distributors. The approach would keep the current transfer pricing rules based on the arm's length principle but supplements them with formula-based solutions in areas where tensions in the current transfer pricing system are the highest.

The OECD only states in this respect that the new rules, taken together with existing transfer pricing rules, will need to deliver the agreed quantum of profit to market jurisdictions and do so in a way that is simple, avoids double taxation, and significantly improves tax certainty relative to the current position. The new rules should also be applicable to both profits and losses.

4. Increased tax certainty delivered via a three-tier mechanism

The Unified Approach Proposal proposes the following three-tier mechanism to share profits between jurisdictions:

- **Amount A – a share of deemed residual profit allocated to market jurisdictions using a formula approach (i.e. the new taxing right).**

In broad terms, the idea developed by the Unified Approach Proposal would be to reallocate a portion of the deemed residual profit of Company T, tax resident in State T based on current rules, between market jurisdictions (i.e. States M and N) in accordance with a new nexus unconstrained by physical presence requirements. The deemed residual profit would be the profit that remains after allocating what would be regarded as a deemed routine profit on activities to the countries where the activities are performed (i.e. State T). Similar to existing profit allocation rules, it would have effective application to both profits and losses, but specific rules may be considered for the treatment of losses (e.g. claw-back or "earn out" mechanism).

Amount A would be determined by simplifying conventions, and would require the determination of the level of the deemed routine profit (to be allocated to State T) and also a decision on the proportion of the deemed residual profit that should go to the market, which in turn would be allocated to particular markets (States M and N) meeting the new nexus rule through a formula based on sales. This method would replicate features of both the residual profit split (RPS) method (by introducing a threshold based on profitability to exclude the remuneration of routine activities) and the fractional apportionment method (by relying on formula-based calculations).

The starting point for the determination of Amount A would be the identification of the MNE group's profits based on the consolidated financial statements under the accounting standards of the headquarters jurisdiction prepared in accordance with the Generally Accepted Accounting Principles (GAAP) or the International Financial Reporting Standards (IFRS).

The next step in calculating Amount A would seek to approximate the remuneration of the routine activities based on an agreed level of profitability. The level of profitability deemed to represent such "routine" profits could be determined by using a variety of approaches, but according to the OECD, a simplified approach would be to agree on a fixed percentage(s), possibly with variances by industry. The profitability of an MNE group can vary substantially across business lines, regions or markets, which suggests that the relevant measure of profits may need to be determined on a business line and/or regional/ market basis.

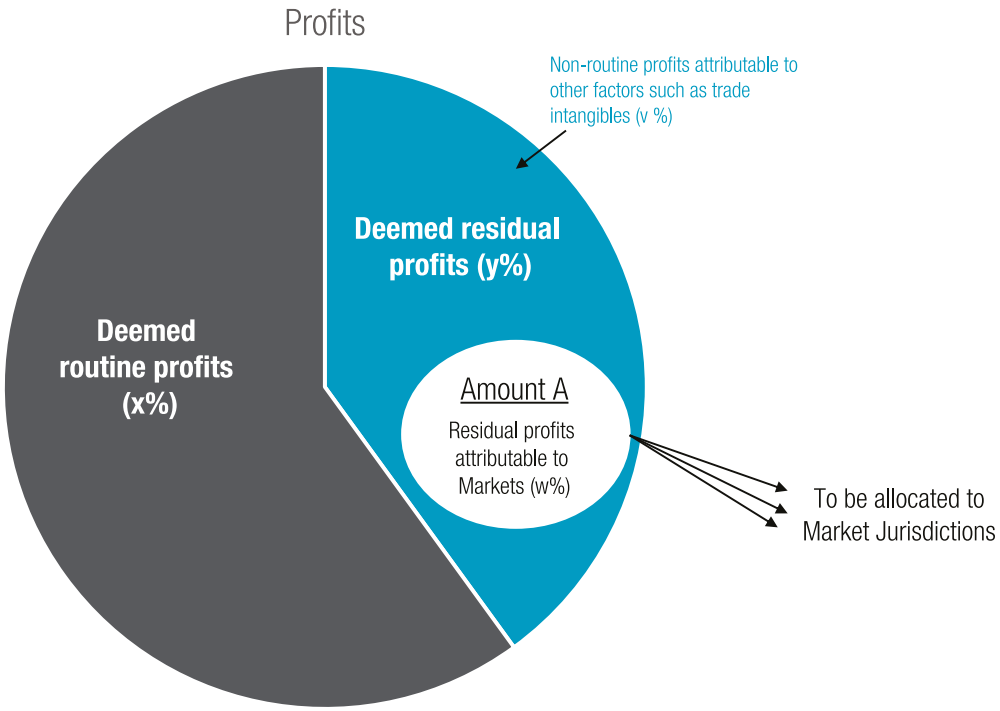
Remuneration of routine activities is defined as profits which would be regarded as rewarding routine functions and therefore would be excluded from the calculation of the pool of profits from which the allocation to market jurisdictions would be made. The completion of this step would not be intended to disturb the actual allocation of the remuneration derived from actual routine activities under the current transfer pricing framework.

Assuming that the proportion of profits to revenues (i.e. profit margin), derived from the consolidated financial statements of Company T, is z%, a portion of that percentage may be regarded as representing routine profits. If that portion is x%, then x% would be ignored for the purposes of the calculation of the non-routine profits reallocated to market jurisdictions.

If the profit margin is z% from which x% is deducted on the basis that it represents the deemed routine profits, then the balance, assumed to be y%, would be regarded as representing the group's deemed non-routine or residual profits.

Once profits in excess of the stipulated level of profitability are deemed to be the group's non-routine profits, it is then necessary to determine the split of those deemed non-routine profits between the portion that is attributable to the market jurisdiction and the portion that is attributable to other factors such as trade intangibles, capital and risk, etc.

The amount of the non-routine profits – the y% – would then need to be allocated between the profits attributable to market jurisdictions (assumed here to be w%) and the profits attributable to other factors such as trade intangibles (assumed here to be v%). Again, a crucial aspect of the "Unified Approach" would be to determine and agree on the method through which w% is determined, and whether this percentage should vary by industry.



The final step of the proposed approach would be then to allocate the relevant portion of the deemed non-routine profit (w%) among the eligible market jurisdictions.

This final allocation should be based on a previously agreed allocation key, using variables such as sales. The selected variables would seek to approximate the appropriate profit subject to the new taxing right.

- **Amount B – a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction.**

Activities in market jurisdictions, and, in particular, distribution functions, would remain taxable according to existing rules (e.g. transfer pricing under the arm's length principle and permanent establishment allocation under Article 7). For this purpose, Amount B would seek to establish a fixed return (or fixed returns, varying by industry or region) for certain "baseline" or routine marketing and distribution activities taking place in a market jurisdiction. The quantum of the fixed return could be determined in a variety of ways (i.e. a single fixed percentage; a fixed percentage that varied by industry and/or region; or some other agreed method). The fixed return under Amount B would seek to reduce disputes in this area where tensions are already quite high as a result of applying the existing transfer pricing rules.

Whilst the distinction between marketing and distribution activities and others performed by an MNE group will, in most cases, be clear, there will be some borderline issues. Therefore, a clear definition of the activities that qualify for the fixed return would be required.

- **Amount C – binding and effective dispute prevention and resolution mechanisms relating to all elements of the proposal, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B.**

Taxpayers and tax administrations would retain the ability to argue that the marketing and distribution activities taking place in the market jurisdiction go beyond the baseline level of functionality and therefore warrant a profit in excess of the fixed return contemplated under Amount B, or that the MNE group or company perform other business activities in the jurisdiction which are unrelated to marketing and distribution.

Amount C would thus cover those cases where there are more functions in the market jurisdiction than have been accounted for with reference to the local entity's assumed baseline activity (which is subject to the fixed return in B above), and the jurisdiction seeks to tax an additional profit on those extra functions in accordance with the existing transfer pricing rules.

ABOUT PILLAR TWO

Pillar Two aims to address ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation, thus ensuring that the profits of internationally operating businesses are subject to a minimum rate of tax.

The GloBE proposal explores an approach which uses a fixed percentage to set the minimum rate and uses adjusted financial accounts to determine the taxable base to be considered.

Why is the GloBE proposal important?

If implemented, the GloBE proposal is likely to result in significant changes to existing international tax rules and the tax landscape at large.

1. Scope of the GloBE proposal

The GloBE proposal targets all multinational enterprises – regardless of whether they operate in the digital economy or not. However, the OECD Programme of Work calls for the exploration of possible carve-outs as well as thresholds and exclusions to restrict the application of the GloBE proposal.

2. Use of adjusted financial accounts to determine income

The Proposal under Pillar 2 looks at how to determine a coherent tax base. Under the GLoBE proposal, financial accounts would be used as a starting point for the tax base determination. The proposal then considers different mechanisms to adjust the financial accounts to allow for the consideration of permanent and temporary differences between the income computed under financial accounting standards and the income computed under the income tax rules across various jurisdictions.

The GloBE Proposal also includes rules that stipulate the extent to which a taxpayer can mix low-tax and high-tax income within the same entity or across different entities within the same group (i.e. the "blending").

3. Minimum tax rate

The work programme would explore an approach using a fixed percentage. The determination of what the minimum tax rate would be is essential. This question is very political, and its answer may give us a new definition of "tax haven". The basis, on which the OECD justifies the statement that a specific rate, for example 15%, would be the minimum rate of tax for purpose of the GloBE proposal, is also crucial. Indeed, if 15% is considered as the minimum tax rate, will it mean that Ireland, for example, having a corporate tax rate of 12.5% will be considered as a "tax haven" because its corporate taxpayers would not be subject to the pre-said minimum tax rate of 15%? And what would be the consequences of this conclusion on the relation between EU Member States and on the application of the EU fundamental rights?

4. New taxing rules

Under the GloBE proposal, jurisdictions would remain free to determine their own tax system, including whether or not they have a corporate income tax and at what level they set their tax rates. However, other jurisdictions will have the right to apply the rules explained below in cases where income is taxed at an effective rate below a minimum rate. If the minimum tax is not met, the new taxing rights under the GloBE proposal would be exercised through 4 rules:

- an income inclusion rule that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate;
- an undertaxed payment rule that would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax) for a payment to a related party if that payment was not subject to tax at or above a minimum rate;
- a switch-over rule to be introduced into tax treaties that would permit a residence jurisdiction to switch from an exemption to a credit method where the profits attributable to a permanent establishment (PE) or derived from immovable property (which is not part of a PE) are subject to an effective rate below the minimum rate; and
- a subject to tax rule that would complement the undertaxed payment rule by subjecting a payment to withholding or other taxes at source and adjusting eligibility for treaty benefits on certain items of income where the payment is not subject to tax at a minimum rate.

Where the income is not taxed at least at the minimum tax rate, the rules would operate as a top-up to achieve the minimum rate of tax. However, the proposal remains silent on the scenario where the top-up rules are not applied. In such case, the targeted level playing field by the OECD proposal would not be reached.

What is next?

Public consultations on Pillar 1 and Pillar 2 were organised and the comments provided will assist the OECD in the development of a solution for its final report to the G20 in 2020.

If consensus is reached on the fact that the Unified Approach Proposal and the GloBE proposal are the way to carry things forward on the road to a global and long-term solution to tax challenges of the digitalisation of the economy, these proposals could lead to a real and substantial modification of international tax principles and deeply alter the international tax landscape.

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Quick fixes

OUR INSIGHTS AT A GLANCE

- On 6 December 2019, the Luxembourg law implementing the quick fixes (EU Directive 2018/1910 on harmonisation and simplification of VAT for cross-border trade) was published. The quick fixes will be applicable to exchanges of goods within the European Union as of 1 January 2020.
- The quick fixes aim to simplify the call-off stock regime applicable to the transfer of goods by a supplier; strengthen the requirement to verify and to document the customer's VAT number in order to exempt intra-EU supplies of goods; to formalise the proof to be kept in order to benefit from the VAT exempt intra-EU supplies of goods and finally to simplify the treatment applicable to chain transactions.

EU legislation is being introduced into all Member States in order to implement "quick fixes" measures in the view of simplifying and securing the VAT treatment applicable to exchanges of goods within the European Union. This new regime will enter into force as from 1 January 2020. The Luxembourg legislator as well as the VAT authorities (Circular 753-2 dated 17 May 2019) have already taken the necessary measures to comply with the EU VAT provisions. The key elements of this new set of measures can be summarised as follows:

Quick fix 1: harmonisation of the call-off stock regime

The main objective of this measure is to simplify the VAT regime applicable to the transfer of goods by a supplier from an EU country A to an EU country B where the goods will be stocked before being taken off and purchased at a later stage by an already known intended customer in country B.

In various EU member states, having a stock in country B for the supplier from country A requires registering for VAT in country B and filing VAT returns, leading to VAT administrative burdens. A transfer of goods between country A and country B has to be reported by the supplier as well as the subsequent local sale subject to VAT carried out to B when the goods are removed from the stock.

As from 1 January, 2020 and provided various conditions are met, the transfer of the goods from country A to country B will no longer be regarded as an "internal" transfer between the supplier A from country A to country B but as an intra-EU supply directly between A and B. The acquirer in country B will perform an intra-EU acquisition of goods at the time the goods are withdrawn from the call-off stock.

The main contribution of this simplification is to relieve the supplier transferring its goods for storage purposes prior to an acquisition in another country from having to register for VAT purposes in that country. Furthermore, this measure decreases the VAT compliance obligations and has a positive cash flow impact on the purchasers (VAT will be declared as due and as deductible in the same VAT return avoiding a VAT pre-financing).

The implementation of this new regime is welcomed in Luxembourg as no simplification regime has been implemented prior to this quick fix.

Quick fix 2: strengthening the requirement to be provided with the customer's VAT number in order to exempt intra-EU supplies of goods

As from 1 January 2020, suppliers will need to verify and to document the customer's VAT number in order to consider that intra-EU supplies benefit from the VAT exemption (supply of the goods from country A to country B between VAT taxable persons). Quoting the valid VAT number of the customer will therefore become a substantive condition to benefit from the VAT exemption.

In practice, Luxembourg suppliers performing intra-EU supplies will have to systematically check the validity of the VAT number of their customers and to quote it on their invoices in order not to charge Luxembourg VAT on these sales.

Quick fix 3: documentary proof for VAT exempt intra-EU supplies of goods

Between VAT taxable persons, intra-EU supplies of goods from an EU country A to an EU country B are VAT exempt in country A provided notably that the goods are dispatched from country A to country B. The intra-EU supply in the country of the seller benefits from a VAT exemption to the extent that the proof of the transport of the goods can be demonstrated.

The new regime formalises the proof to be kept in order demonstrate the transport of the goods. The supplier is required

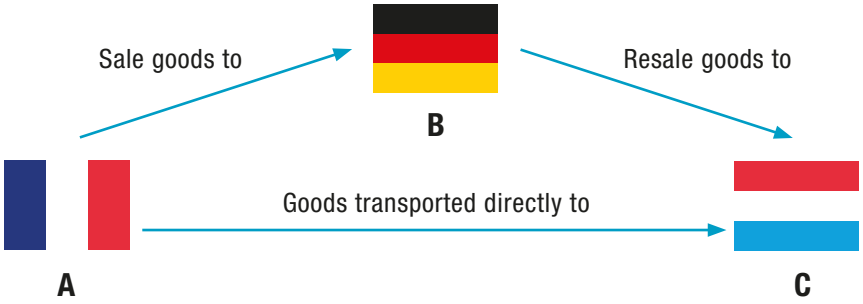
to provide two non-contradictory documents evidencing the transport (CMR letter, bill of lading, airfreight invoice, invoice from the carrier, etc.).

Furthermore, a new requirement has been introduced when the customer arranges for the transport. In this case, the latter shall provide the supplier with a written statement testifying that the goods have been duly shipped or transported to the country of destination.

Quick fix 4: simplification for chain transactions

The current treatment of chain transactions is based on the CJEU cases law and may result in difficulties in determining which transaction may benefit from intra-EU supply of goods VAT exemption.

As from 1 January 2020, a simplification will enter into force to determine the VAT treatment of chain transactions when an intermediary (B) arranges for the transport.



As a general principle, under the new rules, the movement of goods between A and C will be ascribed to the first transaction (i.e. sale from A to B without transport). Thus, it will be considered as a VAT exempt supply of goods. The remaining transaction (resale from B to C) will be qualified as a local sale.

However, when intermediary B provides its country A's VAT number to A, the first transaction (sale from A to B) will be considered as a local sale whereas the remaining transaction (resale from B to C) will be considered a VAT exempt supply of goods.

This simplification brings security as well as clarification to determine which transaction shall be regarded as an exchange of goods across the European Union.

In conclusion, we strongly advise Luxembourg businesses involved in intra-EU transactions to carefully examine their transactions considering these new rules in order to avoid non-compliance risks. Should you have any queries in this respect, ATOZ can provide an in-depth analysis regarding the above-mentioned items.

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VAT deduction right and overhead costs

OUR INSIGHTS AT A GLANCE

- Recently, in the Cambridge University case, the Court of Justice of the European Union ("CJEU") ruled on questions related to the VAT deduction methodology applicable to overhead costs.
- The VAT deduction was challenged by the UK VAT Authorities and the case was referred to the CJEU in order to determine whether VAT on costs linked to the management of a fund, in which were placed endowments and donations to the University, were deductible or not.
- In the absence of a direct and immediate link either between the costs and a particular output transaction or between the costs and the activities of the University of Cambridge as a whole, the CJEU concluded that the input VAT relating to those costs is not deductible.
- This case is of interest as it restates that the input VAT deduction right is not only recognised under the direct allocation method.

The question of the VAT deduction right applicable to "overhead costs" is particularly important for companies performing both activities granting and activities not granting a VAT deduction right. In particular, this question refers to companies earning VAT taxable income (e.g. taxable management fees) as well as VAT exempt income with no VAT deduction right (e.g. income on EU financing activities) or income falling outside the VAT scope (such as dividends).

Input VAT incurred in relation to the VAT taxable turnover is deductible whereas input VAT incurred in relation to the VAT exempt / out of scope turnover is in principle not fully recoverable.

Recently, in the Cambridge University case, the Court of Justice of the European Union ("CJEU") ruled on questions related to the VAT deduction methodology applicable to overhead costs. In this article, we go through this decision and the issues related to the applicable VAT deduction methodology.

The "University of Cambridge" case[1]

The case relates to a University, a non-profit educational institution, performing both supplies subject to VAT (e.g. commercial research, sale of publications, consultancy services, et seq.) and VAT exempted educational services. Those activities were partly financed by donations and endowments. The related amounts were placed in, and invested by, a fund. Income generated by that fund was used to finance the activity of the University. In this context, the University incurred costs linked to the management of the fund and requested the deduction of the input VAT incurred.

This VAT deduction was challenged by the UK VAT Authorities and the case was referred to the CJEU in order to determine whether VAT on costs linked to the management of the fund were deductible or not.

First, the Court ruled that costs incurred in connection with the raising and collection of donations and endowments are not objectively linked to the economic activities of the University but are related to its non-economic activity. Therefore, input VAT incurred in that framework should be considered as not deductible. Following the same reasoning, the Court also ruled that the input VAT on the costs associated with the management of the fund in which the donations and endowments are vested is not deductible given the lack of direct and objective links between these costs and economic activities granting a VAT deduction right.

The Court also addressed the question from the angle of the "overhead expenses". Even when there is no direct and immediate link between a particular input transaction and output transactions giving rise to the right to deduct, the CJEU has already recognised a VAT deduction right when costs are indirectly incorporated into the price of the taxable supplies made by the taxpayer. In such case, the CJEU case law considers that costs do have a direct and immediate link with the taxable person's economic activity as a whole and, as such, are deductible as overhead costs.

In the case at hand, the Court ruled that costs relating to the management of donations and endowments cannot be considered as being some components of the price of the goods and services provided by the University and, consequently, do not form part of the University's overhead costs. The conclusion of the CJEU is based on the fact that the costs at hand are incurred in order to generate resources that are used to finance the activity of the University, mainly by reducing the price of the goods and services supplied. These costs are therefore not incorporated into the

[1] CJEU, C-316/18, The Chancellor, Masters and Scholars of the University of Cambridge, 3 July 2019

turnover of the University and the input VAT incurred cannot be deducted based on the overhead cost theory.

In the absence of a direct and immediate link either between the costs and a particular output transaction or between the costs and the activities of the University of Cambridge as a whole, the CJEU concluded that the input VAT relating to those costs is not deductible.

Outcome

This case is of interest as it restates that the input VAT deduction right is not only recognised under the direct allocation method. This is obvious even if in practice the VAT deduction right based on the overhead cost theory is often questioned by the VAT authorities in the framework of VAT audits.

In order to benefit from a (partial) VAT deduction right based on the overhead cost theory, taxpayers must bear in mind that expenses have to be components of their overall economic activities and have to be indirectly reflected in their turnover.

We would recommend monitoring the VAT deduction methodology used by companies performing both activities granting and activities not granting a VAT deduction right.

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Main corporate implementation trends for 2019 and 2020

OUR INSIGHTS AT A GLANCE

- Luxembourg key corporate implementation developments today and tomorrow – a summary of major developments in 2019 and 2020.
- This article provides an overview of the new key areas of which you need to be aware that may affect corporate law aspects of your business and helps you navigate the legal landscape and plan ahead.

Major developments already in place

EU company law harmonisation project

On 18 November 2019, the EU Council adopted a Directive amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions. The text should facilitate EU companies' cross-border conversions, mergers and divisions.

The new rules introduce comprehensive procedures for cross-border conversions and divisions and provide additional rules on cross-border mergers of limited liability companies established in an EU Member State, offering simplifications that will apply to these operations.

The Directive sets out procedures for verifying the legality of cross-border operations under all the national legal orders concerned and introduces a mandatory anti-abuse control procedure. The procedure will allow national authorities to block a cross-border operation if it is carried out for abusive or fraudulent purposes.

The agreed text provides similar rules on employee participation rights in cross-border conversions, mergers and divisions. It also ensures that employees will be adequately informed of (and consulted with beforehand) the expected impact of the operation. As a result, minority and non-voting shareholders' rights will enjoy greater protection. At the same time, creditors of the company concerned are granted clearer and more reliable safeguards.

Finally, the Directive encourages the use of digital tools throughout cross-border operations. It will be possible to complete administrative formalities, such as the issuance of the pre-operation certificate, online. All relevant information will be exchanged through existing, digitally interconnected, business registers.

EU insolvency law harmonisation project

The EU adopted a Directive on business insolvency in order to harmonise insolvency laws across Member States that have disparate existing legislation.

Shareholder Rights

The law of 1 August 2019 implementing Directive (EU) 2017/828, amending Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies, promotes long-term shareholder engagement. It creates new obligations as regards shareholder identification, the transmission of information, and the facilitation of the exercise of shareholders' rights in listed companies.

Anti-money laundering

The law of 13 January 2019 implements Directive EU 2015/849 which requires each EU Member State to create a central register recording information on the beneficial owners of corporate entities. Luxembourg entities registered with the Luxembourg RCS have to provide a central register of beneficial owners with relevant information on their ultimate beneficial owners. All beneficial owners are concerned, whether they are Luxembourgish or not. The information (with the exception of address and national ID number) will be accessible to the general public on the website of the register (unless a specific restriction to access is obtained).

The requirements of the law of 13 January 2019 were developed and detailed further by the Grand-Ducal Regulation of 15 February 2019 together with the circular LBR 19/01 of 25 February 2019.

For more details, please read our article published in the May 2019 ATOZ Insights:
[https://www.atoz.lu/media/insights-may-2019]

Data protection

The law of 1 August 2019 implements Regulation (EU) 2016/679 of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) entered into force in May 2018. The law creates new obligations for businesses and strengthens data subjects' rights. Data protection authorities have the power to impose onerous financial penalties in the event of infringements.

Brexit

On 8 April 2019, two laws aiming at mitigating Brexit effects and safeguarding the interest of the Luxembourg financial and insurance sectors have been enacted.

The first law aims at ensuring that even in case of a hard Brexit, UK entities of the financial and insurance sectors with Luxembourg activities will still be able to perform some activities in Luxembourg either through the establishment of a branch, or under the freedom of providing services during a limited period of time of up to 21 months, so as to maintain the stability of the Luxembourg financial market and protect Luxembourg customers. Under such provisions, UK management companies of Luxembourg UCITS and UK AIFMs would be able to respectively continue managing Luxembourg UCITS funds and continue providing services to Luxembourg AIFs should a "hard" Brexit occur.

The second law amends the law of 17 December 2010 on undertakings for collective investments, as amended, and the law of 13 February 2007 on specialised investments funds, as amended. Under such provisions, a transitory period of twelve months will be granted, enabling UK UCITS to keep on marketing their shares to retail investors during that period.

On 11 October 2019, the CSSF issued a new press release in relation to the mandatory notification process in the context of Brexit to the attention of all UK managers of alternative investment funds («AIFs») established in Luxembourg had the UK left the EU without an agreement on 31 October 2019.

The FCA (UK Financial Conduct Authority) will be extending the date by which it should be notified by firms and funds for entry into the temporary permissions regime to 30 January 2020. Fund managers will have until 15 January 2020 to inform the FCA if they want to make changes to their existing notification. Firms should continue to comply with existing regulatory requirements.

For more details, please read our ATOZ Alerts:
[https://www.atoz.lu/media/bracing-brexit-luxembourg-updates-notification-procedures-uk-firms-ucis-and-their-managers] and
[https://www.atoz.lu/media/new-communication-cssf-uk-managers-context-hard-brexit]

Circulation of securities

The law of 1 March 2019 amends the law of 1 August 2001 on the circulation of securities in order to adapt and modernise the Luxembourg legal framework in order to take into account new technologies and electronic transfer.

Protection of trade secrets

The law of 2 July 2019 implements Directive (EU) 2016/94 to provide for the measures and procedures to act against the unlawful acquisition, use and disclosure of business secrets under the conditions and within the limits set by the law.

Securitisation

Regulation (EU) 2017/2402 became applicable on 1 January 2019. The regulation lays down a general framework for securitisation, including risk retention and transparency rules. It establishes a new regime for simple, transparent and standardised (STS) securitisations. The law of 16 July 2019 amends the Luxembourg securitisation regime to reflect these changes.

Major developments expected

Anti-money laundering

On 9 August 2019, the draft law n°7467 implementing parts of Directive (EU) 2018/843 of 30 May 2018 (so-called 5th AML Directive) amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directives 2009/138/EC and 2013/36/EU, was presented to The Luxembourg parliament, in order to:

- improve international cooperation between supervisory authorities;
- monitor the use of virtual currencies and of prepaid cards; and
- apply enhanced due diligence measures to strengthen the treatment of "high risk countries".

The draft law n°7216B implementing inter alia Article 31 of (EU) Directive 2015/849 (so-called 4th AML Directive), as modified by the 5th AML Directive, establishes a register of fiduciary contracts and trusts. It also creates new obligations for fiduciary contracts and trusts.

For more details, please read our ATOZ News: [https://www.atoz.lu/media/new-transparency-rules-luxembourg-identification-beneficial-ownership-trusts-fiducies]

Luxembourg modernisation of insolvency law

The draft law n°6539 intends to modernise Luxembourg bankruptcy law, and to prevent bankruptcies through various measures to reorganise companies experiencing financial difficulties. The declared objective is to prioritise the survival of a company by allowing the recovery of a commercial enterprise in difficulty in order to avoid bankruptcy. The draft law proposes that prevention is based on the early detection of financial difficulties and the treatment of these by appropriate procedures rather than liquidation.

There have been no recent developments as regards this draft law.

Non-profit associations and foundations

The draft law n°6054 on non-profit associations and foundations intends to simplify the existing provisions (which date from 1928),

while leaving out those which are no longer useful, in particular:

- simplify the formalities of non-profit organisations and the procedures for approving donations and gifts;
- increase the legal security of structures;
- develop transparency and consistency in the operating rules of non-profit organisations; and
- provide better information to members and third parties.

Patrimonial foundations

The draft law n°6595 intends to introduce an orphan structure called "patrimonial foundation" as a new wealth management vehicle in the form of a private foundation with an attractive tax regime, to be used for patrimonial and inheritance structuring and planning.

There have been no recent developments as regards this draft law.

Cloud Computing Outsourcing

On 27 March 2019, the CSSF issued a new Circular 19/714 in order to update its guidelines on the use of cloud computing infrastructure.

For more details, please read our article published in the May 2019 ATOZ Insights:
[https://www.atoz.lu/media/insights-may-2019]

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