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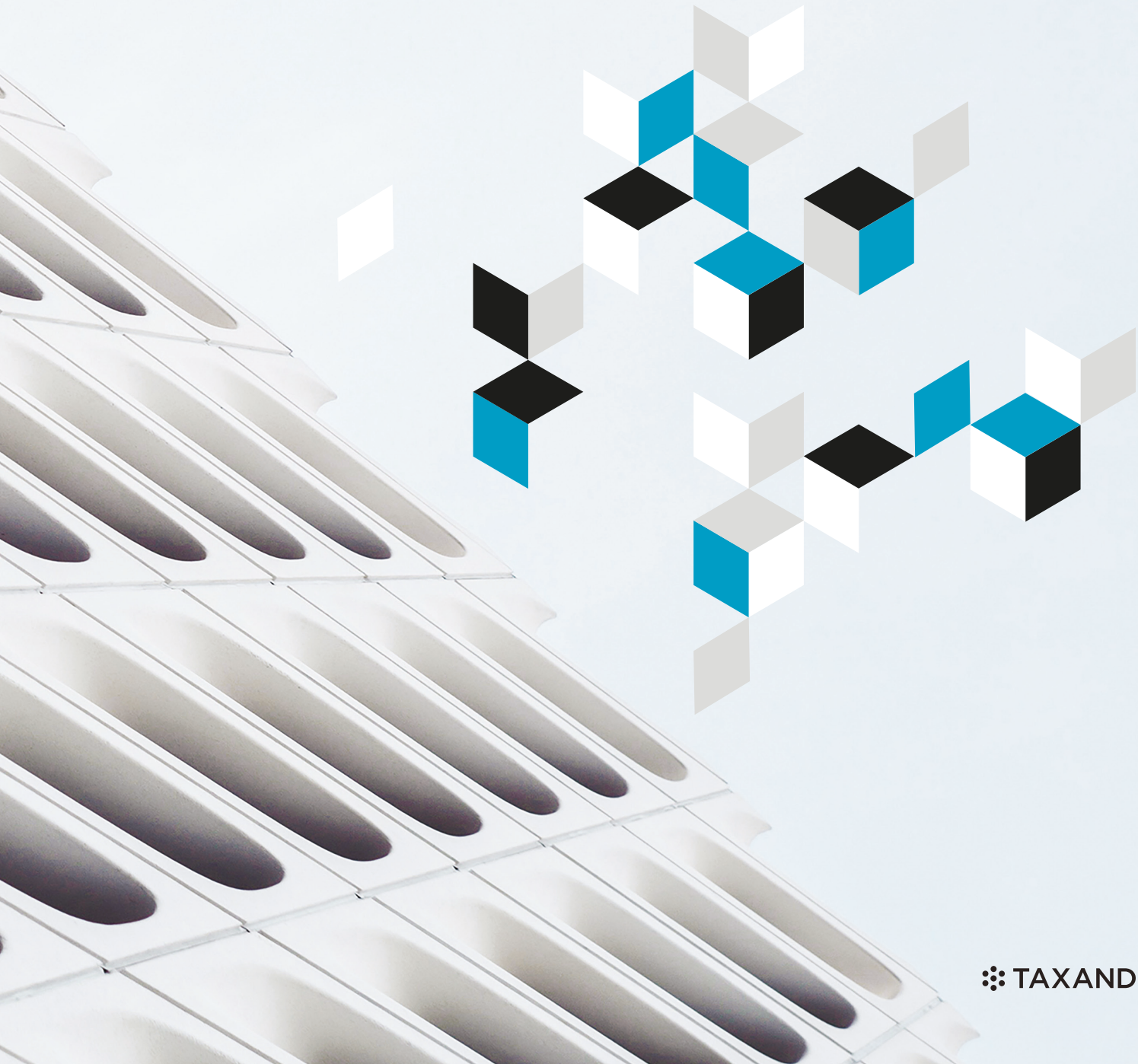
INSIGHTS

MAY 2019



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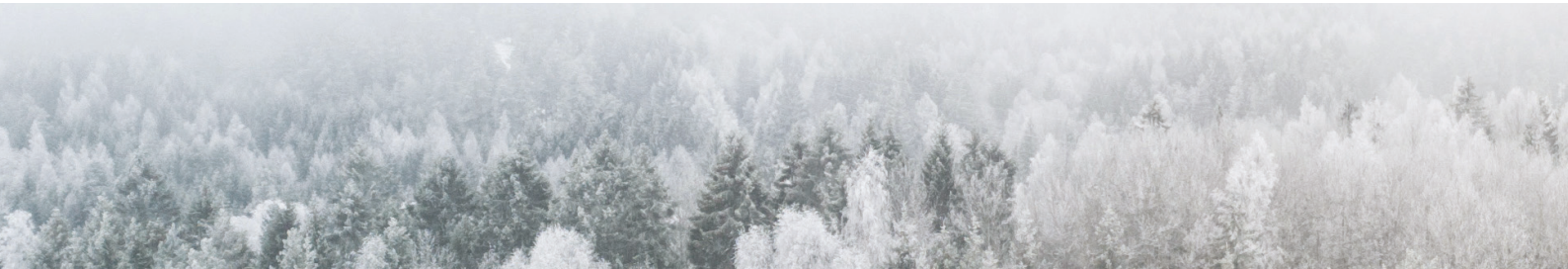


EDITORIAL

Greetings,

Over the past few months, the Luxembourg legislator went ahead with their tax and legal reforms mainly driven by European Directives and international standards.

At the end of April 2019, the Luxembourg Parliament passed the 2019 Budget including a 1% decrease in the corporate tax rate and specific rules on the application of the interest limitation rule introduced in Luxembourg end of 2018, in cases of tax consolidation. We describe the main 2019 budget provisions.

Luxembourg also ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the "MLI"). To some extent, the MLI provisions will modify Luxembourg DTTs. We set out the main consequences of this ratification.

As part of the 2019 tax reform passed end of 2018, the permanent establishment ("PE") definition has been extended to deal with foreign PE of Luxembourg taxpayers. On 22 February 2019, the Luxembourg tax authorities released a circular providing guidance concerning the interpretation of the PE concept in cases where Luxembourg taxpayers have a PE in a treaty country. We consider whether this really brings something new.

Finally, the Luxembourg government launched the process to implement the EU Directive on tax dispute resolution mechanisms in the EU. We present the Luxembourg procedure to resolve situations of double taxation between Luxembourg and one or more European Member States as currently set up in the draft law.

In parallel to the legislative work, the Court of Justice of the EU ("CJEU") had to answer to questions raised by the Danish Court in relation to cases where the Danish tax authorities refused to apply the withholding tax exemption as provided in the Parent-Subsidiary Directive and the Interest & Royalties Directive. A priori, the decision of the CJEU has a high profile but a low impact. We describe the main lessons to be drawn from this decision.

On 14 March 2019, the Administrative Court of Luxembourg referred three interesting questions to the CJEU in relation to the law dated 25 November 2014 on exchange of information upon request. We delve into the Court's questions and the potential impact in Luxembourg of the answers to be given by the CJEU.

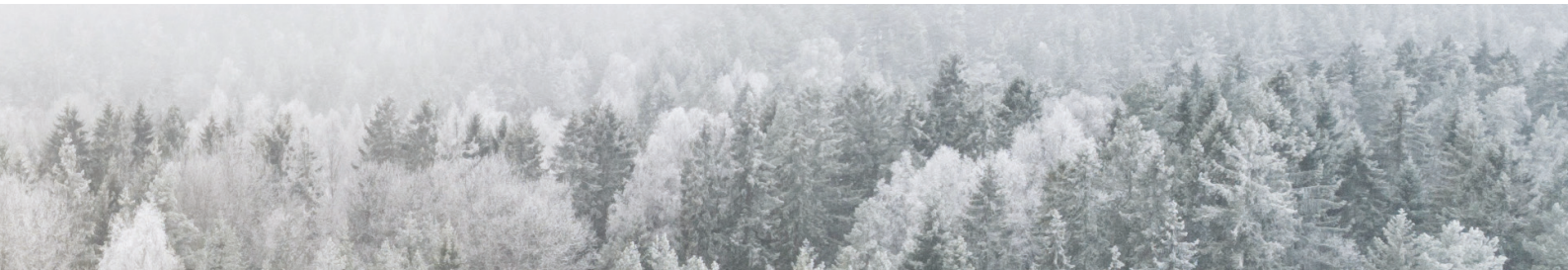
From a legal point of view, a draft law transposing the Directive on the exercise of certain rights of shareholders in listed companies was tabled with the Luxembourg Parliament on 2 February 2019. We provide an overview of the framework set up by the draft law for promoting communication between listed companies and their shareholders in order to allow greater interactivity between them, in line with the current challenges of increased transparency and long-term value creation.

On 27 March 2019, the CSSF issued a new Circular in order to update its guidelines on the use of cloud computing infrastructure to take into account the experience gained by the CSSF and the supervised entities since the release of an initial circular. We are going through the significant changes introduced by the Circular.

Finally, we provide you with a summary of some other major recent legal developments in areas which may affect your business. Amongst the major developments, we deal with the new anti-money laundering measures, the 2016 company law reform, data protection and Brexit. We also summarise expected developments in areas such as the EU company law harmonisation, protection of trade secrets, shareholders rights and securitisation.

We hope you enjoy reading our insights.

The ATOZ Editorial Team



Corporate Tax Reform 2019 – Part 2

OUR INSIGHTS AT A GLANCE

- At the end of April 2019, the Luxembourg Parliament passed the 2019 budget including a 1% decrease in the corporate income tax ("CIT") rate (from 18% to 17%), a broadened scope of application for the reduced corporate tax rate of 15% and specific rules on the application of the interest limitation rule for cases of tax consolidation, applied retroactively from 1 January 2019.
- As for interest limitation, entities belonging to a tax consolidated group may still decide to follow the former rule, meaning that the computation of exceeding borrowing costs and EBITDA would be applied at the level of each entity. The fact that taxpayers have the choice between the two options is positive since, in some cases, benefiting from a EUR 3m safe harbour at the level of each of the consolidated entities might be more beneficial.
- Overall, the tax measures provided in the 2019 budget law are encouraging in that a reduction of the CIT rate and a widening of the scope of the reduced CIT rate means that Luxembourg is taking steps to ensure continued attractiveness for investors in the post-BEPS era while the conditions of the application of the interest limitation rule allow the taxpayer flexibility to choose which option is best suited.

On 25 April 2019, the law on the 2019 budget was passed by Luxembourg Parliament. The law mainly introduces the following corporate income tax measures effective retroactively as from 1 January 2019:

- A 1% decrease (from 18% to 17%) of the corporate income tax ("CIT") rate;
- A broadening of the scope of application of the reduced 15% CIT rate (now applicable up to a taxable income of EUR 175,000);
- Specific rules on the application of the interest limitation rule in cases of tax consolidation.

Decrease of the CIT rate

Effective retroactively as from tax year 2019,

- the CIT rate of 18% is reduced to 17%. This rate applies to taxable income exceeding EUR 200,000. Taking into account the 7% solidarity surcharge (applicable on the CIT rate) as well as the municipal business tax ("MBT") of 6.75% for Luxembourg-City, the aggregate corporate tax rate is reduced from 26.01% (rate applicable until 2018) to 24.94%.
- the reduced CIT rate of 15% applies to taxable corporate income not exceeding EUR 175,000 (instead of the former limit of EUR 25,000). Taking into account the 7% solidarity surcharge (applicable on the CIT rate) as well as the MBT of 6.75% for Luxembourg-City, the aggregate corporate tax rate applicable to taxable income up to EUR 175,000 corresponds to 22.80%. Hence, in practice, the effective tax rate of many Luxembourg companies will be 22.80% instead of 24,94%.
- Finally, income above EUR 175,000 but not exceeding EUR 200,000 is taxed at an intermediary rate varying between 15 and 17%. This is designed to smooth the transition from the reduced CIT rate to the standard CIT rate.

Tax year	Taxable Income (TI)	CIT rate	Global rate (CIT + MBT)
2019	TI ≤ EUR 175,000	15%	22.80%
	TI > EUR 175,000 and ≤ EUR 200,000	EUR 26,250 (i.e. 15% of EUR 175,000) + 31% of the income exceeding EUR 175,000	From 22.80 to 24.94%
	TI > EUR 200,000	17%	24.94%

Amendment of the tax consolidation regime

The law amends the Luxembourg tax consolidation regime (Article 164bis of the Luxembourg income tax law, "LITL") with its main amendment aiming to retroactively introduce as from 1 January 2019 the optional provision under the EU Anti-Tax Avoidance Directive ("ATAD") regarding the interest limitation rule at the level of the fiscal unity. More precisely, the EBITDA and exceeding borrowing costs can now be determined at the level of the consolidated group. In addition, the law introduces additional amendments to clarify some aspects of the tax consolidation regime, such as the use of tax losses or tax credits.

Amendments related to the limitation to the deduction of interest

Interest limitation at tax consolidated group level becomes the rule

Effective retroactively as from 1 January 2019, in cases of tax consolidation, exceeding borrowing costs and EBITDA are determined at tax consolidated group level, i.e. at the level of the integrating company, instead of being computed at the level of each of the entities belonging to the tax consolidated group.

The possibility to apply the limitation at consolidated group level instead of applying it at the level of each entity is optional under ATAD. When implementing ATAD, the Luxembourg Government first decided not to use the option. However, a commitment was made at the very end of the legislative procedure to introduce this option with retroactive effect as from 1 January 2019, which is the aim of this new provision.

The application of the interest limitation at group level means that:

- in a first step, the tax result of each integrated entity of the tax consolidated group is computed individually without applying the limitation to the deduction of exceeding borrowing costs provided by Article 168bis LITL;
- in a second step, once the tax results of all entities have been integrated at the level of the integrating entity, the computation of the EBITDA and exceeding borrowing costs of the integrating entity are performed and the limitation of either 30% of the EBITDA or EUR 3m exceeding borrowing costs applies.

Entities belonging to a tax consolidated group may still decide to follow the interest limitation rule, meaning that the computation of exceeding borrowing costs and EBITDA would be applied at the level of each entity.

Therefore, the application of the interest limitation rule at tax consolidated group level becomes the rule and the limitation at entity level the exception.

The fact that taxpayers have the choice between the two options is positive since, in some cases, benefiting from a EUR 3m safe harbour at the level of each of the consolidated entities might be more beneficial (i.e. when the tax consolidated group option is applied, there would only be one safe harbour of EUR 3m for the consolidated group). However, before making this choice, a detailed analysis of the long term implications will have to be performed since the choice will be binding until the end of the tax consolidation.

How to opt for the interest limitation at entity level?

Because applying the interest limitation at the level of the consolidated group is the rule, taxpayers only need to take action if they would like to apply the interest limitation rule at the level of each entity of the tax consolidated group.

The choice regarding the application of the interest limitation rule generally needs to be made when filing a request for the tax consolidation regime with the Luxembourg tax authorities (*Administration des Contributions Directes*). In this request, all entities of the tax consolidated group have to commit to apply the chosen option as long as the tax consolidation remains in place.

What about tax consolidated groups already in place?

With regard to existing tax consolidated groups, the option to apply the interest limitation rule at the level of each entity will have to be stated in a request to be filed before the end of the first accounting year in respect of which article 168bis LITL (i.e. the interest limitation rule) becomes applicable for the first time. For companies with an accounting year corresponding to the calendar year, this means that a request has to be filed before 31 December 2019. At the time of filing, all entities of the tax consolidated group have to commit to apply the option until the end of the tax consolidation.

Other aspects

The new provisions of Article 164bis LITL dealing with the interest limitation rule include most of the provisions of Article 168bis LITL which have been adapted to the tax consolidation regime: e.g. definitions of borrowing costs and exceeding borrowing cost, grandfathering rule, exemption applicable to financial undertakings, so-called "escape clause", etc.

The new provisions also clarify how to apply the rules on the carry forward of non-deductible exceeding borrowing costs and unused interest capacity when an entity enters/leaves a tax consolidated group.

Amendments aiming to clarify other aspects of the tax consolidation regime

Some other amendments are introduced by the law in order to clarify the following aspects of the tax consolidation rules:

- how to determine the taxable income at group level;
- how to use tax losses carried forward;
- how to use tax credits.

Most of these aspects have been dealt with either in the Grand Ducal Regulation of 18 December 2015 or in individual circulars. However, in order to clarify and simplify the rules, it has been

decided that these aspects should be commonly addressed in one single legal provision, i.e. the amended Article 164bis ITL. Therefore, a new Grand-Ducal Regulation repeals Grand Ducal Regulation of 18 December 2015.

One particular aspect that is governed by the amended Article 164bis ITL is the use of pre-tax consolidation tax losses carried forward. Given that these losses, according to the law, may only be used following the consolidation of the current year income of all members of the tax consolidated group (to the extent a positive taxable income is realised by the tax consolidated group and the entity that incurred the pre-tax consolidation tax losses), there is a risk of lock-in effects and unsystematic results. Unfortunately, the Luxembourg legislator did not remedy these negative aspects during the legislative process.

Implications

Overall, the tax measures provided in the 2019 budget law are positive. The decrease of the CIT rate by 1% should contribute to Luxembourg's attractiveness in the post-BEPS era, a new economic paradigm characterised by more harmonised tax rules, in particular within the EU. Moreover, the extension of the scope of application of the reduced CIT rate of 15% up to EUR 175,000 of taxable income means that many Luxembourg companies will be subject to an aggregate corporate tax rate of 22.80% rather than 24.94%. The implementation of the option provided under ATAD to apply the interest limitation rule at the level of a consolidated group is also very important as it provides flexibility to taxpayers. However, given that the option makes available only one EUR 3m safe harbour for the entire tax consolidated group, taxpayers have to carefully analyse which alternative would be most beneficial in the long run as the choice will be binding until the end of the tax consolidation.

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Luxembourg Ratifies the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

OUR INSIGHTS AT A GLANCE

- On 9 April 2019, Luxembourg deposited its instruments of ratification for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (multilateral convention or "MLI") which will enter into force on 1 August 2019 in Luxembourg.
- Luxembourg took the approach to have all its double tax treaties ("DTTs") in force covered by the MLI. However, for a covered tax treaty to be amended by the MLI, it is required that both contracting states first decide that the MLI should cover the specific DTT and second, that both countries adopt matching options/alternatives.
- As of today, the DTTs concluded by Luxembourg with the following countries are concerned: Austria, Finland, France, Georgia, Guernsey, Ireland, Isle of Man, Israel, Japan, Jersey, Lithuania, Malta, Monaco, Netherlands, Poland, Serbia, Singapore, Slovak Republic, Slovenia, Sweden and the UK.
- MLI provisions will modify Luxembourg DTTs on different timescales depending on the kind of tax (withholding tax or otherwise), the date of entry into force of the MLI for each of the contracting States and the tax year observed by the companies concerned.

On 9 April 2019, Luxembourg deposited its instruments of ratification for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (multilateral convention or "MLI"). The MLI is a comprehensive and flexible convention that allows countries to implement a wide range of tax treaty related BEPS measures with many options and alternatives. Luxembourg took the approach to have all its double tax treaties ("DTTs") in force covered by the MLI. However, for a covered tax treaty to be amended by the MLI, it is required that both contracting states first decide that the MLI should cover the specific DTT and second, that both countries adopt matching options/alternatives. Hence, if one contracting state is in favour of a certain provision while the other contracting state has not adopted an identical option/alternative, the existing tax treaty will not be amended in this respect. In our tax alert dated 9 June 2017, we presented the approach taken by Luxembourg. In this article, we ask what the ratification of the MLI means for Luxembourg DTTs and what is the timeline to expect.

When will the MLI enter into force?

For Luxembourg, the MLI will enter into force on the 1st day of the month following the expiration of a period of 3 calendar months beginning on the date of the deposit, i.e. given that the date of deposit was 9 April 2019, the MLI will therefore enter into force on 1 August 2019.

Which DTTs will be impacted?

The entry into force of the MLI will only affect covered DTTs concluded with those countries where the MLI has entered into force as well.

To check the status of ratification by all MLI signatories and parties, please click here.

As of today, the DTTs concluded by Luxembourg with the following countries are concerned: Austria, Finland, France, Georgia, Guernsey, Ireland, Isle of Man, Israel, Japan, Jersey, Lithuania, Malta, Monaco, Netherlands, Poland, Serbia, Singapore, Slovak Republic, Slovenia, Sweden and the UK.

As from when will the MLI provisions modify Luxembourg DTTs?

As far as the application of the MLI to the DTTs referred above is concerned (i.e. to DTTs concluded with countries for which the MLI has already entered into force or will enter into force on 1 August 2019 at the latest), the MLI will apply as follows:

- with respect to taxes withheld at source on amounts paid or credited, where the event giving rise to such taxes occurs on or after the first day of the next calendar year that begins on or after the latest of the dates on which the MLI enters into force for each of the DTT contracting States (i.e. 1 January 2020);
- with respect to all other taxes, for taxes levied with respect to taxable periods beginning on or after the expiration of a period of 6 calendar months from the latest of the dates on which the MLI enters into force for each of the DTT contracting States (i.e. tax years beginning on or after 1 February 2020). For companies with a tax year corresponding to the calendar year, this means that the application of the MLI provisions is differed until tax year 2021.

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The Amended Luxembourg PE Definition: Is There Really Something New?

OUR INSIGHTS AT A GLANCE

- The PE concept is relevant for both Luxembourg residents and non-residents. Where Luxembourg non-residents have a PE situated in Luxembourg, the profits attributable to this PE are subject to income tax (individuals) or corporate income tax (companies) and municipal business tax. Moreover, non-resident companies are subject to Luxembourg net wealth tax levied on the unitary value of their Luxembourg PE.
- As part of the 2019 tax reform, the PE definition has been extended to deal with foreign PEs of Luxembourg taxpayers. According to the new provision, the only criteria to be considered in order to assess whether a Luxembourg taxpayer has a PE in a country with which Luxembourg has concluded a tax treaty are the criteria defined in the applicable tax treaty. Accordingly, the PE definition included in the tax treaty will be relevant for the analysis as to whether a Luxembourg taxpayer has a foreign PE.
- On 22 February 2019, the Luxembourg tax authorities released a circular that provides further guidance concerning the interpretation of the permanent establishment ("PE") concept in cases where Luxembourg taxpayers have a PE in a treaty country.
- The extended definition as it appears in the new paragraph 5 of Section 16 of the Fiscal Adaptation Law seems to merely confirm the requirements that already existed before the amendment of the Luxembourg PE definition. It may, however, be expected that the Luxembourg tax authorities will verify even more carefully than before whether the criteria of the PE definition in an applicable tax treaties are satisfied.

The 2019 tax reform implements the EU Anti-Tax Avoidance Directive ("ATAD") and other Base Erosion and Profit Shifting ("BEPS") related measures into Luxembourg tax law, including an amendment of the permanent establishment ("PE") definition. The new provision concerns the interpretation of the PE concept in cases where Luxembourg taxpayers have a PE in a treaty country. On 22 February 2019, the Luxembourg tax authorities released a circular (the "Circular") that provides further guidance in this respect. In this article, we analyse the content of the Circular and consider the practical implications of the amended PE definition.

Introduction

The concept of PE plays a prominent role in the tax treatment of cross-border business activities and is relevant for the application of both domestic tax law and tax treaties. However, the purpose of the PE concept is not the same for these respective areas of law.

Under Luxembourg tax law, the PE definition is mainly used to determine if a non-resident enterprise is subject to (corporate) income tax and municipal business tax on its profits realised through a Luxembourg PE. In contrast, the main purpose of the PE concept under tax treaties is to determine the right of a Contracting State to tax the profits of an enterprise which is resident in the other Contracting State. This is because according to Article 7 of the *OECD Model Tax Convention on Income and on Capital* ("OECD Model"), a Contracting State cannot tax business profits of enterprises resident in the other Contracting State unless it carries out its business through a PE located therein.

When an enterprise operates through a PE in the other Contracting State, Article 7 of the OECD Model allocates an unlimited primary taxing right to the host state of the PE. In this regard, the residence state of the enterprise has to adopt a method for the elimination of double taxation. With regard to Luxembourg taxpayers who have a PE in another Contracting State, Luxembourg frequently adopts the exemption method. Thus, Luxembourg is required to exempt profits that are attributable to a foreign PE.

Definition of PEs under Luxembou g tax law

Opening comments

The PE concept in Luxembourg tax law is defined in Section 16 of the Fiscal Adaptation Law that provides for a general PE definition (paragraph 1) and a non-exhaustive list of examples (paragraph 2) which are deemed to constitute a PE for Luxembourg tax purposes.

The PE concept is relevant for both Luxembourg residents and non-residents. Where Luxembourg non-residents have a PE situated in Luxembourg, the profits attributable to this PE are subject to income tax (individuals) or corporate income tax (companies) and municipal business tax. Moreover, non-resident companies are subject to Luxembourg net wealth tax levied on the unitary value of their Luxembourg PE.

Only very little Luxembourg case law regarding the interpretation of the PE definition exists under Luxembourg tax law. It is, however, widely accepted in Luxembourg literature that German case law is a useful source of interpretation given the German origin of the Fiscal Adaptation Law.

The general PE definition

According to the general PE definition provided in Section 16 (1) of the Fiscal Adaptation Law "*a permanent establishment in the sense of tax law is every fixed place of equipment or business facility which serves for the operation of an established business*". Thus, the definition of PEs under Luxembourg tax law contains the following conditions:

- the existence of a "place of equipment or business facility", i.e. a facility such as premises or, in certain instances, machinery or equipment;
- this place of equipment or business facility must be "fixed", i.e. it must be established at a distinct place with a certain degree of permanence;
- the carrying out of the business of the enterprise through this fixed place of equipment or business facility.

"*A fixed place of equipment or business facility*" may be any premises, facilities or installations serving the business activities of a non-resident enterprise irrespective of whether such facilities are suitable for the presence of people or not. Even simple storage areas, a pipeline or an internet server may constitute a PE for Luxembourg tax purposes. Hence, whether or not certain premises, facilities or installations are a place of equipment or business facility within the meaning of this provision depends on the specific activities carried out by the enterprise.

In order to qualify as a PE, the fixed place of equipment or business facility must be maintained by the taxpayer for more than a temporary period. This requires the taxpayer to have a legal right to the property which cannot be revoked or changed without the consent of the taxpayer. This does not, however, require ownership of the property. Instead, renting, sub-letting, leasehold and even gratuitous cession of the property may be sufficient to the extent it suffices for the purposes of the business activities. The control requirement will not be met if the activities are carried out in the premises of a business partner.

The equipment or business facility must further be "*fixed*" in terms of geographical location. Permanent business facilities or equipment include, without doubt, buildings, office premises and other facilities permanently attached to the ground. It should be noted that facilities do not need to be permanently attached to the ground. Transportable facilities such as mobile newspaper stands, maintenance vehicles, camping trailers or tents may be fixed within the meaning of this provision insofar as they are located permanently or frequently (over a longer period of time) at a specific location.

The decisive period for the "permanency test" cannot generally be stated. As a practical guideline, a period of six months may be considered in analogy to the time threshold set out in relation to building and construction sites; this is, however, not a binding rule. Where activities are of a unique or short-term nature, a fixed place of equipment or business facility should generally not constitute a PE.

The fixed place of equipment or business facility must further "*serve for the operation of an established business*". The term "established business" clarifies that the PE concept is only relevant for commercial activities. In the absence of a commercial business, investments in real estate, the renting of tangible assets or licensing intangible assets do not constitute a PE.

Whether or not "*a fixed place of equipment or business facility*" serves the main purpose of the business or is ancillary thereto is irrelevant for the existence of a PE as long as it serves the business of the non-resident enterprise. Furthermore, the commercial activity does not necessarily have to be carried out by employees of the non-resident enterprise. Instead, it may be possible to subcontract the activities to independent subcontractors. In specific cases, a fixed place of equipment or business facility that is fully automated or mechanical without requiring the frequent presence of staff may constitute a PE. Facilities which only indirectly serve the business of a non-resident enterprise should, however, not constitute a PE.

Overall, the threshold that must be met for a PE to be constituted in accordance with the PE definition provided in Section 16 (1) of the Fiscal Adaptation Law is rather low.

PE examples listed in Section 16 (2) of the Fiscal Adaptation Law

Section 16 (2) of the Fiscal Adaptation Law provides a non-exhaustive list of examples which are deemed to constitute a PE. The most relevant examples are:

- The place of corporate management;
- Branch offices;
- Factories;
- Warehouses;
- Places of purchase and sale;
- Permanent agents;
- Building and construction sites or installation projects.

While most of these examples fall within the definition of Section 16 (1) of the Fiscal Adaptation Law, some examples do extend the scope of the PE definition.

The new provision relating to foreign PEs

As part of the 2019 tax reform, the PE Definition has been extended by a 5th paragraph dealing with foreign PEs of Luxembourg taxpayers. According to the new provision, the only criteria to be considered in order to assess whether a Luxembourg taxpayer has a PE in a country with which Luxembourg has concluded a tax treaty are the criteria defined in the applicable tax treaty. Accordingly, the PE definition included in the tax treaty will be relevant for the analysis as to whether a Luxembourg taxpayer has a foreign PE.

According to Section 16 (5) of the Fiscal Adaptation Law, a taxpayer will only be considered to carry out all or part of its business through

a PE situated in the other Contracting State to the extent that the activity performed, when viewed in isolation, constitutes a separate activity and represents a participation in the general economic life of the other Contracting State, unless a specific provision in the applicable tax treaty provides otherwise.

In order to be able to verify the existence of a PE, the Luxembourg tax authorities may request Luxembourg taxpayers to provide confirmation that the other Contracting State considers a PE to exist (for example, a certificate of registration). It is further stated that such confirmation has to be provided when the applicable tax treaty does not provide for a provision that would allow Luxembourg, as residence state of the enterprise, to decline the tax exemption of the income or capital and the other Contracting State interprets the provisions of the tax treaty in a way that excludes or limits its own taxing right.

This provision resembles Article 23A (4) of the OECD Model which allows the residence state of a taxpayer to deny the application of the exemption method in case the other Contracting State interprets the tax treaty in a way that would restrict or exclude its taxing rights. This provision aims at avoiding double non-taxation in case of conflicts of interpretation by the two Contracting States.

Analysis of the new provision and the related Circular

Opening comments

The new provision regarding foreign PEs and the related Circular seem to change the interpretation of the PE concept in outbound cases through the adding of additional requirements. The purpose of this new provision is to avoid conflicts of interpretations deriving from the interaction between domestic tax law and the provisions of a tax treaty.

However, the question arises whether the amended PE definition leads to any requirements that did not exist before. Moreover, it has to be analysed whether Luxembourg would be able to unilaterally eliminate its obligation to exempt profits attributable to a PE located in a tax treaty jurisdiction through a change of domestic tax law.

Considerations regarding Art. 23A (4) of the OECD Model

The new paragraph 5 of Section 16 of the Tax Adaption Law refers to situations where the other Contracting State interprets the provisions of the tax treaty in such a way that would exclude or limit its taxing right. This language is inspired by Art. 23A (4) of the OECD Model that is also referred to in the Circular.

Art. 23A (4) of the OECD Model was included in the 2000 Revision of the OECD Model. The purpose of Article 23A (4) of the OECD Model is to avoid double non-taxation resulting from disagreements between the Contracting States on the facts of a case or on the interpretation of the distributive rules.

Article 23A (4) of the OECD Model applies in the following circumstances:

(i) the source state interprets the facts of a case or the provisions of the Convention in such a way that an item of income or capital falls under a provision of the Convention that eliminates its right to tax that item or limits the tax that it can levy;
(ii) the residence state adopts a different interpretation of the facts or of the provisions of the Convention in that it considers that the item may, in accordance with the Convention, be taxed in the other Contracting State. If paragraph 4 of Article 23 A of the OECD Model did not exist, the residence state would be obliged to exempt that item of income or capital.

Accordingly, the income and capital would either not be taxed at all or, in case of dividends and interest, taxed at a limited rate in the source state. In these circumstances, Article 23A (4) of the OECD Model confirms the taxing right of the residence state and double taxation is avoided via application of the credit method.

The Circular states that a provision drafted along the lines of Article 23A (4) of the OECD Model has been included in around 40 tax treaties concluded by Luxembourg. Nevertheless, this provision may only apply if the host state of the PE considers that its taxing right is restricted by the tax treaty. Whether or not the host state effectively taxes the profits attributable to the PE is wholly irrelevant for the purposes of Article 23A (4) of the OECD Model. This has been acknowledged in the Circular. Thus, when the host state of the PE simply does not exercise its taxing right provided under the tax treaty, the application of the credit method cannot be based on this provision.

The relation between tax treaties and domestic tax law

Domestic tax law and tax treaty law constitute two independent and functionally distinct legal spheres. Whilst domestic law determines the objects and scope of domestic tax liabilities, tax treaty law only determines which of the two Contracting States are entitled to actually exercise the taxing rights under its domestic tax law. Tax treaties may never generate taxing rights under domestic tax law. Rather, as lex specialis vis-à-vis the domestic tax provisions, tax treaties only restrict the taxing rights as provided under domestic tax law. Domestic tax law remains, however, unaffected as long as those rights have not been limited by the treaty.

Not only do tax treaties not dictate that allocated taxing rights must be exercised by a country, they also do not dictate how they are to be exercised (except in certain respects in order to ensure effectiveness). Whether and how those rights are exercised is usually left to the respective ordinary domestic laws. It is therefore possible and common to have a situation where there is a right under a treaty to impose a form of taxation but where the legislature has not decided to impose (or has actively decided not to impose) such a tax liability under domestic law.

Applied to PEs, this means that a Contracting State may not make use of its taxing right provided in accordance with Article 5 and 7 (2) of the OECD Model because of a more restrictive concept of trade or business under domestic tax law. Here, Luxembourg as residence state of the enterprise may, in the absence of specific anti-abuse provisions, not deny the application of the exemption method even if the result is double non-taxation.

A future legislature may pass legislation exercising the taxing right and this would be consistent with the treaty. When new legislation is proposed, the consistency of such legislation with a State's treaty obligations will sometimes be an issue. Importantly, additional taxing rights may only be exercised to the extent they are not restricted under a tax treaty. Nevertheless, the scope of taxing rights under a State's various tax treaties is not identical; while some tax treaties may restrict certain taxing rights under domestic tax law, others may not.

From the point of view of the taxpayer, where one Contracting State does not currently take up its full taxing rights under a treaty, the tax treaty at least serves as a guarantee to the taxpayer that future taxation cannot go beyond the level fixed by the treaty (unless the tax treaty is first abrogated or amended).

Domestic interpretation of the term "business"

The Circular states that Luxembourg may refer to domestic tax law when interpreting terms that are not defined in a tax treaty. This is consistent with Article 3 (2) of the OECD Model which provides that any undefined term in the tax treaty will have the same meaning it has under the law of the Contracting State applying the tax treaty, unless the context requires otherwise.

As regards the interpretation of the term "business", the new Luxembourg PE definition provides that a Luxembourg taxpayer would only be considered to have a PE in the other Contracting State if the activity on its own is an independent activity which represents a participation in the general economic life of the other State. This suggests that to meet the definition, the PE should perform an activity that comes within the scope of a commercial activity within the meaning of Luxembourg tax law.

According to Luxembourg tax law, any activity performed by a Luxembourg company is deemed to be a commercial activity. Thus, one may take the view that any activity performed by a Luxembourg company via a fixed place of business in the other Contracting State should be considered as part of the business of the Luxembourg company which constitutes a PE within the meaning of the tax treaty.

However, according to paragraph 5 of Section 16 of the Tax Adaptation Law, a foreign PE of a Luxembourg company has to, on its own, perform a commercial activity. According to Article 14 (1) of the LITL, the carrying out of a commercial activity requires cumulatively (i) an independent activity (ii) of permanent character, (iii) that is carried out with the intent to realise profits and (iv) participation in the general economic life.

(i) *Independent activity*

The criterion "independent activity" assumes an activity that is carried out by the taxpayer in its own name and on its own behalf. The taxpayer further needs to be able to exercise business initiative and bear the risk of the activity which includes that the profits or losses deriving from the activity are directly allocated to the taxpayer.

(ii) *Permanent character*

The notion of "permanence" is meant to distinguish commercial activity from one-time transactions and wealth management. An activity frequently has a permanent character if, from the beginning, there has been an intention to carry out a lasting activity expected to result in a source of income. Permanence does not, however, require a minimum period or an activity that is performed without interruptions; a temporary or recurring activity may suffice. Given that a PE is only constituted when a fixed place of business has a certain degree of permanency, this criterion should often be met.

(iii) *Carried out with the intent to realise profits*

The activity must be undertaken with the intent to realise profits. Whether or not losses are realised in the start-up phase or during certain periods is irrelevant. Instead, the decisive factor is whether the taxpayer intends to realise an overall profit during the period when the activity occurs. As companies are deemed to have a profit motive, this criterion should frequently be met.

(iv) *Participation in the general economic life*

This criterion partly overlaps with the criteria of permanence and the intent to realise profits and is meant to distinguish commercial activities from wealth management. The commercial activity must be part of the general economic life, or in other words, the enterprise must take part in the provision of goods or services to the market and its activity must be visible to the general public.

In this regard, the existence of a certain organisation, physical substance and publicity may be indications. Whether or not the activity is restricted to a limited circle of customers is irrelevant. In the extreme, it may suffice to have only one customer. In a company group context, a permanent establishment only doing business with affiliates may suffice.

When a Luxembourg company operates part of its commercial activities via a fixed place of business in the other Contracting State, all the conditions of commercial activity as defined in Article 14 (1) of the LITL should generally be met. In any case, the concept of commercial activity as well as the interpretation rule provided under Article 3 (2) of the OECD Model are nothing new and should have already been applied by the Luxembourg tax authorities before the 2019 tax reform.

Illegitimate tax treaty override

An issue that is closely linked with the interpretation and application of tax treaties is the issue of treaty override. The term "treaty override" refers to the enactment of subsequent domestic legislation which conflicts with obligations undertaken by a prior and binding tax treaty. Conflicting domestic legislation may, for example, take the form of a provision stating that treaty provisions are to be disregarded in certain circumstances.

Two situations need to be distinguished:

(i) "Intentional treaty override": where one state knowingly and intentionally enacts legislation conflicting with a treaty obligation;
(ii) "unintentional treaty override": where there is no such intention.

In case of unintentional treaty override, it may be possible to reconcile the tax treaty and the domestic law. In contrast, where intentional treaty override occurs, conflict is manifest and the issue comes down to whether the changes in domestic law prevail.

Importantly, a tax treaty is an international treaty that is binding on the Contracting States. Consequently, the subsequent enactment of domestic legislation which is intended to override a treaty constitutes a breach of international law and a state's international obligations. In this regard, Articles 26 and 27 of the Vienna Convention provide clear rules on the performance of treaties. According to Article 26 of the Vienna Convention, every treaty in force is binding upon the parties to it and must be performed by them in good faith. Furthermore, Article 27 of the Vienna Convention explicitly states that a party to a treaty may not invoke the provisions of its internal law as justification for its failure to perform a treaty.

The overriding of a treaty provision by domestic law may lead to a complaint under the mutual agreement procedure of the treaty, to a referral to an international arbitral body or to the termination of the treaty by the other party.

With regard to profits attributable to a PE located in a Contracting State, Luxembourg frequently adopts the exemption method for the elimination of double taxation. The application of the exemption method is generally not conditional to an effective taxation in the other Contracting State. Thus, Luxembourg is required to exempt such income unless the tax treaty provides for a specific clause that would allow Luxembourg to deny the exemption in the absence of effective taxation in the host state of the PE (i.e. a subject-to-tax or a switch-over clause that provides for the application of the credit method). Otherwise, denying the application of the exemption method when a Luxembourg company has a PE in a Contracting State within the meaning of the applicable tax treaty would represent an illegitimate tax treaty override.

Confirmations to be produced by taxpayers

The Circular further determines how taxpayers have to evidence the existence of a foreign PE. According to the Circular, the tax authorities may always request confirmation that the host state of the PE recognises the PE. This might, for example, be a registration of the PE in the other Contracting State. This is consistent with the taxpayers' cooperation duties; taxpayers have, upon request, to provide evidence that the statements made in the tax returns are correct. The relevant documents should be annexed to the corporate tax returns.

When an applicable tax treaty does not allow Luxembourg to deny the application of the exemption method or the other Contracting State interprets the provisions of the tax treaty in a way that its taxing right is limited or excluded, the taxpayer has to produce confirmation of the existence of the PE in the other Contracting State. Where a taxpayer fails to produce such evidence, the Luxembourg tax authorities will consider that the Luxembourg taxpayer has no PE in the other Contracting State.

As regards the type of information to be provided, the Circular states that taxpayers have to produce a document that proves that the competent authorities of the other Contracting State consider a PE to exist. This might be a tax assessment or a certificate in which the competent authorities of the other Contracting State confirm the existence of the PE.

According to the Circular, it would not suffice to produce a certificate confirming the existence of a commercial activity in the territory of the other Contracting State if that activity does not constitute a PE. However, if the other Contracting State does not make use of its taxing right provided under the tax treaty, Luxembourg cannot unilaterally decide to refuse the application of the exemption method unless the applicable tax treaty provides for a specific anti-abuse provision.

Considerations regarding the amended PE definition

The question arises as to whether the amended PE definition introduces new requirements with regard to foreign PEs of Luxembourg taxpayers or if the new provision is merely a clarification and formalisation of the requirements that already existed.

According to the amended PE definition, the only criteria to be considered when analysing whether a Luxembourg taxpayer has a PE in a treaty jurisdiction are the criteria determined in the PE definition of the applicable tax treaty. This is consistent with the general principle that in a tax treaty context a PE is only constituted (and the host state has only an unlimited primary taxing right over business profits of a non-resident enterprise) to the extent a non-resident enterprise has a PE in accordance with the applicable tax treaty.

As regards the interpretation of the term "business" under Luxembourg tax law and the interpretation rule provided in Article 3 (2) of the OECD Model, the amended PE definition should be considered as a mere clarification. The concept of commercial activity has not changed and was considered in accordance with Article 3 (2) of the OECD Model before the amendment of the domestic PE definition.

Moreover, Article 23A (4) of the OECD Model cannot be used to eliminate double non-taxation where both Contracting States consider that the profits attributable to the PE "may be taxed" by the host state of the PE regardless of whether the latter exercises its taxing right.

Likewise, the Luxembourg tax authorities retain the right to request evidence and documentation from Luxembourg taxpayers that prove the existence of a PE in a treaty jurisdiction; this is part of the taxpayers' cooperation duty.

In light of the above, the new paragraph 5 of Section 16 of the Fiscal Adaptation Law seems to merely confirm the requirements

that already existed before the amendment of the Luxembourg PE definition. It may, however, be expected that the Luxembourg tax authorities will verify even more carefully than before whether the criteria of the PE definition in applicable tax treaties are satisfied.

Conclusion

The new provision included in the domestic PE definition concerns situations in which Luxembourg taxpayers have a PE in a country with which Luxembourg has concluded a tax treaty. The basic idea behind this amendment is the elimination of conflicts of interpretation resulting from the interaction between the domestic PE concept and the PE definition included in tax treaties.

According to the amended PE definition, the only criteria to be considered when assessing whether a Luxembourg taxpayer has a PE in a tax treaty country are the criteria defined in the applicable tax treaty. Moreover, a Luxembourg taxpayer should only be considered to carry out business in the other Contracting State if the activity on its own constitutes an independent activity that represents a participation in the general economic life of that other state.

However, these requirements already existed despite not having been formalised in the PE definition. In the McDonald's State Aid decision, the EU Commission confirmed that Luxembourg correctly applied its domestic tax law and the tax treaty concluded with the US. Ultimately, double non-taxation as it occurred in the case of McDonald's may only be resolved through the amendment of the applicable tax treaty and the inclusion of specific anti-abuse rules such as a subject-to-tax or a switch-over clause which result in the application of the credit method when profits are not taxed in the host state of the PE.

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Implementation of the Directive on Double Taxation Dispute Resolution Mechanisms in Luxembourg

OUR INSIGHTS AT A GLANCE

- On 11 April 2019, the Luxembourg government submitted a new draft law on double taxation dispute resolution mechanisms (the "Draft Law") implementing, 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.
- 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 Draft 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 Draft Law will apply to any complaint submitted from 1 July 2019 onwards with respect to questions related to the tax year starting on or after 1 January 2018. Luxembourg has not opted for the option to apply the Directive with regard to any complaint that was submitted prior to 1 January 2018.

On 11 April 2019, the Luxembourg government submitted a new draft law on double taxation dispute resolution mechanisms (the "Draft Law"). The Draft 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 Draft Law

The purpose of the Draft Law is to establish rules to efficiently resolve situations of double taxation between Luxembourg and one or more European 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").

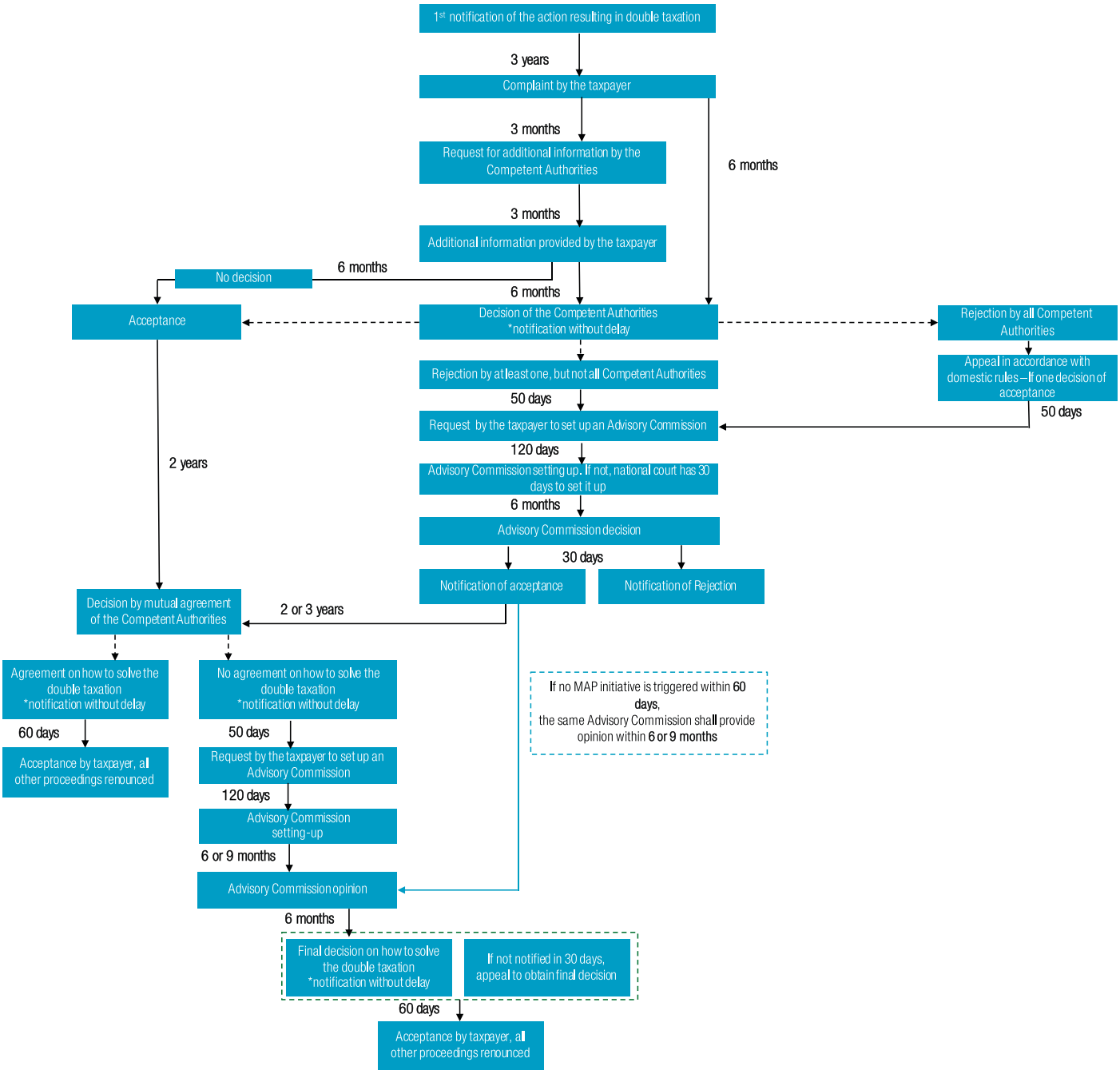
Double Taxation Disputes are related to impositions by two (or more) Member States of taxes in respect to the same taxable income or capital when this gives rise to either an additional tax charge, increase in tax liabilities or cancellation or reduction of losses, all of which could be used to offset 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 Draft Law does not deal with the procedure to be applied for non-EU countries. This procedure is dealt with by a circular dated 28 August 2017.

Double taxation dispute resolution mechanisms

The Draft 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. 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 Draft 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.

Tax dispute resolution mechanism



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 Draft Law and the provisions of the Luxembourg general tax law, or the judicial proceeding. In such case, the relevant time limits set up by the Draft Law shall be suspended. They shall run 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 Draft 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 Draft Law even where 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 Draft 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, where a judgment on the Double Taxation Dispute has already been rendered by the Tribunal or the Administrative Court which has acquired 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 a MAP is initiated under the Draft Law does not prevent the Luxembourg authorities from opening or continuing administrative or criminal proceedings aimed at applying administrative and criminal penalties. Where penalties have been imposed for the absence of declaration, fraud or tax evasion, the competent authority of Luxembourg may refuse access to the MAP.

Implementation timeline

The Draft Law will apply to any complaint submitted from 1 July 2019 onwards with respect to questions related to the tax year starting on or after 1 January 2018. Luxembourg has not opted for the option to apply the Directive with regard to any complaint that was submitted prior to 1 January 2018.

For a detailed overview of the provisions introduced by the Directive and the 3-step process it introduces, please read the dedicated article in our June 2017 ATOZ Insights and our December 2017 ATOZ Insights.

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CJEU Answers Questions of Danish Court Relating to Beneficial Ownership

OUR INSIGHTS AT A GLANCE

- On 26 February 2019, the Court of Justice of the European Union issued its decisions in six joined cases which deal with the interpretation of the Parent-Subsidiary Directive ("PSD") and the Interest & Royalties Directive ("IRD"), referred to collectively as the "Danish Cases".
- The Danish tax authorities claimed that the withholding tax exemptions on dividend and interest payments from Danish companies resulting from the PSD and IRD should not be granted since the recipients (i.e. the EU parent companies) were not the beneficial owners of the payments. The cases were appealed to the Danish High Court which referred questions to the CJEU.
- While it was not for the CJEU to assess the facts in the cases, the Court specified indicia of abusive or fraudulent acts and under which conditions an EU parent company may not be the beneficial owner of interest income with a view to guide the national court in the assessment of the cases. In contrast, in her opinion, the Advocate General Kokott analysed in which cases anti-abuse legislation should not apply and when EU parent companies should be considered as beneficial owners.
- The approach taken by the CJEU in its decisions, describing situations where abuse might be present rather than detailing when the benefits of the PSD and the IRD should be granted, seems to create the perception of a broad interpretation of abuse and fraudulent acts. And unfortunately, the present case law of the CJEU did not contribute much to legal certainty in these times that are characterised by chronic legal uncertainty.

On 26 February 2019, the Court of Justice of the European Union ("CJEU") issued its decisions in six cases which deal with the interpretation of the Parent-Subsidiary Directive ("PSD") and the Interest & Royalties Directive ("IRD", together the "Directives").

For the purposes of the judgments, the cases T Denmark (C-116/16) and Y Denmark Aps (C-117/16) regarding the interpretation of the PSD, and the cases N Luxembourg 1 (C-115/16), X Denmark A/S (C-118/16), C Denmark I (C-119/16) and Z Denmark ApS (C-299/16) regarding the interpretation of the IRD, have been joined.

Background

In the cases, the Danish companies were all owned by a parent company resident in another EU Member State (i.e. Luxembourg, Cyprus or Sweden). The EU parent companies were all directly or indirectly owned by companies resident in third countries or by private equity funds with unknown residency of the investors.

The Danish companies paid out either dividends or interest to their EU parent companies and claimed that such payments of dividends or interest should be exempt from withholding tax in accordance with the PSD or the IRD. Here, the Danish tax authorities claimed that the withholding tax exemptions resulting from the PSD and IRD should not be granted since the recipients (i.e. the EU parent companies) were not the beneficial owners of the payments. The cases were appealed to the Danish High Court which referred questions to the CJEU.

The referred questions in the dividend and interest cases are generally the same. The question on beneficial ownership was only asked in the interest cases, as it is a requirement in the IRD that the recipient of interest payments is the beneficial owner thereof, whereas this is not a requirement in the PSD.

Questions referred to the CJEU

The questions referred by the Danish Court to the CJEU mainly concern three topics:

(i) The first topic relates to the existence of a legal basis enabling a Member State to refuse to grant withholding tax exemptions on dividend and interest payments made to EU parent companies as provided in the PSD and the IRD. The question of the Danish Court further relates to the "beneficial ownership" concept in the IRD.

(ii) In so far as such legal basis exists, the second topic addressed by the questions of the Danish Court concerns the constituent elements of any abuse of rights and the conditions for proving it.

(iii) The third topic of the questions, likewise in the event that it is possible for a Member State to deny the benefits of the PSD and the IRD to an EU parent company, concerns the interpretation of the provisions of the Treaty on the Functioning of the European Union ("FEU Treaty") relating to the freedom

of establishment and the free movement of capital, in order to enable the referring court to establish whether the Danish legislation infringes on those freedoms.

Is there a need for domestic or agreement-based anti-abuse provisions?

Until the adoption of Law No. 540 of 29 April 2015, Danish tax law did not provide for any anti-abuse legislation. Therefore, the question was raised by the Danish Court whether, without a specific domestic or agreement-based anti-abuse provision, it was possible to deny the withholding tax exemptions provided in the PSD and IRD.

In this regard, the CJEU states the general principle of EU Law that a taxpayer cannot enjoy a right or advantage arising from EU Law when the transaction at issue is purely artificial economically and is designed to circumvent the application of the legislation of the Member State concerned.

Thus, when there is a fraudulent or abusive practice, the national authorities and courts should refuse to grant a taxpayer the withholding tax exemptions provided under the PSD and the IRD even if there are no domestic or agreement-based provisions which would require such a refusal. In addition, the withholding tax exemption on interest payments provided in the IRD is restricted to the beneficial owners of the interest.

The answer to this question is important to Danish cases going back as far as 2005 when the Danish tax law did not provide for any general anti-abuse rule. It is not surprising that the CJEU held that EU Law cannot be relied on for abusive or fraudulent ends and benefits may be denied in the absence of specific anti-abuse provisions.

However, this clarification has only a very limited impact for other cases. As of today, all EU Member States have implemented a general anti-abuse rule, at the latest since 1 January 2019 when the Anti-Tax Avoidance Directive ("ATAD") had to be implemented.

How to prove the existence of an abusive practice?

With regard to the question as to how to prove an abusive practice, the CJEU states two requirements:

- First, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the EU rules, the purpose of those rules has not been achieved, and
- Second, a subjective element consisting in the intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining it.

According to the CJEU, the examination of a set of facts is needed to establish whether the constituent elements of an abusive practice are present and, in particular, whether economic operators have carried out purely formal or artificial transactions devoid of any economic or commercial justification, with the essential aim of benefiting from an improper advantage.

A group of companies may be regarded as being an artificial arrangement when it is not set up for reasons that reflect economic reality, its structure is purely one of form and its principal objective or one of its principal objectives is to obtain a tax advantage running counter to the aim or purpose of applicable tax law.

The presence of a certain number of indications may demonstrate that there is an abuse of rights, in so far as those indications are objective and consistent. Such indications can include, in particular, the existence of conduit companies which are without economic justification and must themselves pass the interest to a third company which does not fulfil the conditions for the application of the IRD and the purely formal nature of the structure of the group of companies, the financial arrangements and the loans.

The fact that a company acts as a conduit company may be established where its sole activity is the receipt of interest and its transmission to the beneficial owner or to other conduit companies. The absence of actual economic activity must, according to the CJEU, be inferred from the analysis of all the relevant factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and to expenditure actually incurred, to the staff that it employs and to the premises and equipment it has.

Based on previous case law of the CJEU, the court frequently rejects the presence of abuse in cases where a company has appropriate (as opposed to excessive) substance. In this regard, it is acknowledged that a holding and financing company that exists for legitimate commercial reasons might not need much substance for properly managing its activities.

In addition, with regard to the burden of proof, the CJEU confirms that it is the task of the Member State (or respectively, the competent authorities thereof) to establish the existence of elements constituting an abusive practice while taking account of all the relevant factors, in particular the fact that the company to which the interest has been paid is not its beneficial owner.

Can a SICAR benefit f om the IRD?

In its decision, the CJEU also clarified that a SICAR established in corporate form (S.A., S.C.A., S.à r.l.) may not benefit from the withholding tax exemption on interest provided under the IRD since a SICAR benefits from a tax exemption on all its income (including interest) from investments in risk capital.

Do the fundamental freedoms protect fraud or abuse?

The CJEU further states the obvious that when a withholding tax exemption provided under the PSD or IRD is not applicable because there is found to be fraud or abuse, the application of the freedoms enshrined in the FEU Treaty (freedom of establishment,

free movement of capital) cannot be relied on in order to call into question the legislation of the Member State governing the taxation of the dividend or interest payments.

How to interpret the beneficial ownership concept?

With regard to the interpretation of the beneficial ownership concept as provided in the IRD, the CJEU ruled that Member States cannot refer to concepts of national law as they may vary in scope. This is consistent with the opinion of the Advocate General calling for an autonomous interpretation of the beneficial ownership concept in an EU context.

While the IRD subjects the withholding tax exemption to the condition that the beneficial owner of the income be established in another Member State or a permanent establishment situated in another Member State belonging to a company of a Member State, the PSD does not include any such requirement.

According to the CJEU, the concept of "beneficial owner of the interest" within the meaning of the IRD must be interpreted as designating an entity which actually benefits from the interest that is paid to it. Article 1 (4) of the IRD confirms that reference to economic reality by stating that a company of a Member State is to be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, a trustee or an authorised signatory for some other person.

The CJEU confirms that for the interpretation of the concept of beneficial ownership, EU Member States may also consider the guidance provided in the Commentary to the OECD Model Tax Convention on Income and Capital. The Court further clarifies that the mere fact that the company which receives the interest in a Member State is not its beneficial owner does not necessarily mean that the exemption provided in the IRD is not applicable. Instead, if the beneficial owner that ultimately receives the income satisfies all the conditions of the IRD, the exemption has to be granted.

According to the opinion of the Advocate General, a recipient of interest income who collects the interest in his own name and on his own account (i.e. own benefit) is the beneficial owner. Assuming that the recipient of interest generally collects interest in his own name, the decisive question is whether that interest is being drawn on account or on behalf of a third party. A person who alone can decide on the appropriation of the interest and who bears the risk of loss is acting on his own account, while a person who is bound to a third party in such a way that the third party ultimately bears the risk of loss is acting on behalf of a third party.

A conduit company is not normally regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested party.

According to the Advocate General, a refinancing agreement concluded with a third party on similar terms and at a similar time as in the present case would not, of itself, suffice to assume that a trust relationship exists. Instead, more extensive ties would need to exist that limited the existing powers of the receiving company vis-à-vis third parties.

In general, a company that performs financing activity should be considered as the beneficial owner of the interest income if the following conditions are met:

- The company bears the credit risk in relation to the financing activities;
- The company realises an arm's length remuneration for the functions performed and the risks assumed. Thus, the amount of interest income should exceed the amount of interest expenses;
- The company may cover the costs incurred in relation to the financing activities;
- The company has no legal obligation to pass on the interest income to a third party. Ideally, it is clearly stated in the legal documentation that the finance company may freely enjoy the income and the payment of interest expenses is subject to the approval by the board of directors;
- From a commercial perspective, it may also make sense to not negotiate identical terms (for example, different maturity, interest accrual periods) so as to reinforce beneficial ownership;
- From a practical perspective, the finance company may keep the funds for some time in its bank account. Nevertheless, a finance company needs to be careful to not incur too many costs in this respect since otherwise, it might be difficult to cover the costs and to realise an arm's length profit.

With regard to dividend income, an EU parent company should be considered as the beneficial owner if the company has no legal obligation to pass on the income to a third party. Ideally, it is clearly stated in the legal documentation that the holding company may freely enjoy the dividend income and the payment of interest or other payments under debt instruments financing the participation is subject to the approval of the board of directors. The parent company should keep the cash on its bank account until the directors of the company decide on how to use the cash.

Conclusion

In the present judgments, the CJEU had to answer to questions raised by the Danish Court in relation to six cases where the Danish tax authorities refused to apply the withholding tax exemption as provided in the PSD and IRD.

While it was not for the CJEU to assess the facts in the cases, the Court specified indicia of abusive or fraudulent acts and under which conditions an EU parent company may not be the beneficial owner of interest income with a view to guide the national court in the assessment of the cases. In contrast, in her opinion, the Advocate General Kokott analysed in which cases anti-abuse legislation should not apply and when EU parent companies should be considered as beneficial owners.

The approach taken by the CJEU in its decisions, describing situations where abuse might be present rather than detailing when the benefits of the PSD and the IRD should be granted, seems to create the perception of a broad interpretation of abuse and fraudulent acts. In addition, some of the criteria mentioned by the CJEU seem to lower the threshold of abuse when compared to previous decisions (e.g. dividends are quickly passed on by the EU parent company after their receipt to entities which do not fulfil the conditions of the PSD) which is not helpful when it comes to legal certainty.

However, it can be assumed that the CJEU examined the very same elements in previous cases when analysing the existence of abusive or fraudulent acts and the compatibility of anti-abuse legislation in an EU context. In several judgments in 2017 and 2018, the CJEU reiterated its "wholly artificial arrangement" doctrine that the court has systematically followed since the Cadbury Schweppes case in 2006 (see the cases Eqiom SAS (C-6/16), Deister Holding AG (Case C-504/16), Juhler Holding A/S (Case C-613/16), GS v. Bundeszentralamt für Steuern (Case C-440/17)). Thus, national anti-abuse legislation must be targeted to prevent conduct involving the creation of "wholly artificial arrangements" which do not reflect economic reality and the purpose of which is to unduly obtain a tax advantage.

It is now for the Danish courts to render a final decision in the cases in accordance with the guidance provided by the CJEU and the court's previous case law. It might still take years until these cases will be finally resolved given that appeals might be filed with the Danish Supreme Court. Unfortunately, the present case law of the CJEU did not contribute much to legal certainty in these times that are characterised by chronic legal uncertainty.

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Luxembourg Rules on Exchange of Information upon Request: A New Chapter

OUR INSIGHTS AT A GLANCE

- On 16 May 2017, in the well-known Berlioz case (C-682/15), the CJEU ruled that the Luxembourg rules on exchange of information upon request in force at that time were not in line with the Charter of Fundamental Rights of the European Union. As a result, several amendments to law of 25 November 2014 on exchange of information upon request were introduced by the law of 1 March 2019. Now, based on the new rules, information holders can contest information requests received from the Luxembourg tax authorities and the Luxembourg tax authorities must check the foreseeable relevance of the information requested by foreign tax authorities.
- In light of several prejudicial questions referred to the CJEU regarding the existence of a judicial remedy against information requests for information holders and third parties as well as the interpretation of the standard of foreseeable relevance for information requests, whether the amended procedure of exchange of information upon request is now in line with EU law remains to be confirmed.
- Depending on the CJEU opinion to be rendered on the series of prejudicial questions, Luxembourg tax authorities may have the obligation to notify not only the information holder but also the taxpayer(s) concerned of their information request.

On 14 March 2019, less than one month after the law of 25 November 2014 on exchange of information upon request (the "2014 Law") was amended in order to bring it line with EU law, the Administrative Court of Luxembourg referred three interesting questions to the Court of Justice of the European Union ("CJEU") in relation to the said law.

The answers that will be given by the CJEU to the new prejudicial questions, already called the "Berlioz 2 case law", may lead to umpteenth amendments to the Luxembourg rules on exchange of information upon request in the near future. Thus, it is worth delving further into.

Berlioz case law - Act 1

It is not the first time that the Luxembourg rules on exchange of information upon request have been under scrutiny by the CJEU.

On 16 May 2017, in the well-known Berlioz case (C-682/15), the CJEU ruled that the Luxembourg rules on exchange of information upon request in force at that time were not in line with the Charter of Fundamental Rights of the European Union for the following reasons:

- The right to an effective remedy and to a fair trial laid down in article 47 of the Charter of Fundamental Rights of the European Union (the "Charter") must be interpreted as meaning that a relevant person on whom a pecuniary penalty has been imposed for failure to comply with an administrative decision directing that person to provide information ("information order") in the context of an exchange between national tax administrations pursuant to Directive 2011/16 is entitled to challenge the legality of that decision. However, such challenge was prohibited under the 2014 Law;
- The "foreseeable relevance" of the information requested by one Member State from another Member State is a condition which the request for information must satisfy in order for the requested Member State to be required to comply with that request. Verification of this condition by the requested authority to which a request for information has been submitted by the requesting authority is not limited to the procedural regularity of that request, but must enable the requested authority to be assured that the information sought is not devoid of any foreseeable relevance with regard to the identity of the taxpayer concerned, that of any third party asked to provide the information and to the requirements of the tax investigation concerned. Under the Luxembourg law, the verification required under the 2014 Law was only a procedural regularity check.

As a result, several amendments to the 2014 Law were introduced by the law of 1 March 2019. Now, based on the new rules, information holders can contest information requests received from the Luxembourg tax authorities and the Luxembourg tax authorities must check the foreseeable relevance of the information requested by foreign tax authorities (for more details, see our February 2019 ATOZ Insights and our June 2017 ATOZ Insights.

Berlioz case law – Act 2

In light of the new prejudicial questions referred to the CJEU, whether the amended procedure of exchange of information upon request is now in line with EU law remains to be confirmed. Indeed, even if the version of the 2014 Law under examination is the version existing prior to the 2019 changes, Luxembourg may be required to transpose, once again, the principles laid down in the decision that the CJEU will release.

Existence of a judicial remedy against information requests for the information holder

One of the prejudicial questions referred to the CJEU relates to the compliance of the 2014 Law (before being amended by the law of 1 March 2019) with the Charter to the extent that the Luxembourg rules exclude any recourse, including judicial, by the third party holder of the information against the request of the Luxembourg tax authorities to provide information in order to respond to a request for exchange information from another EU Member State.

Similarly, in a recent case involving an information request by the Swiss tax authorities, on 10 January 2019, the Luxembourg Tribunal referred two questions to the Luxembourg Constitutional Court on the conformity of the 2014 Law to the Luxembourg Constitution in so far as it does not allow for an injunction of the Luxembourg tax authorities to provide information to be challenged.

As the new version of the 2014 Law, passed on 14 February 2019, already deals with the issue, by allowing the information holder to contest information requests received from the Luxembourg tax authorities, the answers expected by both the Constitutional Court and the CJEU on this specific topic should not result in any further amendment to the 2014 Law. It is indeed no longer debatable that the right to an effective remedy implies that the national court must be able to examine the legality of the injunction decision in order to satisfy the requirements of Article 47 of the Charter.

Existence of a judicial remedy against information requests for any person concerned (and not only the information holder)

The draft law released at the end of 2017 in reaction to the Berlioz case law in respect of the lack of an effective judicial remedy initially reintroduced a possibility for any person concerned by the information request to contest the information request (e.g. on the ground that the information request would not meet the foreseeable relevance principle) before Luxembourg courts. However, over the legislative process, the Luxembourg legislator decided to go a step back and to grant this possibility only to the information holder and no longer to any other person concerned (such as the taxpayer itself).

Nevertheless, one of the questions now referred to the CJEU refers precisely to the question as to whether the Charter prohibits a rule that precludes any recourse, including judicial, by the taxpayer under investigation in the requesting Member State and by any third party concerned, against a decision through which the competent authority of that Member State requires an information holder to provide information with a view to respond to a request for exchange of information from another Member State.

According to Article 47 of the Charter which enforces the right to an effective remedy and to a fair trial, anyone whose rights and freedoms guaranteed by the law of the EU are violated has the right to an effective remedy before a tribunal. As a result, Member States are under the duty to provide remedies sufficient to ensure effective legal protection in the fields covered by EU law.

That protection may be invoked by any relevant person in respect of a measure adversely affecting him or her. Such person can thus rely on the right to an effective remedy. The European Court of Human Rights ("ECtHR") has already recognised that a taxpayer, subject to tax investigation, has the right to effective and real procedural safeguards to challenge the surrender of his bank details, thereby protecting him against arbitrary implementation of the agreements concluded by two States in relation to exchange of information.

It must also be concluded from the case law of the ECtHR that a third party whose documents and information concerning economic operations, have been obtained from an information holder by the authorities to be transferred to the authorities of another State, may in principle invoke an interference with their private life within the meaning of Article 8 of the European Convention on Human Rights and must be able to benefit from recourse to ensure the effective control of the measures taken.

The fact that the information holder is entitled to challenge the injunction of the Luxembourg tax authorities to provide information should not, in our view, be considered as sufficient to ensure the effective control of the information injunction. Indeed, if the information holder is not the taxpayer, it may not have any interest in challenging the tax authorities' injunction which constitute an interference with the private life of the taxpayer or of a third party but not of its own, and might find it easier to provide the requested information. Thus, the fact that the information holder is entitled to challenge the injunction does not efficiently prevent any potential harmful consequences of such injunction for the related taxpayer or a third party, nor does it put an end to any alleged violations raised by these latter parties.

Foreseeable relevance of information requests

The "foreseeable relevance" of the information requested from one Member State by another Member State is a condition which the information request must satisfy in order for the requested Member State to be required to comply with that request, and thus a condition for assuring the legality of the information order addressed by that Member State to any relevant person as well as of the potential penalty imposed on that person for failure to comply with that information order.

As a consequence of the Berlioz case law, an obligation has been reintroduced into the Luxembourg information exchange upon request legal framework according to which the tax authorities have to verify that the condition of foreseeable relevance is met prior to sending an information request to the information holder.

The last question referred to the CJEU relates to the interpretation of the standard of foreseeable relevance. The debate is whether a request for information exchange, together with an injunction decision from the authority of the requested Member State, satisfy the standard of "foreseeable relevance" where the applicant Member State indicates i) the identity of the taxpayer concerned, ii) the period covered by the investigation in the Member State and iii) the identity of the holder of the information concerned, while requesting information concerning contracts and related invoices and payments not specified but which are delimited by the criteria relating, firstly, to the fact that they would be held by an identified holder of information, secondly, to the taxation years concerned by the investigation by the authorities of the requesting State and, thirdly, to their link with the identified taxpayer concerned.

The position to be taken by the CJEU in this respect will be useful to define the scope of the standard of foreseeable relevance in Luxembourg as well as in any other EU jurisdiction.

Implications and next steps

At the time of the modification of the 2014 Law, we were of the opinion that, while the changes introduced by the Luxembourg legislator were globally positive, it would have been wiser to introduce the possibility to challenge information requests (as was the case under the procedure applicable prior to the 2014 Law) for the taxpayer concerned. Even if the Luxembourg legislator took the decision not to introduce such rights for the taxpayer, it might be required to do so in the near future, as a result of the CJEU's opinion to come on the prejudicial questions in Berlioz 2. In this case, and contrary to what is currently happening, Luxembourg tax authorities would have the obligation to notify not only the information holder but also the taxpayer(s) concerned of their information request. We will update you as soon as the CJEU decision has been made available.

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Luxembourg Starts Implementing the Shareholders Rights Directive II

OUR INSIGHTS AT A GLANCE

- The draft law n°7402/00 transposing the Shareholders Rights Directive II was tabled with the Luxembourg Parliament on 2 February 2019.
- The Shareholder Rights Directive II provides a framework for promoting communication between listed companies and their shareholders in order to allow greater interactivity between them, in line with the current challenges of increased transparency and long-term value creation.
- The draft law amends the law of 24 May 2011 on the exercise of certain shareholders rights in general meetings of listed companies through measures of increased transparency and independence aimed to provide shareholders with more information to facilitate the exercise of their voting rights.

The financial crisis revealed that in many cases, shareholders supported managers' excessive short-term risk taking, focusing too much on short-term returns. The European Commission announced in a communication on 12 December 2012 entitled "Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies", a number of initiatives in the area of corporate governance, in particular to encourage shareholders to further intervene in governance issues and to improve transparency between companies and investors. This implies a clear strategic orientation for statutory management of companies, who are required to put an adequate strategy into place in order to obtain long-term results.

In May 2017, Directive (EU) 2017/828 ("Shareholder Rights Directive II"), amending Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies ("Shareholder Rights Directive") with a view to promoting long-term shareholder engagement, was published. The Shareholder Rights Directive II provides a framework for promoting communication between listed companies and their shareholders in order to allow greater interactivity between them. This is in line with the current challenges of increased transparency and long-term value creation. The Member States are required to bring into force the laws, regulations and administrative provisions necessary to comply with the Shareholders Rights Directive II by 10 June 2019.

The draft law n°7402/00 transposing the Shareholders Rights Directive II was tabled with the Luxembourg Parliament on 2 February 2019.

The draft law amends the law of 24 May 2011 on the exercise of certain shareholders rights in general meetings of listed companies (the "SHR Law") through the following measures:

- establishment of a framework for listed companies to identify their shareholders, and the obligation for intermediaries to promptly transmit information related to shareholders and to facilitate the exercise of their rights;
- mandatory transparency of voting and engagement of institutional investors and asset managers, and of certain aspects of asset management contracts;
- obligation for proxy advisers to provide information on their methods and to disclose their conflicts of interest;
- disclosure of the remuneration policy and individual remuneration, in combination with a shareholder vote; and
- increased transparency and independent advice on larger transactions with related parties, and the submission of the most important decisions for shareholder approval.

In the interest of greater legibility, the draft law introduces chapters in the SHR Law.

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Circular CSSF 19/714: A Practical Update to Cloud Computing Outsourcing

OUR INSIGHTS AT A GLANCE

- On 27 March 2019, the CSSF issued a new Circular 19/714 (the "Circular") in order to update its guidelines on the use of cloud computing infrastructure to take into account the experience gained by the CSSF and the supervised entities since the release of an initial circular.
- Significant changes have been introduced including: the application of the Cloud Circular to investment fund managers, supervision of the ECB in addition to the CSSF for Luxembourg credit institutions, removal of the obligation to notify the CSSF of outsourcing activities which are not considered material, the obligation for supervised entities to maintain a register including all cloud computing outsourcing performed, widened liability for supervised entities towards their clients, clarification regarding the obligation for the management of a supervised entity to review and update the outsourcing policy of the cloud computing provider as well as enhanced reporting obligations and GDPR compliance.
- The various new obligations are "applicable with immediate effect" with the two following exceptions: the obligation to establish the cloud computing outsourcing register is delayed to 6 months from the entry into force of the Circular, except for investment fund managers who benefit from a one-year period.

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

In the introduction to the Circular, the CSSF clearly explains that the purpose of the update is notably to "take into account the experience gained by the CSSF and the supervised entities" since the release of the CSSF's initial "Cloud Circular" 17/654 which clarified to what extent cloud computing infrastructure could be outsourced.

The CSSF also acknowledges that although the requirements of the European Banking Authority ("ECB") on the subject, as published in December 2017 (EBA/REC/2017/03), were already covered in its initial Cloud Circular, the CSSF applied too constraining principles insofar as the CSSF did not require any principle of proportionality to be met.

In order to reflect the above outcomes and harmonise the content of the Cloud Circular with the latest applicable regulations and circulars, the following main aspects have been amended or introduced:

Inclusion of investment fund managers

The widely commented CSSF Circular 18/698 on the authorisation and organisation of investment fund managers incorporated under Luxembourg law mentioned (under point 143) that the Cloud Circular should apply to investment fund managers.

This point is now expressly covered in the Circular, which now applies to "all investment fund managers subject to Circular CSSF 18/698".

An additional authority

The concept of competent authority is widened to also include the ECB in addition to the CSSF, but only for Luxembourg credit institutions that are subject to the supervision of the ECB.

Obligation of notification now limited to material activities

An important finding of the CSSF is that most requests received under the Cloud Circular did not relate to critical or material activities, and created a burden that did not seem proportionate to the aim of the Cloud Circular.

Therefore, the CSSF introduced the principle of proportionality: outsourcing activities which are not considered material are no longer subject to notification to the CSSF.

The related analysis on the materiality of the outsourced activity must include an analysis of the risk: the risks listed under point 137 of CSSF Circular 18/698 may provide guidance as to what kind of analysis would be required from investment fund managers in addition to the risks already listed in the Cloud Circular.

However, the Circular specifies that in cases where the management of the cloud computing resources made available through the client interface is performed by an entity that is not an agreed primary or secondary IT operator of the financial sector (as defined in the law of 5 April 1993 on the financial sector, as amended - hereinafter the "LFS"), then the required risk analysis must be made broadly, and not only at the level of the resource operator, as previously required.

New register to be maintained

The simplification of the reporting mentioned above is offset by the new obligation for supervised entities to maintain a register which shall include all cloud computing outsourcing performed (whether material or not).

Such a register must be delivered upon request to the CSSF or the ECB, as the case may be.

However, no guidance is given as to the form and content of such a register.

A widened liability

Under the Cloud Circular, the fact that the resource operator was subject to an obligation of professional secrecy under article 41 (5) of the LFS allowed for a delegation of the regulatory obligations and responsibility of the supervised entity towards its clients.

The Circular removed this exception, so that the supervised entity now remains liable towards its clients even if the resource operator is subject to such professional secrecy obligation.

Continued monitoring

The Circular clarifies the obligation for the management of a supervised entity to review and update the outsourcing policy of the cloud computing provider on a regular basis and to ensure that any changes are implemented rapidly.

However, no guidance is provided on what can be considered as appropriate timing when reference is made to reviews performed on a "regular basis" or to the "rapid" implementation of changes. In the absence of said indications, the management should be prepared to defend, on a case by case basis, the timing it decided to follow.

The implementation of a dedicated policy disclosing the timing requirements for regular reviews, as well as specific events triggering ad hoc reviews, could be of help to define the policy of the management in this respect as well as anticipate and foresee any potential issues and ways to solve them.

Another key question is, in case of outsourcing, the extent of the obligation, and related liability, of the management to ensure that "appropriate changes" are implemented at the level of the provider.

The Cloud Circular mentions that any outsourcing should be documented by an "official and detailed contract": the terms of which should therefore specifically define what "appropriate changes" refers to, and should describe the way in which such changes are handled.

Enhanced reporting

A new point 30 inserted by the Circular provides that cloud computing services providers now have the obligation to report specific information to the signatories of the agreements formalising the outsourcing of the cloud computing infrastructure.

If the signatory and the supervised entity are not the same person, appropriate measures need to be implemented as the signatory will then have obligations towards the supervised entity: indeed, the fact that the supervised entity is not party to the agreement should not preclude it from performing its obligations or receiving any information needed.

The already very broad right to audit provided for under the Cloud Circular is now balanced by the possibility to charge a reasonable fee in consideration thereof, and by a principle of proportionality of the right of audit in light of the risks.

Data protection

The Circular did not neglect to amend the provisions of the Cloud Circular relating to data protection, by clearly stating that with regards to the data that is subject to outsourcing, the supervised entities will have to ensure compliance with GDPR (as well as with the requirements of the National Commission for Data Protection), as well as with the obligation of professional secrecy under article 41 (2a) of the LFS.

Entry into force

It is worth noting that despite the new questions raised by some of the changes, the various new obligations are "applicable with immediate effect" with the two following exceptions: the obligation to establish the cloud computing outsourcing register is delayed to 6 months from the entry into force of the Circular, except for investment fund managers who benefit from a one-year period.

Any necessary action should therefore be swiftly implemented by the entities falling within the scope of the amended Cloud Circular.

What's next?

The CSSF mentions that guidelines and a dedicated Q&A will be made available very soon. Hopefully these will bring clarity to some of the points that this warmly welcomed update does not yet provide.

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Main Corporate Implementation Trends for 2018 and 2019

OUR INSIGHTS AT A GLANCE

- Luxembourg key corporate implementation developments today and tomorrow – a summary of major developments in 2018 and 2019.
- 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 in order to help you navigate the legal landscape and plan ahead.

Major developments already in place

Anti-money laundering

The law of 13 January 2019 implementing Directive EU 2015/849 requiring each EU Member State to create a central register recording information on beneficial owners of corporate entities entered into force on 1 March 2019 with a 6-month transitional period. By 31 August 2019, existing Luxembourg entities registered with the Luxembourg RCS will 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 to the 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 have further been developed and detailed 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 ATOZ Alert.

Transitional period of the 2016 company law reform

The transitional period granted to companies to amend their articles of association in order to comply with the mandatory provisions of the company law reform dated 10 August 2016 expired on 23 August 2018. Clauses of the articles of association that were not amended to reflect the mandatory provisions of the company law reform shall be disregarded, and the mandatory provisions shall apply and replace them.

Simplification of the business license regime

The law of 18 July 2018 amends the law of 2 September 2011, regulating access to craft, commercial and industrial, as well as independent professions.

Professional qualifications are no longer required to obtain the business license as regards "commercial activities not otherwise regulated".

The category of "counsel" and "economic counsel" has been removed and persons carrying out such activities need to obtain a business license applicable to "commercial activities not otherwise regulated". As a result, professional qualifications are no longer required for the exercise of such activities. Business licenses granted prior to the entry into force of the law will remain valid for commercial activities and services.

The specific business license obligations applicable to supermarkets and hypermarkets have been abolished.

Commercial leases

The law of 3 February 2018 on commercial leases significantly amends the regime applicable to commercial leases to strengthen the protection granted to tenants.

Data protection

The 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 Regulation is implemented by the law of 1 August 2018. It 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 by 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, the 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 in case of "hard" Brexit.

The second law aims at modifying 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.

For more details, please read our ATOZ Alert.

Circulation of securities

The law of 1 March 2019 amending the law of 1 August 2001 on the circulation of securities aims at adapting and modernising the Luxembourg legal framework in order to take into account new technologies and electronic transfer.

Major developments expected

EU company law harmonisation project

On 27 March 2019, the Permanent Representatives Committee of the Council of the EU endorsed a deal reached with the European Parliament on a draft 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 formalities, such as the issuance of the pre-operation certificate, online. All relevant information will be exchanged through existing, digitally interconnected, business registers.

Subject to approval by the European Parliament's Legal Affairs committee, the Directive will be formally adopted by the two co-legislators and will apply 36 months after its entry into force.

EU insolvency law harmonisation project

The EU is expected to agree its position on the proposal for a Directive on business insolvency in order to harmonise insolvency laws across Member States that have disparate existing legislation.

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 in difficulty. The declared objective is to privilege 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.

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.

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

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.

Protection of trade secrets

The draft law n°7353 aims to transpose Directive (EU) 2016/94 and 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 draft law.

Securitisation

The 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 draft law n°7349 will amend the Luxembourg securitisation regime to reflect these changes.

Shareholders Rights

The draft law n°7402/00 transposing Directive (EU) 2017/828, amending Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies with a view to promoting long-term shareholder engagement, was published on 2 February 2019. It will create new obligations as regards shareholder identification, the transmission of information, and the facilitation of the exercise of shareholders' rights in listed companies.

Cloud Computing Outsourcing

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

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