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BANKING & FINANCE

1.CSSF Circular 11/517 regarding the implementation of the Law of 20 May 2011 amending existing provisions on issue of electronic money

CSSF Circular 11/517 of 5 July 2011 summarises the modifications introduced by the Law of 20 May 2011 into the Law of 10 November 2009 on payment services in relation to the issue of electronic money (cf. EHP Newsletter July 2011 p. 8).

This new Circular indicates that the abandonment of the principle of exclusivity of activity as electronic money issuer entails new requirements as regards the protection of funds received from the clients in exchange for electronic money. These requirements, as well as the conditions of supervision, are going to be the subjects of specific circulars.

With regard to the new system of exemptions applicable to electronic money institutions, the Circular points out that monetary value kept on instruments enumerated in Article 3, point k) of the Law, i.e. payment instruments which can only be used within the premises of the issuer or for transactions in a limited network or for a limited range of goods and services, are excluded from the scope of this Law. As a result, exemptions shall no longer be necessary for services based on such instruments. The same applies to monetary value used in payment transactions excluded according to Article 3, point l) of the Law, for instance payments made through telecommunication or electronic means where the paid services are provided through the same means.

2.CSSF Circular 11/515 regarding the implementation of the Law of 28 April 2011 modifying certain provisions relating to the financial sector

The Law of 28 April 2011 facilitates the permission process under the Law of 5 April 1993 on the financial sector. The permission for changes in the corporate object, designation or legal form of a bank or a financial sector professional (FSP) may be directly granted by the CSSF instead of the Minister. The same applies for the creation or acquisition of subsidiaries in Luxembourg and abroad. The creation of agencies or branches in Luxembourg no longer requires any permission.

In the context of provision of services on Luxembourg territory without establishment, the new law added a paragraph 5 to Article 32 of the financial sector law introducing a requirement for permission for third country financial institutions.

Pursuant to the Circular, approval delivered by the Minister is required if the following conditions are met cumulatively:

1. the person or entity originates from a third country, i.e. a non-EU country or a non-EEA country;
2. the person or entity is not established in Luxembourg;
3. the person or entity exercises a banking or FSP activity in its country of origin ; and
4. occasionally or temporarily, one or several agents physically come to Luxembourg in order to provide any service which is governed by the law on the financial sector. This provision does not apply to persons or entities which channel their activities to Luxembourg from their country of origin.

According to the Circular, these terms have to be considered in the light of Luxembourg laws, and in particular in the light of the definitions contained in the law on the financial sector. The mere fact that a person or entity has a client domiciled in Luxembourg does not mean that it exercises its activities in Luxembourg.

The approval of the Minister is not required for activities which take place before (i.e. preparatory activities) or following (i.e. courtesy visits) the activities referred to in Article 32 (5) of the law on the financial sector.

3.Other Banking and Finance News

CSSF Circular 11/519 regarding the risk analysis in relation to the fight against money laundering and terrorist financing (AML/CTF)

COMMERCIAL

4.Law of 23 October 2011 on competition

The Law of 23 October 2011 on competition (*Mémorial* A dated 28 October 2011, n° 218, pages 3756 et seq.) will enter into force on 1 February 2012 and will replace the Law of 17 May 2004 on competition. The latter implemented the Regulation 1/2003 on the implementation of the rules of competition laid down in Articles 81 and 82 of the TEU (the "2004 Law") into Luxembourg law.

A modification of the 2004 Law appeared to be necessary because there is an evolution from a largely punitive approach, to which the 2004 Law was limited, to an authority performing important awareness-raising and education work to make aware the undertakings of the existence of competition law (report from the committee

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for foreign trade economy and solidarity economy, draft law n° 58166[11], page 2).

The main changes vis-à-vis the 2004 Law are the following:

- Merger of the Competition Council and the Competition Inspectorate into a single body, i.e. the Competition Council:

The new law provides for a single authority, the Competition Council. The Competition Council carries out investigations on the one hand, and on the other hand it takes decisions. To guarantee a separation between the powers of investigation and the powers of decision, a functional separation within the Competition Council is operated: the member of the Competition Council who is leading the investigation cannot take part in the decision-making process.

- Adaptation of the procedural rules:

With a view to simplifying the procedures, an adaptation of the procedural rules was carried out while observing the rights of the defence. The 2004 Law provides for a statement of objections and, where appropriate, a statement of rectified objections notified to the Investigation Division, as well as a preliminary assessment and a final decision by the Council. The new law limits procedural acts to a statement of objections and a final decision.

- Strengthening the means of action of the Competition Council:

The means of action of the Competition Council are strengthened. It can now issue, on its own initiative or at the request of the Minister, an opinion on all issues regarding competition. It may also intervene in the legislation process. The Competition Council is also authorised to carry out sector inquiries and market investigations.

Thus, the Council does not only assume the role of ensuring compliance with competition rules, but also becomes a promoter of the principles of free competition with the economic actors.

5.Law of 2 September 2011 governing access to the professions of craftsman, merchant, manufacturer and other independent professions

The Law of 28 December 1988 governing access to the professions of craftsman, merchant, manufacturer and some other independent professions has been replaced by the Law which came into force on 25September 2011.

The Law introduces the principle of implicit authorisation in the case of silence of the Administration after 3 months from the submitted request for authorisation, a consultation of a specific committee no longer being required except for hypermarkets of more than 400 square metres.

The Law provides for the change of certain definitions and basic conditions for the application for authorisation of an establishment.

The Law also strengthens the concept of establishment. Article 5 of the Law insists on the material setting up of an establishment, the use of an address for registration purposes only being prohibited.

The condition of professional honour to be met by the person on whose behalf the establishment authorisation is issued has also to be fulfilled in the name of the main shareholder or by the person who is in a position to have a significant influence on the management or administration of the company.

The Law reflects the conditions set forth in other European countries so as to avoid discrimination issues. In this context one of the main changes relates to the relaxing of the conditions for the issue of an authorisation, i.e. in the case of effective and licit professional practice of three years.

Finally the Law allows gas stations which were obliged to have a closing day once a week to open 7 days a week.

CORPORATE

6.CSSF Circular 11/518 and CSSF Regulation 11-01 relating to the adoption of professional standards within the framework of the Law of 18 December 2009 on the audit profession

CSSF Circular 11/518 announces the entry into force of CSSF Regulation 11-01 and adopts further explanatory documents of the international auditing standards.

The new Regulation repeals CSSF Regulation n°10-01 concerning the adoption of standards in connection with the publication of the Law of 18 December 2009 on the audit profession.

CSSF Regulation n°11-01 is subdivided into three chapters, each having a specific purpose.

- The aim of Chapter 1 is to adopt standards regarding statutory auditing of annual accounts. The International Federation of Accountants (IFAC) elaborated on some clarified

international standards on auditing (ISAs) which are partly declared compulsory by the CSSF Regulation, whereas **CSSF Circular 11/518** adopts the "Specifications and/or explanations" and "Appendix" sections.

The relevant ISAs are applicable to statutory audits carried out for periods starting from 1January 2011.

- In the field of other missions reserved exclusively to *réviseurs d'entreprises agréés* (approved statutory auditors) under the Law of 18 December 2009 on the audit profession, Chapter 2 of the CSSF Regulation declares mandatory the professional standards on the following missions:

  - Contributions in kind

Appendix 2 of the CSSF Regulation describes the professional duties and the content of the report on a contribution in kind to be established by a *réviseur d'entreprises agréé* in case such a report is required by corporate law.

The *réviseur d'entreprises agréé* already in charge of the statutory audit of the company can accept such a mission insofar as it only concerns the control of the evaluation of the contribution or of the component that has been acquired. The actual description and evaluation is made by the founders or the board of directors, who are responsible for these acts.

The control carried out by the *réviseur d'entreprises agréé* regards the existence of the contributions or the components that have been acquired, their individual and global value, as well as the value of the shares issued against contributions in kind.

The *réviseur d'entreprises agréé* also examines whether the evaluation methods applied by the founders or the board of directors are appropriate. However, the *réviseur d'entreprises agréé* does not take into account the usefulness of the transaction.

  - Merger/de-merger auditor

The professional duties and the rules to be observed when establishing the report on a merger or de-merger project are described.

The CSSF Regulation gives some indications as to the respective responsibilities of the management bodies of the companies and the *réviseur d'entreprises agréé*.

The *réviseur d'entreprises agréé* examines if the evaluation methods determined by the management are appropriate and applied correctly and if the exchange ratio is relevant and reasonable so that no shareholder or partner suffers a disadvantage. The evaluation methods for the two companies concerned have to be homogeneous.

A de-merger operation also entails the obligation to draft a report concerning the contributions in kinds. The latter and the report on the de-merger project can be drafted by the same *réviseur d'entreprises agréé*.

The *réviseur d'entreprises agréé* in charge of the statutory audit of one or several companies concerned can accept the mission relating to the (de)merger operation. This will not harm his independence.

  - Liquidation auditor

When a company is in liquidation, the liquidators shall make a report to the general meeting regarding the employment of the corporate assets and shall present supporting accounts and documents. The meeting appoints auditors to examine those documents. The auditors need to have the professional qualification of *réviseurs d'entreprises agréés* in the case of companies which exceed two out of three criteria laid down in Article 35 of the Law of 19 December 2002 on the trade register and annual accounts of firms.

The examination is restricted to the faithful transcription of the liquidation operations into the liquidation accounts and to the consistency of the report with the liquidation accounts.

The *réviseur d'entreprises agréé* who was in charge of the statutory audit can be appointed liquidation auditor. However, the *réviseur d'entreprises agréé* who was in charge of the statutory audit as well as the liquidation auditor cannot act as a liquidator. The Regulation points out that the term « *réviseur d'entreprises agréé* » also includes network firms in the sense of Article 1 (27) of the Law of 18 December 2009 on the audit profession. The legal mandate of the *réviseur d'entreprises agréé* automatically ends when the company is dissolved.

  - Interim dividend contribution

Where it is the administrative body's responsibility to draft and present a true and fair accounting statement, the *réviseur d'entreprises agréé* is responsible for drafting a report concerning the interim dividend contribution and, in particular, compliance with the conditions set out in Article 72-2 of the Law of 10 August 1915 on commercial companies.

The control carried out by the *réviseur d'entreprises agréé* concerns essentially the absence of overvaluation of assets and underestimation of liabilities.

Particular attention is paid to:

- The continuity of accounting methods and of their application;
- The independence of the accounting periods;

- Liabilities which might become due before the date of the accounting statement and which might have an adverse effect on the accounting result;
- Events taking place after the drafting of the accounting statement.

- Chapter 3 deals with the adoption of standards on professional ethics and internal quality control under the Law of 18 December 2009 on the audit profession.

According to CSSF Circular 11/527 presenting an update of the legal and regulatory framework of the audit profession, CSSF Circular 11/518 is repealed and integrated in the new circular as of 1 January 2012.

7.Other Corporate News

RCSL Circular 11/2 Branch Registration Process

DATA PROTECTION

8.Protection of privacy in the electronic communication sector

The Law of 28 July 2011 (the "Amending Law") has amended, *inter alia,* the Law of 30 May 2005 concerning the protection of privacy in the electronic communication sector (the "Electronic Communication Data Protection Law").

The amendments result from the implementation of the EU Directive 2009/136/EC (forming part of the "Paquet Telecom" together with Directive 2009/140/EC which has reformed the European legal and regulatory framework of the electronic communication network and services) and amending the former Directive 2002/58/EC. Directive 2009/140/EC concerning mainly the electronic communication services and networks was introduced into Luxembourg law by the Law of 27 February 2011.

The main changes that have been introduced in the Electronic Communication Data Protection Law through the Amending Law relate to "Security", "Confidentiality" and "Unrequested communication". The aim of the Luxembourg legislator is to provide an adequate high level of protection of private data to all users of electronic communication technologies irrespective of the specific electronic communication means being used.
In order to cover, in the broadest manner, the various means of electronic communication and to ensure that the rules on privacy protection cover the largest number of users, some of the definitions provided in the Electronic Communication Data Protection Law have been broadened so as to include a large range of electronic communication means.

Security

By virtue of the Amending Law, the Luxembourg legislator has inserted in the Electronic Communication Data Protection Law certain specific provisions as to the required measures to be taken /procedures to be adopted by the service providers of publicly available electronic networks (the "Service Providers") to ensure at all times the highest security level for private data processed via the networks or services they offer.

It should be noted that general security requirements regarding the processing of private data were previously stipulated in the Electronic Communication Data Protection Law by way of reference to relevant articles of the general Law of 2 August 2002 concerning the protection of individuals as to the processing of their personal data (the "General Data Protection Law") but the legislator is keen to emphasise these requirements, expressly and specifically, particularly in the light of the increasing number of private data thefts, losses or deterioration.
Pursuant to the new legislation, the Service Providers have an obligation to report to the Commission Nationale de la Protection des Données (CNPD) and to the relevant user/customer any intrusions in the private data which the Service Provider processes (in the widest sense) in relation to the service provided by him (unless he can evidence that appropriate measures are in place which render the private data unreadable or unusable to a non-authorised third party). The Electronic Communication Data Protection Law includes specifications about the content and details of the notification to be made to the CNPD and the user in the case of violation of private data.

The Amending Law has also introduced sanctions for Service Providers who face repeated intrusions and violations of private data of their users/customers. These sanctions may incur a fine of up to EUR 50,000.

Service Providers are also obliged to keep an inventory of the various violations, the context in which these have happened, consequences and remedies they have put in place to avoid future intrusions, limit the consequences of a violation etc.

By setting penal sanctions (ranging from fines up to imprisonment) in the case of failure by the Service Provider to comply with the obligations to ensure security (i.e. the measure taken upfront and the relevant information and inventory (after the violation)), the legislator insists on the importance of the security of the processing of private data. The legislator has even introduced the possibility for a court to order the violating service provider to terminate the processing of the relevant data

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Cookies

Prior to the Amending Law, there was (and still is) a general prohibition for all persons other than the user to store, listen to or intercept communications and data traffic without the consent of the user/customer. There are certain exceptions to this general prohibition.

One of the exceptions related to the storage of information or access to information stored on the users' terminal equipment by means of cookies. Prior to the Amending Law such access or storage was not prohibited provided, however, the user was aware of such storage/access, the aim of the storage/access and provided he was given the possibility to oppose such processing. With the adoption of the Amending Law, the legislator has introduced the necessity to receive express consent (opt-in) from the user to allow such storage/access.

Other amendments

There are some additional amendments which have been introduced into the Electronic Communication Data Protection Law, of which the following merit a brief mention.

Emergency call-location data

The Amending Law has re-introduced (after its removal by previous amending law) the possibility for the recipients of emergency calls to access information on the location of the emergency caller in addition to traffic information. There is an obligation towards the service provider or operator to forward and communicate available data received in relation to emergency calls to emergency numbers by a "Push" mode to the emergency call centres. The Amending Law also specifies the scope of "available data" that shall be transmitted and the technical measures to allow the transfer of the relevant data in the most efficient manner to the emergency call centres.

Un-requested Communications

The Amending Law widens the scope of the unrequested means of communication which, until the recent change comprised only telephone calls, to means of electronic communication such as SMS, MMS etc.

INVESTMENT FUNDS

9.AIFMD and implementing measures

On 16 November 2011, 5 months after the publication of the Alternative Investment Fund Managers Directive ("AIFMD") in the Official Journal of the European Union, the European Securities Markets Authority ("ESMA") issued its technical advice to the European Commission on possible implementing measures. This technical advice will be used by the European Commission to adopt the level 2 implementing measures and is divided into 4 parts :

I. General provisions, authorisation and operating conditions;
II. Depository;
III. Transparency requirements and leverage;
IV. Supervision.

Luxembourg has already started to work actively on draft legislation in order to anticipate the implementation of the AIFMD. Luxembourg aims at having the relevant bill of laws deposited before its parliament during the second quarter of 2012 and at implementing AIFMD by year end 2012, far in advance of the deadline for implementation by the Member States provided for in the AIFMD i.e. 22 July 2013.

10.ALFI UCITS IV implementation project - Q&A on Risk Management and KIID

New Q&A on risk management process (issue 1)

The Association of the Luxembourg Fund Industry ("ALFI") published on its website the first issue of a Q&A (dated November 2011) on Circular CSSF 11/512 on Risk Management for UCITS which implements UCITS IV regulations and more particularly the CESR Guidelines 10-788 on risk measurement and calculation of global exposure and counterparty risk for UCITS.

Q&A on CSSF Circular 11/512

This Q&A aims at addressing very specific and practical questions regarding, *inter alia*, (i) the disclosure of the level of leverage, how the level of leverage can be computed and estimated and how often this information should be updated; (ii) the computation of portfolio risk calculations and more particularly when conducting stress testing or duration netting in the context of the commitment approach; (iii) content of reporting relating to the risk management functions to the conducting officers and board of directors. This document, which represents the view of a group of participants, may be subject to amendments or may be supplemented with additional Q&A from time to time.

Updated Q&A on KIID (issue 11)

ALFI also published on its website the eleventh issue of its Q&A (dated 19 December 2011) relating to the Key Investor Information Document (KIID) to be issued by UCITS by 1 July 2012.

Eleventh issue of Q&A on KIID

This Q&A aims at addressing questions raised when implementing the measures adopted by the European Commission by Regulation n° 583/2010 of 1 July 2010, as well as related regulatory guidelines and, in particular, questions relating to the content of the KIID but also about using KIID in distribution networks. This document, which represents the view of a group of participants, may be subject to amendments or may be supplemented with additional Q&A from time to time.

LABOUR

11.Law of 28 October 2011 modifying provisions relating to the Financial Sector

The purpose of the Law of 28 October 2011 is, in particular, to implement Directive 2010/76/EU, i.e. the CRD III Directive into the 5 April 1993 Law on the financial sector.

We refer in this context to our newsletter of December 2010 in which the CRD III Directive was commented on.

Indeed, remuneration policies and practices have lately been regulated by the Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 (Capital Requirement Directive III) amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations and the supervisory review of remuneration policies. Thereafter, the CSSF issued Circulars 10/496 and 10/497 on defining capital ratios and implementing rules on remuneration policies. On March 2011, the regulator added Circular 11/505 explaining the application of the proportionality principle to be considered in the context of the setting up of remuneration policies.

Article 2 of the Law of 28 October 2011 modifies Articles 5, 17 and 53 of the Law of 5 April 1993 on the financial sector. It is interesting to note that the sentences added to Articles 5 and 17 of the Law of 5 April 1993 match exactly the wording of Directive 2010/76/EU in its Article 3 a) §1.
In order to reinforce internal governance procedures and the appropriate mechanism of internal control of credit institutions and investment firms, the Law of 28 October 2011, following the provisions of the Directive, introduces the obligation for financial undertakings to establish "*remuneration policies and practices that are consistent with and promote sound and effective risk management*".

The amended provisions of the 5 April 1993 Law give the CSSF a legal basis to exercise its control over financial undertakings. It should be noted here that the assessment of the remuneration policy and practice of an institution has to be reported in the next ICAAP (Internal Capital Adequacy Assessment Process) report for 2011, to be released in 2012. Thus, if the CSSF notices, for example, that a financial undertaking has drawn up an inappropriate remuneration policy, the CSSF may intervene and request that the remuneration policy be changed and, if the persons in charge of the administration or the management of that undertaking do not respond to that request, the CSSF may use its right of injunction.

Lastly, through the modifications brought to Article 53 of the Law of 5 April 1993, the Law of 28 October 2011 adds to the Luxembourg financial authority's powers the right to require financial undertakings to limit the variable remuneration to a certain percentage of total net income, or to use their net profits, to increase their own funds above the minimum requirements. Elements to be taken into account while assessing the appropriate level of own funds are defined.

12.Changes to the amended Law of 29 August 2008 on the free movement of people and immigration

On 17 November 2011, the bill of law n°6306 amending the amended Law of 29 August 2008 on free movement of people and immigration (hereafter the "Law") was voted on. The Law, which has not yet been published, is expected to come into force during the course of the month of January 2012

The Law implements Council Directive 2009/50/EC of 25 May 2009 on the conditions of entry and residence of third-country nationals for the purposes of highly qualified employment.

The Law introduces the *EU Blue Card* which will be delivered to third-country nationals who apply for a residence permit as highly qualified workers.

The procedure and the conditions themselves will not change, except that the Minister will have to notify his decision within 90 days following the submission of the request by the issue or the refusal of a temporary residence authorisation. In the absence of a response within this delay, the request will be considered as refused, the applicant being entitled to challenge this implicit refusal before the Court. Upon receipt of the temporary residence authorisation, the applicant will be allowed, as in the past, to reside and work in

Luxembourg. When filling in the declaration on arrival, the applicant will submit a request for the issue of an *EU Blue Card*.

The *EU Blue Card* will allow: (i) highly qualified workers, after a two-year period, to benefit from equal treatment with Luxembourg nationals except for jobs relating to public interest or authority and functions within an entity governed by public law, for which Luxembourg citizenship is required as per applicable law; (ii) highly qualified workers having stayed for at least 18 months in another EU Member State to come to Luxembourg with their family and apply for an *EU Blue Card* in order to be allowed to work in Luxembourg; and (iii) highly qualified workers who intend to apply for a long-term permit for which five years' interrupted residence in Luxembourg is required to invoke a residence period completed in another EU Member State as holder of an *EU Blue Card,* provided they meet the conditions of a 2-year period of residence in Luxembourg directly prior to submission of the request

TAX

13.Taxation of cross border employee remuneration in light of the German - Luxembourg double tax treaty

In the context of the procedures initiated by the German tax authorities by the end of 2010 against German commuters working in the financial sector, an agreement was reached on 26 May 2011 between the Luxembourg and German tax authorities (the "Mutual Agreement") as to the practical application and the interpretation of Article 10 paragraph 1 of the Luxembourg - German double tax treaty dated 23 August 1958 (the "Treaty").

Following article 10 paragraph 1 of the Treaty, the remuneration earned by an employee who is resident in Germany and working for a Luxembourg employer is taxable in Luxembourg if the activities are or were performed in Luxembourg. Where the activities are not performed in Luxembourg, the right of taxation of the remuneration is granted to the country of residence of the employee. Practical issues and a risk of double taxation resulted from the difference of tax treatment by Luxembourg / Germany authorities in case employees were travelling abroad for work purposes.

The Mutual Agreement clarifies such difference of treatment so to resolve the application of practical issues.

Indeed Germany and Luxembourg have now agreed on a common interpretation whereby:

(a) the right of taxation is allocated between the country of residence and employment based on:

(i) the ratio of the number of working days performed in Luxembourg on the contractual agreed working days (excluding holidays, week-ends and public holidays) ;
(ii) the contractually agreed monthly salary includes salary related to holidays and any other allowance or benefit;
(b) remuneration related to overtime work is allocated separately; and
(c) remuneration received for sickness or maternity leave is only taxable in the country of employment.

The authorities have also agreed for a 20-day *de minimis* provision during which an employee can work outside of the country of employment before his/her salary related to these working days becomes taxable in the country of residence of the employee, provided that this salary is taxed in the country of employment.

Two additional mutual agreements were signed between Luxembourg and Germany on 7 September 2011 as to the taxation of commuters.

The first relates to the taxation of severance and compensation payments, whether for dismissal or resignation and unemployment benefits.

Pursuant to this agreement, the severance or compensation related to salary or other benefits, or to the termination of the employment agreement, is taxable based on the rules agreed between both countries under the Mutual Agreement. Should the severance be however related to welfare benefits, , the taxation right would be allocated to the country of residence, in accordance with Article 12 of the Treaty.

The second additional agreement aims at aligning the existing allocation of the right to tax income from professional drivers to railway engine drivers and accompanying personnel

14.VAT news

During the last six months Luxembourg has improved its attractiveness in the VAT field both in the “real” and in the “virtual” economy:

1. VAT-free zone regime for goods in Luxembourg since 1 October 2011.

The purpose of the VAT-free zone regime is to put in place a VAT suspension system for transactions concerning goods stored in specific locations to increase the competitiveness of Luxembourg in the field of logistics and warehousing.

The VAT-free zone regime may either be operated independently from or aligned or combined with the already existing similar suspension regimes for customs and excise duties, thus permitting streamlining payment of applicable taxes and duties on exit of the goods from the VAT-free zone regime.

The main advantages of the VAT-free zone regime are, on the one hand, that no Luxembourg VAT registration is required from foreign operators whose sole activity in Luxembourg is the trading of goods placed under the VAT-free zone regime; and on the other hand, the suspension regime allows no VAT pre-financing in connection with transactions on goods placed under the VAT-free zone regime.

No VAT will be due when the goods enter whether by local supply, intra-community acquisition or import of goods as well as for any services during their stay in the VAT free zone in relation to the entry, storage, maintenance, improvement or sale of the goods.

Once the goods leave the warehouse, VAT becomes due under applicable standard rates by the person removing the goods from the warehouse and not necessarily the initial supplier of the goods or services.

Running a VAT-free zone regime is subject to registration and reporting obligations.

2. Reduced 3% VAT rate applicable on eBooks from 1 January 2012

The Luxembourg VAT authorities announced on 12 December 2011 that eBooks will benefit from the reduced 3% VAT rate which is already applicable to paper books. There is no definition of the concept of ”book” in Council Directive 2006/112 of 28 November 2006, and since both tend to satisfy the same consumer needs, paper books and eBooks are therefore to be treated in the same way under the VAT neutrality principle.

This is a further favourable VAT measure to increase the attractiveness of Luxembourg as a place of choice for providers of electronic goods and services.

15.New tax treaties and amendment of existing tax treaties

Luxembourg has also during the second half of 2011 enlarged its tax treaty network and clarified existing tax treaty provisions, especially with the Russian Federation, given that Luxembourg has become for Russian investors and entrepreneurs a jurisdiction of first choice to launch IPO vehicles.

Amendment of tax treaty with the Russian Federation

Luxembourg and the Russian Federation signed a protocol (the “Protocol”) on 12 November 2011 amending the existing tax treaty (the “Treaty”) between the two countries on a large number of points, the most important of which are analysed hereafter:

1. Luxembourg investment eligible for treaty protection

Luxembourg SICAV/SICAF investment funds also set up as SIFs, will benefit from treaty protection for investments into the Russian Federation.

2. Distributions by certain real estate investment funds qualified as real estate income

The Protocol provides that income earned by a resident of a Contracting State investing through an investment fund established in the other Contracting State, organised primarily for investing into immovable property located in the other Contracting State, is considered as income from immovable property, and may therefore be taxed in the state where that property is situated.

Given the narrow scope of this provision, however, which only concerns on the one hand, Russian residents investing into Luxembourg immovable property through a Luxembourg investment fund; and on the other hand, Luxembourg residents investing into Russian immovable property through a Russian investment fund but not Russian residents investing into Russian immovable property through a Luxembourg investment fund, its application should be of limited importance.

3. Abolition of the tie-breaker rule

The Protocol replaces the OECD-MC standard tie-breaker rule for determining the tax residency of a body corporate by a more case-by-case based approach. The Protocol instead stipulates that if a company’s effective place of management cannot be determined, the competent authorities of both Contracting States will determine by mutual agreement in which state the company concerned is a tax resident, by taking into account factors, such as:

- Place where the board meetings or meetings of any other equivalent corporate body are usually held;
- Place where the company’s senior day-to-day management is carried out; and
- Place where the management generally exercises its activities

It needs to be seen what the exact practical implications of such a new test are, given that the above test generally was also made under the OECD-MC standard tie-breaker rule to determine the “place of effective management” of a given corporate taxpayer. The question seems to remain open what happens in case the relevant competent authorities are not able to reach an agreement and more exactly whether in such a case the tax payer would not be considered a resident either of Russia or Luxembourg.

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4. More favourable reduced withholding tax rate

The withholding tax rate for dividends is reduced from the current 10% to 5%, provided that the beneficial owner of the dividend is a company that holds directly at least 10% of the capital in the dividend paying company; and its investment has an acquisition price of least EUR 80,000 or the equivalent in Roubles. If these requirements are not met, as before, a 15% rate applies.

This provision does not materially improve the situation of Russian companies investing into a Luxembourg company, except for dividends paid during the first 12 months as in this case Luxembourg domestic tax law does not automatically provide, in the light of the recent doctrine of the tax authorities, for an exemption but for a withholding that may be refunded upon expiry of the 12-month period, except where specific arrangements are taken with the tax office in charge of the dividend paying company. The new provision, however, improves the investment situation for a direct investment of Luxembourg companies into the Russian Federation.

It is further specified that the definition of the concept of "dividend" under the tax treaty also includes the income from depositary receipts and from units in investment funds or any other type of collective investment vehicle, unless that income qualifies as income from immovable property (see 2.above).

This is, however, a simple confirmation of Luxembourg tax practice and in any event distributions and redemption of units in Luxembourg investment funds for the benefit of a Russian resident are not subject to Luxembourg taxation, including withholding tax.

5. Transfer of shares in real estate companies

The Protocol provides that in the case of the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in the other state, the right to tax such gains is given to the state where the property is situated, unless the gains are realised in the course of a corporate reorganisation or if a company whose shares are sold is listed on a recognised stock exchange if the seller is a pension fund, a similar entity or the government of a Contracting State.

It is worth noting that for the provision to apply and to allow the state where the real estate is located the right to tax, it is not necessary that the company whose shares are sold and which directly or indirectly holds the immovable property, needs to be a resident in Luxembourg or in the Russian Federation. It thus may also be a company located in another State. Since it seems that the tax treaty between Cyprus and the Russian Federation contains a similar provision, the amendment to the Treaty means that the sale by a Luxembourg company of shares in a Cyprus company which directly or indirectly holds Russian real estate assets, is no longer taxable in Luxembourg but in the Russian Federation.

6. Extended exchange of information provisions

The provision on exchange of information is aligned with Article 26 of the OECD Model Convention also concerning information held by a financial institution or a bank.

7. Limitation on benefits

The Protocol introduces a "limitation on benefits" provision that would seem to tackle treaty shopping situations. The benefits of the Treaty are denied, if the competent authorities of both Contracting States come to the conclusion that one of the main objectives of setting up a company in one of the Contracting States is to obtain the benefits of the Treaty.

This provision would seem to be of rather limited importance from a Luxembourg perspective. It needs to be seen whether the Luxembourg tax authorities, well aware of the importance of Luxembourg as investment hub for international investors, would easily give in to the Russian tax authorities and agree on abusive situations when the corporation at stake had regularly been set up and been operated out of Luxembourg with a minimum of business substance.

New tax treaty with Barbados in force

The tax treaty with Barbados finally entered into force on 8 August 2011. The main attraction of this tax treaty is that dividend payments, including (typical) silent partnership income, by a corporation resident in one Contracting State to a corporation resident in the other Contracting State are exempt from withholding tax, if the beneficial owner of the dividend has been holding at least 10% for at least 12 months. Unlike under Luxembourg domestic law, the tax treaty, even though it requires that the dividend recipient be a resident of the other Contracting State, does not spell out a subject-to-tax condition of, currently, at least 10.50%. Given the attractive local tax treatment in Barbados, this may open new investment opportunities for international investors.

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