ELVINGER HOSS LUXEMBOURG LAW

NEWSLETTER

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ASSET MANAGEMENT AND INVESTMENT FUNDS

1. UCITS

1. ESMA Q&A on UCITS: Update

On 12 October 2016 and on 21 November, ESMA added new questions to its Q&A on the application of the UCITS Directive. In these updates ESMA clarifies certain points, among which are the following:

A. Diversification rules: Investment in other UCITS and/or UCIs

Pursuant to Article 56(2)(c) of the UCITS Directive (Article 48 (2) of the Law of 17 December 2010 on undertakings for collective investment ("**UCI Law**")), a UCITS ("**Investing UCITS**") may acquire no more than 25% of the units of any single UCITS or other UCIs ("**Target Fund**").

The CSSF already clarified in its FAQ on UCITS[1] that the Investing UCITS is to be understood as the sub-fund of an umbrella structure (by application of Article 40 of the UCI Law)[2].

In its updated Q&A, ESMA takes a restrictive approach and concludes that the Target Fund is also to be understood as a sub-fund of an umbrella structure. Therefore, the sub-fund of an umbrella UCITS (Investing UCITS) is not allowed to acquire more than 25% of the units of a single sub-fund of another umbrella UCITS or other UCIs (Target Fund).

ESMA further states that existing UCITS and their management companies which apply a different interpretation at the Target Fund level must at the earliest convenience adjust the Investing UCITS portfolios whilst acting with due skill, care and diligence in the best interests of the Investing UCITS. The compliance monitoring process applicable to UCITS should be adapted accordingly.

New UCITS and new sub-funds of existing UCITS will need to comply immediately with this interpretation.

Subsequent to ESMA taking such position, we have been advised by the CSSF that they will, in their regulatory practice, adopt the same views as ESMA in relation to investments by a sub-fund of an umbrella UCITS in a sub-fund of another umbrella UCITS but not in relation to cross sub-fund investments where a sub-fund of an umbrella UCITS invests into another sub-fund of the same umbrella UCITS.

B. Definition of the term "regulated market in a Member State" in Article 50(1)(b) of the UCITS Directive (Article 41(1)(b) of the UCI Law)

Article 41(1)(b) of the UCI Law provides that securities and money market instruments in which a UCITS invests must be dealt in on a regulated market.

In its updated Q&A, ESMA clarifies that the term "regulated market" is to be understood as including a "multilateral trading facility" (MTF) as defined in Article 4(1)(15) of MiFID[3] under certain conditions.

C. Translation requirements in relation to the remuneration disclosure

In the case of marketing of a UCITS in another Member State, the information on the remuneration policy has to be made available on a website (as per Article 78(4) of the UCITS Directive/Article 159(4) of the UCI Law) and falls under the scope of Article 94(1)(c) of the UCITS Directive (Article 55(1)(c) of the UCI Law) and should be translated, at the choice of the UCITS, into one of the following:

- the official language, or one of the official languages, of the UCITS host Member State,

[1] CSSF FAQ concerning the UCI Law, version 2, 24 August 2016.
[2] See our March 2016 Newsletter on the same subject.

[3] "**MiFID**" refers to Directive 2004/39/EC on markets in financial instruments.

- a language approved by the competent authorities of that Member State, or
- a language customary in the sphere of international finance.

D. Collateral management and cash reinvestment in short-term money market funds

A UCITS can (prospectus permitting) invest more than 10% of the NAV in other UCITS or UCIs but in that case, in line with Article 50(1)(e)(iv) of the UCITS Directive (Article 41(1)(e) last indent of the UCI Law), it is no longer an eligible investment for other UCITS.

In its updated Q&A, ESMA clarifies that where a UCITS re-invests cash collateral in short-term money market funds, this should be taken into account when calculating the aforementioned 10% limit of investments (if applicable) in UCITS or other UCIs.

E. Impact of SFTR Regulation[4]

UCITS management companies, UCITS investment companies and AIFMs must provide information on the use made of securities financing transactions and total return swaps in the AIF/UCITS annual reports, as well as in each half-yearly report for UCITS (Article 13 of the SFTR Regulation).

In its updated Q&A, ESMA clarifies that the information must be included in the next annual or half-yearly report to be published after 13 January 2017 which may relate to a reporting period beginning before that date.

For this purpose, we assume that the date on which a report is published is the date it has been published on a website, sent to investors or made available at the registered office of the UCITS/AIF, whichever is the earlier.

2. CSSF FAQ on UCITS: Update

On 24 August 2016, the CSSF added new questions to its FAQ concerning the UCI Law.

The CSSF clarifies the following points, among others:

A. Eligible assets

Under Article 77(3) of the UCI Law, master funds may invest in other UCITS and/or UCIs (including as a fund of funds) within the meaning of Article 41(1) (e) of the UCI Law. Diversification rules apply to underlying assets of transferable securities that do not embed a derivative element.

Where a UCITS invests in transferable securities which do not embed a derivative element (as described in CSSF FAQ 1.6) in accordance with the UCITS rules, the CSSF always took the view that although there is no obligation for the UCITS to undertake a look-through to ensure the eligibility of the underlying assets, a look-through should be made in order to ensure a minimum diversification of the portfolio's underlying economical exposure.

In its updated FAQ, the CSSF recalls that a UCITS portfolio which would be exclusively composed of different structured transferable securities (not embedding a derivative element) where all of them would be linked to the performance of the same underlying asset, would not be acceptable.

More importantly, the CSSF explains which diversification criteria should be applied at this level. In principle, not more than 20% of the UCITS net assets should be exposed to one underlying asset. This limit can be raised to up to 35% for one single underlying asset.

B. OTC derivative transactions and efficient portfolio management techniques: Eligible counterparty

The following conditions must be fulfilled in order for an institution to act as counterparty to OTC derivative transactions and efficient portfolio management techniques referred to in Articles 41(1) g) and 42(2) of the UCI Law:

- it must be authorised by a financial authority;
- it must be subject to prudential supervision;

[4] "**SFTR Regulation**" refers to Regulation (EU) 2015/2365 on transparency of securities financing transactions and of reuse.

- it must either be located in the EEA, or in a country belonging to the Group of ten or have at least an investment grade rating;
- it must be specialised in such transactions.

If the counterparty does not fulfil any one of the first three criteria, the UCITS must demonstrate that the prudential rules applicable to such a counterparty are equivalent to those laid down in the EU law.

C. Audit reform (Directive 2014/56/EU)

The CSSF confirms that:

- a UCITS whose shares/units are admitted to trading on a regulated market (as defined by Article 4(1) of MiFID[5]) qualifies as public-interest entity ("**PIE**"). This means that UCITS listed on the Luxembourg Stock Exchange are PIEs whereas UCITS traded on the Euro MTF market are not.
- the CSSF reminds the main implications for UCITS qualifying as PIE e.g. the mandatory rotation of the UCITS' audit firm, the delimitation of the provision of non-audit services and the enlargement of the audit report., the CSSF further confirms that, by way of derogation, UCITS are not required to set up an audit committee.

3. New CSSF Circular on UCITS depositaries

On 11 October 2016, the CSSF published its new Circular 16/644 on UCITS depositaries ("**New Circular**") which replaces the now former CSSF Circular 14/587 on the same topic.

For a detailed overview of the UCITS V depositary regime as described in the New Circular, see our Newsflash dated 13 October 2016.

The New Circular does not provide guidance on the topic of independence of the UCITS, its Management Company and its Depositary and the latter's delegates and the impact on the board composition of each of these entities. We understand that guidance in relation to this topic should soon be provided by the CSSF, possibly in the form of a FAQ.

2. AIFMD

ESMA Q&A on AIFMD: Update

In October and November 2016, ESMA updated its Q&A on AIFMD. Amongst the newly added questions, we have selected the following:

A. Impact of SFTR Regulation

ESMA takes a position as regards the SFTR reporting obligation for UCITS management companies, UCITS investment companies and AIFMs, which will become applicable on 13 January 2017. The information on the use made of securities financing transactions and total return swaps must be included in the next annual or half-yearly report to be published after 13 January 2017 which may relate to a reporting period beginning before that date.

For this purpose, one may reasonably assume that the date on which a report is published is the date it has been published on a website, sent to investors or made available at the registered office of the UCITS/AIF, whichever is the earlier.

B. Delegation

Functions performed by the AIFM:

ESMA question: *"Where the AIFM does not itself perform the functions set out in Annex I of the AIFMD, does this release the AIFM from its responsibility to ensure compliance of the relevant function(s) with the AIFMD?"*

ESMA Answer: *"No. Where a third party performs a function stated in Annex I of the AIFMD, this function should be considered as having been delegated by the AIFM to the third party. Therefore, the AIFM should be*

[5] "**MiFID**" refers to Directive 2004/39/EC of 21 April 2004 on markets in financial instruments.

responsible for ensuring compliance with the requirements on delegation set out in Article 20 of the AIFMD and the principle expressed in Article 5(1) of the AIFMD according to which the single AIFM appointed for an AIF is responsible for ensuring compliance with the AIFMD. For the avoidance of doubt, this applies to all functions stated in point 1 and point 2 of Annex I of the AIFMD."

We have purposely quoted rather than summarised or explained the relevant Q&A because the position ESMA seems to adopt does not, in our view, comply with the provisions of the Level I AIFMD.

ESMA seems to imply that, even if it performs only portfolio and risk management functions for the AIF, the AIFM should in all circumstances be responsible for ensuring compliance with the administration and marketing functions as if it had contractually agreed to perform these functions and delegated these to third parties.

This is clearly not in line with the Level I provisions of the AIFMD which, by stating in Annex I that the AIFM shall at least perform portfolio and risk management functions, clearly mean that the AIFM is not required to perform the administration and marketing functions.

ESMA's statement "Where a third party performs a function stated in Annex I of the AIFMD, this function should be considered as having been delegated by the AIFM to the third party" in our view lacks legal basis.

Hopefully, national competent authorities will recognise that ESMA's position is not justified in the presence of clear Level I provisions on the subject.

Back-to-back delegation:

ESMA takes the position that an external AIFM cannot delegate the performance of the functions stated in Annex I of the AIFMD to the governing body (or any other internal resource) of the AIF that it manages. According to ESMA, the external AIFM of an AIF is entitled to delegate to third parties the task of carrying out functions on its behalf (Article 20 of the AIFMD) the AIF itself is not a 'third party' for the purposes of Article 20(1) of the AIFMD.

3. PRIIPs

A. Delay and amendments to level 2 measures

On 9 November 2016, the EU Commission confirmed its agreement on the postponement of the application of the **PRIIPs Regulation** (i.e. Regulation 1286/2014 on key information documents ("**KID**") for packaged retail and insurance-based investment products ("**PRIIPs**")). According to the legislative proposal, the entities falling within the scope of the PRIIPs Regulation will have up to 1 January 2018 ("**Deadline**") to produce a PRIIPs KID.

The EU Commission also asked the European Supervisory Authorities ("**ESAs**") to review the regulatory technical standards ("**RTS**") in order essentially (i) to clarify the treatment of multi-options products (MOPs) and the methodology for the calculation of future performance scenarios and (ii) to provide guidance on the use of the comprehension alert.

The review and amendment of the RTS's provisions on transaction costs and the possibility to include past performance information in the KID were also identified by the industry as crucial issues; however, the mandate to the ESAs does not include any reference to these two points.

The revised RTS must be submitted to the EU Commission within 6 weeks (i.e. before 22 December 2016). The Commission expects the final RTS to be in place in the course of the first semester 2017 and apply as of 1 January 2018.

B. Possibility for Luxembourg non-UCITS funds to benefit from the exemption and to publish UCITS KIIDs instead of PRIIPs KIDs

Article 32(2) of the PRIIPs Regulation aims at extending the benefit of the exemption provided for a UCITS fund to provide a PRIIPs KID until 31 December 2019 to certain non-UCITS funds offered to retail investors. It specifies that when a Member State applies rules on the format and content of the UCITS key investor information document ("**UCITS KIID**") to non-UCITS funds offered to retail investors, those non-UCITS funds benefit also from the exemption.

Based on the option given to non-UCITS undertakings for collective investment ("**UCIs**") to produce a UCITS KIID[6], it is expected that Luxembourg UCIs will benefit from the exemption mentioned above provided that (i) they publish a UCITS-KIID-like document for each retail share class issued and (ii) their prospectus/issuing documents refer to the availability to investors of the UCITS-KIID-like document upon request or on a website, to the extent that both (i) and (ii) are complied with before the Deadline.

This position, however, may not be shared by the competent authorities of the host Member State(s) where the Luxembourg UCIs are marketed.

4. Benchmark Regulation

On 29 June 2016, the Benchmark Regulation, i.e. Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds was published in the Official Journal of the European Union.

The Regulation aims at establishing a common regulatory framework at EU level under which benchmarks are provided, produced and used, and to restore trust in indices used as financial benchmarks.

The Regulation has a more significant impact for benchmark providers, but new requirements are also applicable to benchmark users.

As a result, the Regulation will have an impact on UCITS, their Management Companies and AIFMs to the extent that the latter use benchmarks for measuring the performance, for defining the asset allocation of a portfolio or for computing performance fees. These entities may only use benchmarks that are provided by an authorised benchmark administrator, or a non-EU provider that satisfies the equivalence requirements set out in the Regulation and will need to establish actions they will take if a benchmark materially changes or ceases to be provided. Prospectuses shall include clear and prominent information stating that the benchmark is provided by an administrator included in the public register of authorised and registered administrators maintained by ESMA. The Regulation will apply from 1 January 2018[7].

For further insight on the key features brought by this Regulation, see the article "Benchmark Regulation: Key features and impact on investment funds" published on our website.

5. CSSF Annual Report

The publication of its annual report always represents an opportunity for the CSSF to confirm and to clarify, where necessary, its regulatory practice.

In July 2016 (and August 2016 for the English version), the CSSF published its Annual Report for the year 2015.

Among the items addressed in this report, we have selected the following:

A. Requirements as regards annual reports – significant events disclosure

Annual report of UCI(TS), SIFs and SICARs must take into account significant events which occurred during the period between the end of the financial year and the publication of the report. The annex to the annual report must also mention information on the nature and

[6] According to Article 161(1) of the UCI Law, "A UCI, other than a UCITS, is authorised to draw up a document containing key investor information, within the meaning of this law. In that case, the document in question must contain a clear statement that the UCI which draws up the key investor information is not a UCITS subject to Directive 2009/65/EC."

[7] Except for the critical benchmark provisions (i.e. Chapter 4 and Article 46 of the Benchmark Regulation), which became applicable in June 2016. Certain transitional provisions are also provided.

financial impact of each significant event occurring before the end of the financial year which is not mentioned in the profit and loss account.

Financial reports of funds with multiple sub-funds must include not only the financial statements of the umbrella structure, but also the financial statements per sub-fund, according to section III, Chapter L of IML Circular 91/75, including information regarding sub-funds which have been liquidated or closed during the relevant financial year.

B. Fight against money laundering and terrorism financing

In conformity with CSSF Regulation 12-02, the managers of a management company or of an AIFM must put in place measures with regard to:

- the identification and evaluation of risks related to money laundering and terrorism financing to which a UCI is exposed;
- the categorisation of the UCI's clients according to the predefined levels of risks; and
- the efficient mitigation of risks related to money laundering and terrorism financing.

This management and mitigation of risks policy should be set in writing and the controls performed to ensure that this policy is effectively applied must be documented in writing.

C. Requirements as regards management letters

The *dirigeants* of a UCI are required to take a position on any comments made by the statutory auditor in their management letter and to indicate how they will take them into account. Their position must be documented in writing and communicated to the CSSF at the same time as the management letter.

D. Requirements as regards UCITS counterparties deposit rules

The CSSF stresses that management companies must have in place organisational arrangements to ensure that for each UCITS, cash management operations are made within the legal limit (i.e. no more than 20% of its net asset value deposited with a single body – see Article 43 (1) of the UCI Law).

E. Requirements on the risk profile of UCITS

The CSSF highlights the importance of the determination and description of the risk profile of a UCITS and of the setting-up of internal limits within the risk management system of UCITS management companies and of self-managed UCITS.

The CSSF states that the risk profile contains a qualitative description and an explanation on the risk appetite for all risks likely to be significant for a UCITS managed according to its investment policy. Moreover, the CSSF expects that indicators with regard to levels of risk and corresponding internal limits will be integrated into this risk profile.

Finally, the CSSF stresses that the risk profile of the UCITS must be approved before launch and updated when relevant (for example when modifying the investment policy of the UCITS) by the board of directors of the UCITS management company or of the self-managed UCITS.

6. CSSF Regulation on out-of-court complaint resolution

CSSF Regulation 16-07 relating to out-of-court complaint resolution, entered into force on 11 November 2016 and on the same date repealed the previous CSSF Regulation on this subject, i.e. the CSSF Regulation 13-02.

The Regulation 16-07 further details the procedure for the amicable settlement of complaints filed against any professional subject to the prudential supervision of the CSSF (e.g. banks, investment funds, management companies, AIFMs, etc.). This procedure aims at facilitating the resolution of complaints against professionals without judicial proceedings.

The Regulation 16-07 also reflects the changes brought by the Law of 17 February 2016 introducing out-of-court settlement of consumer disputes in the Consumer Code.

Without being exhaustive, the new Regulation prescribes delays for the introduction and handling of complaints and requires professionals subject to the CSSF supervision to inform their clients in a clear, comprehensible and easily accessible manner on the different possibilities for actions, including information on the CSSF acting as an out-of-court complaint resolution body.

7. VAT on directors' fees

The Luxembourg indirect tax authorities have clarified their position on the VAT regime of directors' fees by a Circular letter 781 dated 30 September 2016. The circular clearly states that directors' fees are subject to VAT under normal conditions.

The authorities mentioned that they expect a strict implementation of their analysis as of 1 January 2017.

The tax authorities have not specifically considered the fund industry; however, they have confirmed that the VAT exemption on the management of investment funds could apply to services rendered by directors of investment funds which specifically relate to exempt services and not to corporate mandates.

Specifically, in relation to directorships on management companies and AIFMs, this may require an assessment as regards directors' services related to corporate aspects regarding the management company/AIFM (subject to VAT) and the services related to the management of the investment funds (VAT exempt) with a consequent split of the directors' remuneration for VAT purposes.

BANKING, INSURANCE AND FINANCE

1. Luxembourg Resolution Fund: Ex-ante contributions

In the context of the Banking Union and the harmonisation of resolution rules, on 28 September, the CSSF enacted the Regulation 16-06 ("**CSSF Regulation**") relating to *ex ante* contributions to be paid to the *Fonds de résolution Luxembourg* ("**FRL**").

The CSSF Regulation sets out the annual amount to be contributed to the FRL by Luxembourg branches of institutions established in non-EU countries, as well as certain investment firms which are authorised to carry out certain limited services and activities ("**16-06 Entities**").

Considering their relatively low risk profile, the 16-06 Entities shall contribute a fixed amount depending on their total liabilities, excluding own funds and covered deposits, as follows:

Total liabilities, less own funds and covered deposits (in EUR million)	Lump-sum amount of annual contribution
≤ 100	EUR 150
> 100 and ≤ 150	EUR 200
> 150 and ≤ 200	EUR 300
> 200 and ≤ 250	EUR 500
> 250	EUR 650

If the annual target level is not reached, 16-06 Entities with total liabilities exceeding EUR 300 million will have to contribute the difference.

At the latest by 1 July each year, the resolution department of the CSSF notifies to each institution the annual amount to be contributed by it – save for the amounts to be contributed for years 2015 and 2016, which are to be notified as of the entry into force of the CSSF Regulation, i.e. on 15 October 2016. The amounts to be contributed shall then be transferred to the FRL within 10 working days from the date of dispatch of the information regarding the payment methods.

Commission Delegated Regulation (EU) 2015/63 of 21 October 2014, as amended, sets out the contributions to be paid by:

(i) institutions falling within the scope of the Banking Union (i.e. Luxembourg credit institutions and Luxembourg investment firms which shall legally have an initial capital of at least EUR 730,000, and which are covered by the consolidated supervision of the parent undertaking carried out by the ECB) ("**Luxembourg-based Banking Union Institution**"); and

(ii) institutions which are to be considered as risky and thus not within the scope of the CSSF Regulation. To sum up, small institutions shall pay a lump-sum amount, defined according to their assets, while large institutions and risky small institutions shall pay a risk-adjusted contribution (in this regard, please also see Circular CSSF-CODERES 16/02 of 15 November 2016, the purpose of which is the collection of data from the Luxembourg-based Banking Union Institutions for the calculation of the 2017 ex-ante contributions to the Single Resolution Fund).

The FRL is competent to collect the contributions paid by all these entities; however, the amounts contributed by the Luxembourg-based Banking Union Institutions shall be subsequently transferred by the FRL to the Luxembourg compartment within the Single Resolution Fund.

COMPETITION

Adoption of the Law on compensation for competition law infringements

On 15 November 2016, the Luxembourg Parliament adopted the Law on certain rules governing actions for damages for competition law infringements and amending the amended Law of 23 October 2011 on competition ("**Law**"). It implements [Directive 2014/104/EU]() of 26 November 2014 on antitrust damages actions ("**Directive**").

The Law reflects the objectives of the Directive: improving the effectiveness of private enforcement as to infringements of European Union and national competition law and fine-tuning the interplay between private damages actions and public enforcement by the European Commission and national competition authorities.

On the one hand, the Law facilitates actions for damages through the introduction of certain specific procedural rules.

First, their exercise is simplified by a set of presumptions with respect to the existence of an infringement of competition law and its effects:

- an irrebuttable presumption of its existence in the event of an infringement of competition law found by a final decision of the Competition Council;
- evidence of the fact that such an infringement has occurred when it is established by a final decision of a competition authority of another Member State;
- a rebuttable presumption that cartel infringements cause harm; and
- a rebuttable presumption for the indirect purchaser who introduces an action for damages that the overcharge resulting from a competition law infringement has been passed on to him, the defendant having for his part, however, the possibility to invoke as a defence, in an action for damages introduced by a direct purchaser, that the latter passed on such an overcharge to a lower level of the distribution chain.

Second, access to evidence, essential for competition law-based claims, is facilitated through certain disclosure rules. Upon request of the claimant, a judge may, under certain conditions relating to the proportionality of such a request, order the disclosure of information, including with respect to evidence in the file of a competition authority. However, considering their importance for the public enforcement of competition law, statements made by companies for the purpose of a leniency application and settlement submissions are protected: they cannot be subject to a disclosure order and evidence related to them obtained solely through access to the file of a competition authority is inadmissible. Other evidence, including that established by a competition authority and sent to the parties in the course of proceedings, cannot be disclosed until that authority has closed its proceedings. In any event, the production of confidential evidence ordered by a judge is subject to certain protective measures.

Third, with the exception of certain specific rules applicable to small and medium-sized undertakings and immunity recipients, joint and several liability of undertakings which have infringed competition law through joint behaviour allows the injured party to require full compensation from any of them until it has been fully compensated.

Fourth, whereas the Directive imposes on Member States to ensure that limitation periods for bringing actions for damages are of at least five years, the Law refers in this respect to Luxembourgish general procedural law principles, which provide for a ten-year limitation period for commercial claims.

On the other hand, the Law encourages consensual dispute resolution. In accordance with the Directive, it provides for the suspension of the limitation period to bring an action for damages for the duration of the consensual dispute resolution process and the suspension of the proceedings relating to the action for damages during a maximum period of two years. In addition, certain rules govern the exercise of the remaining claim of the settling injured party.

Lastly, it is worth noting that the Law does not enact provisions relating to collective redress despite a Commission Recommendation of 11 June 2013 on collective redress inviting Member States to introduce mechanisms allowing for collective damages actions.

EMPLOYMENT

1. New restrictions on employer's right to check criminal records

Amendments to the Law of 29 March 2013 relating to the organisation of criminal records were introduced by the [Law of 23 July 2016] and will enter into force on 1 February 2017.

As of 1 February 2017, the employer's right to request a criminal record from the employee will be restricted.

In the framework of a recruitment process:

- The criminal record will be divided into 5 different categories ("*bulletins*") each reporting different information. The employer may only request to be provided with the 3rd category of criminal record ("*bulletin n°3*") which refers to certain crimes. However in cases where a driving licence is specifically required for the job vacancy, the employer may also request the 4th category of criminal record ("*bulletin n°4*") which, besides the information provided in the 3rd category of the criminal record, refers also to driving prohibitions.

- In order to be entitled to request the candidate to produce a criminal record, the employer will have (i) to state in the published job offer that an extract of the employee's criminal record (either 3rd or 4th category) has to be provided to the employer and (ii) to justify in writing to the candidate the relevance of this request regarding the job vacancy.

During the execution of the employment contract the employee's criminal record may only be requested by the employer:

- when legally provided; or

- in case of a change of the employee's position justifying a new control of the employee's integrity and respectability.

The duration of storage of the criminal record is shortened:

- If the candidate is hired, the employer may keep the produced criminal record for 1 month running from the conclusion of the employment contract.

- If the candidate is not hired, the produced criminal record will have to be destroyed immediately.

- Should the criminal record be produced during the employment relationship, it may only be kept for a maximum period of 2 months from its production except if otherwise provided for by law.

The penalty for infringement of the legal provisions is a term of up to one year's imprisonment and/or a monetary fine of up to EUR 5,000 (or EUR 10,000 for legal entities). The penalty for any violation with respect to the duration of storage of criminal records is a monetary fine of up to EUR 3,000 (or EUR 6,000 for legal entities).

2. Parental leave reform

The [Law of 3 November 2016] on the reform of parental leave setting out new rules for parental leave shall be applicable as of 1 December 2016.

The main objectives of the reform are to promote the conciliation of family and professional life, so as to increase the proportion of fathers taking advantage thereof, to promote equal opportunities and to better respond to the needs of parents.

The most significant amendments introduced by the reform are presented in the article "[Parental Leave Reform]" published on our website.

3. Bill of Law 6992: Enhanced mobility of workers and new immigration possibilities for investors

The amended Law of 29 August 2008 on free movement of persons and immigration will soon face major changes to be introduced by the Bill of Law 6992, currently being discussed by the Parliament in Luxembourg ("**Bill**").

Firstly, the Bill aims at implementing Directive 2014/66/EU of 15 May 2014 on the conditions of entry and residence of third-country nationals in the framework of an intra-corporate transfer ("**ICT Directive**") and Directive 2014/36/UE of 26 February 2014 on the conditions of entry and stay of third-country nationals for the purpose of employment as seasonal workers.

The implementation of the Directive relating to seasonal workers will most likely have little to no impact on the Luxembourg economic landscape. However, the implementation of the ICT Directive will be of interest for international groups which for instance have their holding companies based in Luxembourg.

The provisions relating to intra-corporate transfer ("**ICT**") aim to facilitate mobility of intra-corporate transferees within the European Union (excluding the United Kingdom, Ireland and Denmark) and to reduce the administrative burden associated with work assignments in several Member States (recital 25 of the ICT Directive).

Only managers (employees of a certain level), specialists (employees with specific professional knowledge) and trainee employees may benefit from the facilitated conditions on entry and the mobility provisions of the ICT Directive.

The Bill contains legal conditions in the case where a company based outside the EU temporarily assigns an employee (who is not a citizen of the EU, i.e. third country nationals) to a company based in Luxembourg.

The most significant changes introduced by the Bill are presented in the article "Bill of Law 6992: Enhanced mobility of workers and new immigration possibilities for investors" published on our website.

INFORMATION AND COMMUNICATION TECHNOLOGY

1. Clarification regarding hyperlinks to protected works

Right holders of protected works and operators of websites may want to consider the recent clarification made by the Court of Justice of the European Union ("**Court**") in the case *GS Media* (C-160/15 of 8 September 2016) regarding the need to obtain authorisation from right holders to post hyperlinks on the Internet that target works protected by copyrights, freely available to the public on other websites [where such works have not been lawfully published on the targeted website]. The solution found by the Court is supposed to ensure a fair balance between the protection of intellectual property rights and the freedom of expression and information.

The placement of hyperlinks on websites allows web users to access content located on other websites by means of a clickable link that redirects users to the targeted content. By doing so, hyperlinks contribute to the good functioning of the Internet and to the exchange of opinions and information, which fall within the scope of the freedom of expression and information, safeguarded by Article 11 of the Charter of Fundamental Rights of the European Union ("**Charter**").

On the other hand, hyperlinks may allow web users to find protected works that are located on websites which are protected by measures to restrict public access. Therefore, hyperlinks may go against the protection of intellectual property rights, which are safeguarded by Article 17 (2) of the Charter.

In previous cases *Svensson* (C-466/12 of 13 February 2014) and *BestWater* C-348/13 of 21 October 2014), the Court already identified criteria to determine whether the posting of a hyperlink to protected works, freely available to the public on another website, is subject to the authorisation of the right holder of such works where it is considered that the right holder authorised the initial publication of its works on such a website. In this respect, the Court held that the posting of a hyperlink to protected works requires the consent of the right holder if the hyperlink allows the works to be made available to a "new public" which was not taken into account by the right holder when it authorised the initial publication of such works on the Internet. This is the case in particular where the hyperlink concerned allows web users to circumvent access restriction measures and thus renders the works available to a public larger than initially authorised by the right holder.

In the case *GS Media* of 8 September 2016, the assessment of the Court is based on the consideration that the right holder did not authorise the initial publication of its works on the Internet. In this respect, the Court identified an additional criterion to be taken into consideration where the hyperlink targets another website on which the protected works have been published without the authorisation of the right holder and is freely available to all Internet users on this website.

Regarding the facts of the *GS Media* case, Sanoma Media Netherlands BV ("**Sanoma**"), the publisher of the magazine *Playboy*, ordered photos of Mrs B.D., a Dutch TV personality, to be published in the next edition of *Playboy* magazine. Before this publication, GS Media BV posted successive hyperlinks on its website "GeenStijl" redirecting to other websites (owned by third parties) hosting the photos of Mrs B.D., without the authorisation of Sanoma.

The hosting websites successively removed the litigious photos at the request of Sanoma. However, despite the demands of Sanoma to remove the hyperlinks from the website "GeenStijl", GS Media continued to post new hyperlinks to other hosting websites on which the photos reappeared without the authorisation of Sanoma.

According to Article 3(1) of the Directive 2001/29/EC of 22 May 2002 on copyright in information society ("**Copyright Directive**"), authors shall have the exclusive right to authorise or prohibit any communication (including the making available) to the public of their works. As the concept of "communication to the public" is not defined by the Copyright Directive, the Court was asked in the *GS Media* case to determine whether the act of posting a hyperlink to protected works, freely available to the public on another website despite the absence of consent of the right holder, constitutes "communication to the public" that should normally be authorised by the right holder.

In the previous cases of *Svensson* and *BestWater* (see above), the Court did not clarify whether the fact that the right holder authorised or was considered to have authorised the publication of its works on the target website constitutes a criterion that may have an impact on the qualification of the concept of "communication to the public". Indeed, the Court only considered that the works were made available to a "new public".

In the *GS Media* case, the Court had to determine for the first time whether the fact that the operator posting the hyperlink ("**hyperlinker**") knew or should have known that the right holder did not consent to the initial publication could have an impact on the solution at hand.

In this respect, the Court first recalled that the concept of "communication to the public" should be interpreted broadly in compliance with Recital 23 of the Copyright Directive.

In this respect, the Court identified several criteria based on other previous cases to be considered as follows: (i) the indispensable role of the operator, meaning that the works could not be made available without its intervention as well as the deliberate nature of its intervention, in full knowledge of the consequences of its action, (ii) the concept of "public" should cover an undetermined number of potential recipients and involve an important number of persons, (iii) to be qualified as "communication to the public", the protected work should be communicated using specific technical means, different from those previously used or, failing that, to a "new public" not already taken into account by the right holder when it authorised the initial communication to the public of its works.

The Court then clarified that in the case at hand (*GS Media*), it was clear that the right holder did not authorise the initial publication of its works on the "GeenStijl" website. Therefore, the Court considered the fact that the "hyperlinker" knew or should reasonably have known that the targeted works were initially unlawfully published on the Internet and noted that the posting of a hyperlink to such works, even if they have been made freely available to the public on other hosting websites, should be qualified as "communication to the public". That is the case where the right holder notifies the "hyperlinker" that the works targeted by the hyperlink were published without its authorisation.

Also, in particular when a hyperlink is posted for profit-making, the "hyperlinker" is presumed to have known that the targeted works were unlawfully published on the Internet. Consequently, the fact of knowingly posting such a hyperlink constitutes "communication to the public" that should normally be authorised by the right holders. The Court noted, however, that such a presumption of knowledge of the unlawfulness of the initial publication of the works on the Internet can be reversed.

In conclusion, operators posting hyperlinks directing the users to protected works published on the Internet should seek the authorisation of the right holder of such works (i) in case they know or should reasonably know that such works have been made available on the Internet without the consent of the right holder or (ii) in case they post the hyperlink for profit-making. However, if the "hyperlinker" can prove ignorance (or could reasonably ignore) that the works had been initially published without the consent of the right holder, an authorisation of the right holder would not be required.

This solution is aimed at ensuring effective protection of the interests of the right holders as well as the freedom of speech and information. Indeed, it can be difficult for an individual to verify whether a particular work published on the Internet is made available with the consent of the right holder, *a fortiori* where such rights of communication to the public are sub-licensed and considering in particular the fact that the content of the website targeted may be modified after the posting of the hyperlink and host new protected content without the "hyperlinker" being aware of it. The fact remains that debates may now focus on what the "hyperlinker" is supposed to reasonably know about its target.

2. Open WiFi: Responsibility for copyright infringements

Businesses making an open internet access available to the public from their shops can be reassured as they are not liable for the acts of anonymous users using such internet access.

According to Preliminary Ruling C-484/14 of 15 September 2016 the Court of Justice of the European Union ("**Court**"), the operator of a shop who makes its Wireless Local Area Network ("**WiFi network**") available to the public is not liable for copyright infringements committed by users of that network. Therefore, the right holder is not entitled to claim for compensation on the grounds that third parties used that network to infringe its rights. However, national courts can require such an operator to terminate or prevent infringements, which can be done by securing the internet access by means of a password.

It should be noted that in Luxembourg, the provision of a communication network such as a WiFi network may be subject to the filing of a prior notification with the *Institut Luxembourgeois de Régulation* in compliance with Article 8 of the Law of 27 February 2011 on electronic communications.

Under Article 12 (1) of the Directive 2000/31/EC ("**e-Commerce Directive**"), intermediate providers of mere conduit services are exempt from liability for the information transmitted provided that three cumulative conditions are satisfied: (i) the provider does not initiate the transmission, (ii) it does not select the receiver of the transmission and (iii) it does not select or modify the information contained in the transmission.

In the case at hand, Mr T.F., who runs a business of lighting and sound systems, offered an internet connection to the public free of charge via a non-secured WiFi network to encourage people to visit his shop. At the same time, a piece of music was made available to the public by means of Mr T.F.'s WiFi network without the authorisation of the right holder, Sony Music Entertainment Germany GmbH ("**Sony Music**"). The liability of Mr T.F. was challenged before the German courts by Sony Music for having at least contributed to the copyright's infringement.

The Court confirmed that offering an open WiFi network on a free-of-charge basis to attract potential customers constitutes an "information society service" normally provided for remuneration and may thus be covered by the liability exemption provided by the e-Commerce Directive. In this respect, the Court recalled that the remuneration of a service supplied in the course of an economic activity does not require a payment from the recipient of the service (see C-291/13, *Papasavvas*). According to settled case law, this is the case where a service provider provides free services for the purpose of advertising the goods sold or the services provided by such a service provider since the cost of that activity is incorporated into the price of those goods or services of the service provider.

Mr T.F. should thus be exempt from liability under Article 12 (1) of the e-Commerce Directive for the information transmitted via its WiFi network provided the provision of that communication network remains a technical, automatic and passive process for the transmission of the information, without any further conditions to be satisfied. Consequently, Sony Music should be precluded from claiming compensation from Mr T.F. for the copyright infringements committed by third parties using his WiFi network.

However, the Court also stated that under Article 12 (3) of the e-Commerce Directive, Sony Music may claim for injunctive relief before a national court against the continuation of that infringement, as well as payment of related procedural costs. In practice, the national court should strike a fair balance between the protection of the copyrights of Sony Music and the constraint on Mr T.F.'s business, which also have an impact on the liberty of information of users of the WiFi network.

In this respect, the Court found, contrary to the Advocate General, that securing the WiFi network with a password was sufficiently proportionate and effective to ensure a fair balance between the rights at stake as such a measure could allow the identification of the users of the WiFi network, who would thus be dissuaded from infringing copyrights. However, the proposed alternative measures consisting of monitoring all information transmitted or terminating the internet connection were rejected by the Court. In any case, the effectivity and proportionality of an obligation to secure an internet connection might remain subject to debate as it encounters certain obstacles underlined by the Advocate General, such as the necessary costs and organisation measures required to identify users and retain their data, which is normally incumbent on telecom operators and other internet service providers.

TAX

1. Tax treaties news

Australia

Australia is in negotiations with Luxembourg to enter into a double tax treaty. Officials met in Sydney on 29 September 2016. Negotiations are ongoing.

New Zealand

Officials of Luxembourg and New Zealand met on 26 to 27 September 2016 in Wellington and agreed to resume negotiations for a double tax treaty.

Turkmenistan

Officials from Luxembourg and Turkmenistan met in Ashgabat on 6 September 2016 and expressed their intention to negotiate and sign a double tax treaty. During that meeting, Luxembourg also signed an air transport agreement with Turkmenistan.

United States

On 22 June 2016, Bill 7006 was submitted to the Luxembourg Parliament. The Bill proposes to introduce a provision into a protocol modifying the existing double tax treaty between Luxembourg and the United States.

The protocol aims at tackling situations of double non-taxation resulting from a different interpretation of the permanent establishment ("**PE**") concept by Luxembourg and the United States. Indeed, under certain circumstances, income may be exempt in Luxembourg as it is deemed attributable to a US PE while at the same time the US exempts such income from tax in the US.

The proposal will allow the US, in certain cases, to deny the benefits of the treaty, including reduced withholding tax rates, to income that is considered by Luxembourg laws as profits attributable to a permanent establishment of the US.

The Bill provides for a retroactive application of these provisions. Indeed, where the treaty is amended by a protocol containing such provisions, and if the protocol so provides, upon entry into force of such a protocol, the provision will have effect for amounts paid or credited on or after the third day following the publication of the Luxembourg law (enacting the Bill) in the Official Gazette.

Ukraine

On 30 September 2016, Luxembourg and Ukraine signed a protocol to the double tax treaty of 6 September 1997, which is not yet in force.

The protocol introduces a modernised "exchange of information" provision (Article 26), a new definition of permanent establishment (paragraph 3 of Article 5) and a new "non-discrimination" provision (new paragraph 7 of Article 24). Articles 10 (dividends), 11 (interest) and 12 (royalties) are also amended. Under the treaty, as amended by the protocol, withholding tax rates are as follows:

Dividends: standard rate of 15% and 5% if the receiving company owns at least 20% of the share capital of the company paying the dividends;

Interest: 10% and 5% on interest paid in connection with the sale on credit of industrial, commercial or scientific equipment or interest on bank loans; and

Royalties: standard rate of 10% and 5% on royalties concerning copyright on scientific work, patent, trademark, secret formula or process information concerning industrial, commercial or scientific experience.

2. Tax reform 2017

On 26 July 2016, Bill 7020 dealing with the announced tax reform was submitted to the Luxembourg Parliament. The following summary does not address all tax measures announced by the Government and some of these measures may still change in the course of the legislative process.

Corporate tax measures

The standard corporate income tax rate will be reduced from 21% to 19% in 2017 and be further reduced to 18% in 2018. The aggregate income tax rate (including the municipal business tax and the solidarity surcharge) for companies with a registered office in Luxembourg City would be 27.08% in 2017 and 26.01% in 2018. For companies with an annual profit not exceeding EUR 25,000, the standard corporate income tax rate will be reduced to 15% in 2017 (resulting in an aggregate tax rate of 22.8%).

The carrying forward of tax losses incurred as from 1 January 2017 should be limited to 17 years as far as income tax and municipal business tax are concerned. Tax losses incurred between 1 January 1991 and 31 December 2016 may still be carried forward without any limitation in time.

The minimum net wealth tax for companies whose sum of financial assets exceeds (i) 90% of their total balance sheet and (ii) EUR 350,000, are currently subject to a minimum tax of EUR 3,210. This minimum net wealth tax will be increased to EUR 4,815 in 2017.

As from the tax year 2017, limited companies must file corporate income tax, municipal business tax, and net wealth tax returns electronically.

The Bill provides for an increase of the complementary and global investment tax credits from 12% to 13% and from 7% to 8% respectively (while the current 2% rate for investments exceeding €150,000 will remain unchanged). The investment tax credit for assets approved for the special depreciation regime will be increased from 8% to 9% (while the current 4% rate for investments exceeding €150,000 remains unchanged). To comply with ECJ's case law C-287/10 (*Tankreederei*), investment tax credits shall also be applicable to investments made in the European Economic Area (EEA).

With effect from 1 January 2016, the Bill has extended the possibility to roll over foreign exchange gains to all companies which have their capital expressed in a foreign currency. Currently, only banks, insurance companies and companies trading in financial assets are entitled to such a roll-over.

VAT

According to the current drafting of the Bill, directors, managers, curators and liquidators will be jointly and personally liable in case of breach of compliance obligations and/or for VAT debts of companies they manage. The tax authorities shall be entitled to directly issue a personal constraint (*appel en garantie*) against managers for outstanding VAT payments owed by the company they manage.

Registration duties

The 0.24% registration duty due on debt claims documented in public deeds (notably in case of contribution of such claims to the share capital) will be abolished.

Individual tax measures

The global tax schedule will be revised and additional income brackets and tax rates are added. A tax rate of 41% will be introduced on the portion of annual income exceeding EUR 150,000 while a 42% rate will be introduced on the portion of annual income exceeding EUR 200,004 (for singles in tax class 1).

The 0.5% temporary tax (*impôt d'équilibrage temporaire budgétaire*) will be abolished as of 2017.

The final withholding tax on interest payments to Luxembourg resident individuals (RELIBI) shall be increased from 10% to 20%.

Married couples and registered partners will be eligible to opt to be taxed individually.

3. Changes to transfer pricing regime

On 12 October 2016, the Luxembourg Government submitted Bill 7050 on the 2017 budget to the Parliament. The Bill proposes to include a new Article 56bis on the arm's length principle in the Luxembourg Income Tax Law ("**LITL**"). The new Article 56bis LITL will, if enacted, introduce into the LITL many of the key principles of the OECD Transfer Pricing Guidelines, as amended by the 2015 BEPS Report on Actions 8-10.

In particular, the proposed Article 56bis LITL states the importance of the comparability analysis to "accurately delineate" a controlled transaction, lists the main comparability factors that need to be identified in the commercial or financial relations between controlled parties and provides for the possibility to disregard a transaction for transfer pricing purposes where such a transaction does not, in substance, have a valid commercial rationale (non-recognition rules).

Although this new Article 56bis LITL does not represent a radical change - since Luxembourg, as an OECD member country, generally follows the OECD Transfer Pricing Guidelines - the merit of such new provisions is to provide further clarity and legal certainty about the application of the arm's length principle under Luxembourg tax law.

4. VAT

1. VAT Circular letter 781 dated 30 September 2016

The Luxembourg indirect tax authorities have clarified their position on the VAT regime of directors' fees by a Circular letter 781 dated 30 September 2016. The circular clearly states that directors' fees are subject to VAT under normal conditions.

The indirect tax authorities mentioned that they expect a strict implementation of their analysis as of 1 January 2017.

The tax authorities have not specifically considered the fund industry; however, the indirect tax authorities have confirmed that the VAT exemption on the management of investment funds could apply to services rendered by directors of investment funds which specifically relate to exempt services and not to corporate mandates.

2. VAT – pending case

On 6 October 2016, the Advocate General of the Court of Justice of the European Union (ECJ) released her opinion in the case C-274/15 brought by the European Commission against Luxembourg concerning an exemption from VAT for services provided by an "Independent Group of Persons" to its members. The Independent Group of Persons, created by the Grand Ducal Decree of 21 January 2004, allows services rendered by the group to its members under certain conditions, and has been largely used in the financial sector.

In its opinion, the Advocate General considers that the Luxembourg regime is in breach of the EU VAT Directive 2006/112/EU especially because the services exempt under the Luxembourg regime are not limited to services specifically related to exempt services provided by the member or services that are out of scope of VAT.

If the ECJ follows the position of the Advocate General, professionals of the financial sector in Luxembourg using an Independent Group of Persons should carefully reconsider the way it structures services rendered by the group.

For any further information please contact us or visit our website at www.elvingerhoss.lu.

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