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LUXEMBOURG LAW

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Cross-border services by third-country firms

CSSF recognises first equivalent third countries and clarifies when an investment service is rendered in Luxembourg.

On 2 July 2020, the CSSF published two important documents in relation to the provision of cross-border services by third-country firms:

- **CSSF Regulation 20-02** which lists the first third countries with equivalent supervision regimes for MiFID II services performed to *per se* professional clients or eligible counterparties in Luxembourg; and
- **CSSF Circular 20/743** which amends an existing circular (**Circular 19/716**) on the regime applicable to third-country firms wishing to provide investment services to clients in Luxembourg in accordance with Article 32-1 of the Financial Sector Law, which transposed the third-country regime of MiFID II Directive and MiFIR.

The clarifications in the CSSF Circular 20/743 are particularly relevant for investment funds and their managers.

They imply that:

- the provision of investment management services to Luxembourg UCITS and AIFs by an investment manager established outside the EU/EEA (in the typical scenario where a UCITS management company or an AIFM delegates investment management to an investment manager established outside the EU/EEA) should not be deemed to be a provision of services "in Luxembourg" for the purpose of the Financial Sector Law (as long as the third-country manager is not established in Luxembourg or does not otherwise provide its services in Luxembourg);
- MiFID II rules do not apply to such provision of services. Application of Article 32-1 of the Financial Sector Law (and related CSSF authorisation process) is therefore not triggered. Only the investment management delegation rules set forth in the UCITS Law[1] and the AIFM Law[2] apply in that case.

For more information on CSSF Regulation 20-02 and CSSF Circular 20/743, see the **Newsflash** on our website.

1 "**UCITS Law**" refers to the Law of 17 December 2010 on undertakings for collective investment, as amended.

2 "**AIFM Law**" refers to the Law of 12 July 2013 on alternative investment fund managers, as amended.

CSSF Annual report 2019

*The report on the CSSF activities and on the development of Luxembourg's financial centre in 2019 has been released and is available on the **CSSF website**.*

The annual report includes, in addition to statistical data, information on the CSSF's regulatory practice in all areas (including investment funds, management companies and AIFMs) where the CSSF is the competent authority.

As regards the supervision of investment fund managers and UCIs, the CSSF recalls in this report, particularly the importance of:

- rigorously complying with the deadlines for the communication of the financial information to the CSSF (and the need to prepare the financial reports with due care (i.e. they must be accurate in form and content);
- complying with the transparency requirements as regards investment policies and underlying risks in the UCITS prospectuses. Information on the investment strategies, on the investment decision-making processes (including, in particular, the aspects of selection, allocation, weighting, diversification and possible risk budget), on the use of derivative financial instruments and on the UCITS' risk profile must be sufficiently granular (especially for UCITS which pursue more sophisticated investment strategies, make greater use of derivative financial instruments or invest in complex products);

The CSSF also clarifies some elements as regards risk management policies of investment fund managers ("**IFMs**") and recalls the obligation for IFMs to provide a satisfactory explanation on the systems used in relation to stress tests, liquidity risk management, operational risk management and counterparty risk management in their risk management policy.

The annual report 2019 also includes some interesting findings in relation to on-site inspections relating to governance of IFMs (best execution, supervision of delegates, management information, AML/CFT, etc.).

Finally, as regards AML/CFT requirements under the supervision of the CSSF UCIs department, the report highlights the need for IFMs to further improve:

- the due diligence measures applied to the intermediaries, as required by Article 3 of CSSF Regulation 12-02;
- the key performance indicators enabling the ongoing monitoring by IFMs of the activities delegated to registrar and transfer agents in accordance with the requirements of point 466 of Circular CSSF 18/698;
- the programmes of continuing education (those programmes must be adapted to the specificities of investment funds and they must take into account the regulatory provisions applicable in Luxembourg);
- the frequency and documentation of controls in respect of the identification of the persons, entities and groups subject to prohibitions or restrictive measures in financial matters, as required by Article 33 of CSSF Regulation 12-02;

- the due diligence measures on the assets held by the funds, as required by point 309 of Circular CSSF 18/698;
- the due diligence requirements when entering into a business relationship: in particular, systematic procurement of sufficient information must be ensured in order to assess the nature of the intermediary's activities and the ML/TF risks relating thereto;
- the filtering device with respect to the sanctions lists; in this context, the CSSF reiterates that the filter must also apply to legal representatives and beneficial owners of the relevant entities; and
- the inadequate application of the risk-factor approach linked to distribution.

Covid-19: Flexibility regarding reporting for banks and financial service providers

In its **Communiqué of 23 March 2020** on the subject of regulatory reporting in the context of the COVID-19 crisis the CSSF asks supervised entities to perform their regulatory reporting when it is due but also offers some leniency.

- In general

The CSSF indicates that if for operational reasons supervised entities experience difficulties in preparing or validating their CSSF reporting due to staff not being available, for example because they work remotely without having full access to all systems, they should contact it through their usual channels as soon as possible and ahead of reporting deadlines. The CSSF also says that during the COVID-19 crisis it will not apply a strict enforcement policy with regard to reporting if delays are duly justified. It also specifies that the leeway it applies will be closely coordinated with national authorities, the ESAs as well as the European Central Bank.

The CSSF's **FAQ** provides guidance on reporting flexibility granted to banks and other financial service providers. In principle, submission on time of regulatory reports is encouraged but upon reasoned request, the CSSF can grant exceptions to filing deadlines. The FAQ should be referred to for details on which reporting obligations are affected for various players, including banks, payment institutions/electronic money institutions, investments firms, support Persons of the Financial Sector ("**PFS**"), and specialised PFS.

- Transparency

In a **Communiqué of 27 March 2020**, the CSSF describes a temporary measure providing flexibility applying to certain reporting deadlines in the Law of 11 January 2008 on transparency requirements for issuers (the "**Transparency Law**"), by granting issuers an extra two months to make the necessary publications of periodic information. The temporary measure applies to issuers for which Luxembourg is the home Member State pursuant to the Transparency Law for reporting periods ending on 31 December 2019 or after that date but before 1 April 2020. However, the CSSF expects issuers to take all necessary and reasonable measures in order to publish periodic information within, or as near as possible to, the deadlines set by the Transparency Law and that they inform markets and the CSSF of anticipated reporting delays. The CSSF

also reminds issuers and holders of securities to comply with ongoing disclosure requirements in the Transparency Law (such as regarding major holdings or managers' transactions) and in Regulation (EU) No 596/2014 on market abuse ("**MAR**"), notably regarding inside information. Finally, the CSSF also asks issuers to refer to the European Securities and Markets Authority (ESMA)'s **Statement of 27 March 2020** on actions to mitigate the impact of COVID-19 on the EU financial markets regarding publication deadlines in the context of the Transparency Directive.

- SFTR

In a **Communiqué of 9 April 2020**, the CSSF draws attention to the European Securities and Markets Authority (ESMA)'s **Statement of 26 March 2020**, aimed particularly at credit institutions, regarding the postponement of the reporting obligations related to securities financing transactions under Regulation (EU) 2015/23651 (SFTR) and under Regulation (EU) No 600/2014 (MIFIR). The CSSF indicates that it will not prioritise its supervisory actions towards counterparties, entities responsible for reporting and investment firms in respect of their reporting obligations pursuant to SFTR or MiFIR, regarding (i) SFTs concluded between 13 April 2020 and 13 July 2020, and (ii) SFTs subject to backloading under SFTR. However, it expects relevant entities to be sufficiently prepared ahead of the next phase of the reporting regime, i.e. 13 July 2020, in order to start reporting as of this date.

- Extension of deadlines for disclosing financial statements and other reporting in the financial sector

On 7 May 2020, the Luxembourg Parliament adopted a law extending the deadlines for publishing annual accounts and related reports mentioned in certain specific laws of the financial sector during the state of emergency declared in the context of the COVID-19 crisis, as discussed in our **Newsflash on this topic**.

This law has to be read in conjunction with the Law of 22 May 2020, which is of a general nature and concerns deadlines for convening annual general meetings and for filing and publishing annual accounts, consolidated accounts as well as related reports for all Luxembourg companies. You can read more on this general law and the interaction between the two laws **here**.

Brexit

Brexit: Personal data transfers under and after the transition period

In our **previous publication** on the consequences of a no-deal Brexit on personal data transfers to the UK, we noted that if the no-deal scenario persists after 29 March 2019, the UK will be considered as a "third country" under the GDPR[1]. The EU and the UK have negotiated extensions of this deadline.

The UK ceased to be a Member State of the EU on 31 January 2020. However, the UK benefits from a transition period lasting until 31 December 2020. During this period, EU law, including the GDPR, continues to apply to the UK. Therefore, no additional safeguard is required for personal data transfers to the UK, at least until the end of this year. What will happen after 31 December 2020 is still uncertain.

On 18 March 2020, the European Commission published a **draft agreement** on the new partnership with the UK[2] and is currently considering adopting an adequacy decision. Any such decision would provide that the UK ensures an adequate level of personal data protection and thus allows personal data transfers to the UK as if they would take place within the EEA.

To facilitate the discussions with the European Commission, the UK government has drafted a **policy paper**, which is intended to demonstrate that the UK meets the required data protection standards and will continue to do so. The UK data protection legal framework is composed, in particular, of (i) the "UK" GDPR, as incorporated under the European Union (Withdrawal) Act 2018 and (ii) the Data Protection Act 2018, both as amended by the Data Protection, Privacy and Electronic Communications Regulations 2019.

Should the European Commission not adopt an adequacy decision covering personal data transfers to the UK and the transition period is not extended beyond 31 December 2020, the UK will be considered under the GDPR as a "third country" not benefiting from an adequacy decision. In this context, personal data transfers to the UK would be prohibited, unless appropriate safeguards or derogations can be relied on. As **previously mentioned**, however most of the available safeguards would be difficult to implement within a short timeframe (e.g. binding corporate rules, certification mechanisms or codes of conduct). The available derogations are also unsatisfactory for non-occasional transfers.

Therefore, the soundest alternative would be for EU-based controllers to enter into (or mandate their processors to enter into) **Standard Contractual Clauses** ("SCCs") with the UK personal data importers. The existing SCCs have been adopted on the basis of the old data protection regime under Directive 95/46/EC (repealed by the GDPR) and have not been updated since the GDPR came into force. Notwithstanding this gap, the GDPR provides that such SCCs shall remain in force until amended, replaced or repealed.

Nevertheless, possible transfers remain limited under the SCCs, which only cover transfers from EU controller (to non-EU controller/processor). Transfers from EU processors (to non-EU controllers/processors) are not possible with the existing SCCs. The European Commission is still working on Standard Data Protection Clauses, which are expected to address these matters.

Please read our further **article** on the temporary period following the deal struck between the EU and the UK over Brexit on 24 December 2020.

This may also interest you :

- **Data Protection - Consequences of a no-deal Brexit on personal data transfers to the UK**
- **EU Entities can continue to transfer personal data within the Privacy Shield framework**

> 1 **Regulation (EU) 2016/679**.
> 2 See notably PART TWO, Title VII, Chapter two, " *Data flows and personal data protection*", p. 135.

Brexit: Personal data transfers under and after the transition period

Tax

The draft Budget Law for the year 2021 is released!

On 14 October 2020, Luxembourg's Minister of Finance, Pierre Gramegna, tabled before the Parliament the draft budget law for the year 2021 (the "**Draft Budget Law**").

The Draft Budget Law proposes amendments which, according to the Government, aim at restoring tax justice at the level of Luxembourg tax residents. In this context, it is noteworthy that some of the most salient tax measures included therein would affect certain Luxembourg investment funds holding real estates in Luxembourg and the current stock-option regime.

Please find below the key suggested tax measures:

- **Introduction of a 20% withholding tax on income derived by Luxembourg investment funds from real estate located in Luxembourg**

The Draft Budget Law proposes to introduce a 20% withholding tax levied on income (e.g. rental income, capital gains) deriving from real estate located in Luxembourg ("**Luxembourg Real Estate**") held by Luxembourg Investment Funds directly or through transparent entities or common funds (*fonds commun de placement*).

"Luxembourg Investment Funds" include entities with a legal personality (but excluding the limited partnership - *société en commandite simple*) subject to:

  - the Law of 17 December 2010 relating to undertakings for collective investments (the so-called "Part II Funds");
  - the Law of 13 February 2007 relating to specialised investment funds (SIFs); and
  - the Law of 23 July 2016 relating to reserved alternative investment funds (RAIFs).

Where the Luxembourg Investment Fund derives income from the Luxembourg Real Estate held through one or more transparent entities or common funds, the 20% withholding tax would be levied on the portion of the income pro rata to the Luxembourg Investment Fund's interest/units in the tax transparent entities or common funds.

The Luxembourg Investment Fund must file a return with the Luxembourg tax authorities ("**LTA**") regarding the 20% withholding tax before 31 May of the year following the year in which the real estate income is received or realized and the relevant tax amount must be paid by 10 June.

All Luxembourg Investment Funds (regardless of whether they derive real estate income during the calendar years 2020 and 2021) must inform the LTA before 31 May 2022 if they hold or do not hold Luxembourg Real Estate during the calendar years 2020 and 2021.

Finally, Luxembourg Investment Funds changing their legal form in the course of 2020 or 2021 to become a transparent entity or a common fund and holding directly or indirectly at the time of the change Luxembourg Real Estate, must also inform the LTA.

- **Explicit prohibition, as of 1 January 2021, for private wealth management companies (*société de gestion de patrimoine familial*, "SPFs") to hold real estate through tax transparent companies.**

The Law of 11 May 2007 on SPFs would be amended so as to clearly state therein that SPFs are prohibited from holding real estates through:

  - one or more, Luxembourg or non-Luxembourg, tax transparent companies, such as non-commercial real estate companies *(sociétés civiles immobilières)*. The Law of 11 May 2007 on SPFs remains however unchanged, however, on the possibility for a SPF to hold real estate through tax opaque companies; or

  - one or more common funds *(fonds communs de placement)* and other foreign entities subject to a comparable legal and tax regime.

- **Increased of the registration duties due upon a contribution of a real estate in exchange for shares**

One of the main differences between asset deals compared to share deals is the relatively high Luxembourg registration duty applicable on the transfer of a Luxembourg Real Estate.

Indeed, transfer of Luxembourg Real estates against cash are subject to a proportional registration duty of 7% (including 5 % registration fees increased by 2/10^{ths} plus 1% transcription tax). By contrast, contributions of a Luxembourg real Estate to a company upon incorporation (or at a later stage by capital increase) remunerated by shares are subject to a proportional registration duty of 1,1% (including 0,5 % registration fees increased by 2/10^{ths} plus a 0.5% transcription tax). In case of a later sale of shares of a fully taxable company no further registration tax will apply.

The Draft Budget Law now proposes that the contribution of a Luxembourg Real Estate to a corporate entity remunerated by shares will be subject to a proportional registration duty of 3.4% (including 2 % registration fees, increased by 2/10^{ths} plus a 1% transcription tax).[1] The aim is to achieve a more coherent taxation of share deals versus asset deals.

- **Abolition of the current stock option regime**

According to the Budget Law, the current tax regime of stock options plans governed by circular letter L.I.R. 104/2 issued by the LTA on 29 November 2017 would be abolished on 1 January 2021.

However, in order to keep Luxembourg attractive for talents, a new participative premium regime (*prime participative*) would be introduced and the current inpatriate regime would be amended.

- Introduction of a new participative premium regime

In parallel to the abolition of the Stock Options Circular, new measures would be introduced allowing employees to participate in the profits of their company in a tax-attractive manner, i.e. so-called participative premium regime.

Article 95 of the Luxembourg income tax law (the "LITL") would be modified to ensure that the participative premium will qualify as a salaried income for the employee for Luxembourg tax purposes. If the conditions set out below are met, the participative premium will benefit from a 50% tax exemption at the level of the employee. Concurrently, this participative premium will be tax deductible at the level of the employer as operating expenses (as provided under the proposed amendment of Article 46 of the LITL).

The conditions under which the participative premium may be granted would be laid down in a new paragraph 13a to be inserted in Article 115 of the LITL and contain conditions to be fulfilled by both the employer and the employee:

a) Conditions to be fulfilled by the employer:

(i) the employer must realise income that qualifies either as commercial profit, agricultural profit or profit deriving from an independent activity;

(ii) the employer must hold [regular accounts] (*comptabilité régulière*) during the fiscal year in which the participative premium is granted as well as during the previous fiscal year;

(iii) the amount of the participative premium allocated to the employees is limited to 5% of the profit of the financial year immediately preceding the year in which the premium is granted; and

(IV) the employer shall provide the competent withholding tax office (*bureau d'imposition RTS*), with a nominative list of all employees benefiting from the participative premium during the fiscal year. This communication is to be made in the form prescribed by the withholding tax office and at the time the participative premium is settled (*au moment de la mise à disposition*). In addition, it shall include all elements necessary in order to assess that the conditions relating to the

exemption are met.

b) Conditions to be fulfilled by the employee:

(i) the beneficiary of the participative premium must be an employee (i.e. he/she must receive an income deriving from a contract of employment);

(ii) the participative premium may not exceed 25% of the employee's ordinary annual remuneration of the fiscal year during which the participative premium is allocated. For the determination of this 25% threshold, the employer must take into consideration the deemed gross annual salary (*salaire brut annuel présumé*) to be received by the employee during that year. Advantages in kind and other gratifications, however, will not be taken into account. The 25% threshold is to be calculated exclusive of the participative premium; and

(iii) the employee must be personally affiliated to the Luxembourg social security system or to a foreign social security system covered by a bilateral or multilateral instrument.

- Regime for inpatriates

The regime currently applicable for foreign workers in Luxembourg ("inpatriates") is regulated through an administrative circular, *Circulaire du directeur des contributions* L.I.R. – n° 95/2 dated 27 January 2014 ("Circular n° 95/2"). The Draft Budget Law foresees a legal basis for this regime by supplementing Article 115 of the LITL.

The Draft Budget Law introduces an inpatriation allowance, for an amount not exceeding 30% of the annual remuneration of the inpatriate that would be exempt from taxation. This inpatriation allowance corresponds to an additional flat-rate premium paid by the employer to the inpatriate to compensate for the differential in the cost of living. In addition, expenses and costs related to hiring inpatriates incurred by the employer would also tax be exempt. Further details on those expenses may be provided in a Grand-Ducal Regulation.

While the majority of the conditions required for the application of such a fiscal regime for inpatriate remains unchanged in the Draft Budget Law, some features of the Circular No. 95/2 would be adjusted, such as the annual remuneration of the inpatriate which would be increased from EUR 50,000 to EUR 100,000. Furthermore, the inpatriate would benefit from the amended tax regime for up to 8 years instead of the 5 years provided in the Circular No 95/2.

- Amendments to the Luxembourg Fiscal unity regime prior to 2015

On 14 May 2020 (C-749/18), the European Court of Justice ruled that Luxembourg's former tax unity regime was contrary to EU freedom of establishment.

The Draft Budget Law intends to implement, for fiscal years 2020, 2021 and 2022, the possibility to dissolve an existing Luxembourg fiscal unity composed of a Luxembourg resident integrating parent company holding one or more Luxembourg resident integrated subsidiaries and to create a new fiscal unity that incudes, in addition, Luxembourg resident sister companies of the Luxembourg resident integrating parent company, without any negative retroactive taxation for the existing members that would otherwise result from the dissolution of the fiscal unity.

The change of fiscal unity is subject to the following cumulative conditions:

- the integrating parent company of the dissolved fiscal unity becomes the integrating subsidiary of the new fiscal unity;
- the change of unity for 2020, 2021 or 2022 must be jointly requested by all the concerned companies on 31 December of the relevant fiscal year, at latest;
- the amount of entities part of the new fiscal unity must be effectively larger compared to the dissolved fiscal unity;
- the new members must remain in the fiscal unity for a period of at least 5 years, whereas the computation of the 5-year period at the level of the former members remains unchanged.

The change of fiscal unity will not have an impact on:

- the choice made, if at all, to apply the interest limitation rule at the level of the fiscal unity rather than individually to each member of the fiscal unity; and
- tax losses incurred prior to or during the dissolved fiscal unity, which will continue to be carried forward insofar as they would have been carried forward at the level of the relevant member had the change of fiscal unity not been made.

The existing Luxembourg tax unity regime had already been amended in 2015 to implement the horizontal tax unity following a prior ruling of the ECJ. Please refer to our previous **newsflash** for more information.

- **Modification of the Law of 17 December 2010 relating to undertakings for collective investments (the "UCI Law") in order to encourage investment in sustainable economic activities**

The European Commission has adopted various measures in the field of sustainable finance aiming at taking due account of environmental, social and governance (ESG) considerations. Luxembourg is willing to maintain and reinforce its position as pioneer in this sector.

Against this background, a new paragraph 3 would be inserted in Article 174 of UCI Law in order to encourage Luxembourg undertakings for collective investments ("**UCIs**") to invest in sustainable economic activities.

According to this new paragraph 3, UCIs, or individual compartments thereof, may benefit from reduced subscription tax rates depending on the value of their net assets invested in economic activities that qualify as environmentally sustainable within the meaning of Article 3 of EU Regulation 2020/852 of 18 June 2020 (the "**Qualifying Activities**").

The reduced subscription tax rates would be of:

- 0.04% if at least 5% of the total net assets of the UCI, or of the individual compartment, are invested in Qualifying Activities;
- 0.03% if at least 20% of the total net assets of the UCI, or of the individual compartment, are invested in Qualifying Activities;
- 0.02% if at least 35% of the total net assets of the UCI, or of individual compartment, are invested in Qualifying Activities; and
- 0.01% if at least 50% of the total net assets of the UCI, or of individual compartment, are invested in Qualifying Activities.

The subscription tax rates mentioned above would only apply to the net assets invested in Qualifying Activities.

For UCIs, or compartments thereof, willing to benefit from such reduced rates, the part of net assets invested in Qualifying Activities on the last day of the UCI's financial year shall be controlled by an approved statutory auditor (*révsieur d'entreprises agréé*) or, as the case may be, certified by the auditor in the framework of a reasonable assurance audit (*mission d'asssurance raisonnable*). This part and the percentage corresponding to net assets invested in Qualifying Activities against the total net assets of the UCI, or its individual compartment, must be included in the annual report or in an assurance report.

A statement certified by the approved statutory auditor (*attestation certifiée*), containing the percentage of the net assets invested in Qualifying Activities as determined in the annual report or the assurance report, must be filed with the Luxembourg indirect tax authorities ("**LITA**") with the first subscription tax return following the annual report or the assurance report. This percentage will be used as a basis to determine the tax rate to the part of the net assets invested in Qualifying Activities for the 4 quarters following the filing of the statement.

During a transition period ending on 1 January 2022, entities willing to benefit from the reduced subscription tax rates must electronically file their quarterly return at the rate of 0.05% together with a corrective statement (*déclaration rectificative*) based on a form made available by the LITA.

- **Increase of the small businesses' VAT threshold**

In order to allow a greater number of taxable persons to benefit from administrative simplification represented by the VAT exemption regime referred to in Article 57 of the amended Law of 12 February 1979 concerning value added tax ("VAT Law"), it is proposed to raise the threshold of EUR 30,000 currently provided for in the said article to EUR 35,000.

It must be noted that taxable persons whose annual turnover is EUR 35,000 or less were already exempt from VAT as of 1 January 2020 based on an authorisation granted to Luxembourg by the Council of the European Union via Decision No 2019/2210. The EU Council's decision was directly applicable but not yet enshrined in the VAT Law.

1 a city surtax of 50% of the registration fees must be added if the building is located in Luxembourg City.