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Asset management and investment funds

Relocations from the UK: ESMA's Opinion on supervisory convergence

On 31 May 2017, ESMA published an **Opinion** with nine general principles to be followed by national authorities in the context of the authorisation and supervision of regulated entities ("**Opinion**"), especially in the case where part of the management functions are delegated or outsourced to a third country entity.

These principles have been adopted in the context of Brexit[1] and the relocation of entities, activities and functions in the EU following the UK's decision to withdraw from the EU. The objective is to ensure a consistent and harmonised approach by the supervisory authorities of the 27 EU Member States which will remain in the EU ("**National Competent Authorities**" or "**NCAs**").

The Opinion covers, amongst other things, the AIFMD, the UCITS Directive, MiFID I and MiFID II.

Most of the principles are already followed and applied by NCAs; however, in this Opinion, ESMA clarifies them and sets the limits of delegation/outsourcing.

Emphasis is placed on various points, such as the conditions to be fulfilled by an entity in order to be authorised by an NCA, the (objective) reason for relocation, the avoidance of a letter-box entity, the substance requirements (and key functions which should remain in the EU), the corporate governance, the ability to direct and control outsourced or delegated functions, …

In the future, ESMA intends to establish a forum – the Supervisory Coordination Network – to allow NCAs to report on and discuss issues in relation to the relocation of UK market participants and to promote consistent decisions by NCAs. Further measures to support supervisory convergence could be taken by ESMA, including issuing Q&As, providing additional opinions to NCAs, and conducting peer reviews.

ESMA also published on 13 July 2017 three sector-specific opinions:

- an **Opinion for the asset management sector** (for more insight on this Opinion, see our Article "**Relocations from the UK: ESMA's Opinion on asset management**");
- an **Opinion for investment firms**; and
- an **Opinion for secondary markets**.

1. For more insight on Brexit, see our articles on this topic in the EU law Section.

Relocations from the UK: ESMA's Opinion on asset management

On 13 July 2017, ESMA published its Opinion for the asset management sector in the context of Brexit[1] ("**Asset Management Opinion**"). This Opinion follows the publication in May 2017 of a more general

Opinion on the supervisory approach to relocations from the UK[2].

The Asset Management Opinion covers various aspects (authorisation, governance and internal control, delegation, supervision) in relation to the following entities ("**Targeted Entities**"):

- authorised UCITS management companies;
- self-managed investment companies; and
- authorised AIFMs.

As far as Luxembourg is concerned, it is our view that the current regulatory practice of the financial supervisory authority ("**CSSF**") as regards authorisation of the Targeted Entities is already in line with the fundamental principles set forth in the ESMA opinions.

This being said, the Asset Management Opinion comprises a number of points which are not in line with the level 1 and level 2 provisions of the UCITS and AIFM Directives and therefore, in our opinion, lack legal basis. The main examples in that respect are the following:

- ESMA takes the view that in the context of the management of UCITS, a management company may not delegate portfolio management and risk management at the same time. Where this is in line with the level 2 provisions of the AIFM Directive and therefore applies in relation to AIFs, it clearly lacks legal basis in relation to UCITS.
- The Asset Management Opinion seems to impose additional requirements when functions are delegated to entities established in third countries compared to delegation of functions to entities based in EU Member States. These additional requirements (other than requiring that the relevant entity must be subject to supervision and that there must be cooperation between supervisory authorities) lack legal basis.
- More generally, raising the requirements in relation to management companies delegating to or otherwise interacting with entities located in third countries generally, on the sole background of potential relocations of UK firms to an EU 27 country, is clearly inappropriate.

We will publish a more detailed newsflash in relation to this topic in due course.

> **1.** For more insight on Brexit, see our articles on this topic in the EU law Section.
> **2.** For more insight on the ESMA Opinion published in May 2017, see our article **"Relocations from the UK: ESMA's Opinion on supervisory convergence"**.

PRIIPS: ESAs' Q&A and EU Commission's Guidelines

On 4 July 2017, two long-awaited PRIIPs[1] documents were published by the EU authorities:

- The first is a Communication from the EU Commission which includes **Guidelines** on the level 1 PRIIPs Regulation (**(EU) 2014/1286**). The objective of these Guidelines is to facilitate the implementation of, and the compliance with, PRIIPs Regulation by clarifying the interpretation of a few level 1 requirements (including scope, multi-option PRIIPs and territorial scope).

- The second is a **Q&A** published by the ESAs (European Supervisory Authorities: EBA, EIOPA and ESMA) in relation to the PRIIPs Delegated Regulation (**(EU) 2017/653**). The Q&A aims at promoting common supervisory approaches and practices in the implementation of the key information document (KID). It relates to the technical methodologies on risk, performance scenarios, and cost disclosure requirements. It also addresses specific issues in relation to e.g. derivatives or multi-options PRIIPs.

> 1. "**PRIIPs**" refers to packaged retail and insurance-based investment products.

PRIIPS: Impact on Luxembourg funds

The CSSF has also recently taken position on a few issues in relation to the impact of PRIIPs Regulation on:

- Luxembourg AIFs (**CSSF FAQ on AIFM**);
- Luxembourg UCIs (**CSSF FAQ on UCIs**);
- SIFs and SICARs (**CSSF FAQ on SIFs and SICARs**).

These FAQs address various issues amongst which the availability of the exemption from producing a PRIIPs KID for Luxembourg retail investment funds (other than UCITS funds) which have issued a UCITS KIID as well as the notification process of a PRIIPs KID to the CSSF.

Money Market Funds Regulation: Publication OJEU

On 30 June 2017, the Money Market Funds Regulation (EU) **2017/1131** was published in the Official journal of the EU.
It will be directly applicable in the Member States from 21 July 2018.

More information on this Regulation is available in our **Newsletter May 2017**.

UCITS share classes and independence management company/depositary

The CSSF has recently clarified, in its **FAQ on undertakings for collective investment** (UCIs):

(i) The impact of the **ESMA Opinion on UCITS share classes** on Luxembourg UCITS share classes.

The newly added questions and answers include information on the CSSF's position on the transitional provisions included in the ESMA Opinion and the high-level principles adopted by ESMA, i.e. common investment objective, non-contagion, pre-determination, and transparency.

(ii) The application of the rules provided in the UCITS V Delegated Regulation (**Regulation (EU)**

2016/438) to ensure the independence of the UCITS management company from the UCITS depositary. On 11 July 2017, ESMA also updated its Q&A on the application of the UCITS Directive, amongst other, on the same subject by adding a new Section VIII-"Independence of management boards and supervisory functions".

AIFMD ESMA Q&A: Update July 2017

On 11 July 2017, ESMA included three new questions in its **Q&A on the application of the AIFMD**. These questions clarify the reporting requirements for:

- loans purchased on the secondary market;
- conversion of the total value of assets under management; and
- currency of the net asset value.

Banking and financial services

EBA Guidelines on Remuneration policies: CSSF position

On 16 June 2017, the supervisory authority ("CSSF") adopted **CSSF Circular 17/658** ("Circular") in relation to the adoption of the **EBA Guidelines on sound remuneration policies** (EBA/GL/2015/22), which the CSSF intends to follow. The Circular repeals the existing CSSF Circular 10/496 and specifies that CSSF Circulars 10/497 and 11/505 will be amended shortly.

The main amendments introduced by the EBA Guidelines are described in the Circular and the following points are worth mentioning:

- It has been clarified that non-CRR[1] subsidiaries within a CRR group, included in the scope of prudential consolidation of a consolidating institution in a Member State, should (i) have remuneration policies in line with the group-wide remuneration policy for all staff, as well as (ii) comply with the requirements set out in Articles 92(2), 93 and 94 of CRD IV[2] (including the bonus cap), corresponding to Articles 38-5, 38-6 and 38-7 of the Law of 5 April 1993 on the financial sector, at least for the identified staff whose professional activities have a significant impact on the group's risk profile. This approach will therefore have an impact on staff of management companies/AIFMs which are part of a CRR group and whose professional activities have a significant impact on the group's risk profile.
- According to the EBA's interpretation of the application of the principle of proportionality in respect of remuneration policies, the wording of Article 92 (2) of CRD IV would no longer permit the neutralisation of requirements in terms of remuneration policy. Nevertheless, the CSSF maintains the application of CSSF Circular 11/505, so that all the requirements that could be neutralised until now may continue to be neutralised until the application of new European rules in the area.

The CSSF further mentioned that it envisages publishing an FAQ in relation to the EBA Guidelines during the course of this year.

> 1. "**CRR**" refers to **Regulation (EU) 575/2013** of 26 June 2013 on prudential requirements for credit institutions and investment firms.
> 2. "**CRD IV**" refers to **Directive 2013/36/EU** of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

Corporate, mergers & acquisitions

EU Regulation on insolvency proceedings

EU Regulation 2015/848 of 20 May 2015 on insolvency proceeds ("**New Regulation**"), recasting the former Regulation (EC) 1346/2000 of 29 May 2000 ("**Former Regulation**"), came into force on 26 June 2017[1] . The New Regulation will apply to any insolvency proceedings opened as from 26 June 2017.

The main changes are:

- COMI: the New Regulation codifies the concept of "centre of main interests" ("**COMI**") and establishes a rebuttable presumption that COMI corresponds to the registered office of the company. Such a presumption will not, apply, however, if there has been a move of the registered office during the three-month period prior to the opening of proceedings.
- Opening of secondary insolvency proceedings: It will now be possible to open secondary proceedings in another EU Member State not only if the debtor has an establishment in that EU Member State at the time of the opening of main insolvency proceedings, but also if the debtor had an establishment in that EU Member State in the three-month period prior to the request to open main insolvency proceedings.
  The New Regulation introduces the possibility for the courts to refuse to open secondary insolvency proceedings (i) if the insolvency practitioner in the main insolvency proceedings gives a unilateral undertaking in respect of the assets located in the Member State, in which secondary insolvency proceedings could be opened, that when distributing those assets and proceeds received as a result of their realisation, it will comply with the distribution and priority rights under national law that creditors would have if secondary insolvency proceedings were opened in that Member State and (ii) if such an undertaking has received the consent of a majority of creditors. Such secondary proceedings shall also be postponed in case a temporary stay of individual proceedings has been given in the main proceedings in order to preserve the effectiveness of the later proceedings and that appropriate measures are put in place to protect the interests of local creditors.
- Group of companies: In case insolvency proceedings are opened in relation to several companies of a same group, the courts and the office-holders appointed will have to cooperate and communicate with each other.
- Register: The New Regulation will establish by June 2018 "national insolvency registers". These

registers will be created by every Member State. By June 2019, these registers will be publicly accessible via the European e-justice portal facilitating the coordination of cross-border insolvency proceedings, avoiding parallel procedures and informing the courts as well as the creditors.

1. Articles 24 and 25 of the New Regulation concerning the establishment of national insolvency registers and the interconnection of these national registers shall apply from 26 June 2018 and 26 June 2019, respectively.

Dispute resolution

Enforcement of an arbitral award cancelled in its country of origin

Until recently, the Luxembourg courts have adopted a transnational concept of arbitration: in view of its private nature, they deemed that there was no reason to consider that the jurisdictions of the country in which the arbitration was seated had more authority over the awards handed down there than in other countries, in particular those in which the enforcement of such awards was pursued.

They therefore refused to take into consideration decisions to cancel foreign awards handed down in the country of origin of such awards and granted them exequatur in Luxembourg despite the cancellation to which they had been subject in their country of origin.

In a judgment of 27 April 2017, the Court of Appeal confirmed a movement that it had initiated in 2015 and refused to grant exequatur to an arbitral award handed down in Mexico which had in the meantime been set aside by the Mexican national courts.

It considered the State of the arbitration seat as determinant and underlined that the New York Convention of 10 June 1958 on the Recognition and Enforcement of Foreign Arbitral Awards, applicable both in Luxembourg and in Mexico, *fix the arbitral award in the country in which, or under the law of which, it was handed down* because it *acknowledges that a competent authority of that country has the power to set aside or suspend the award*.

The Court of Appeal further specified that in Luxembourg law, *the existence of a foreign award effective in its country of origin constitutes a condition for the declaration of enforceability of the decision*, it being understood that an award set aside in its country of origin is no longer effective.

The Court was able to conclude that the exequatur of an award set aside in its country of origin must be refused in Luxembourg, which is aligned with the solution virtually unanimously adopted throughout the world.

Law on EU account preservation order

The **Law of 17 May 2017** on the implementation of Regulation (EU) 655/2014 of 15 May 2014 establishing a European Account Preservation Order procedure entered into force on 27 May 2017.

Although the Regulation is directly applicable in Member States, with the exception of the United Kingdom and Denmark, from 18 January 2017 it has been necessary to adapt national procedural law in order to ensure its application in Luxembourg.

In particular, regarding the obtaining of account information provided for in Article 14 of the Regulation, Luxembourg has opted for the obligation on all banks in its territory to disclose, upon request by the competent authority, whether the debtor holds an account with them.

The banking authority (*Commission de Surveillance du Secteur Financier*) is designated as the authority responsible for obtaining and transmitting account information at the request of a court of a Member State.

EU law, competition and antitrust

Brexit: State of play

On 29 March 2017, the United Kingdom ("**UK**") formally notified the European Council of its intention to leave the European Union ("**EU**") in accordance with Article 50 of the Treaty on European Union ("**TEU**") following the results of the UK referendum held on 23 June 2016.

This notification is a necessary first step triggering the negotiation procedure described in Article 50 TEU. It follows from Article 50 TEU that the UK withdrawal will take effect, and EU Treaties will cease to apply to the UK, at the latest two years after this notification, unless this period is extended by unanimous decision of the 27 remaining Member States and the UK.

At a European Council summit on 29 April, the 27 remaining Member States adopted **Guidelines**, which define a two-phased approach for the Brexit negotiations and set out the overall EU positions and principles. During a first negotiation phase, arrangements for an orderly withdrawal will be agreed on. They cover technical issues, such as post-withdrawal rights of EU and UK citizens living in the UK and the EU respectively, a financial settlement, the future situation in Ireland, the status of the EU and the UK's joint international commitments in international organisations and conventions, the location of the seats of EU agencies and facilities currently located in the UK, and the sort of pending administrative and judicial procedures before EU bodies upon the date of withdrawal. According to the Guidelines, an overall understanding on the framework for the future relationship between the EU and the UK should be identified during a second phase of the negotiations as soon as the European Council decides that sufficient progress has been made in the first phase.

In essence, this second phase should cover the start of the negotiations on a comprehensive free trade agreement, covering all aspects of the future economic relationship between the UK and the EU 27-bloc, including the provision of services. To the extent necessary, the negotiations may also seek to determine transitional arrangements on the continued application of the EU regulatory framework to the UK during an interim period.

On 22 May 2017, the Council of the European Union, meeting in EU27 format, adopted a **Decision** authorising the opening of Brexit negotiations with the UK and nominating the European Commission as the EU negotiator. It also adopted **negotiating Directives**, which reflect the two-phased approach set out by the European Council and which are a mandate for the Commission for the first phase of the

negotiations.

On 19 June 2017, Michel Barnier, the EU Chief Negotiator, and David Davis, UK Secretary of State for Exiting the European Union, launched the first round of Brexit negotiations in Brussels.

Brexit: ECJ Opinion on EU external trade competence

On 16 May 2017, the Court of Justice of the European Union ("**CJEU**"), in a rare full court composition, delivered its **Opinion** in Case 2/15 on the extent of the Union's exclusive competence to negotiate free trade agreements.

The case relates to the proposed EU/Singapore free trade agreement, one of the first "new generation" bilateral free trade agreements containing, in addition to classical provisions on the reduction of customs duties and of non-tariff barriers in the field of trade in goods and services, provisions on various matters related to trade, such as intellectual property protection, investment, public procurement, competition and sustainable development. In accordance with a procedure set out in Article 218(11) of the Treaty on European Union ("**TFEU**"), the Commission submitted a request to the CJEU for an opinion to determine whether the EU has exclusive competence enabling it to sign and conclude the envisaged agreement by itself and pursuant to a qualified majority vote in the Council (Article 207(4) TFEU), excluding Member States' veto power.

The analysis of the CJEU is significant for the procedure applicable to the free trade agreement that the UK is hoping to negotiate with the EU in the Brexit context.

On the basis of a detailed analysis of the scope of the EU exclusive competence in the area of the common commercial policy (Article 3(1)(e) TFEU), the CJEU asserts that the EU cannot conclude the agreement with Singapore by itself because certain parts of the agreement fall within a competence shared between the EU and the Member States. However, it ruled that the extent of the EU's exclusive competence is broader than was advised in **Advocate General Sharpston's Opinion** of 21 December 2016, in which several areas were identified for which the EU did not have exclusive competence.

According to the CJEU, the only areas in the EU/Singapore free trade agreement falling within shared competence with Member States are the fields of non-direct foreign trade investment (portfolio investments made without any intention to influence the management and control of an undertaking) as well as the regime governing dispute settlement between investors and Member States.

Any future free trade agreement entered into by the EU covering these areas of shared competence will have to be ratified by Member States (including by regional parliaments where relevant). This will also be the case for a future free trade agreement between the EU and the UK, expected to be even broader than the EU/Singapore trade agreement, which may cause further delays in the establishment of that future relationship. However, given the small number of areas that the CJEU has excluded from exclusive EU competence, such an agreement may be able to enter into force on the basis of provisional application even without ratification by all Member States since such ratification would only be required to give effect to areas of shared competence, to the extent that they form part of such a future agreement.

Brexit: Regulatory convergence in financial services

Upon withdrawal from the EU, the United Kingdom ("**UK**") will become a third country under EU internal market regulation. UK financial sector firms will lose passporting rights granted by EU internal market

directives allowing for the free provision of financial services throughout the Member States of the EU on a cross-border basis or by creating an establishment.

UK market participants are weighing up their options to maintain access to EU financial markets and may seek to relocate entities, activities or functions to the remaining 27 Member States. In this context, they may want to minimise the transfer of effective performance of functions of activities from the UK by relying on the outsourcing or delegation of certain activities or functions to UK-based entities.

In an **Opinion** published on 31 May 2017, addressed to the national competent authorities ("**NCAs**") of the remaining 27 Member States, the European Securities and Markets Authority ("**ESMA**"), with a view to minimising supervisory arbitrage risks when entities, activities and functions are relocated following the UK's decision to withdraw, sets out nine principles to foster consistency in relation to their authorisation, supervision and enforcement. In three sector-specific **opinions** with respect to investment firms, investment management and secondary markets, published on 13 July 2017, ESMA provides further guidance to NCAs within the specific context of relocations from the UK to the remaining 27 Member States. More details on these documents can be found in the Asset management and investment funds section of **our Newsletter**.

Further, on 11 July 2017 the European Insurance and Occupational Pensions Authority ("**EIOPA**") issued similar **principles** to foster supervisory convergence and to ensure consistency in the authorisation process related to the relocation of (re)insurance undertakings governed by the Solvency II framework from the UK to the remaining 27 Member States. The principles concern the following subjects: authorisations and approvals, governance and risk management, outsourcing of critical and important activities, on-going supervision and monitoring by the EIOPA.

Finally, on 14 July 2017, the European Banking Authority ("**EBA**") published final draft regulatory technical standards ("**RTS**") on the information credit institutions need to provide to competent authorities in the Member States when applying for authorisation, as well as final draft implementing technical standards ("**ITS**") containing the templates to be used for such submissions. The EBA explains that the RTS aim at promoting a prudent common approach for the licensing of banking activities in the EU and support a level playing field by harmonising the information required to ensure compliance with the Capital Requirements Directive ("**CRD**"), notably regarding the programme of operations and structural organisation, initial capital, effective direction and the place of business of applicants. The EBA encourages the European Commission to adopt the RTS and ITS as soon as possible to support the rigorous review of applications by banks seeking to relocate in the context of Brexit.

Confirmation of annulment of EPT fine for abuse of dominance

In a **judgment** of 1 June 2017, the Administrative Court confirmed the **annulment** by the Administrative Tribunal of **Decision 2014-FO-07** of the Competition Council ("**Council**"). In that decision, the Council had imposed a fine of 2.52 million euros on "Entreprise des Postes et Télécommunications" ("**EPT**"), known as "POST Luxembourg", for abuse of its dominant position in fixed telephony and internet access services through the use of bundled discounts for fixed telephony, internet access and mobile telephony services in 2006 and 2007. This decision, adopted in November 2014, closed an examination procedure triggered by a competitor complaint in 2006.

Upon appeal, the Administrative Tribunal quashed Decision 2014-FO-07. It held that the contested decision was in manifest breach of the reasonable time requirement considering, in particular, the fact that the statement of objections was issued only in January 2014. Further, it considered that EPT's right of access to the file was violated, notably because no access was granted to certain statistics in support of the Council's market definition analysis. It also found one information request addressed to EPT to

have presented material flaws implying its nullity. On substance, the Administrative Tribunal considered that the Council's market definition analysis was subject to criticism and that it applied a method of analysis of the contested rebate scheme which did not respect the European Commission's guidance in this area. The Administrative Tribunal concluded that, independently of the question of the consequences to be attached to these flaws individually, taken together, they were cause for annulment. It also concluded that a renewed analysis of the merits of the case would violate the reasonable time requirement and the principle of legal certainty.

In its appeal before the Administrative Court, the Luxembourg State contested these findings and argued that the Administrative Tribunal erred in law since it limited itself to considering that, taken together, the alleged flaws of Decision 2014-FO-07 justified its annulment.

In its judgment of 1 June, the Administrative Court confirmed with vigour the violation of the reasonable time requirement. As to the main plea, it considered that, in view also of the evolving and complex nature of competition law matters, a balancing analysis can be made on the basis of which the cumulative effect of different flaws can lead to the annulment of an administrative decision even if each of them taken individually would not have had such effect. It further found that the Administrative Tribunal rightly criticised the extent of access to the file that had been granted to EPT and the effects of certain formal defects of an information request. It also confirmed the flaws with respect to the methodology applied by the Council to analyse the alleged anti-competitive behaviour.

The judgment confirms the need for due process considerations, notably as far as the length of administrative proceedings is concerned as well as with regard to the respect of procedural guarantees, such as access by the defendant to all key documents. It is a victory for EPT whereas the fact that both courts declined to review the merits of the case leaves the complainant and possibly affected consumers empty-handed if seeking compensation for damages of the alleged anti-competitive behaviour. Finally, since there is no further appeal, the principle of the balancing analysis, retained without any precedent being cited, cannot be challenged on its legal merits, at least not within the context of this particular case.

Rejection of competition law complaint against Amazon

By its **Decision 2017-C-02** of 21 June 2017, the Competition Council ("**Council**") rejected a complaint filed against Amazon Services Europe S.à r.l. ("**Amazon**") in June 2016 for an alleged abuse of a dominant position in online distribution services.

The complainant, who sold products through Amazon's internet platform pursuant to an agreement entered into in 2007, alleged that Amazon's unilateral decision to put an end to the contractual relationship without prior notice constituted an abuse of the latter's dominant position on the market for services rendered by online distribution platforms.

The Council established the relevant market, from a product point of view, to be the upstream market for platform services to third party vendors wishing to sell their products through internet sites such as Amazon's, the downstream retail market for sales of products through such a platform not being directly affected by the contested practice. The definition of the relevant market from a geographical perspective and the question whether Amazon held a dominant position on the relevant market were left open since the Council did not find it necessary to come to a definitive finding on these issues.

As to the alleged abuse, the Council considered, in essence, that the unilateral termination of a contractual relationship without objective justification, as such, is not sufficient to establish an abuse of a dominant position consisting in the exclusion of a competitor from the market. In addition, in the case at hand, no evidence was found of any exclusionary intention on Amazon's side. Also, an objective

justification was given for the termination of the agreement, namely the repeated infringement of Amazon's terms and conditions by the complainant. Finally, the Competition Council rejected the argument that Amazon's platform was to be considered as an essential facility since it was not established that it was indispensable for the complainant's business activity given the existence of numerous competing platforms.

Although the circumstances of the case did not warrant an elaborate analysis, the decision offers proof of the increased interest in competitive conditions created by the complex vertical relationships governing online markets and services.

Tax

VAT: Judgement on Luxembourg Independent Group of Persons regime

Under Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax as amended ("**VAT Directive**"), services provided by a taxable person (company or individual) are subject to VAT. However, Article 132(1)(f) provides an exemption, under certain conditions, for services rendered by an independent group of persons ("**IGP**") to its members, which has been literally implemented into Luxembourg VAT Law 1and further specified in the Grand Ducal Regulation of 21 January 2004.

In its **judgment of 4 May 2017**, the Court of Justice of the European Union ("**ECJ**") ruled that Luxembourg's extensive interpretation of the IGP regime had led to an implementation of the exemption that was not in line with the VAT Directive.

Following the arguments of the European Commission which initiated the infringement procedure against Luxembourg, the ECJ held three grounds for complaint:

(1) It follows from the wording of Article 132(1)(f) that the exemption applies to the supply of services by an IGP to its members provided that (i) the services are directly necessary for the exercise of the member's activities and (ii) that these activities are either exempt or concern those members that are not taxable persons.

The current Luxembourg IGP regime extends the benefit of the exemption to members of the IGP who also carry out taxable activities, under the sole condition that their annual turnover free of VAT derived from these taxable activities does not exceed 30% (or 45% in certain cases) of the member's total annual turnover free of VAT related to all their taxable and exempt activities.

The ECJ ruled that the IGP regime does not prevent members of an IGP from exercising taxable activities. However, such members may only benefit from the exemption, "in so far as those services are directly necessary for those members' exempt activities or in relation to which they are not taxable persons". Consequently, the services provided by an IGP to its members that are directly necessary for the latter's taxable activities are subject to VAT.

(2) Luxembourg has wrongly authorised members of an IGP to deduct, from the VAT they are liable to pay on their taxable transactions, the VAT due or paid by the IGP with respect to the goods and services received for the purpose of its own activities.

The ECJ recalled that "the IGP is a taxable person in its own right, which is separate from its members who are also taxable persons". Hence, in light of the general principle of VAT neutrality, members cannot

be entitled to a right of deduction regarding the VAT borne by the IGP on its own input transactions, from their own VAT liability.

(3) Luxembourg IGP regime excludes from the scope of VAT the allocation to the IGP, by one of its members, of expense incurred by that member in his name, but on behalf of the IGP. On the contrary, the ECJ considered such a transaction to be subject to VAT, notably because the IGP and its members are both separate taxable persons for VAT purposes.

> 1. Article 44(1)(y) of the Law of 12 February 1979 on value-added tax.

VAT: ECJ case-law to come on Independent Group of Persons regimes

The independent group of persons ("IGP") EU regime1 has been implemented into national laws in different ways, which has led to an incoherent application of the exemption among the Member States. With that respect, the IGP EU regime will be further clarified in the near future since there are currently three pending cases before the ECJ:

The IGP EU regime has been implemented into national laws in different ways, which has led to an incoherent application of the exemption among the Member States. With that respect, the IGP EU regime will be further clarified in the near future since there are currently three pending cases before the ECJ:

(1) In *DNB Banka AS* (C-326/15), the ECJ will have the opportunity to shape the personal scope of the IGP regime. In essence, the question is whether:

- the IGP has to be a separate legal person distinct from its members to qualify as taxable person for VAT purposes and therefore benefit from the exemption as long as it independently carries out an economic activity;
- the exemption is applicable in case expenses which are incurred by the IGP for the supply of services and reimbursed by its members, include an uplift (*in fine* a percentage of consideration).

(2) By contrast, *Aviva* (C-605/15) concerns the material and territorial scope of the IGP regime and raises the issue as to whether:

- a group of insurance companies can benefit from the IGP regime to the extent that their activities are deemed to be in the public interest;
- the exemption can be extended to services supplied by a cross-border group to its members established in other EU or non-EU countries or is restricted to members which are subject to the same domestic legal system as the IGP itself.

(3) Lastly, the European Commission has initiated an infringement procedure against Germany (C-616/15) which has restricted the scope of the IGP regime solely to the health sector as it considers that:

- the *rationale* behind the exemption is to exclude activities that are not in the public interest; and
- any extension to all sectors of the economy would give rise to distortions of competition.

> 1. "**IGP**" refers to the exemption for services rendered by an independent group of persons to its members provided in Directive 2006/112/EC of 28 November 2006 on the common system of value added tax as amended.

ATAD II

On 29 May 2017, the Council of the European Union adopted **Directive 2017/952/EU** ("**ATAD II**") amending the Anti-Tax Avoidance Directive (**Directive 2016/1164/EU "ATAD I"**). The aim of ATAD II is to put in place a dissuasive regime regarding hybrid mismatches (being for instance the result of differences in the characterisation of financial instruments) with third countries (i.e. non-EU Member States), thus widening the scope of ATAD I.

The geographic expansion comes alongside a broadening of the material scope of ATAD, such as an inclusion of permanent establishment mismatches, hybrid transfers, imported mismatches, reverse hybrid mismatches as well as dual resident mismatches.

The provisions of ATAD II will have to be implemented by Member States by 31 December 2019 at the latest, and be applicable as of 1 January 2020, with the exception of the reverse hybrid entity rule, which will have to be implemented into national law by 31 December 2021 and be applicable as of 1 January 2022.

For further insight on this directive, see the article **Atad II** published on our website.

ECJ challenges the Luxembourg law on exchange of information

On 16 May 2017, the Court of Justice of the European Union ("**ECJ**") delivered its long- awaited judgment in the ***Berlioz case*** regarding the compliance of the Luxembourg Laws of 29 March 2013 implementing the Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation ("**Directive**") and of 25 November 2014 on the procedure applicable to the exchange of information in tax matters, with respect to the Charter of Fundamental Rights of the European Union ("**Charter**").

In an action before the Luxembourg courts, Berlioz Investment Fund S.A. disputed the administrative fine received from the Luxembourg tax authorities following its refusal to provide the names and addresses of the shareholders of its French subsidiary (being audited by the French tax authorities), and the proper basis of the injunction, on the grounds that the requested information was not "foreseeably relevant" for the purpose of the tax investigation. According to the current Luxembourg Law of 25 November 2014, no remedy is granted against the injunction or the request for information and the Luxembourg tax authorities shall only perform a formal review of the request for information from the foreign tax authorities which the Luxembourg tax authorities implement by verifying only the name of the foreign tax authorities and a reference to the legal basis for the exchange (e.g. relevant double tax treaty).

In this context, a preliminary ruling was referred to the ECJ which has responded as follows:

- The ECJ confirmed the applicability of the Charter in the context of a litigation regarding the administrative fine applied to an information holder refusing to provide the information requested by the injunction arising from an exchange of information procedure based on the Directive.
- The ECJ ruled that Art. 47 of the Charter grants an information holder the right to discuss the proper basis of such an injunction.
- The ECJ ruled that the foreseeable relevance of the requested information is a condition of the proper basis of the request for information and, as a result, of the injunction.
- The ECJ concluded that, according to Art. 47 of the Charter guaranteeing the right to an effective remedy and to a fair trial, national courts do not only have jurisdiction to discuss the administrative fine but also jurisdiction to review the proper basis of the injunction in the context of a request for exchange of information.
- The ECJ ruled that (i) the review expected from the national authorities to ensure that the requested information is not devoid of any foreseeable relevance, and that (ii) the review by national courts must be limited to the verification that the requested information manifestly does not have foreseeable relevance, in order not to interfere with the effectiveness of the provisions of the Directive combating tax avoidance and tax evasion, and in particular the procedures for the exchange of information. Such "foreseeable relevance" should be established (or its absence) based on the identity of the taxpayer concerned and the purpose of the relevant tax investigation.
- The ECJ ruled that, a national court must have access to the foreign request for information without allowing the information holder to access to the whole of the request of information to the information holder as regards the confidentiality of the document. The information holder shall only have access to the essential information of the request for information and, if not sufficient, shall be provided with further information by the national court.

Tax treaties news

Italy

On 7 April 2017, the Luxembourg tax authorities published an update stating that the amending protocol and exchange of letters, signed on 21 June 2012, to the double tax treaty between Luxembourg and Italy, entered into force on 20 January 2015 and not on 25 October 2014, as previously reported. The protocol clarifies the taxes covered by the double tax treaty and provides for new exchange of information provisions.

Cyprus

On 8 May 2017, a double tax treaty on income and capital was signed between Luxembourg and Cyprus.

The following withholding tax rates will apply under the treaty:

- Dividends: the treaty provides for a standard withholding tax rate of 5% which can be reduced to 0% if the receiving company directly owns at least 10% of the capital of the company paying the dividends.
- Interest: 0%, the treaty provides for an exclusive taxation in the jurisdiction of residence of the beneficiary of the interest.

- Royalties: 0%, the treaty provides for an exclusive taxation in the jurisdiction of residence of the beneficiary of the royalties.

Luxembourg applies the credit and exemption methods for the avoidance of double taxation.

Negotiations

Based on recent public information, Luxembourg has started negotiations to sign new double tax treaties on income and capital with Kosovo, Ivory Coast, the Democratic Republic of Congo and Cuba.

Luxembourg and Norway have also expressed their intention to negotiate an update to the existing double tax treaty on income and capital of 6 May 1983.

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

The information contained herein is not intended to be a comprehensive study or to provide legal advice and should not be treated as a substitute for specific legal advice concerning particular situations.

We undertake no responsibility to notify any change in law or practice after the date of this newsletter.