BSP Newsletter

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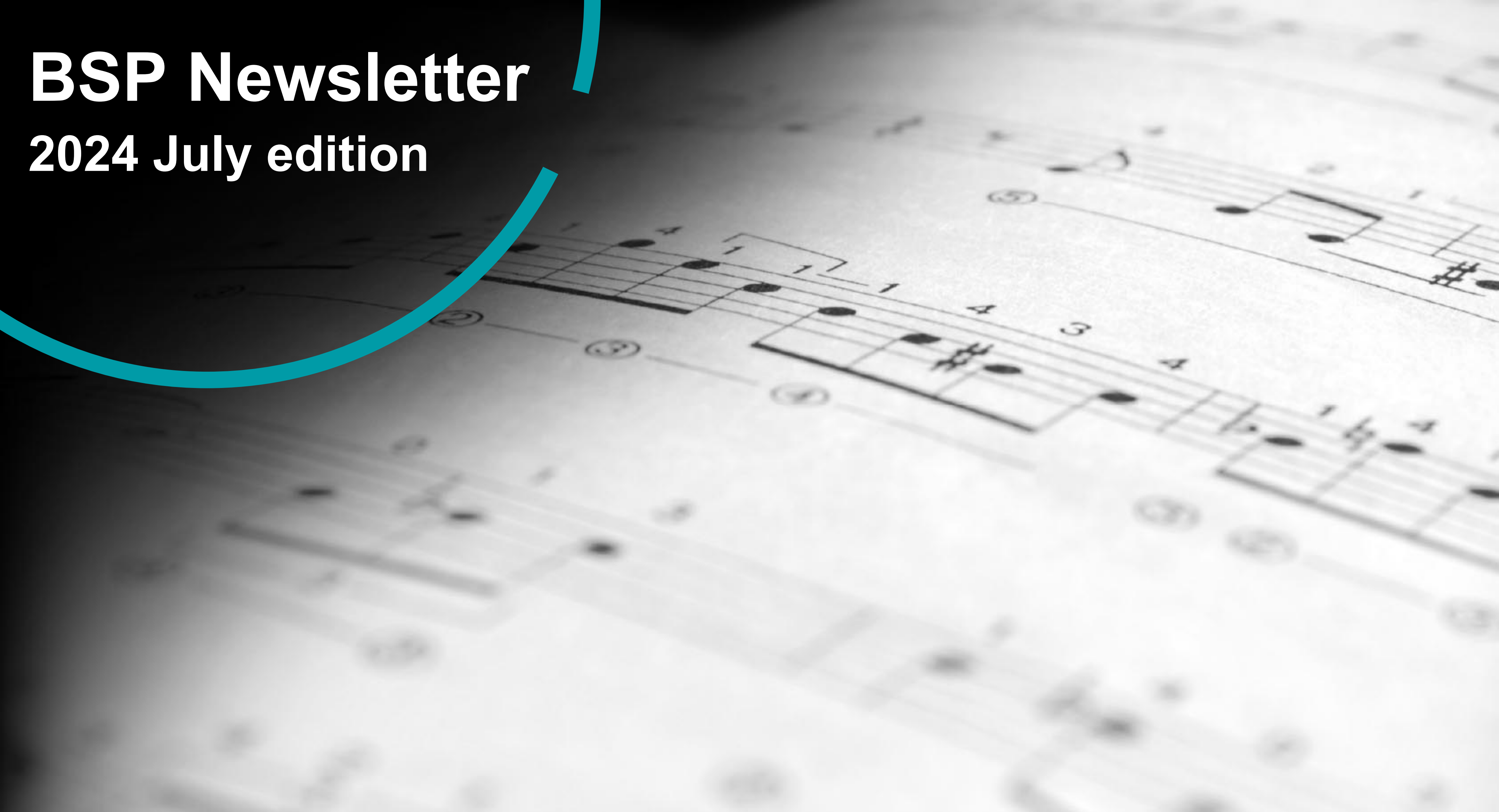

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SUMMARY

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AML/CFT | THE EU COMPREHENSIVE PACKAGE: ESSENTIAL TAKEAWAYS

On 19 June 2024, the European Parliament and Council published the new anti-money laundering and countering the financing of terrorism ("**AML/CFT**") package – **an extensive reformative legislative package** – that consists of **three main legal texts**:

- **Regulation (EU) 2024/1624** of 31 May 2024 aimed at preventing money laundering and terrorist financing ("**ML/TF**"), commonly known as the EU AML Single Rulebook ("**AMLR**"). This regulation will come into effect on 10 July 2027, except for specific new obliged entities, for whom it will apply **from 10 July 2029.**
- **Directive (EU) 2024/1640** of 31 May 2024 concerning mechanisms to prevent financial system abuse for ML/TF ("**AMLD6**"). This directive will be applicable **as of 10 July 2027.**
- **Regulation (EU) 2024/1620** of 31 May 2024 establishing the authority for AML/CFT ("**AMLAR**") in the EU. This regulation will take effect **from 1 July 2025**. However, specific provisions will apply earlier, on 26 June 2024, and 31 December 2025.

Critiques of the previous AML/CFT framework

This AML/CFT package, aimed at strengthening and harmonizing the AML/CFT rules in the EU follows substantial progress in combating ML/TF related issues. It tackles key challenges encountered in enforcing previous legal instruments, such as:

- the diverse implementation made it challenging **to enforce consistent AML/CFT-related measures** across all EU Member States;
- the enforcement instruments available were **insufficient to detect and penalize illicit financial activities** effectively. This hindered the framework's ability to deter criminals;
- **inconsistent AML/CFT supervision across EU Member States** made it difficult for EU financial intelligence units ("**FIUs**") to cooperate due to **a lack of a unified AML/CFT framework** across the union.

Strengthening the AML/CFT measures in the EU

The main objectives of this package are threefold:

- It **addresses systemic weaknesses and closes loopholes** that criminals exploit to launder illicit proceeds or finance terrorist activities within the financial system.
- It **harmonizes the AML/CFT legal framework** across the EU Member States **through a single rulebook.**
- It **establishes a decentralized EU regulatory body** called the EU AML/CFT Authority ("**AMLA**") to ensure consistent implementation of the AML/CFT rules and coordination among national authorities.

The Package's key components: an overview

1. AMLR – The EU AML Single Rulebook

The **AMLR expands the previous AML/CFT framework** and introduces several important provisions that **exhaustively reinforce AML/CFT-related measures across the EU**. These provisions include on:

- the scope of application on obliged entities,
- internal policies, controls, and procedures of obliged entities,
- customer due diligence ("**CDD**"),
- beneficial ownership transparency,
- reporting obligations,
- Information sharing,
- data protection and record-retention, and
- measures to mitigate risks deriving from anonymous instruments.

Extended scope of obliged entities

The **scope of entities** that are subject to AML/CFT requirements, referred to as **the 'obliged entities',** is extended. Despite **certain exemptions**, the following entities are now within the AMLR's ambit:

- crypto-asset service providers ("**CASPs**") that amount to a value of at least EUR 1,000;
- traders involved in high-value goods trading such as jewelry, luxury watches, precious metals and stones, aircraft, motor vehicles, watercraft, art crafts, and others;
- professional football clubs in certain transactions, and football agents. Member States may exempt

smaller clubs if they can demonstrate low risk, for example, those with a turnover of less than EUR 5 million in the last 2 years;
- gambling service providers with certain exemptions.

Internal policies, procedures, and controls

In scope entities must establish **internal policies, procedures, and controls to reduce their exposure to the risk of ML/TF**. The management of the obliged entity has to appoint (i) a designated '**compliance officer**', and (ii) a board member, known as the '**compliance manager**' – both globally responsible for ensuring adherence to the AML/CFT rules as defined in the AMLR.

Reinforcement of CDD: simplified or enhanced

The AMLR reinforces the CDD requirements while introducing tightened specific detailed measures concerning cases where obliged entities must exceed simplified due diligence and perform enhanced due diligence ("**EDD**") such as:

- **cross-border correspondent relationships for CASPs**;
- financial and credit institutions dealing with **high-net wealth individuals**, exceeding €50 million and assets under management exceeding €5 million;
- occasional transactions and business relationships involving **high-risk third countries**, based on a risk assessment aligned with the FATF lists.

EU-wide limit for cash payments

In-scope entities must follow the new EUR 10,000 cash payment limit. Member States have the flexibility to set a lower maximum if needed due to specific national risks, subject to a three-month notification. Customers are required to be identified and beneficial owners verified in occasional cash transactions of at least EUR 3,000.

Consolidating and reinforcing beneficial ownership transparency

In scope entities must implement a streamlined beneficial ownership transparency to customers and counterparties. The concept of beneficial ownership remains the same, but a clearer framework has been established for identifying individuals who ultimately own or control legal entities, as well as multi-layered or complex ownership structures.

The threshold for ownership interest, shares, or voting rights is set at 25 percent or more. Member States should use a risk-based approach for categories of entities with high-risk to ML/TF. They can propose a threshold of no more than 15 percent to the EU Commission. However, the EU Commission has the authority to set a higher threshold based on risk, as long as it is lower than 25 percent.

In cases of medium-high risk to ML/TF, if the relevant entity is based outside the EU, it must register its beneficial ownership in the central register (in Luxembourg, currently the *registre des bénéficiaires économiques,* "**RBE**") before establishing a business relationship with an in-scope entity in the relevant EU Member State.

Furthermore, stricter requirements have been set for reporting discrepancies in beneficial ownership registers.

Provisions on data protection and record retention have been revised to allow competent authorities access to information on beneficial ownership held by in scope entities.

Additional potential countermeasures and "high-risk third countries"

Obliged entities shall be required to apply EDD measures to occasional transactions and business relationships involving third countries deemed high-risk. Either the obliged entities or the EU Member States, if the high-level risk justifies it, may adopt additional countermeasures, to protect the union's financial environment from potential ML/TF risks. If Member States adopt further countermeasures, they shall notify the EU Commission thereof who may cause such measures to be revoked if they are deemed unnecessary.

2. AMLD6

The AMLD6 widens the regulatory scope of ML offenses, clarifies definitions related to those offenses and their perpetrators, and enforces stricter penalties across Member States. It covers provisions that could not be included in the AMLR: (ii) Registers, (iii) FIUs, (iv) AML Supervisions, (v) Cooperation, (vi) Data Protection. The following summarizes the key aspects of the AMLD6.

Central registers of beneficial ownership

AMLD6 provides for robust rules regarding beneficial ownership information and their recording in Central

Registers. The central register contains information about the beneficial ownership of legal entities and legal arrangements, as well as details about nominee arrangements and foreign legal entities (in Luxembourg, currently the RBE). This information must be accurate, up-to-date, and verified. It should be retained for at least 5 years, with an additional 5-year period in the case of a criminal investigation under Article 10.

Furthermore, those registers are reliable databases for beneficial ownership information. They cross-check the data with financial sanctions and ensure, within a reasonable time, that the submitted information is accurate and consistent. If there are any issues, registration can be withheld. In case of uncertainty, authorities have the right to conduct on-site inspections.

Access to the registers is granted to FIUs, other competent authorities, self-regulatory bodies, and obliged entities free of charge and in digital form. Public access is conditional and granted to persons with a legitimate interest, e.g., the press.

National AML supervision, central account registers and FIUs

AMLD6 aims to enhance collaboration between FIUs and other competent authorities, i.e., AMLA, Europol, Eurojust, and the European Public Prosecutor's Office. By fostering reciprocal cooperation and information exchange, AMLD6 seeks to improve the efficiency in addressing complex or cross-border financial crime cases. The directive also provides FIUs with increased capabilities to better detect and track cases of ML/TF.

Moreover, AMLD6 improves the organisation of national AML/CFT-systems by exhaustively outlining mutual cooperation between FIUs and supervisors. In this regard, the obliged entities will be supervised using a risk-based approach by separate national supervisors. These supervisors have the authority and obligation to conduct essential off-site, on-site, and thematic checks, as well as any other necessary inquiries and assessments, pursuant to Article 40. Additionally, they are expected to collaborate with each other and with the FIUs.

A single central register (in Luxembourg, the Central Register of Bank Accounts, CRBA) will further contain information about accounts identified by International Bank Account Numbers ("**IBANs**"), including virtual IBANs, securities accounts, and CASPs accounts. The central account registers in Member States will be interconnected to enable efficient exchange of information with FIUs.

Statistical reporting, supervisory colleges and regulatory technical standards:

Member States are required to maintain and publish AML/CTF statistics to review effectiveness.

AMLD6 imposes a requirement on Member States to establish supervisory colleges in both financial and non-financial sectors within the union, as well as with counterparts in third countries. In this regard, AMLA will issue guidelines that should be subsequently incorporated into legal frameworks by Member States.

3. AMLA

AMLA is the new decentralized body of the EU, to be based in Frankfurt am Main, Germany, and to be fully operational by Summer 2025.

AMLA's purpose is to tone-up the AML/CFT framework, ensure high-quality supervision, promote harmonization, and facilitate information exchange among FIUs and other competent authorities within the union. Its function is twofold:

- **Supervision**
  AMLA combines both direct and indirect supervisory competences over financial entities. AMLA directly supervises ML/TF high-risk entities, including CASPs. It also indirectly supervises other financial entities by collaborating with national financial supervisors. In the non-financial sector, AMLA mainly coordinates with national supervisors and promotes their supervisory alignment.
- **Harmonization and coordination**
  AMLA is required to follow a standardized supervisory methodology. Given the cross-border nature of ML/TF, AMLA will create an integrated mechanism with national supervisors to ensure in-scope entities comply with AML/CFT-related obligations in the financial sector. While supporting those in the non-financial sector. It will issue guidelines, recommendations, and opinions to promote consistency among those supervisors.

Additionally, AMLA is mandated to create and maintain a central AML/CTF database of information to facilitate AML supervisory activities.

AMLA is entrusted to support and coordinate between FIUs. This involves, amongst other actions, participating in joint ML/TF analysis and managing the FIU's information exchange system (FIU.net).

Luxembourg: horizons ahead

The primary legal AML/CFT instruments in Luxembourg consist of the law of 12 November 2004, as amended ("**AML Law**"), the Grand-Ducal Regulation of 1 February 2010, as amended, and the law of 13 January 2019 related to the RBE. The AML Law is supported by various AML/CFT circulars and guidelines issued by national competent authorities, e.g., the CSSF.

The AML/CFT framework in Luxembourg is heavily influenced by the EU harmonization efforts. Additionally, as a member of the OECD and a jurisdiction within the FATF, Luxembourg, like any other EU Member State, is expected to comply with the new EU AML/CFT package and by adjusting its relevant legal framework according to the provisions of the AMLR and the AMLD6 within three years, and the AMLAR within one year.

LUXEMBOURG NPL LEGISLATION AND CLARIFICATIONS IN RESPECT OF THE FINANCIAL COLLATERAL LAW

On 3 July 2024, the draft law No. 8185 (the "**Draft Law**") has been voted on for the first time before the Luxembourg Parliament (*Chambre des Députés*). A second vote on the Draft Law by the Luxembourg Parliament is normally required under the Luxembourg Constitution but it is expected that as permitted by the Luxembourg Constitution, the Luxembourg Parliament together with the Luxembourg Council of State will waive the requirement for such second vote. The version of the Draft Law that was voted on (the "**Final Draft Law**"), has been revised and submitted by the Finance Committee, upon receiving the pertinent opinions of the Chamber of Commerce, the designated commissions, and the Council of State.

In an article published on 3 April 2024, we had summarised the highlights of the Draft Law. For a comprehensive overview of the Draft Law, we refer you to our previous newsletter article on the topic available here.

Updates on the Draft Law

The Final Draft Law includes certain clarifications relating to:

- the transfer of non-performing loans;
- amendments to the Luxembourg law of 5 April 1993 on the financial sector;
- amendments to the Luxembourg law of 23 December 1998 establishing the financial sector supervisory commission (CSSF); and
- amendments to the Luxembourg law of 18 December 2015 on the failure of credit institutions and certain investment undertakings.

These are mostly minor and technical changes aiming at aligning them fully with the relevant EU directives and regulations and providing legal coherence among the provisions of the relevant laws.

A notable amendment worth mentioning is the addition of a new paragraph to Article 2 of the Final Draft Law. This amendment clarifies that Article 1699 of the Luxembourg Civil Code, which allows debtors of litigious claims being transferred to extinguish the transferred claim by repaying the transfer price to the assignee with interest, will not apply to the transfer of non-performing loans as defined by the Final Draft Law. The aim of this amendment is to prevent Article 1699 of the Luxembourg Civil Code from hindering the objective of facilitating the transfer of creditors' rights under non-performing loans.

Amendment to the Financial Collateral Law

The Final Draft Law also includes an amendment to the Luxembourg law of 5 August 2005 on financial collateral arrangements (the "**Financial Collateral Law**"), which provides a much-anticipated clarification in respect of what "foreign law" and "foreign reorganisation and liquidation measures" mean within the sense of the Financial Collateral Law.

The amendment under the Final Draft Law incorporates new definitions of "national or foreign provisions", "foreign law" and "reorganisation measures, liquidation proceedings or any other similar national or foreign proceedings", that expressly include provisions, laws and measures of the States party to the European Economic Area (the "**EEA Member States**") **and any other State**.

This is a highly welcomed development, as it reinstates legal certainty, particularly in light of recent court rulings that have limited the scope of Article 20 and Article 24 of the Financial Collateral Law. These articles state that financial collateral arrangements, as defined by the Financial Collateral Law, are valid and enforceable against third parties despite any reorganisation, winding-up measures, or similar national **or foreign** proceedings. The recent rulings had restricted the applicability of these articles to proceedings initiated solely within EEA Member States. These new definitions will ensure that Luxembourg financial collateral arrangements remain valid and enforceable, regardless of any reorganisation or winding-up proceedings initiated, not only within EEA Member States but also in any other country worldwide.

Entry into Force

Provided that the requirement for a second vote of the Final Draft Law is waived, the Final Draft Law will enter into force four days after its publication in the Official

Journal of the Grand Duchy of Luxembourg.

BASEL III | CRD VI AND CRR III HARMONISING EU BANKING

Basel III finalisation: CRD VI and CRR III have been published

The Capital Requirements Directive (Directive 2013/36/EU), and the Capital Requirements Regulation (Regulation 2013/575/EU) and aiming to ensure resilience of the EU banking sector against economic shocks, have been amended to **implement the final standards of Basel III**.

Directive (EU) 2024/1619 of 31 May 2024 amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, and environmental, social and governance risks ("**CRD VI**") and Regulation (EU) 2024/1623 of 31 May 2024 amending Regulation (EU) No. 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor ("**CRR III**") have been published in the Official Journal of the European Union on 19 June 2024. They entered into force 20 days from their publication, i.e. 9 July 2024. Except for some of its provisions which apply from 9 July 2024, CRR III will apply from 1 January 2025. EU Member States will have until 11 January 2027, subject to certain exemptions, to transpose CRD VI.

Cross border banking services by third-country firms

Among this new package, one particular point of attention is the new rules CRD VI introduces with respect to the provision of cross-border banking services by third-country firms.

The cross-border provision of non-MiFID II banking services by third-country firms and the establishment of branches in the EU are mainly covered by Member States' national rules. In Luxembourg, the law of 5 April 1993 and Circular 11/515 from the CSSF are relevant in this respect. Currently, if banking services are provided on a pure-cross border basis and do not involve physical presence in Luxembourg, they do not normally trigger the requirement to have a licence or establish a branch.

Harmonised authorisation requirements

CRD VI will introduce a new article 21c in the Capital Requirements Directive, making the provision of core banking services subject to harmonised authorisation requirements across the EU Member States. Core banking services for the purpose of article 21c are:

- taking deposits and other repayable funds,
- lending, and
- providing guarantees and commitments.

More specifically, third country firms seeking to provide such services in the EU, without acting through a subsidiary, will have to establish a branch in a Member State unless they fall within one of the narrow exemptions provided for in article 21c of CRD VI, such as:

- reverse solicitation,
- interbank operations, or
- intragroup operations.

The requirements laid down in this article 21c will not apply to contracts entered before 11 July 2026.

EBA GUIDELINES ON LOAN ORIGINATION AND MONITORING | CSSF FAQ REGARDING CIRCULAR 22/824

Background

On 29 May 2020, the EBA published final guidelines (the "**Guidelines**") on the granting and monitoring of loans, the aim of which was to ensure that entities granting loans have adequate procedures for granting and monitoring loans to prevent loans from ending up as non-performing loans (**"NPLs"**). On 22 December 2022, the CSSF published Circular 22/824 (the "**Circular**") in order to inform that, in its capacity as national competent authority, it would apply the Guidelines. Consequently, the Guidelines became part of the CSSF's administrative and regulatory practice. The Circular applies since **31 March 2023.**

Please refer to our previous newsletter article for more information on the scope of the Guidelines.

CSSF FAQ

On 29 March 2024 the CSSF published Frequently Asked Questions ("**FAQ**") in relation to the Circular in which the CSSF clarified how Lombard loans, being secured by a diversified and liquid collateral, should be considered under the provisions of the Circular. The CSSF set out criteria to be applied by institutions when granting Lombard loans in line with Part III of the Circular (in particular, paragraph 33). The CSSF furthermore confirmed that Lombard loans at origination benefit from the exception as set forth in paragraph 97 of the Guidelines, provided that they meet such criteria.

On 16 May 2024, the CSSF updated the FAQ to clarify its expectations regarding interest rate increase scenarios for a robust sensitivity analysis for all variable/revisable interest rate loan agreements financing retail residential immovable properties.

DORA I ENSURING DIGITAL OPERATIONAL RESILIENCE IN THE EUROPEAN FINANCIAL SECTOR

Overview

The European Union's financial sector's digital operational resilience is undergoing significant enhancement through the implementation of Regulation (EU) 2022/2554 ("**DORA**" or the "**Regulation**") and Directive (EU) 2022/2556 (the "**Directive**") both adopted on 14 December 2022. Complementing and transposing these EU measures, Luxembourg has enacted the Law of 1 July 2024 (the "**Law**"), amending various national laws to implement DORA and transpose the Directive.

As highlighted in our October 2023 newsletter, the primary aim of DORA is to bolster the EU financial system's digital operational resilience by establishing robust "**ICT**" (Information and Communication Technology) frameworks. This necessity stems from the increasing importance of ICT-related products and the corresponding rise in cyber threats that could potentially trigger systemic crises within the financial sector.

Key pillars of DORA

DORA is structured around five fundamental pillars:

- ICT risk management;
- ICT incident management, classification, and reporting;
- Digital operational resilience testing;
- ICT third-party risk management; and
- Information sharing.

These pillars constitute the foundation of the legislative and regulatory measures derived from DORA, which will be enforceable from 17 January 2025.

Scope of application

DORA targets 20 types of financial entities listed in Article 2 of the Regulation ("**In-Scope-FEs**"), including credit institutions, investment firms, trading venues and credit rating agencies. However, professionals of the financial sector ("**PFS**") as defined in the Law of 5 April 1993 on the financial sector, as amended, are excluded from its scope.

Furthermore, DORA's impact extends to ICT third-party service providers critical for financial entities. The Commission Delegated Regulation (EU) 2024/1502 of 22 February 2024 outlines the criteria for designating these providers as critical, emphasizing their significant role in maintaining the financial system's integrity.

Supervision of the affected entities is conducted by the European Supervisory Authorities ("**ESAs**"), namely the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA), alongside relevant national authorities.

Legislative and regulatory framework

At the EU level, DORA acts as a consolidated instrument addressing ICT risks within the financial sector, while the Directive complements it by amending existing European directives. DORA's provisions are directly applicable across all EU Member States. The ESAs have been tasked with drafting regulatory technical standards ("**RTS**") and implementing technical standards (ITS), to be adopted by the European Commission.

The initial set of RTS/ITS was published in January 2024, following consultations that ensured simplified, efficient requirements and sector-specific considerations. These standards, formalised through delegated and implementing acts, define the obligations under DORA. The subsequent set of rules is expected to be submitted to the Commission by 17 July 2024.

Specific highlights of DORA

- **Single EU-hub (Art. 21 DORA)**

DORA introduces the possibility of a centralized institution for handling major ICT-related incident reports, either by coordinating with competent authorities or receiving reports directly from In-Scope-FEs.

- **Mandatory testing framework (Art. 26 DORA)**

A comprehensive testing framework based on the TIBER-EU framework has been established to help enhance cyber resilience through controlled cyberattacks.

- **Register of information (Art. 28.9 DORA)**

In-Scope FEs must maintain a register of ICT service contracts, which may be requested by financial supervisors to monitor ICT-related dependencies.

- **EU-level oversight by ESAs (Chapter VII DORA)**

The ESAs have been granted oversight powers over ICT third-party service providers, including investigations and inspections, starting from 2025.

Luxembourg's national legislation

The Law equips competent Luxembourg authorities (CSSF and CAA) with supervisory powers and establishes an administrative fines regime of up to EUR 5 million.

The Law was published on 2 July 2024 in the Luxembourg Official Gazette and shall become effective on 17 January 2025.

CSSF circular

The CSSF has issued **Circular CSSF 24/847** to replace the previous Circular CSSF 11/504, introducing an enhanced ICT-related incident reporting framework, aligning with DORA's requirements.

Action items for financial entities and ICT service providers

To ensure compliance, financial entities must assess their current ICT frameworks and address deficiencies promptly. The principle of proportionality (Article 4 DORA) regulates the severity of requirements based on the entity's size and service nature. ICT service providers must also adapt to DORA's requirements, given their significant role in supporting financial sector clients.

EU LISTING ACT | INTERESTING REGULATORY CHANGES IN THE PIPELINE

On 7 December 2022, the European Commission put forward a set of measures to further develop the EU Capital Markets Union (**"CMU"**). These measures which are commonly referred to collectively as the "**Listing Act**" comprise proposals for:

1. an amending regulation amending Regulation (EU) 2017/1129 ("**Prospectus Regulation**"), Regulation (EU) 600/2014 ("**MiFIR**") and Regulation (EU) 596/2014 ("**MAR**");
2. an amending directive amending Directive 2014/65/EU (**"MiFID"**) and repealing Directive 2001/34/EC (the "**Listing Directive**");
3. a new directive on multiple-vote shares for small and medium-sized enterprises ("**SMEs**").

Background

The Listing Act is part of the wider CMU initiative, which was originally launched in 2015 with the aim of broadening access to market-based sources of financing for EU companies at each stage of their development. In this context, the Listing Act aims to simplify the listing requirements, including post-listing, in order to make public capital markets more attractive for EU companies and facilitate access to capital for SMEs.

Proposed amendments to existing legislation

The Listing Act proposes various amendments to existing capital markets legislation. We summarise some of the key proposed amendments below.

Proposed amendments to the Prospectus Regulation:

- Exemption for secondary issuances expanded – the exemption from publishing a prospectus in case of admission to trading on a regulated market of new securities fungible with securities already admitted to trading to be amended so that it will apply if new securities represent less than 40% (increased from 20%) of the number of securities already admitted; it is also proposed to extend this exemption so that it applies to offers to the public.
- Introduction of a new exemption from the obligation to publish a prospectus for secondary issuances of securities that are fungible with securities that are already admitted to trading for at least 18 months, either on a regulated market or an SME growth market, subject to fulfilment of certain conditions (which shall include the making available of a short summary document).
- Introduction of a new EU "Follow-on Prospectus" for secondary issuances which would replace the simplified prospectus for secondary issuances, where the company cannot rely on any of the other exemptions available. The “Follow-on Prospectus” would have less burdensome disclosure requirements than the simplified prospectus.
- Shortening of minimum IPO offer period from six days to three days.
- Introduction of a new EU Growth *issuance document* which would replace the EU Growth *prospectus*. This issuance document would have lighter requirements than the EU Growth prospectus.
- Introduction of a new harmonised threshold of EUR 12 million (based on total consideration of all offers made by the same issuer over a 12-month period) below which all offers of securities to the public shall be exempted from obligation to publish a prospectus.
- Introduction of a standardisation requirement for the format and content of all prospectuses (in particular regarding the order of disclosure) and introduction of a 300-page limit for IPO prospectuses.
- Clarification of rules regarding prospectus supplements – in particular confirming that investors may withdraw their subscriptions within three working days from when an issuer publishes a supplement correcting material mistakes or inaccuracies or adding significant new factors.

Proposed amendments to MAR:

- Narrowing of the scope of the disclosure obligation regarding inside information in relation to “protracted processes”.
- Provision of detailed conditions to be satisfied to justify the delay of disclosure of inside information.
- Change in timing for when the obligation arises to notify competent authorities of a delay in disclosure

of inside information so that this must be done immediately after the decision is taken to delay disclosure, rather than immediately after the disclosure of the information to the public.
- Granting of more protection to “Disclosing market participants” carrying out market soundings in accordance with the MAR from allegations of unlawfully disclosing inside information. There will not be a presumption that the disclosing market participant has unlawfully disclosed inside information in case of non-compliance with the relevant information and record-keeping requirements.
- Lightening of the requirements to keep insider lists so that issuers shall only be required to keep a list of “permanent insiders”.
- Increase of the threshold (from EUR 5,000 to EUR 20,000) over which "managers transactions" (i.e. transaction in securities conducted by persons discharging managerial responsibilities and persons closely associated with them) need to be notified. Insofar as competent authorities are authorised to raise the threshold at a national level, this has been raised from EUR 20,000 to EUR 50,000.

Changes to MiFID:

- Introduction of an increase in the threshold under which the “unbundling rules” under MiFID shall not apply. This should increase the availability of research for companies, SMEs in particular. The proposed threshold under which the "unbundling rules" would not apply is EUR 10 billion.

Repeal of Directive 2001/34/EC

The Commission has proposed to repeal the Listing Directive (which by its nature is a minimum harmonisation directive) because it is viewed as giving Member States a broad discretion to deviate from its rules leading to fragmentation. It is also noted that most of the Listing Directive is now redundant due to various amendments over time. The full repeal of the Listing Directive has met with some criticism however. The Listing Directive makes a distinction between *being listed on an official list* and *admission to trading on a trading venue*. As most companies whose shares are admitted to trading are also listed on an official list, these two concepts have begun to be considered as one, namely that a company is “listed”. However, these are distinct concepts: companies can be named on an official list without having been admitted to trading on a trading venue – as is the case with companies listed on the Securities Official List of the Luxembourg Stock Exchange. If the Listing Directive is repealed as currently proposed by the Commission, this important distinction will almost certainly be lost.

Introduction of a new directive on multiple vote shares

The Commission, through the Listing Act, has proposed to introduce a new minimum harmonisation directive in order to ensure that there is consistent implementation of multiple vote share structures across all Member States: companies listing for the first time on SME Growth Markets could use multiple-vote share structures.

Next steps

The proposals set out by the Commission in the Listing Act are the result of feedback received during a public consultation period, which opened on 19 November 2021 and closed on 25 February 2022. The Listing Act is currently open to feedback until 14 March 2023. The Commission will submit the feedback to the European Parliament and the Council. The timing for final adoption of the proposal at the level of the European Parliament and Council is unknown at this point.

EU MARKET ABUSE REGULATION | ESMA GUIDANCE ON GOOD PRACTICES FOR PRE-CLOSE CALLS

Background

Pursuant to Regulation (EU) No. 596/2014 on market abuse (the "**Market Abuse Regulation**" **or** "**MAR**"**),** in the 30 days before the publication of half yearly and annual results of an issuer whose securities are admitted to trading, persons discharging managerial responsibilities ("**PMDR**") are presumed to possess inside information (i.e. the forthcoming financial results); as such, PDMRs are prohibited (subject to certain exceptions) from trading in the issuer's securities. This 30-day period is referred to as a "**closed period**". Many issuers hold **pre-close calls** with analysts during the closed periods in order to bring them up to speed because during the closed-period the issuers usually refrain from making any public comments. The analysts are thereby considered better informed to generate research, forecasts and recommendations in short-order after the publication of the financial statements.

It has been observed that pre-close calls can influence markets expectations and in turn, the price of financial instruments. ESMA and national regulators having observed ***"high volatility episodes"*** in EU share prices, some of which took place shortly after pre-close calls with analysts, ESMA issued best practices guidance in the form of a statement on 29 May 2024 (the "**Statement**").

Content of Statement

With this Statement, ESMA reminds issuers of the **prohibition of unlawful disclosure of inside information** under MAR and **the obligation that public disclosure of inside information** should take place in accordance with Article 17 of MAR and Commission Implementing Regulation (EU) 2016/1055.

The Statement then proceeds to list various **best practices** that should be used to reduce the risk of unlawful disclosure of inside information.

- Prior to a pre-close call, identify what information shall be disclosed.
- Publicly announce upcoming pre-close calls.
- Simultaneously provide the material used (e.g. slides) during "pre-close calls" on the issuer's website.
- Record "pre-close calls" so that they can be made available to National Competent Authorities upon request.
- Maintain records of disclosed information during "pre-close calls" and publish them on the issuer's website for public access.

In anticipation of closer scrutiny by EU regulators going forward, these best practices should be carefully considered and implemented, whereby appropriate, by the relevant departments of EU issuers.

MIFID II AND MIFIR | VARIOUS DEVELOPMENTS

Updates to ESMA Q&A

On 2 February 2024, ESMA updated its questions and answers on MiFIR data reporting. With this update, ESMA updated the list of national client identifiers for natural persons to be used in transaction reports pursuant to the priority specified in Annex II of the Commission Delegated Regulation (EU) 2017/590.

ESMA Public Statement - deprioritisation of supervisory actions on RTS 28 reports

On 13 February 2024, the ESMA issued a Public Statement to provide clarity to market participants regarding their reporting requirements under RTS28, pending the full application of the new rules under MiFID II. ESMA expects National Competent Authorities ("**NCAs**") not to prioritize supervisory actions towards investment firms concerning the periodic RTS28 reporting obligation until the forthcoming transposition into national legislation in all Member States of the MiFID II review. Under the revised MiFID II/ MiFIR framework, investment firms are no longer obligated to annually report detailed information on trading venues and execution quality through RTS28 reports. This statement aims to promote coordinated action by NCAs under MiFID II.

New Amending Directive and Regulation

On 8 March 2024, the following were published to improve access to market data and transparency:

1. Directive 2024/790 of 28 February 2024 ("**New Directive**") amending MiFID II
2. Regulation 2024/791 of 28 February 2024 ("**New Regulation**") amending Regulation (EU) No 600/2014 (MiFIR)

The New Regulation generally aims at enhancing data transparency, removing obstacles to the emergence of consolidated tapes, optimising the trading obligations and prohibiting receiving payment for order flow. The New Directive's target is to improve the transparency requirements on markets in financial instruments and the resilience for regulated markets. It strengthens the obligation to execute orders on the most favourable terms for clients and introduces new transparency obligations for operators of trading venues.

ESMA Public Statement - transition for the application of the MiFID II/MiFIR review

On 27 March 2024, ESMA published a Public Statement aimed at providing practical guidance on some key points to support the transition and consistent application of MiFID II and MiFIR in light of the changes introduced to them by the New Directive and New Regulation; the guidance focuses on various aspects such as equity transparency, systematic internalised regime, designated publishing entities, and reporting.

EU SECURITISATION REGULATION | EBA FINAL GUIDELINES FOR ON-BALANCE SHEET STS SECURITISATIONS

Background

Article 26a(2) of the Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (the "**EU Securitisation Regulation**") provides that the EBA (in close cooperation with ESMA and EIOPA), may adopt, guidelines and recommendations on the harmonised interpretation and application of the requirements for **simple**, **transparent** and **standardised** ("STS") **on-balance-sheet** securitisations. On 27 May 2024, EBA issued a final report (the "**Final Report**") containing such guidelines (the "**On-Balance Sheet STS Guidelines")**.

The EBA had previously issued guidelines and recommendations on the harmonised interpretation and application of the STS requirements for both:

- non-asset-backed commercial paper (ABCP) (pursuant to Article 19(2) of the EU Securitisation Regulation (EBA/GL/09); and
- ABCP securitisation (pursuant to Article 23(3) of the EU Securitisation Regulation (EBA/GL/2018/08) (the "**ABCP and non-ABCP STS Guidelines**").

Compliance with STS criteria is one of the prerequisites for the application of a more risk-sensitive regulatory treatment of exposures to securitisations under the EU securitisation framework for originator institutions (updated by the Capital Markets Recovery Package in 2021).

Purpose and Content of the Final Report

The purpose of the On-Balance Sheet STS Guidelines is to promote a uniform interpretation and application of the criteria on *simplicity*, *standardisation*, *transparency* and of specific requirements concerning the credit protection agreement, the third-party verification agent and the synthetic excess spread applicable to **STS on-balance-sheet securitisation**. As is the same for the ABCP and non-ABCP STS Guidelines, they are intended to facilitate a common understanding of the criteria by originators, original lenders, securitisation special purpose entities (SSPEs), investors, competent authorities and third-party verification agents verifying STS compliance throughout the European Union.

The Final Report also includes targeted amendments to the ABCP and non-ABCP STS Guidelines, to ensure that the interpretation provided by the EBA is consistent across the three sets of guidelines.

As a whole, the On-Balance Sheet STS Guidelines and the amended the ABCP and non-ABCP STS Guidelines aim to ensure the proper implementation of the EU securitisation framework, thereby contributing to a safe and sound EU securitisation market.

Next Steps

The On-Balance Sheet STS Guidelines are currently being translated into the official languages of all the Member States. They will apply 2 months after the last translation.

Consolidated versions of the ABCP and non-ABCP STS Guidelines will also be published in due course; they will enter into force two months following this publication.

MARKETS IN CRYPTO-ASSETS (MICA) | RECENT EU AND LUXEMBOURG DEVELOPMENTS

Entry into force of MiCAR

On 29 June 2023, the amended Regulation (EU) 2023/1114 of 31 May 2023 on markets in crypto-assets ("**MiCAR**"), entered into force, establishing **a harmonised framework** for the offer to the public and admission to trading on a trading platform:

- of asset-referenced tokens ("**ART**");
- of e-money tokens ("**EMT**"), and
- other crypto-assets,

as well as requirements for crypto-asset service providers ("**CASP**").

MiCAR is part of the **Digital Finance Package** published by the European Commission on 24 September 2020 which includes the Pilot Regime for market infrastructures based on distributed ledger technology (Regulation (EU) 2022/858) and DORA (Regulation (EU) 2022/2554.

Titles III and IV of MiCAR which relate to the authorisation and supervision of ARTs and EMTs are applicable since 30 June 2024.

The rest of the provisions of MiCAR (in particular those setting out the requirements for CASPs) will apply from 30 December 2024.

Entry into force of Delegated Regulations under MiCAR

The following Delegated Regulations supplementing MiCAR were published in the Official Journal on 30 May 2024 and entered into force on 19 June 2024 – in advance of the application of the MiCAR provisions on ARTs and EMTs:

- Delegated Regulation (EU) 2024/1503 supplementing MiCAR by specifying the fees charged by the EBA to issuers of significant ARTs and issuers of significant EMTs;
- Delegated Regulation (EU) 2024/1504 supplementing MiCAR by specifying the procedural rules for the exercise of the power to impose fines or periodic penalty payments by the EBA on issuers of significant ARTs and issuers of significant EMTs;
- Delegated Regulation (EU) 2024/1506 supplementing MiCAR by specifying certain criteria for classifying ARTs and EMTs as significant; and
- Delegated Regulation (EU) 2024/1507 supplementing MiCAR by specifying the criteria and factors to be taken into account by ESMA, the EBA and competent authorities in relation to their intervention powers.

Final draft Guidelines and Technical Standards of the EBA

On 7 May 2024, the EBA published a press release announcing three sets of final draft regulatory technical standards (RTS) and one set of final draft implementing technical standards (ITS) relating to MiCAR's provisions on ARTs:

- draft RTS on information for assessment of a proposed acquisition of qualifying holdings in issuers of ARTs under Article 42(4) MiCAR;
- draft RTS on the procedure for the approval of white papers of ARTs issued by credit institutions under article 17(8) MiCA; and
- draft RTS and ITS on information for authorisation as issuers of ARTs under article 18(6) and (7) MiCA.

On 13 June 2024, the EBA published a press release announcing a package of technical standards and guidelines under the MiCA Regulation on prudential matters, namely own funds, liquidity requirements, and recovery plans:

- guidelines on recovery plans under Articles 46 and 55 of Regulation (EU) 2023/1114;
- draft RTS to specify the minimum contents of the liquidity management policy and procedures under Article 45(7)(b) of Regulation (EU) 2023/1114;
- draft RTS to specify the highly liquid financial instruments with minimal market risk, credit risk and concentration risk under Article 38(5) of Regulation (EU) 2023/1114;
- draft RTS to further specify the liquidity requirements of the reserve of assets under Article 36(4) of Regulation (EU) 2023/1114;
- draft RTS to specify the procedure and timeframe to adjust the own funds requirements for issuers of significant asset-referenced tokens or of e-money

tokens subject to such requirements;
- draft RTS on adjustment of own funds requirements and stress testing of issuers of asset-referenced tokens and of e-money tokens subject to such requirements.

On 19 June 2024, the EBA published a further press release announcing a package of technical standards and guidelines under MiCAR on the topics of reporting, liquidity stress testing and supervisory colleges thereby completing the delivery of EBA technical standards under MiCAR:

- draft RTS on the methodology to estimate the number and value of transactions associated to uses of asset-referenced tokens as a means of exchange under Article 22(6) of Regulation (EU) No 2023/1114 (MiCAR) and of e-money tokens denominated in a currency that is not an official currency of a Member State under Article 58(3) of that Regulation;
- draft ITS on the reporting on asset-referenced tokens under Article 22(7) of Regulation (EU) No 2023/1114 (MiCAR) and on e-money tokens denominated in a currency that is not an official currency of a Member State pursuant to Article 58(3) of that Regulation;
- guidelines establishing the common reference parameters of the stress test scenarios for the liquidity stress tests referred in Article 45(4) Regulation (EU) 2023/1114;
- draft RTS on supervisory colleges under Article 119(8) of Regulation (EU) No 2023/1114 (MiCAR).

The draft RTS and ITS listed above will be submitted to the Commission for endorsement following which they will be subject to scrutiny by the European Parliament and the Council before being published in the Official Journal of the European Union.

The guidelines listed above will be translated into the official EU languages and published on the EBA website. The deadline for competent authorities to report whether they comply with the guidelines will be two months after the publication of the translations.

ESMA Q&A and Technical Standards

On 25 May 2024, ESMA published a new Q&A in respect of the publication of information by CASPs providing the service of exchange of crypto-assets for funds or other crypto-assets.

Final reports of ESMA on Technical Standards

Following a series of consultations by ESMA (in close cooperation with EBA, EIOPA, and the ECB) for purposes of delivering level 2 and level 3 measures under MiCAR, ESMA has published final reports containing draft technical standards specifying certain requirements of MiCAR:

- On 25 March 2024 – first package final report
- On 3 July 2024 – second package final report

A third package final report is still awaited noting that the consultation for same closed on 25 June 2024.

On 24 March 2024, ESMA published its final report on draft technical standards specifying requirements for cooperation, exchange of information, and notification between competent authorities, European Supervisory Authorities (ESAs), and third countries under MiCAR.

On 31 May 2024, European Securities and Markets Authority (ESMA) published the final report on draft technical standards specifying certain requirements in relation to conflicts of interest for CASPs under the MiCA Regulation.

ESMA and EBA – Joint Guidelines

On 27 June 2024, both ESMA and EBA have released joint guidelines on the suitability of members of the management body, and on the assessment of shareholders and members with qualifying holdings for issuers ARTs and CASPs, under MiCAR.

Operationalisation of MiCAR in Luxembourg

On 21 May 2024, Draft Law No. 8387 (the "**Draft Law**") has been submitted to the Luxembourg Parliament (*Chambre des Députés*). The Draft Law seeks to operationalise MiCAR by designating the CSSF to oversee the regulation's application, by providing the CSSF with the required supervisory and investigative powers and by establishing an appropriate sanctions framework.

Furthermore, the Draft Law aims to operationalise Regulation (EU) 2023/1113 on information accompanying transfers of funds and certain crypto-assets ("**TFR2**" or the "**Transfer of Funds Regulation 2**") which recasts the first European Regulation on information accompanying transfers of funds ("**TFR1**"). TFR1 was operationalised in the amended law of 10 November 2009 on payment services (the "**Payment Services Law**"). The Draft Law proposes to repeal the relevant TFR 1 provisions of the Payment Services

Law and instead incorporate them together with the new provisions arising from TFR2, into the Luxembourg law of 16 July 2019 on the operationalisation of European Regulations (the "**Law of 16 July 2019**").

Due to the creation of a harmonised EU authorisation regime for CASPs under MiCAR, the Draft Law also intends to repeal with effect from 30 December 2024, the registration provisions for CASPS which are currently included the Luxembourg law of 12 November 2004 (the "**AML Law**"). From 30 December 2023, CASPs shall be obliged entities under the AML Law.

CSSF guidance in respect of MiCAR

The CSSF is inviting all entities which are considering a notification or submission of an authorisation file with a view to the provision of CASP services or the issuance of ART or EMT to contact it now to kick off an initial discussion. Further guidance and recommendations of the CSSF are available here.

EU CROWDFUNDING REGULATION | NEW ESMA Q&A

On 27 May 2024, ESMA published new questions and answers regarding Regulation (EU) 2020/1503 on European crowdfunding service providers for business (the "**Crowdfunding Regulation**").

With respect to prudential requirements for control functions (compliance, risk and audit) of crowdfunding service providers ("**CSPs**"):

- ESMA has clarified the seniority between the own funds and the insurance policy in case of losses for the CSP whose prudential safeguards are combination of own funds and insurance policy;
- ESMA has explained what should be done with a possible own risk excess of the insurance policy that CSPs subscribe to comply with the prudential safeguards established under Article 11 of the Crowdfunding Regulation

Still on the topic of control functions, ESMA confirms that all CSPs shall establish, in the context of their organisational arrangements, a risk management framework whose complexity is also determined by the various provisions which are applicable to the specific activities provided by the CSP taking into account the nature, scale and complexity of such activities. EMSA further confirms that when CSPs intermediate loans, such risk management framework shall at least assess the risks related to the loans intermediated on the crowdfunding platform.

A further new question on default rate disclosure to clients has been published; an answer from ESMA is not available at time of printing.

All new ESMA questions and answers are available by using the search tool at this link.

CSRD I DRAFT LAW N°8370: TRANSPOSING DIRECTIVE (EU) 2022/2464 ON CORPORATE SUSTAINABILITY REPORTING

Summary

Draft Law n°8370 (the "Draft Law") was introduced on 29 March 2024 before the Luxembourg Parliament to transpose the Corporate Sustainability Reporting Directive (CSRD) and the Commission Delegated Directive (EU) 2023/2775 into national legislation. This new framework will replace the existing regime established by the law of 23 July 2016, which implemented Directive 2014/95/EU (the "NFRD" regime).

The Draft Law proposes amendments to:

- the law of 10 August 1915 on commercial companies,
- the law of 19 December 2002 on the register of commerce and companies, and on the accounting and annual accounts of undertakings,
- the law of 5 April 1993 on the financial sector, along with sector-specific legislation related to financial and accounting reporting obligations for credit institutions and the insurance sector.

Under the new regime, companies will be required to disclose information on:

- the impact of their activities on sustainability issues (impact materiality),
- how sustainability issues affect their financial performance (financial materiality).

Reporting must adhere to the European Sustainability Reporting Standards (ESRS) developed by the European Financial Reporting Advisory Group (EFRAG), ensuring consistent and comprehensive disclosures across all sectors.

New adjusted size criterion / Scope

The new regime expands the scope of the NFRD, targeting large companies and/or parent companies of large groups. It introduces enhanced non-financial reporting obligations on sustainability matters on both a stand-alone and consolidated basis. The size criteria for determining applicable companies will be increased by 25% in terms of total balance sheet and net turnover, considering inflation and aiming to reduce administrative burdens. However, this adjustment may lead to certain large companies being reclassified as medium-sized, thus potentially excluding them from CSRD obligations.

Timing for implementation

The implementation of the Draft Law's requirements will be phased in as follows:

- from 1 January 2024 for large listed companies and their parent companies,
- from 1 January 2025 for large non-listed companies and their parent companies,
- from 1 January 2026 for listed medium and small-sized companies,
- from 1 January 2028 for non-EU companies with EU subsidiaries or branches, subject to certain turnover thresholds and criteria.

Opinion of the Luxembourg Chamber of Commerce on the draft Grand-Ducal Regulation transposing the Delegated Directive ("Draft GDR")

The Luxembourg Chamber of Commerce has welcomed the Draft GDR and recommended its approval, with reservations regarding Article 4. The Chamber suggested revising this provision to allow companies the option to benefit from the increased thresholds from 1 January 2023. The categorization into one or the other group is determined by meeting two out of three relevant criteria (balance sheet total, net turnover, and number of employees) for at least two consecutive financial periods.

MODERNISATION OF THE ACCOUNTING LAW | OPINION OF THE LUXEMBOURG BAR

Background

As reported in our previous newsletter article, a draft law to modernise the Luxembourg accounting legislation (the "**Draft Law**") was submitted to the Luxembourg Parliament (*Chambre des Députés*) in July 2023. This Draft Law No. 8286 intends to clarify and consolidate general accounting legislation, currently spread in several legislations, into a single accounting law and foresees the introduction of new accounting obligations.

As a reminder, some of the main changes proposed by that Draft Law include:

- a mandatory auditors' report for interim dividend payments for all SARLs regardless of their size;
- the abolition of the *office* of "*commissaire aux comptes";*
- the introduction of a "bottom-up approach", i.e. shifting the focus from large companies to small undertakings. The small-sized companies' regime will become the norm and additional requirements will be added for medium and large-sized companies;
- new audit requirements for holding companies having a total balance sheet exceeding EUR 500 million, who will need to have the annual accounts certified by a *réviseur d'entreprises agrée;*
- the introduction of a new "micro entities" category as an optional regime with simpler requirements;
- the introduction of the definition of "Control" in the context of a group; and
- new requirements for entities in liquidation / dissolved, the Draft Law making it clear that the general accounting principles apply before and after a dissolution with liquidation.

Opinion of the Luxembourg Bar

On 24 April 2024, the Luxembourg Bar Association (*Ordre des avocats du barreau de Luxembourg)* ("**LBA**") issued its opinion on the Draft Law.

The key comments of the LBA include the following:

- **the necessity of requiring an auditors' report on interim dividend payments for all companies** established under the legal form of a SARL goes against the spirit of the interim dividend procedure whose purpose is to allow the rapid payment of a dividend, subject to the safeguards already in place to protect third parties. Hence, this new requirement may not be appropriate as it appears to be cumbersome, costly, and put unnecessary burden on companies. The LBA also considers this measure to have a detrimental effect on the attractiveness of Luxembourg companies and may constitute a competitive disadvantage for the financial centre.
- the proposed **abolition of the *commissaire aux comptes*** would undermine the objective of providing quality financial information. The *commissaire aux comptes* acts as a counterweight to the management body and has prerogatives conferred by law, designed to ensure that shareholders are adequately informed and protected against any excesses of power by the management body. It is also an essential tool for structuring corporate governance.
- the current wording of article 470-1 of the Draft Law suggests that the **consolidated financial statements must be approved by the general meeting**. The LBA opined that from a practical point of view, the approval of consolidated financial statements by the general meeting would be problematic. Indeed, if the consolidated financial statements were to be approved by the general meeting, they could only be approved if the annual financial statements themselves had been approved, which would require two shareholders' meetings to be held within the timeline allowed for approving the financial statements. Secondly, the scope of the discussions at the general meeting would be limited, as the management body would only be able to respond with regard to the accounts for which it is responsible. Lastly, the discharge would relate only to the individual financial statements.
- the Draft Law introduces a different **definition of "control"** from that in the law of 5 April 1993 on the financial sector. It defines the concept of control without introducing the concept of dominant influence (which constitutes a situation of exclusive control according to the Directive (EU) 2013/34 (the

“**EU Directive**”). Based on the Draft Law, such a situation of exclusive control would not exist in Luxembourg. However, the incomplete transposition of the definition of control may trigger a different interpretation and application of the law, while it is a common concept which is included in the text of many Luxembourg laws.

The Chamber of Commerce has also recently given an its opinion on the Draft Law. on 24 May 2024. It is anticipated that the legislative process for the adoption of the Draft Law will accelerate in the coming months and that once approved, the provisions of the Draft Law will be applicable from 1 January 2025.

CSDD I EU TAKES BOLD STEP: NEW DIRECTIVE MANDATES CORPORATE ACCOUNTABILITY FOR SUSTAINABILITY AND HUMAN RIGHTS

On 5 July 2024, the Directive 2024/2859 on **Corporate Sustainability Due Diligence (CSDDD**) (the "Directive") was published in the Official Journal of the European Union. This new law requires companies to ensure their activities are sustainable and respect human rights across their entire value chain. The Directive represents a major shift, potentially reshaping industries and enhancing corporate accountability.

Key requirements

Scope of application

- **Large companies and high-risk SMEs:** The Directive applies to large EU companies and smaller enterprises in high-risk sectors.
- **Global impact:** Non-EU companies operating within the EU market are also required to adhere to these standards, ensuring fair competition.

Due diligence obligations

- **Risk identification:** Companies must establish mechanisms to identify potential environmental and human rights risks in their value chains.
- **Preventive measures:** Policies and procedures must be developed and implemented to prevent and mitigate identified risks.
- **Transparency:** Regular reports on due diligence efforts and outcomes must be published, with independent audits verifying their accuracy.

Non-compliance consequences

- **Sanctions:** Non-compliance can result in significant fines and other sanctions. Victims of violations are entitled to seek legal remedies.

Enhanced Whistleblower Protections

The Directive also strengthens protections for whistleblowers, promoting transparency and accountability within organizations. Individuals reporting violations of sustainability standards are protected against retaliation, with secure and confidential reporting mechanisms required.

Recommended Actions

- **Risk assessment**: Identifying potential risks related to human rights and the environment in operations and supply chains is crucial.
- **Compliance strategies**: Developing and implementing policies to address identified risks ensures alignment with the new directive.
- **Reporting systems**: Establishing transparent reporting mechanisms, verified by independent audits, is essential.
- **Employee training**: Educating employees on new requirements and the importance of compliance fosters a culture of responsibility.
- **Whistleblower policy review**: Updating whistleblower policies to meet enhanced protections ensures adherence to the Proposed Directive.

Strategic Importance

With the Directive set to be incorporated into national laws, early compliance can provide a strategic advantage. Addressing these requirements proactively not only avoids penalties but also enhances corporate reputation and builds trust with stakeholders.

Conclusion

The Directive marks a significant shift towards more responsible business practices. Understanding and implementing the necessary steps to comply with these regulations is crucial for businesses to navigate the evolving landscape and capitalize on the benefits of sustainability and human rights compliance.

NEW PROVISIONS FOR HIGHLY QUALIFIED THIRD-COUNTRY NATIONALS

The law of 4 June 2024 amending the law of 29 August 2008 on the free movement of persons and immigration (the « **Immigration Law** ») was published in the Official Journal on 27 June 2024 (the "**Law**").

The Law entered into force on 1 July 2024.

The Law transposes into national law Directive (EU) 2021/1883 on the conditions of entry and residence of third-country nationals for the purposes of highly qualified employment (the "**Directive**").

The main purpose of the Law is to provide the EU with a targeted legal migration system capable of addressing skills shortages and making it easier for highly qualified workers to join the workforce. More specifically, the Law provides to the benefit of EU Blue Card holders:

- more flexible and inclusive admission criteria;
- more extensive rights;
- more favourable conditions for family reunification;
- greater mobility within the EU.

More flexible and inclusive admission criteria

Until now, the Immigration Lct required applicants for an EU Blue Card to present a valid employment contract for a highly qualified work of at least one year. The Law adapts this requirement, and now foresees a duration of **at least six months**.

The other admission criteria, i.e. proof of **highly professional qualifications** and remuneration at least equal to an amount to be set by Grand Ducal regulation, remain unchanged. It should be noted, however, that regarding the requirement for highly professional qualifications, the Law supplements Article 45 (2) of the Immigration Law to fully reproduce the requirements of the Directive concerning the documents to be submitted in support of the application for an EU Blue Card. Highly professional qualifications will have to be attested by:

- a **higher education degree**, where the studies required to obtain this diploma last at least three years (*bachelor's degree*);
- **highly professional skills**, i.e. knowledge, skills and abilities attested by at least five years' professional experience at a level comparable to higher education qualifications, and which are relevant to the profession or sector concerned. For the *manager* and ICT specialist, this period is limited to three years in seven years preceding the application for an EU Blue Card.

Finally, the Law formally enshrines the administrative practice whereby any residence permit issued by the Minister **entitles its beneficiary to obtain the required visa**, where appropriate. Thus, once an application for an EU Blue Card has been approved, the Minister must also issue the necessary entry visa to the third-country national concerned.

Enhanced rights for EU Blue Card holders

Regarding the **period of validity**, the EU Blue Card is in principle valid for four years, renewable upon request for the same period.

However, the Law specifies that if the EU Blue Card expires during the renewal procedure, the third-country national remains authorised to reside on Luxembourg territory as a highly qualified worker until the Minister has ruled on the renewal application.

Regarding the **access to the labour-market** for EU Blue Card holders, the Immigration Act provided that during the **first two years of employment,** the holder's access to the labour-market was limited to the activity for which he or she had been admitted, with any employer.

The Law considerably extends the EU Card holder's access to the labour-market. From now on, a change of employer or a modification affecting the admission requirement laid down in the Immigration Act are possible during the **first twelve months** of legal employment on the territory. Such a change must be communicated in advance to the Minister, who may object within a maximum period of 30 days (during which the EU Blue Card holder's right to change jobs is suspended).

In the case of **unemployment**, the Immigration Act provided the withdrawal of the EU Blue Card if the period of unemployment exceeded 3 consecutive months, or if it occurred more than once during the period of validity of the EU Blue Card. The law now makes these conditions more flexible, and stipulates that the EU Blue Card may be withdrawn and/or not renewed if:

- the period of unemployment exceeds 3 months for holders of an EU Blue Card for less than two years;
- the period of unemployment is more than 6 months for holders of an EU Blue Card for at least two years.

The Law also grants EU Blue Card holders:

- the right to exercise a **subsidiary self-employment activity** alongside their main activity in a highly qualified job;
- the right to **education and vocational training** (excluding scholarships and study loans);
- the right to **recognition** of diplomas, certificates, and other professional qualifications.

Finally, an EU Blue Card holder will be able, for the purposes of applying for **long-term resident status**, to rely not only on years of legal and uninterrupted residence within the territory of the EU as an EU Blue Card holder (as currently provided for by the Immigration Act), but also as the holder of a residence permit as a researcher, student, or beneficiary of international protection.

Long-term residents of another Member State holding a long-term residence permit as « *Former holder of an EU Blue Card* » will also be entitled to work as **employed or self-employed persons in Luxembourg,** without having to fulfil the conditions laid down in Articles 42 and 51 respectively of the Immigration Law on the issue of residence permits with a view to exercise an employed or self-employed activity.

Greater mobility within the EU

The Immigration Act so far provided that for a **stay of up to three months**, all third country nationals were required to have a residence permit in order to carry out an employed or self-employed activity, except in the case of business trips.

The Law introduces a new exemption for holders of a valid EU Blue Card issued by another Member State, wishing to stay and work in Luxembourg for up to 90 days in any 180-day period. This exemption also applies to holders of a long-term residence permit as « *Former holder of an EU Blue Card* », issued by another Member State.

These nationals are now exempt from the requirement to have a visa, a work permit, or an authorization other than the EU Blue Card, in order to carry out a business activity in Luxembourg for a period of up to 90 days. Business activity is defined as a temporary activity directly related to the employer's business interests and to the professional duties of the EU Blue Card holder, including attending internal or external business meetings, attending conferences or seminars, negotiating business deals, undertaking sales or marketing activities, exploring business opportunities, or attending and receiving training courses.

For **stays of more than three months**, the Immigration Law previously stipulated that after 18 months of residence in the first Member state, the holder of an EU Blue Card could move to another Member state for the purpose of highly qualified employment. No later than one month after entering Luxembourg territory, the third-country national had to apply for an EU Blue Card to the Minister. The applicant was not authorized to work until the Minister had issued a residence permit.

Firstly, the Law reduces the period of residence in the first Member state for mobility purposes in a second Member state, **from 18 months to 12 months**. This period is even reduced to 6 months of legal residence in the first Member State if the EU Blue Card holder makes use of his/her right to mobility for the second time. An application for an EU Blue Card must still be made in Luxembourg within one month of the third-country national's arrival on Luxembourg territory. However, the Law now allows applicants to submit their application while still residing on the territory of the first Member State, and especially to **start working immediately** after submitting their application for a full residence permit in the second Member State, without having to wait for the Minister to issue a residence permit.

With a view to introducing a fast-track procedure for processing EU Blue Card applications in the event of mobility, the Law introduces a **maximum period of 30 days** for the Minister to reach a decision. This initial deadline may be extended by a further 30 days in duly justified exceptional circumstances linked to the complexity of the application.

Family reunification for family members of an EU Blue Card holder

The Immigration Law already provides for the possibility of certain family members of an EU Blue Card holder issued in a first Member State, and who have applied for mobility in Luxembourg, to accompany or join the latter, if the family was already established in the first Member state.

To this end, family members must apply for a residence permit. Under the Immigration law, this application could only be made if the family member concerned resid outside Luxembourg.

The Law provides that even before an application for a residence permit is submitted, the family members of an EU Blue Card holder **may enter and reside in Luxembourg** if they hold a valid residence permit obtained on the first Member state as family members of an EU Blue Card holder.

With the aim of facilitating the swift entry of highly qualifies workers, the Law provides that residence permits to family members will be issued at the same time as the EU Blue Card, where the applications were lodged simultaneously. Finally, if the family member joins the holder of an EU Blue Card, an **accelerated procedure** is provided for by the Law, and the residence permit must be granted within 30 days pf the submission of the application.

CSSF CIRCULAR 24/856 | INVESTOR PROTECTION IN THE EVENT OF NAV CALCULATION ERROR AND NON-COMPLIANCE WITH INVESTMENT RULES

Published on 28 March 2024 this circular enters into effect on 1 January 2025 and replaces CSSF Circular 02/77.

CSSF Circular 24/856 aims at extending and codifying the rules applicable to Luxembourg investment funds in the event of a NAV calculation error, an investment breach or other errors that can arise in the management of such funds. It imposes obligations in terms of the procedures that have to be in place and certain disclosures that need to be made in the prospectus.

All regulated fund structures are in scope i.e. UCITS, Part II Funds, SIFs or SICARs as well as MMFs, EuVECAs, EuSEFs and ELTIFs regardless of form.

It sets out clearly the rules applicable to each entity concerned by such errors/breaches including the fund's governing body, the AIFM or management company, the administrator, and the depositary.

The circular makes it clear that the governing body of the fund (or the managers of the portfolio manager under the supervision of the governing body of the fund) must ensure that there are proper procedures in place to avoid errors and, if they do happen, to ensure that the provisions of this circular are applied.

The CSSF is clear however that the general principle is that if an error /non-compliance causes harm, those that caused it due to non-compliance with the obligations which are applicable to them, are liable to ensure it is repaired.

NAV Calculation Errors

Each in scope fund or, if applicable, its manager, must have policies and procedures in place to ensure a proper valuation of the assets and liabilities of the fund, in accordance with all applicable rules. Such policies and procedures should limit as much as possible the risk of errors and should allow for detection of errors as soon as they happen.

While closed ended funds fall outside the scope of the rules of the conduct set out in section 4 of the circular, they are still obliged to have policies and procedures in place and to correct errors in NAV calculations.

The circular defines what a NAV calculation error is and it sets out the circumstances where it could occur.

Only NAV calculation errors that exceed certain thresholds must be notified to the CSSF and corrected in accordance with the rules set out in the circular. The circular sets out different tolerance levels (calculated as a percentage of the NAV) for different types of funds and different investment strategies including MMF, UCITS, and ELTIFs and Part II Funds available to retail investors. In certain circumstances Part II Funds and ELTIFs may apply higher thresholds than those set out in the circular.

For SIFS, SICARs, EUVECAs and EUSEFs as well as Part II Funds and ELTIFs that are only available to well informed investors or professional investors, the governing body of the fund together with the Manager can determine the tolerance thresholds considering the criteria outlined in the circular. In no event can a tolerance level be higher than 5%.

As soon as a NAV calculation error is discovered, the circular sets out detailed rules to be followed by the various parties involved to correct and remediate such error. The circular provides for two different methods of calculating the financial impact of any error - the compound method and the non-compound method. Whatever method is used should be decided by the internal policies applicable to the fund.

Breaches of Investment Rules

Once a breach of an investment rule by a fund is discovered, steps need to be taken to correct the error and indemnify the fund in case of loss. It first needs to be determined whether the breach is an active or a passive breach.

Passive breaches which result from events outside the control of the fund need to be corrected as soon as possible but are not subject to the extensive rules set out in the circular for correction and regularisation and do not need to be notified to the CSSF.

Active breaches, which are breaches resulting from **intentional acts** (most notably investment or disinvestment decisions), or the **absence of any act**

or decision when a breach was foreseeable, must be dealt with in accordance with the provisions of the circular.

The CSSF points out that both pre and post trade controls need to be in place to avoid breaches in the first place and to catch them as soon as possible if they do occur. Post trade controls must be done at the latest by the date of the next following NAV calculation. In between NAV calculation dates, the CSSF expects controls to be carried out on whether assets are eligible for the fund and on the level of holdings in one issuer. Any thresholds calculated based on NAV, such as risk diversification thresholds, can be controlled on each NAV calculation date.

Once a breach is discovered, the steps necessary to regularise the fund and the calculations to determine whether the fund has suffered because of such breach, need to be done as soon as possible. Where the fund has suffered, it needs to be compensated. There are no tolerance thresholds.

Every fund must have a policy in place governing how investment breaches are dealt with. Such policy must set out the methods for determining the impact. The circular foresees two methods for determining the financial impact – the accounting method and the economic method.

Other Errors

In addition, the circular also sets out rules for dealing with the following:

- incorrect application of swing pricing rules,
- payment of costs/expenses not in conformity with the fund rules,
- misapplication of the cut-off rules, and
- allocation errors.

Miscellaneous

The circular also sets out rules regarding paying indemnity amounts to investors and/or to intermediaries on behalf of the end investors.

The policy put in place by the fund can allow for *de minimis* rules. The fund always must be compensated for the damage that it suffers but *de minimis* rules can be applied to amounts that should be paid to investors. Any *de minimis* rules should be to avoid the investor losing money, for example if bank charges exceed the amount to be paid to the investor.

Costs involved to correct a NAV calculation error, or an investment breach should not be borne by the fund.

The circular has an entire section on when the auditor becomes involved. The auditor may carry out controls that the circular has been complied with in the context of the distinct report it has to do pursuant to CSSF circular 21/790. In certain distinct cases a special auditors report will be required; namely with the error or investment breach relating to a UCITS or a Part II Fund and the total amount of indemnification being greater than EUR 50,000 or if an amount to be paid to one investor exceeds EUR 5,000.

The CSSF are to be notified via a special form of breaches or NAV calculation errors and in general, they should be informed within 4 to 8 weeks after the date that the error or breach was first detected.

The CSSF will make an amended form available for notifying errors/investment breaches prior to the entry into force of the circular on 1 January 2025.

UCITS, Part II Funds, MMFs and ELTIFs should update their prospectuses at the next update in order to inform investors that the rights of final beneficiaries may be affected when paying compensation in the event of errors/non-compliance when they have subscribed through a financial intermediary.

UCITS I CSSF UPDATES FAQS IN RESPONSE TO US SETTLEMENT CYCLE CHANGES

On 20 June 2024, the CSSF has released an update on its Frequently Asked Questions concerning Circular CSSF 02/77 on protection of investors in case of NAV calculation errors, non-compliance with investment rules and other types of errors at UCI level (which will be replaced by Circular CSSF 24/856 on 1st January 2025) and the FAQ on the Law of 17 December 2010 relating to UCI.

New "T+1" Settlement Cycle

In the context of moving the standard settlement cycle from T+2 to T+1 amongst others in the United States, UCITS may be facing operational challenges, including from an investment compliance perspective, resulting notably from timing gaps between the settlement cycles on the asset side (securities transactions) and on the liability side (subscriptions/redemptions).

Indeed, most securities transactions in the United States, as well as other jurisdictions (Canada and Mexico) have followed a T+2 settlement cycle. This means that transactions settle two business days after the trade date. For instance, if you sold shares of X stock on Monday, the transaction would be completed, or "settled," on Wednesday.

With effect from end of May 2024, most securities transactions in those jurisdictions have moved from a standard settlement cycle of T+2 to T+1. This change implicates that securities transactions will settle just one business day after the trade date. So, if you sell shares of X stock on Monday, the transaction will now settle on Tuesday instead of Wednesday.

CSSF Updates FAQs

The updated FAQs provide detailed guidance on CSSF's expectations for investment compliance under these new circumstances.

The clarifications have been included in the following FAQs:

- Circular CSSF 02/77 FAQ: addition of question 4.a and modification of question 4 (now 4.b).

The FAQ suggests that compliance measures may include shortening the UCITS settlement cycle, using cash management solutions, diversifying bank accounts, considering temporary borrowings, and exploring extended settlement periods. UCITS must ensure continuous adherence to investment restrictions and manage any passive breaches resulting from timing gaps.

- Law of 17 December 2010 FAQ: revision of question 1.14 (version 19).

The new version of the question 1.14 broadens the conditions under which the 20% limit on ancillary liquid assets may be temporarily breached. Previously limited to exceptionally unfavorable market conditions like the September 11 attacks or the Lehman Brothers bankruptcy, the new guidelines now include any exceptional circumstances, providing greater flexibility to protect investor interests.

AIFM / UCITS | ESMA ON PERFORMANCE FEES

ESMA updates its Q&A on costs and fees

ESMA published on 8 and 24 May 2024 further responses to questions on the application of performance fees, expanding their Q&A on costs and fees.

The Q&A concern the **application of a minimum performance reference period to additional reference indicators** and **whether the manager of a Fund of Funds ("FoF") can charge performance fees**.

Scope of application

According to the ESMA Guidelines on performance fees in UCITS and certain types of AIFs (the "**Guidelines**"), the guidelines on performance fees apply to UCITS and certain AIFs.

The AIFs in scope are those which are marketed by their AIFM to retail investors in accordance with Article 43 of the AIFM Directive, except for closed-ended AIFs; and open-ended AIFs that are EuVECAs (or other types of venture capital AIFs), EuSEFs, private equity AIFs or real estate AIFs.

Application of a minimum performance reference period to additional reference indicators

The original question posed to ESMA reads as follows:

Where a manager applies an additional reference indicator to the performance fee model (e.g.: a hurdle rate on top of the High-Water Mark model or the benchmark model), should the minimum performance reference period be applied to the additional reference indicator?

ESMA answered the question by explaining that the minimum performance reference period is applied to the **performance fee model** in line with paragraphs 40-42 of the Guidelines. It is not necessary for the fund manager to apply the minimum performance reference period to the **additional reference indicator** as long as:

- the final combination (performance fee model and additional reference indicator) does not result in higher fees for investors compared to the sole use of the performance fee model; and
- the performance fee model (without the additional reference indicator) is consistent with the fund's investment objectives, strategy and policy.

The organisation and computation of the performance fee shall be disclosed appropriately in the prospectus to the investors in line with paragraph 46 of the Guidelines.

Fund of Funds manager charging performance fees

The original question posed to ESMA reads as follows:

Can the manager of Fund of Funds charge performance fees?

ESMA answered the question by explaining that the charging of performance fees must always be in line with paragraph 18 of the Guidelines, namely the manager of a FoF should always be able to demonstrate to the national competent authorities ("**NCA**") how the performance fee model of a fund it manages constitutes a reasonable incentive for the manager and is aligned with the investors' interests.

Furthermore, ESMA elaborates that as a general principle, where the investment policy of a FoF requires the active management of the FoF and the determination of the allocation in the underlying funds has a material impact on the FoF performance, performance fees for the manager of the FoF could be considered as justified.

Lastly, the assessment on how performance fees are justified in light of the investment policy of the FoF should also be reflected in the fund documentation, including the fund rules or instruments of incorporation. The fund documentation may be reviewed on a case-by-case basis by the NCA, where needed.

UCITS | ESMA CALL FOR EVIDENCE ON THE REVIEW OF THE COMMISSION DIRECTIVE 2007/16/EC ON UCITS ELIGIBLE ASSETS

On 7 May 2024, ESMA published a call for evidence on the review of the Commission Directive 2007/16/EC on UCITS Eligible Assets (the "**UCITS EAD**").

Background

Under Directive 2009/65/EC of 13 July 2009 (the "**UCITS Directive**"), a UCITS fund is permitted to invest only in specific asset classes, which include:

- bank deposits and financial derivative instruments.
- money market instruments and other investment funds,
- certain transferable securities.

The UCITS EAD complements the UCITS Directive by establishing specific criteria that an instrument must meet to be eligible for investment by a UCITS.

However, since its adoption in 2007, the range and variety of financial instruments traded on financial markets have grown significantly.

In June 2023, the European Commission requested ESMA to provide technical advice on reviewing the UCITS EAD and analyse whether any divergences have been detected.

Call for Evidence

Convergence issues and clarity of key concepts

ESMA seeks to gather evidence and views from stakeholders on the clarity of key concepts under the UCITS EAD, as well as potential interpretation and convergence issues. To this end, ESMA's call for evidence sets out several questions which seek to ascertain stakeholders' practical experience of the UCITS EAD. For example, there are questions relating to recurring or significant issues stakeholders may have had with the interpretation or consistent application of UCITS EAD rules on financial indices, money market instruments and with the notions of "liquidity" and "liquid financial assets". ESMA ask stakeholders to explain their understanding of "**ancillary liquid assets**" and whether the "**transferable security " criteria** set out in the UCITS EAD are adequate and clear enough.

Direct and indirect UCITS exposures to certain asset classes

ESMA seeks to assess possible risks and benefits of UCITS gaining exposures to asset classes on which there are divergent views as regards their eligibility as UCITS investments.

This covers both direct and indirect exposures, by way of, for example, delta-one instruments, embedded derivatives, and replications of financial indices.

The questions set out in ESMA's call for evidence are aimed at further solidifying ESMA's understanding of the extent to which UCITS have gained direct and indirect exposures to certain asset classes that may give rise to risk for retail investors. ESMA is interested in receiving stakeholder feedback to assess the merits of allowing UCITS to gain direct or indirect exposures to a range of asset classes, including unlisted equities, commodities, and crypto-assets.

The questions are also raised whether a look-through approach is required to determine the eligibility of assets and what are the risks and benefits of UCITS investments in securities issued by securitisation vehicles.

ESMA finally asks whether stakeholders have observed any issues with respect to the interpretation or consistent application of the UCITS EAD other than those linked to the questions specifically raised.

Next Steps

ESMA will review all feedback submitted by 7 August. Following this review, ESMA is expected to provide its final technical advice to the European Commission by 31 October 2024.

UCITS | UK PUBLISHES OFR REGULATION CONFIRMING EQUIVALENCE OF EEA UCITS

Introduction

On 14 May 2024, the UK Government released official Regulations confirming its equivalence decisions regarding EEA states under the UK's Overseas Funds Regime (OFR). An explanatory memorandum, providing further clarification, accompanied the Regulations The Regulations take effect on 16 July 2024.

Background

In January 2024, the UK Government declared all EEA states (which include the EU's 27 Member States plus Iceland, Liechtenstein, and Norway) equivalent under the OFR concerning UCITS schemes (whether umbrella or standalone), excluding Money Market Funds (MMFs).

For further details please see our previous article.

What is the OFR in UK?

The OFR provides a simplified process for overseas schemes, such as EEA UCITS, to seek recognition from the Financial Conduct Authority (FCA). This recognition enables these schemes to be marketed to UK retail investors under section 271A of the Financial Services and Markets Act 2000 (FSMA 2000). Applications can be made by scheme operators if the scheme originates from a country approved by HM Treasury (HMT) and is of a specified type for that country. The publication of these Regulations is positive news, ensuring that EEA UCITS, excluding MMFs, can continue marketing in the UK without disruption. This follows their transition from the "Temporary Marketing Permission Regime" to formal recognition under the OFR.

A roadmap was issued on 1 May 2024 by the FCA and HM Treasury to explain the OFR.

ESG | ESMA ISSUES FINAL REPORT ON FUND NAMES GUIDELINES

Harmonised criteria for ESG and sustainability terms in fund names

The European Securities and Markets Authority ("**ESMA**") has published the final report on fund names guidelines. The aim is to prevent "greenwashing" by ensuring that environmental, social and governmental ("**ESG**") criteria and sustainability terms used in fund names are backed by substantial evidence of sustainability characteristics or objectives. These guidelines, are intended to enhance investor protection and provide clear criteria for asset managers.

Key guidelines overview

- Minimum investment thresholds
  - Funds using sustainability, environmental or impact related terms in their names must allocate at least 80% of their investments to meet environmental or social characteristic or sustainable investment objectives in accordance with the binding elements of the investment strategy.
  - Funds using sustainability-related terms should, in addition, commit to invest meaningfully in sustainable investments.
  - Funds using "transition or impact related terms in their names should also ensure that investments used to meet the 80% threshold referred to above are on a clear and measurable path to social or environmental transition or are made with the objective to generate a positive and measurable social or environmental impact alongside a financial return.
- Exclusions
  - Funds using transition, social and governance, sustainability or impact related terms should exclude investments in companies involved in activities related to controversial weapons, or in the cultivation and production of tobacco or companies that benchmark administrators find in violation of the UN Global Compact principles or the OECD Guidelines for Multinational Enterprises.
  - In addition, funds using environmental, sustainability or impact related terms in their names should exclude certain investments in companies with activities relating to hard coal and lignite, oil fuels, gaseous fuels and that derive 50% or more of their revenues from electricity generation with GHG intensity above a certain threshold.

Consultation feedback and amendments

ESMA's consultation of November 2022 received 125 responses from asset managers, NGOs, and consumer representatives. Based on this feedback, several amendments were made, including:

- Removal of the 50% threshold for sustainable investments for the use of sustainability-related words in funds' names.
- Introduction of a commitment to invest "meaningfully" in sustainable investments; and
- Adjustment of exclusion criteria to accommodate transition-focused strategies.

Next steps and implementation

The guidelines will be translated into all EU languages and published on ESMA's website. The guidelines will apply three months after publication of the translations. New funds created after the application date should apply the guidelines immediately, while existing funds have a six-month transitional period.
Competent authorities must notify ESMA within two months whether they comply, intend to comply, or do not intend to comply with the guidelines.

ELTIF 2.0 | ESMA'S RESPONSE TO THE EUROPEAN COMMISSION TECHNICAL STANDARDS

The European Securities and Markets Authority ("**ESMA**") responded to the European Commission's ("**EC**") request for amendments to the European long-term investment fund ("**ELTIF**") regulatory technical standards ("**RTS**").

Background

Since the introduction of ELTIFs in 2015, their adoption in the EU has been slow. To address this, the EC amended the original ELTIF rules with Regulation (EU) 2023/606 (the ELTIF Regulation, also known as "**ELTIF 2.0**") which took effect on 10 January 2024. These new regulations aim to make ELTIFs more attractive to both asset managers and investors. ELTIF 2.0 tasked ESMA with developing draft RTS to specify:

- the conditions under which the life of an ELTIF aligns with the life cycles of its individual assets and various features of its redemption policy.
- the requirements for cost disclosure. On 19 December 2023, ESMA submitted draft RTS to the EC. The EC responded on 6 March 2024, with concerns that ESMA's proposals extended beyond its technical mandate, particularly concerning redemptions and liquidity management tools.

ESMA revised RTS

On 22 April 2024, ESMA issued its response, including an opinion and revised RTS, addressing six key areas:

Notification of material changes to redemption policy

ESMA initially proposed that ELTIF managers inform regulators of changes to the fund's redemption policy within three business days of a material change. The EC preferred that these notifications be submitted in advance. ESMA agreed to this approach and now the ELTIF managers must notify regulators of any material changes at least one month before implementation, or as soon as possible after unplanned changes.

Minimum notice periods for redemption and liquidity requirements

ESMA originally proposed a 12-month minimum notice period for redemptions with liquid asset holdings based on a sliding scale. The EC found these requirements too strict for ELTIFs, which are meant for illiquid investments. ESMA revised the rules, reducing the liquidity requirements for shorter notice periods and removing the blanket 12-month rule.

Revised notice periods and requirements:

Notice Period	Minimum percentage of liquid assets to be held by the fund [1]	Maximum percentage of liquid assets that can be redeemed [2]
Less than 12 months to 6 months (included)	10%	90%
Less than 6 months to 3 months (included)	15%	67%
Less than 3 months to 1 month (included)	20%	50%
Less than 1 month	25%	20%

Liquidity management tools

ESMA had previously required ELTIF managers to implement at least one anti-dilution tool. The EC argued this would disincentivize the use of other suitable tools. ESMA ultimately removed this mandatory requirement.

Redemption gates

ESMA proposed linking redemption gates to notice periods, with a broader requirement for use in specific circumstances. The EC expressed concerns about limiting gates to "exceptional circumstances." ESMA clarified that redemption gates can be used alongside other liquidity management tools.

Cost disclosure

The EC found ESMA's proposed cost disclosure methodology inconsistent with existing EU legislation.

ESMA agreed to change the cost calculation method from capital-based to net asset value-based, aligning with the EC's suggestion.

Minimum holding periods

The EC disagreed with ESMA's criteria for setting minimum holding periods, seeing it as mandatory and conflicting with ELTIF flexibility. ESMA maintained that minimum holding periods are essential and did not amend its stance.

Next Steps

ESMA's revised RTS shows a willingness to accommodate the EC's concerns on liquidity management and cost disclosures. However, issues remain around the redemption notice and minimum holding periods. The EC may adopt the RTS with relevant amendments or reject it. The European Parliament and the Council have three months to object to the adopted version.

GROUND-BREAKING WORLDWIDE ARTIFICIAL INTELLIGENCE ACT

On 21 May 2024, the Council of Ministers of the European Union (the "**Council**") unanimously approved a regulation (the "**AI Act**") harmonising the rules on artificial intelligence ("**AI**"). The Council's position concludes a legislative journey which began on 21 April 2021 with the adoption by the European Commission of a proposal regulation based on article 114 of the Treaty on the Functioning of the European Union ("**TFEU**") and agreement by the European Parliament on 13 March 2024.

Background

Given the increasing significance of AI systems which are rapidly permeating all sectors on a worldwide scale, the intervention of the EU's lawmakers is certainly necessary. This first attempt at global AI regulation could even be considered as AI-based tools are already integrated into various systems that impact citizens' daily lives, market operators and consumers. Furthermore, their usage is expected to grow significantly, with ongoing deployment of newer technologies to enhance outcomes and address evolving market needs.

The approach of the AI Act aims to ensure a proper and systematized collection of information, which is essential for an optimal exploitation of AI, while, at the same time, it intends to ensure the highest level of transparency and accountability. Furthermore, governance structures are put in place to guide the transition towards an economy and even a society whereby AI-based systems are closely aligned with the values enshrined in Article 2 of the Treaty on European Union ("**TEU**"), such as human rights, equality, freedom and democracy as well as the protection of basic assets such as the environment.

Definition of Artificial Intelligence

The framework of the AI Act is based on a very broad definition of artificial intelligence. Accordingly, Article 3 of the AI Act defines the AI as "[…] a machine-based system that is designed to operate with varying levels of autonomy and that may exhibit adaptiveness after deployment, and that, for explicit or implicit objectives, infers, from the input it receives, how to generate outputs such as predictions, content, recommendations, or decisions that can influence physical or virtual environments".

Following the same logic which underpins definition of the Organization for Economic Cooperation and Development ("**OECD**"), this phrasing is as neutral and flexible as possible to avoid the risk of quickly becoming outdated by the rapid evolution of technologies. The main elements of the definition, being (i) operations being led autonomously by AI systems, (ii) adaptiveness and, most of all (iii) the inferring act of generating output from inputs received by the user, appear sufficiently wide to apply to the development of more and more innovative AI systems.

Scope of the AI Act

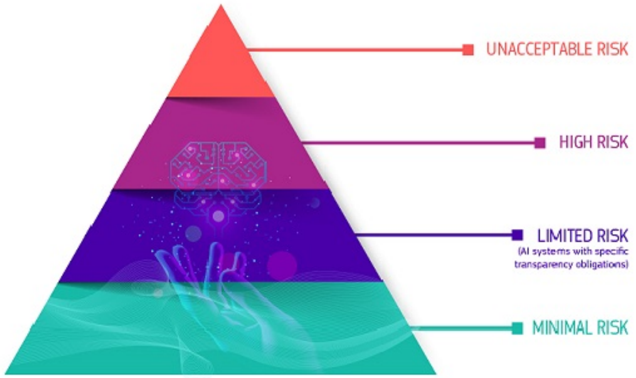
The AI Act applies principally to AI providers, who are defined as natural or legal (private or public) persons developing and marketing AI systems (or general-purpose AI models), whether for payment or free of charge. Providers need to first assess and document the type of AI systems and the risks associated therewith, as well as make available such information to deployers and users. Other stakeholders subject to the AI Act include product manufacturers, importers, and distributors.

Specific obligations are also imposed on deployers, being developers of AI systems, who may use under their authority, for this purpose, *other* AI systems, and market these under their own name or trademark. In particular, deployers must take all possible precautions to ensure that they receive all relevant information relating to AI systems from providers (especially when using high-risk AI tools) or otherwise request it.

Similar to most EU internal market legislation, the AI Act has a wide territorial scope. It applies to providers who market AI systems within in the EU, regardless of their location or establishment outside the EU. Deployers of AI systems within the EU are also subject to the AI Act. This includes providers and deployers of AI systems located outside the EU, so long as those systems are used within the EU.

A Risk-based Approach

The AI Act advocates an approach to the use of AI systems essentially based on four (4) levels of risk:



[Source: https://digital-strategy.ec.europa.eu/en/policies/regulatory-framework-ai]

A Risk-based Approach: AI Systems source of unacceptable risks

Certain AI systems are considered to bear consequences particularly detrimental to the EU values and, as such, the risk inherent in their use is considered unacceptable. Therefore, the marketing of such AI systems is forbidden. The AI Act (Article 5, para. 1, therein) breaks down the list of prohibited AI systems as follows:

- AI systems deploying subliminal, manipulative or deceptive techniques in view of distorting behaviour and prevent informed decision-making, causing significant harm to individuals;
- AI systems exploiting vulnerabilities related to age, disability or socio-economic status in view of distorting behaviour and causing significant harm;
- Biometric categorisation systems inferring sensitive attributes (race, political opinions, trade union membership, religious or philosophical beliefs, sex life or sexual orientation), with the exception of the tagging or filtering of lawfully acquired biometric datasets or where law enforcement agencies categorise biometric data;
- “Social scoring” AI systems, allowing the evaluation or classification of individuals or groups based on their social behaviour or personal traits, resulting in a prejudicial or unfavourable treatment;
- AI systems fostering the assessment of the risk of persons committing criminal offences solely based on profiling or personality traits (unless it is used to supplement human assessments based on objective and verifiable facts directly related to criminal activity);
- Facial recognition AI systems allowing the creation of databases by the untargeted extraction of facial images from the internet or from video surveillance images;
- AI systems inferring emotions in workplaces or educational establishments, except for medical or security reasons; and
- AI systems allowing real-time remote biometric identification in publicly accessible areas for law enforcement purposes, unless where required to (i) search for missing persons, abduction victims, and people who have been human trafficked or sexually exploited, (ii) prevent substantial and imminent threat to life, or foreseeable terrorist attack, or (iii) identify suspects in serious crimes (the AI Act mentions, non-exhaustively: murder, rape, armed robbery, narcotic and illegal weapons trafficking, organised crime, and environmental crime). The exceptional use of AI systems for this purpose is surrounded by safeguards aimed at modulating the often opposing needs for public security and the protection of fundamental rights.

A Risk-based approach: high-risk AI systems

High-risk AI systems involve or may involve a high risk to the health and safety or fundamental rights of individuals. Such systems are not subject to a straightforward prohibition, but their use is subject to compliance with certain mandatory requirements and a conformity assessment.

In accordance with Article 6 of the AI Act, high-risk AI systems can be, respectively, (i) those used as a safety component or a product covered by certain EU laws and required to undergo a third-party conformity assessment under the same laws (such laws being expressly considered in annex I to the AI Act), or (ii) those used in a number of specific cases (as detailed in annex III to the AI Act)[*], a number of exception being provided. [†]

The AI Act imposes specific obligations on providers of high-risk AI systems, as these are required to:

- establish a risk management system throughout the high-risk AI system’s lifecycle;
- conduct data governance, ensuring that training, validation and testing datasets are relevant, sufficiently representative and, to the best extent

possible, free of errors and complete according to the intended purpose;

- draw up technical documentation to demonstrate compliance and provide authorities with the information to assess that compliance;
- design their high-risk AI system for record-keeping to enable it to automatically record events relevant for identifying national level risks and substantial modifications throughout the system's lifecycle;
- provide instructions for use to downstream deployers to enable the latter's compliance;
- design their high-risk AI system to allow deployers to implement human oversight;
- design their high-risk AI system to achieve appropriate levels of accuracy, robustness, and cybersecurity; and
- establish a quality management system to ensure compliance.

A risk-based approach: limited- and minimal-risk AI systems

In contrast with AI systems bearing unacceptable- and high-risk, AI systems involving limited or minimal risk are generally considered as lawful and only required to comply with certain minimum transparency requirements.

Several AI systems are considered of limited risks under the AI Act, such as those for emotion recognition and biometric categorisation systems, chatbots and several kinds of content generation. Such AI systems are mainly subject to disclosure requirements, as providers and deployers need to provide individuals with all the relevant information (subject to limited exemptions).

Other systems, such as videogames and spam filters integrating AI, are considered to pose minimal risks and as such are not subject to mandatory requirements. Nevertheless, providers are encouraged to voluntarily adhere to specific codes of conduct.

Provision of AI general purpose models and systems

Under the AI Act, general-purpose AI ("**GPAI**") *models* are refined as models displaying significant generality and competently performing a wide range of distinct tasks, then integrated into a variety of downstream systems or applications (the definition does not cover AI models used for research, development, or prototyping activities *before* their placement on the market). GPAI *systems* are AI systems based on such GPAI models and have the capability to serve a variety of purposes, both for direct use as well as for integration in other AI systems.

Given GPAI systems can be used as such or integrated into high-risk AI systems, providers of GPAI models are subject to strict obligations, mainly aimed at producing a body of technical documentation allowing information, training, testing and evaluating the results, smoothing the integration of the AI model into further AI systems and respecting the EU rules on copyright and intellectual property.

Specific rules are provided for GPAI models when these present systemic risks, as providers are under a notification obligation to the European Commission, which assesses (possibly requesting the advice of a qualified alert from the scientific panel of independent experts) whether a GPAI model has systemic implications. Furthermore, providers of GPAI models implying systemic risks are also required to track, document and report possible incidents to the Artificial Intelligence Office (the "**AI Office**") and national competent authorities, take action to mitigate systemic risks and ensure an adequate level of cybersecurity protection.

Importantly, following the logics of internal market and mutual recognition, GPAI model providers may demonstrate compliance with their obligations if they voluntarily adhere to a code of practice. Once harmonised standards are published, compliance with these will lead to a presumption of conformity.

Governance matters

The complexity of the AI Act prompted the EU lawmaker to establish specific governance bodies. As such, the AI Office, established at European level, has the task of supervising the implementation and enforcement of the AI Act. In particular, the European Commission shall entrust its competences to enforce the provisions on GPAI models to the AI Office (for instance as to the evaluation of GPAI models).

As in the case of other agencies established at the EU level, the AI Office shall assist national competent authorities, in particular regarding market surveillance of high-risk AI systems. As predicted, the office shall assist AI providers in drafting codes of conduct, which should foster their compliance with the relevant standards under the AI Act.

Besides the AI Office, an Artificial Intelligence Board, composed of representatives of EU member states will assume a steering function by providing soft law advice, opinions and recommendations.

Sanctions

Article 99 of the AI Act provides for penalties, articulated, in conformity with the principle of proportionality, on the seriousness of the breach and the size and turnover of the author. Therefore, both the type and intensity of the sanction are variable, with orders, warnings and fines being applicable, based on several criteria. Among the most significant penalties, the following can be considered:

- failure to comply with the prohibition on AI systems may be sanctioned with fines up to EUR 35m or 7% (seven percent) of the total worldwide annual turnover, whichever is greater;
- a breach of certain provisions relating to high-risk AI systems may result in a fine up to EUR 15m or 3% (three percent) of the total worldwide annual turnover, whichever is greater; and
- the provision of incorrect, incomplete or misleading information to competent authorities may also result in a fine of up to EUR 7.5 m or 1% (one percent) of total worldwide annual turnover, whichever is greater.

Entry into force

The AI Act is expected to be published in the Official Journal of the European Union in July 2024 and, in accordance with the TFEU's rules, will enter into force 20 (twenty) days following its publication and should become applicable 24 (twenty-four) months as of the date of entry into force.

Nevertheless, the act establishes certain specific timelines for the applicability of its provisions, as the provisions:

- on prohibited AI systems shall be applicable 6 (six) months after the entry into force of the AI Act,
- on GPAI shall be applicable 12 (twelve) months thereafter,
- on high-risk AI systems (under annex III) shall be applicable 24 (twenty-four) months thereafter, and
- high risk AI systems (under annex I) shall be applicable 36 (thirty-six) months thereafter.

The way forward

An analysis of the provisions of the AI Act reveals how, in this first attempt to create a comprehensive regulation for AI, the EU lawmakers tried to strike a very delicate balance. They sought to establish necessary limits on the use of intrusive technologies whilst also enhancing basic public policies such as public security and public order.

This issue is particularly evident as the AI Act establishes exceptions, even for the use of unacceptable AI systems, notwithstanding their potential impact on fundamental rights. Given that the legislative provisions required extremely nuanced case-by case implementation, it is difficult to predict whether the safeguards outlined in the AI Act might hinder efficient utilisations of AI systems in the security area or inadvertently intrude upon individuals' private lives. Article 2 of the TEU underscores the principle that security should transform into repression, reminiscent of a chilling *Minority Report* scenario.

The three-year long legislative process itself, though not uncommon in other, potentially less impactful areas of the internal market, vividly illustrates this dilemma, as the initial proposal from the European Commission underwent significant amendments (largely by the European Parliament). As the EU strives to set the benchmark for AI, mainly addressing US-resident providers, its stands at the forefront of this modern retelling of the eternal conflict between freedom and authority.

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[*] Such as AI systems relating to biometrics not causing unacceptable risks, critical infrastructure, education and vocational training, employment, access to essential public or private services, law enforcement, management of migration, asylum and border control and administration of justice and democratic processes.

[†] I.e., except if the AI system (x) performs a narrow procedural task; (y) improves the result of a previously completed human activity; (z) detects decision-making patterns or deviations from prior decision-making patterns and is not meant to replace or influence the previously completed human assessment without proper human review; or (t) performs a preparatory task to an assessment relevant for the purpose of such cases (as listed in annex III to the AI Act).

STATE OF THE NATION | TAX MEASURES ANNOUNCED DURING THE PRIME MINISTER'S GENERAL POLICY STATEMENT

On 11 June 2024, Prime Minister Luc Frieden delivered before the Luxembourg Parliament (*Chambre des Députés*) his first general policy statement on the state of the nation (the "**Statement**").

In his Statement, the Prime Minister announced specific and general tax measures to be adopted within the next couple of years. These measures may be summarised as follows:

For companies

- As of 1 January 2025, the maximum corporate income tax (*impôt sur le revenu des collectivités*) rate will be lowered down to 16% (instead of 17% currently).
- Registration tax (*tax d'abonnement*) for actively managed exchange-traded funds (ETF) will also be lowered next year (without further details).

For natural persons

- As of 1 January 2025, the progressive income tax scale will be adjusted by 2.5 additional indexation tranches. This means that the amounts of net income on which the different tax rates will apply will be increased by 6.4%.
- The government is also contemplating changing the tax system by 2026 to keep a single tax class (instead of the classes 1, 1a and 2 currently existing). In the meantime, single-parent families will receive a tax allowance (to be proposed by the Minister of Finance).
- The profit-sharing scheme and the impatriation scheme will be made more attractive. The new terms are to be defined this year and applied as of next year.
- Most of protective shields put in place in Luxembourg to contain energy prices will be cancelled on 1 January 2025. However, persons with low income will receive additional support, notably through the energy tax credit and energy allowance, which will be increased.

LUXEMBOURG PILLAR TWO LAW | PROPOSED AMENDMENTS

Update to Pillar Two legislation

On 12 June 2024, draft law No. 8396 has been submitted to the Luxembourg Parliament (*Chambre des Députés*) (the "**Draft Law**") proposing amendments to the Luxembourg law on Pillar Two (see our previous newsflash on the Pillar Two law).

Council Directive (EU) 2022/2523 of 15 December 2022 (the "**Pillar Two Directive**") has been transposed through the Luxembourg law of 22 December 2023 ("**Pillar Two Law**") meeting the transposition deadline of 31 December 2023.

The work of the OECD/G20 Inclusive Framework ("**IF**") has been ongoing since the issuance of the Pillar Two Directive notably with the issuance of several sets of Agreed Administrative Guidance ("**AAG**"), which either provided clarifications or introduced additional technical rules; the Pillar Two Law already took into consideration certain aspects of these AAG.

The Draft Law aims to incorporate several items from the February, July and December 2023 AAG as well as clarifications from the OECD 2022 Commentary.

Transposition approach

The Draft Law provides that the amendments should have the same application date as for the Pillar Two Law (fiscal years starting as from 31 December 2023).

Comments to the Draft Law give further insight on the transposition approach:

- OECD/IF deliverables form a global and coherent system,
- taxpayers must be provided with legal certainty,
- these updates are possible as potential tax liabilities arising from the Pillar Two Law are not yet definitive, and
- Luxembourg rules must reach the qualified status under the forthcoming peer review in order to avoid double taxation.

In this context, the June 2024 AAG might lead to further updates to the Luxembourg Pillar Two legislation.

Comments to the Draft Law recall that these additions should also be interpreted in light of the OECD/IF work as permitted by Recital 24 of the Pillar Two Directive.

Key updates

The Draft Law intends to introduce the following key updates:

Filing obligations

- **Pillar Two returns content, format and first filing deadline**
  - a single return should be filed for the Top-Up Tax, Under Taxed Profit Rule and Domestic Top-Up Tax
  - the Pillar Two returns must follow the format of the latest Globe Information Return approved by the IF
  - the first filing obligations should not arise before 30 June 2026.

Scope clarifications

- **Investment funds/real estate funds and excluded entities**

Based on the OECD 2022 Commentary (Chapter 1-§45), entities held by an investment fund/real estate fund that does not qualify as an ultimate parent entity ("**UPE**") solely on the basis that it is not required to prepare consolidated financial statements can still be considered as Excluded Entities where the relevant conditions are met.

- **Deemed consolidation test (including details for investment funds)**

Comments to the Draft Law, in line with the OECD 2022 Commentary, clarify that the deemed consolidation test does not change the outcome of the application of the Acceptable Financial Accounting Standard when testing for the line-by-line consolidation. Where such norm does not result in a line-by-line consolidation, the deemed consolidation test does not change this outcome and where a special law applicable to investment funds grants an exemption from consolidating line by line entities held for investment, the entity cannot be considered as meeting the test. Comments to the Draft Law also add that the same approach applies for the deemed consolidation test when assessing the presence of a Controlling Interest and where line-by-line consolidation only takes place because of a contractual obligation or on a voluntary basis, the test is not met.

- **Sovereign wealth funds as Governmental Entities**

The Draft Law intends to introduce the exclusions of Sovereign Funds qualifying as a Governmental Entity whose principal purpose is managing or investing the government's or jurisdiction's assets through the making and holding of investments, asset management, and related investment activities for the government's or jurisdiction's assets. In line with the February 2023 AAG - section 1.4., such entities will not be considered to be an UPE and will not be considered part of a Multi-National Enterprise Group ("**MNE Group**") to achieve the neutrality initially planned by the OECD/IF for Governmental Entities.

- **Meaning of "ancillary" activity for Non-Profit Organisations**

Certain Constituent Entities can be considered as Excluded Entities where they are held 95% by an Excluded Entity and are engaged in activities accessory to the activities of their controlling entity. In line with the February 2023 AAG - section 1.6., the Draft Law introduces a definition of an accessory activity where the main Excluded Entity is a Non-Profit Organisation (so-called "bright-line test").

Definitions

- **EUR 750 million revenue threshold**

Given the potential variations between accounting standards and MNEs practices, the amendments clarify which items are to be considered for the purpose of the EUR 750 million revenue threshold: (i) economic benefits arising from delivering or producing goods, rendering services, or other activities that constitute the MNE Group's ordinary activities, (ii) net gains (realised or unrealised) from investments and (iii) income or gains separately presented as extraordinary or non-recurring items (based on the December 2023 AAG.).

- **Fiscal year mismatch between UPE and Constituent Entity**

Guidance from the December 2023 AAG - sections 3.2.3. and 3.2.6. - has been included to resolve situations where the financial year of a Constituent Entity (or a Joint Venture or a JV Group of the MNE Group) diverges from the UPE's financial year whether the entity is included in the Consolidated Financial Statements of the UPE or not.

- **Mismatch between fiscal year and tax year of Constituent Entity**

Guidance from section 3.3.3. of the December 2023 AAG has been included to clarify the computation of the Adjusted Covered Taxes where a Constituent Entity (or a Joint Venture or a JV Group of the MNE Group) is required under domestic legislation to apply a diverging taxable period.

Transitional CbCR Safe Harbour

- The transitional CbCR safe harbour provides for three simplified tests based on data from the group's country-by-country report and is applicable until the financial year ending on 30 June 2028. For groups meeting one of the three tests, the Top-Up Tax shall be deemed zero.
- The Draft Law intends to introduce the guidance from the December 2023 AAG - section 2 and notably rules pertaining to hybrid arbitrage arrangements applicable to arrangements entered into or amended after 18 December 2023 to benefit from this safe harbour.

Qualified Domestic Minimum Top-up Tax ("QDMTT")

- **QDMTT** considered as payable in a jurisdiction does not include the amounts challenged by the MNE Group (under certain conditions) or considered as not assessable/collectible by local tax authorities. Such amount being included for the fiscal year during which it is no longer challenged and has been paid (based on July 2023 AAG - section 4).
- Where the QDMTT is not considered as payable under the above conditions, the **QDMTT Safe Harbour** (i.e., option not to compute the Top-up Tax for a jurisdiction where a QDMTT applies) cannot apply (based on July 2023 AAG - section 5.1.).

Luxembourg QDMTT updates

- Rules governing allocation of Covered Taxes between Constituent Entities: Currently these rules are disregarded for the computation of the QDMTT. Under the proposed amendments they would notably remain applicable for tax transparent entities (based on the July 2023 AAG).

- Use of different accounting standards by Luxembourg Constituent Entities: In case Luxembourg Constituent Entities prepare their local financial statements based on different accounting standards, relevant computations must be based on IFRS. The Draft Law specifies that in such case the IFRS refers to the IFRS as adopted by the UE.
- Functional currency: clarifications based on the July 2023 AAG - section 4, § “Currency for QDMTT computations”, to resolve situations where Luxembourg Constituent Entities use different currencies. The rule notably clarifies that EUR applies where all Luxembourg Constituent Entities prepare EUR denominated financial statements based on an acceptable financial accounting standard. Where at least one Luxembourg entity does not apply EUR, the Luxembourg entities must opt for a five-year period either for EUR or the currency used for the UPE’s consolidated financial statements.
- Exclusion of groups in the initial phase of their international activity from the QDMTT: The Draft Law intends to make use of the option provided by the July 2023 AAG and extend the 5 years exclusion already applicable for the Top-up Tax and Under Taxed Profit Rule to the QDMTT.

Determination of the qualifying income or loss / Determination of the GloBE Income or Loss

- Treatment of **Restricted Tier One Capital** relevant for insurance companies is aligned to the treatment of Additional Tier One Capital (based on the February 2023 AAG - section 3.3).
- **Technical provisions of insurance companies** are not deductible when they economically relate to Excluded Dividends or Excluded Equity Gain or Loss resulting from investments on behalf of policy holders (based on the February AAG - section 3.4).
- The **Equity Investment Inclusion Election** is adjusted to reflect the February 2023 AAG - section 2.9 adding § 57.2 to the OECD 2022 Commentary on Article 3.2.1(c) of the Model Rules notably to include impairments. Such option notably allows for an exception to the general exclusion of certain Equity Gains or Losses from the GloBE Income or Loss (with adjustments to the treatment of related Covered Taxes).

Other updates

- **Substance-based income exclusion and tangible leased assets**: clarification of the treatment of tangible assets under an operational leasing agreement (based on the OECD July 2023 AAG - section 3).
- **Special rules for corporate restructuring and holding structures - Transfer of assets and liabilities**: introduction of the precisions from the July 2023 AAG - section 2.1. under which the result from an intra-group disposal of asset shall be determined under the arm’s length principle.
- **Investment Entity Tax Transparency Election**: addition of the specific rules introduced by the July 2023 AAG – section 3.4., taking into account the specifics of mutual insurance companies in the context of this election.
- **Transition rules:** clarifications essentially in relation with the treatment of deferred tax in the context of the transition year and intra-group asset transfers before applicability of the Pillar 2 rules (based on the additions of the February 2023 AAG - section 4).
- **Allocation of taxes arising under a Blended CFC Tax Regime**: update of these rules to consider the precisions added by the February 2023 AAG - section 4.

LUXEMBOURG CASE LAW | ABUSE OF LAW IN THE CONTEXT OF PERMANENT ESTABLISHMENTS AND INTEREST FREE LOANS QUALIFICATION

On 8 May 2024, the Luxembourg Lower Administrative Tribunal (the "**Tribunal**") (n° 47267) ruled on the tax qualification of interest-free loans ("**IFLs**") granted by a parent company to a Luxembourg subsidiary (the "**Company**") as well as the non-existence of a Malaysian permanent establishment (the "**Branch**").
In the case at hand, a Luxembourg company (the "**Company**") was granted two IFLs used to finance the acquisition of participations in two companies (the "**Subsidiaries**"). The Company requested an advance tax ruling on the allocation of the participations to the Branch. The Luxembourg tax administration (the "**LTA**") rejected the request on the grounds that the transaction was not compliant with legal provisions. The structure was nonetheless implemented and during the tax assessment procedure, the LTA reclassified the IFLs as hidden capital contributions, denied the recognition of the Branch and identified the existence of an abuse of law under §6 of the Luxembourg tax adaptation law (*Steueranpassungsgesetz* – "**StAnpG**"), which the Tribunal ultimately followed.

Reclassification of the IFLs as hidden capital contributions

As usual, the Tribunal held that the classification of the IFLs should be determined based on the characteristics of the instruments and the circumstances surrounding their conclusion. The Tribunal emphasized the importance of identifying the economic reality of the transaction through an overall assessment. The Tribunal relied on parliamentary commentary to the tax law and previous case law, including a recent decision by the Luxembourg Higher Administrative Court of 23 November 2023 (no. 48125C) (for more information on this decision, please refer to our previous Newsletter) to set out the criteria to assess the debt or equity qualification of the IFLs.
First, the Tribunal analysed the criteria which tend towards a reclassification of the IFLs as equity:

- **Absence of an interest rate:** While it is emphasized that this indicator alone is insufficient to justify such a reclassification, it is nonetheless an equity-like feature. The **lender's ability to potentially impose an interest rate** foreseen in the IFLs was considered as not creating a compensation and as inconsistent with market conditions, thus insufficient to reverse the equity-like aspect on that point. Likewise, an **interest rate of 1%** in case of default of the borrower does not remedy the absence of an interest rate.
- **Disproportion between share capital and loaned funds**: A debt/equity ratio of 0.1/99.9 was considered as indicating an undercapitalization, placing the risk of loss entirely on the lender and thus, contributed to the equity-like features of the IFLs.

Although these elements were not raised by the LTA, the Tribunal highlighted two additional indicators suggesting the instruments should be classified as equity:

- **Absence of guarantee/collateral**: granting half a billion USD loan without guarantees was deemed inconsistent with market conditions.
- **Allocation of the proceeds to long-term investments**: The proceeds of the IFLs were used essentially to finance long-term investment thus contributing to the equity-like features of the IFLs.

The Tribunal acknowledged that two indicators suggested a debt classification:

- **Maturity of 10 years**.
- **Absence of a stapling clause**.

However, the Tribunal concluded that these two indicators were insufficient to sustain a debt classification overall. Even though the agreements do not include participating interest features, liquidation proceeds participation, conversion options, repayment in shares options or voting rights, the overall circumstances were considered. The Tribunal emphasized that it is not a matter of merely summing up the indicators, as the legislator did not intend to give more weight to certain criteria. The Tribunal concluded that the indicators collectively establish that the IFLs should be considered, for tax purposes, as hidden capital contributions as an independent third party under market conditions would not have provided such an amount with virtually no equity, without any guarantee and remuneration. The Tribunal considered that the Company could only benefit from such conditions due to the relationship with the lender (i.e., belonging to the same Group).

The taxpayer also argued that based on the 15/85 debt-to-equity ratio required by the administrative practice for holding companies, only 15% of the IFL should be requalified as equity. The Tribunal rejected such argumentation on the grounds that the taxpayer did not demonstrate the existence of such practice and even in such case, a partial requalification would require that 85% of the debt bears interest and effectively qualify as debt. Therefore, the Tribunal supported the full reclassification of the IFLs as equity.

Acknowledgment of abuse of law in the context of the Malaysian permanent establishment

The non-recognition of the Branch

The Tribunal ruled that the non-recognition of the Branch is justified since in practice the sole document supporting the existence of the Branch was a “Service Level Agreement” - whose actual implementation remained unproven - and a board resolution. These documents, without concrete evidence of actual operations, indicated in the eyes of the Tribunal only preparatory activities and did not allow the conclusion that a “branch” existed under the Luxembourg-Malaysia double tax treaty.

The Tribunal stated that the Company’s activity should be performed in Malaysia through a fixed place of business, even if the Branch conducts only holding activities. The Tribunal underscored the effective business activity and tangible substance in the “branch” as essential criteria. Finally, and perhaps surprisingly, the Tribunal added that the recognition of a “branch” by Malaysian authorities does not constitute binding legal evidence for the LTA or the Tribunal.

Abuse of law

Next to the non-recognition of the Branch, which does not *ipso facto* characterize the existence of an abuse of law in the meaning of the §6 StAnpG, the Tribunal continued its analysis and relied on the usual cumulative elements to assess the existence of abuse of law:

- **Use of private law forms or institutions:** the operation involved the acquisition of participations, set-up of the Branch, and allocation of the participations to the Branch.
- **Tax savings resulting from the bypassing or reduction of the tax burden:** the Company acknowledged that the allocation of the participations to the Branch was based on the inability to benefit from the participation exemption regime. The Tribunal considered that the arrangement aimed to reduce, for the years concerned, the net wealth tax burden.
- **Use of inappropriate means:** the Tribunal considered that the normal means would have been to be fully subject to net wealth tax when unable to benefit from the provisions of §60 of the Luxembourg evaluation law (*Bewertungsgesetz* – “**BewG**”) that foresees a net wealth tax exemption for qualifying participations, rather than attributing those participations to the Branch to effectively exclude them from being subject to net wealth tax.
- **Absence of any valid extra-fiscal related reasons that might justify the means chosen:** based on consistent case law, the burden of proof is not on the LTA to demonstrate a lack of economic reason behind the operation but on the Company. As the Branch was disregarded, no economic reason could be evidenced.

Given that the conditions were fulfilled, the Tribunal concluded that the arrangement constituted a “wholly artificial arrangement” aimed at obtaining a tax advantage for net wealth tax purposes and acknowledged the existence of abuse of law.

The Tribunal’s decision is pending confirmation as an appeal has been lodged in front of the Higher Administrative Court.

LUXEMBOURG CASE LAW | RULES ON CARRIED FORWARD TAX LOSSES

On 25th April 204, the Luxembourg Higher Administrative Court handed down a judgment (48917c) regarding the right to carry-forward tax losses for Luxembourg companies.

In the case at hand, a company which had previously engaged in a holding activity and generated tax losses, acquired and sold a real estate asset which generated a significant capital gain in 2014. The company sought to reduce its taxable profit by utilising those carried forward tax losses.

The Luxembourg Tax Administration ("*LTA*") rejected the tax losses arguing that the transaction was abusive. The LTA noted that the company has been "dormant" from 2009 to 2013 and had previously engaged in a holding activity. The LTA took the view that the beneficial owner of the company should have make the real estate transaction himself rather than through the company.

First of all, the Higher Administrative Court recalls that in accordance with the Article 114 of the Luxembourg Income Tax Law ("**LITL**") the tax losses attach to the legal personality of the company and may be deducted indefinitely for tax losses generated prior to 1 January 2017, and for a period of up to 17 years after 1 January 2017.

The Higher Administrative Court noted that an abuse of law may be demonstrated where the criteria of legal and fiscal personality of the taxpayer is used for the sole purpose of circumventing this requirement and the resulting prohibition on transferring the said losses, for the sole purpose of using the losses carried forward in order to avoid taxation of the related profits.

The Higher Administrative Court found that the case did not meet the criteria of abuse. The Higher Administrative Court noted in particular:

- the company's ownership had not changed since its incorporation – thus excluding the application of the Mantelkauf theory;
- tax losses may continue to be utilised even if the company has ceased its economic activity or profession in so far as the conditions of Article 114 of the LITL are met. Thus, a company which has generated tax losses from one activity, is entitled to cease this activity and start another which could generate profits.

In the case at hand, the change from a holding activity to real estate activity could not be viewed as an inappropriate use of legal forms. The Court went further and recalled that a taxpayer is entitled to carry out a transaction though a tax opaque company rather than in his private capacity since the taxpayer is still allowed to enjoy the choice of the least taxed route provided that he does not carry out transactions with the sole aim of benefiting himself or causing others to benefit from tax advantages that the legislator did not intend to grant in the circumstances created by the said person directly or through an opaque company.

Thus, the Higher Administrative Court concluded that in the absence of an inappropriate use of legal forms, the transaction cannot be regarded as abusive.

RELIBI LAW I HIGHER ADMINISTRATIVE COURT RULES ON THE LIMITS OF THE APPLICABILITY OF THE LAW

In a decision dated 21 March 2024 (no. 49678C), the Higher Administrative Court upheld a decision by the Director of the Luxembourg tax authorities ("**LTA**"), who in a specific case refused to apply the final withholding tax on savings income in the form of interest payments made in Luxembourg to beneficial owners who are individuals resident in the Grand Duchy of Luxembourg, as provided for in the amended law of 23 December 2005 ("**Relibi Law**").

The case concerned the taxation of interest paid on bonds issued by a Luxembourg limited liability company offering consulting services (the "**Company**").

In the context of a request for repayment by a former Luxembourg resident bondholder, the LTA gained access to the (draft) subscription agreement of the bonds issued by the Company leading the LTA to question the correct taxation of the bondholders. As per the terms of the subscription agreement the subscription of the bonds was restricted to individuals who are (i) shareholders of the Company and (ii) employees of a related entity. The bonds, which carried interest at a very attractive rate, were not transferable. The funds borrowed were used to make loans to entities in which the bondholders had a direct or indirect interest. According to the LTA, and contrary to the approach taken by bondholders, the terms of the bonds implied that the interest paid on the bonds should not benefit from the final withholding tax provided for by the Relibi Law amounting to 10% at that time but should be subject to taxation by way of assessment with application of the progressive tax scale.

The Higher Administrative Court ruled that no procedural irregularities had been committed by the LTA, since:

- the adversarial principle did not require the LTA to provide the bondholders with the draft subscription agreement prior to the issue of the tax assessments, considering that it is a document that the bondholders should have in their possession.
- the director of the LTA was competent to instruct the tax offices competent for the respective bondholders to proceed with their reassessment without violating the exclusive competence of taxation that belongs to the tax offices.
- the LTA did not breach tax secrecy because no prohibited disclosure took place.

Regarding the application of the Relibi Law, the Higher Administrative Court confirmed the refusal to apply the final withholding tax. By reference to the parliamentary work that led to the Relibi Law, the Higher Administrative Court pointed out that the Relibi Law does not apply to payments made by a private company to its shareholders that are not intended to remunerate and encourage savings. After recalling the principle of economic assessment, the Higher Administrative Court carried out an overall analysis of the situation. Taking into account the particular conditions of the bonds, the Higher Administrative Court adopted the same conclusion as to the non-application of the Relibi Law in the present case insofar as the payment of interest is to be qualified more as a payment made in consideration of the status of shareholder, or of employee, than as a payment of interest representing the remuneration paid in connection with savings.

Finally, to avoid double taxation, the Higher Administrative Court authorised the bondholders to set off the withholding tax paid against the taxation by way of assessment on the basis of Article 154 of the Luxembourg income tax law.

SPF | ISSUANCE OF RESIDENCE CERTIFICATES TO FAMILY WEALTH MANAGEMENT COMPANIES

On 4 June 2024, the Luxembourg Tax Authorities (the "**LTA**") issued the administrative circular L.I.R. n° 159/2 (the "**Circular**"). The Circular provides details on the issuance of residence certificates to Luxembourg family wealth management companies (*sociétés de gestion de patrimoine familial*) ("**SPFs**") governed by the Law of 11 May 2007 (the "**SPF Law**").

The legal framework applicable to SPFs

SPFs are companies which adopt the form of a limited liability company, a public limited company, a partnership limited by shares or a cooperative company organised in the form of a public limited company and whose exclusive object is the acquisition, holding, management and realisation of financial assets, excluding any commercial activity.

SPFs are designed to serve as investment companies for individuals acting within the management of their private wealth.

Tax status

Under Article 4 of the SPF Law, SPFs are exempt from income tax, municipal business tax and net wealth tax. However, they are subject to a yearly subscription tax in accordance with Article 5 of the SPF Law.

As a result of this specific tax status, SPFs are excluded from the double tax treaties entered into by Luxembourg and cannot claim the benefit of the European Union directives.

Issuance of residence certificates on the basis of domestic law

Under domestic law, SPFs are to be considered Luxembourg residents where the conditions set out in Article 159 of the Luxembourg income tax law ("**LITL**") are met, i.e. where:

- they are constituted in one of the forms listed in Article 159 LITL; and
- they have their registered office or central administration in the Grand Duchy of Luxembourg.

The first condition should, in principle, always be met as an SPF must be incorporated in the form of a corporate entity, in accordance with Article 1 of the SPF Law.

A residence certificate may therefore be issued where the SPF's registered office or central administration is located in Luxembourg. This certificate must be issued by the Direct Tax Administration.

All applications for a residence certificate must specify:

- the name, tax identification number and address of the company, as well as the date of adoption of the SPF tax status;
- the language in which the certificate is to be drawn up (i.e. French, German or English); and
- the reason for the request (in particular why the certificate of residence is required, with an express reference to the provision of the foreign legislation which, in order to be applied, requires the production of a residence certificate).

The tax office may request additional information or supporting documents and will then issue the residence certificate, which will be sent to the registered office of the company.

FASTER | COUNCIL OF THE EUROPEAN UNION REACHES POLITICAL AGREEMENT

Background

As a reminder, on 19 June 2023, the European Commission released a [proposal for a Council Directive on Faster and Safer Relief of Excess Withholding Taxes](#) ("**FASTER Proposal**") laying down rules on the issuance of a digital tax residence certificate by EU Member States and the procedure to release any excess withholding tax ("**WHT**") that can be withheld by an EU Member State on dividends from publicly traded shares and, where applicable, interest from publicly traded bonds paid to registered owners who are resident for tax purposes outside that EU Member State. On 14 May 2024, the Council of the European Union ("**Council**") reached an agreement on the FASTER Proposal.

In the EU, investors face double taxation on income from securities (dividends and interest) in cross-border situations as:

- taxes may be withheld in the source country as WHT.
- taxes may also be levied in the residence country of the investors as income tax.

Double tax treaties between countries as well as certain domestic legislations aim to alleviate this by allowing reduced WHT rates or exemptions in the source country. The reduced WHT rate or exemption is either applied directly at the point in time when the dividend/interest is paid (relief at source) or is refunded pursuant to a reclaim by the investor (refund procedure). As, on the one hand the current WHT procedures are often complex, costly, time-consuming and varying significantly across EU Member States in terms of documentation requirements and digitalization levels and on the other hand inclined to fraud, as highlighted by recent tax scandals, the objective of the FASTER Proposal is twofold:

- introduce more efficient and harmonized procedures across the EU for the relief of WHTs on income from publicly traded securities (dividends on equities and interest on bonds) in cross-border cases to enhance the development of the Capital Markets Union.
- address the risk of fraud / revenue losses for EU Member States.

Key measures of the FASTER Proposal

This FASTER Proposal shall notably implement the following measures. Two **fast-track procedures** complementing the existing standard refund procedure:

- **relief-at-source procedure:** under this procedure, the correct amount of taxes (reduced WHT rate/exemption) will be applied by the withholding agent at the time of the dividend/interest payment.
- **quick refund procedure:** under this procedure, the refund is ensured in case of over-withholding within 50 days from the date of payment (extended by the Council agreement – see below).

To benefit from the fast-track procedures under the FASTER Proposal, investors will need to engage with Certified Financial Intermediaries ("**CFIs**"), who are required to assist with these procedures. CFIs must be recorded in a national register (see below).

- **Common EU digital tax residence certificates ("eTRC")**

Issuance of a digital tax residence certificate in a harmonised manner across the EU. This certificate will be required to benefit from the fast-track procedures.

- **A national register and standardised reporting obligations for financial intermediaries**

The national register will allow the CFI to apply for a WHT relief on behalf of their clients through the fast-track procedures. Standardised reporting will provide tax authorities with the essential information to check the eligibility for the WHT relief, to track the relevant payments and to avoid potential tax abuse or fraud in a harmonised way.

Agreement of the Council on 14 May 2024

The FASTER Proposal, as agreed by the Council following the meeting on 14 May 2024, contains a number of changes from the initial FASTER Proposal, the key aspects of which may be summarised as follows:

- the Council agreed to insert new provisions regarding **indirect investments**. These provisions ensure that legitimate investors, such as certain collective investment undertakings or their investors, have access to the fast-track procedures.
- the Council agreed to add an **exemption from the application of the relief** systems for certain EU Member States that already have a comprehensive relief at source system and meet a national financial market capitalization representing less than 1.5% of the overall EU market capitalisation during each of four consecutive years. However, the Council maintains the principle that eTRC system applies to all EU Members States without exception.
- the Council extended the period for EU Member States to issue a digital residence certificate to **14 calendar days** (from initially one working day) with validity limited to one calendar year maximum.
- the Council extended the period for EU Member States to complete the **Quick Refund System**: The excess WHT shall be refunded by the tax authority of the source State **within the second month following the dividend or interest payment date** (i.e., within 60 calendar days after the end of the request period). EU Member States shall **apply interest on the amount** of such refund for each day of delay after the 60th day.
- the Council added **additional discretion on excluding high-risk cases from fast-track** procedures, notably, allowing EU Member States to exclude certain high-risk cases from the fast-track procedures. **Dividends exceeding EUR 100,000 per registered owner per payment date can be excluded**, except for large regulated collective investment undertakings and certain pension funds. Exclusions can also apply to **dividends on shares acquired within five days before the ex-dividend date**, dividends associated with **unsettled financial arrangements** and certain cases involving **non-certified intermediaries**.

Conclusion

The European Parliament delivered its opinion on 28 February 2024. However, due to the changes made by the Council during negotiations, the European Parliament will be consulted again on the agreed text. Upon its adoption, it will be published in the EU's Official Journal and enter into force. The current FASTER Proposal requires EU Member States to transpose the Directive into national legislation by 31 December 2028, with the national rules becoming applicable as from 1 January 2030.

HOT I DIRECTIVE PROPOSAL ESTABLISHING A HEAD OFFICE TAX SYSTEM FOR SMES IN EUROPE

On 10 April 2024, the European Parliament ("**EU Parliament**") adopted its non-binding report on the proposal for a Council directive establishing a Head Office Tax system for micro, small and medium size enterprises and amending Directive 2011/16/UE.

Background

On 12 September 2023, the European Commission proposed a directive establishing a Head Office Tax System ("**HOT**") for micro, small and medium sized enterprises ("**SMEs**"). The HOT system intends to **simplify tax obligations** of standalone SMEs with one or more permanent establishments ("**PEs**") in other EU Member States.

The proposal intends to simplify the tax compliance obligations of SMEs operating in the EU through PEs. Such SMEs can opt to compute the taxable basis of their PEs under the rules applicable to the head office, file a single tax return and pay the tax liability to the head office EU Member State, thus interacting only with a single tax authority. The latter would apply the tax rate of the PEs' relevant EU Member State, exchange the filed return, and share tax revenue with relevant EU Member States without affecting taxing rights allocation provided under the relevant double tax treaties.

For more information on the proposal, please refer to our previous newsflash.

EU Parliament report

To comply with the EU legislative procedure, the proposal requires unanimity in the Council for its adoption, following consultation of the EU Parliament and the European Economic and Social Committee.

At the level of the EU Parliament, the Economic and Monetary Affairs Committee adopted its report on 22 February 2024 supporting the overall proposal and proposing to extend the initial proposal to further alleviate SMEs compliance burden.

On 10 April 2024, the EU Parliament adopted its report, with the following key proposals:

- Extended scope: SMEs having a maximum of two subsidiaries should also benefit from the regime (while the initial proposal was only open to SMEs operating exclusively through PEs) and these subsidiaries should be included in the simplification mechanism.
- Turnover condition: while the initial proposal subjected eligibility to the condition that the joint turnover of the PEs in the last two years did not exceed the double of the head office turnover, the report proposes to set the limit to the triple of the head office turnover over a three-year period.
- Reduced waiting period: reduce the eligibility requirement for the head office SME to have been tax resident in its EU Member State for at least 2 years to being tax resident since the previous fiscal year or since incorporation.
- Extended deadline: the deadline for head offices to notify their domestic tax authorities to apply the HOT system should be reduced from 3 months before the end of the fiscal year preceding the application to 2 months before the end of the fiscal year.
- Extended application period: the application period should be extended from 5 to 7 years for SMEs opting to apply the HOT system.
- Shortened transposition time frame: The transposition and application timeframe should be reduced by one year, requiring a transposition by 31 December 2024 and application as from 1 January 2025.

Economic and Financial Affairs Council (ECOFIN) report

On 21 June 2024, ECOFIN approved a draft report to the European Council on tax issues providing an overview of the developments on several EU direct tax initiatives, including an update on the status of the HOT proposal, in the context of the coming change to the EU Presidency.

According to ECOFIN, a large number of EU Member States raised serious concerns regarding several aspects of the proposal, such as the administrative challenges that the current proposal may create for tax authorities, the potential effect on tax revenues and tax sovereignty of EU Member States as well as risks linked to competitiveness of the domestic markets.

Several EU Member States believe that a more general discussion on this topic should take place before any further technical progress can be made. The report also suggests that additional work could be performed with the objective of preparing a discussion on the policy choices that would need to be made.

ECJ CASE LAW I AG KOKOTT OPINES ON THE ENFORCEABILITY OF LEGAL PROFESSIONAL PRIVILEGE VIS-À-VIS TAX AUTHORITIES

In a case involving a Luxembourg law firm which had been ordered by the Luxembourg Tax Authorities to disclose all documentation relating to advice given to a client for the purpose of an exchange of information upon request with the tax authority of another EU Member State, the Luxembourg Higher Administrative Court (*Cour administrative*) decided to stay proceedings and to refer a number of questions to the Court of Justice of the European Union (the "**ECJ**") for a preliminary ruling on the compatibility of Directive 2011/16/EU and Luxembourg national legislation with the Charter of Fundamental Rights of the European Union and, more specifically, with the protection of lawyers' professional secrecy guaranteed by Article 7 of that Charter. Please refer to our October 2023 Newsletter for more details on the background of the case and the reference for preliminary ruling.

On 30 May 2024, Advocate General Juliane Kokott (the "**AG**") presented her opinion to the ECJ.

Key points of the advocate general's Opinion

First of all, the AG points out that lawyers' professional secrecy enjoys a special protection, which is justified in particular by the fact that lawyers are entrusted with a fundamental task in a democratic society, namely the defence of litigants. Lawyers' professional secrecy is not only meant to protect the individual interests of lawyers and their clients, but also the general interest of an administration of justice that meets the requirements of a State governed by the rule of law.

The AG deduces from the above that the protection of professional secrecy excludes any distinction between different areas of law: legal advice in the field of company law and tax law should therefore be considered as being protected in the same way as representation of individuals in criminal or civil law proceedings for instance. Similarly, the legal form under which the lawyer or client acts is irrelevant.

The AG concludes that an injunction decision issued in the context of an exchange of information on request in tax matters, requesting a law firm to disclose all documentation relating to advice given to a client in connection with certain transactions, including the set-up of an investment structure, constitutes an infringement of the right to respect for communications between lawyer and client, guaranteed by Article 7 of the Charter of Fundamental Rights of the European Union.

While such an infringement may in some cases be justified in the light of the legitimate objective of combating tax avoidance and evasion, a strict proportionality test is required, according to the AG, in which the requested Member State must take account of the particular importance attached to the lawyer as an independent auxiliary of justice in a State governed by the rule of law. Directive 2011/16/EU gives the Member States a sufficient margin of discretion to meet the requirements of Article 7 of the Charter when transposing it into national law.

Implications for Luxembourg Legislation

The current Luxembourg legislation, under which advice and representation provided by a lawyer in tax matters, with the exception of criminal tax law, are generally excluded from the protection of legal professional privilege, when it comes to the collection of information by the tax authorities, does not allow for the required case-by-case balancing and is therefore, in the AG's view, contrary to Article 7 of the Charter.

Although the AG's opinion is often followed by the ECJ in practice, it is not binding and only the judgment to be delivered by the ECJ will acquire the force of res judicata.

ECJ CASE LAW I VAT - ADIENT CASE - NOTION OF FIXED ESTABLISHMENT

Key takeaways

On 13 June 2024, the European Court of Justice ("**ECJ**") issued its ruling in case **C-533/22** (*Adient* case) **pertaining to whether an affiliated undertaking may be regarded as a fixed establishment of another foreign group company for VAT purposes**.

Facts of the case

Adient group is a leading manufacturer on the worldwide automative market.

On 1 June 2016, **Adient Germany concluded a contract with Adient Romania for the provision of intragroup services**, including both services for the manufacturing of tolls and automotive products (the "**Manufacturing Services**"). The manufacturing services consisted, for Adient Romania, in transforming raw materials provided by Adient Germany for the manufacture of seat covers. **The ancillary services carried out by Adient Romania** consisted, inter alia, in taking delivery of, storing, inspecting and managing the raw materials and in storing the finished products. **Adient Germany remained the legal owner of the raw materials**, semi-finished products and finished products throughout the manufacturing process. Both Adient Germany and Adient Romanian are VAT registered in Romania. However, for the purposes of the receipt of the Manufacturing Services by Adient Germany from Adient Romania, Adient Germany used its German VAT number. As such, no VAT was charged in Romania, and instead the supplies were subject to the reverse charge procedure in Germany. Indeed, both parties to the intragroup agreement took the view that the supplies of services were made at the place where the recipient of those services was established i.e., Germany. Consequently, Adient Romania issued invoices excluding VAT, since, in its view, those supplies should be taxed in Germany by virtue of the business-to business VAT rules.

Nonetheless, the Romanian tax authorities took the position that **Adient Romania should be regarded as a VAT fixed establishment of Adient Germany**. Therefore, according to the Romanian tax authorities, **Adient Romania was deemed rendering its services to a local Romanian branch of Adient Germany instead of Adient's German head office**. **The services would then attract Romanian VAT instead of German VAT.**

Outcome of the ECJ's ruling

The ECJ ruled that **Adient Romania is not to be regarded as a VAT fixed establishment of Adient Germany. The main key takeaways of the ECJ's decision are as follows:**

- an independent group company does not constitute itself a fixed establishment of a different affiliated undertaking solely by reason of (i) **the presence of a shareholding link between those two**, or (ii) such **same companies are bound as between themselves by a contract for the provision of intragroup services**;
- neither the fact a VAT taxable company has a **local structure located in another member state** i.e., Romania (other than the Member State of its business i.e., Germany) **which intervenes in the supply of finished good** resulting from the Manufacturing Services, nor the fact that the delivery of goods of those same finished goods mostly takes place outside the country of manufacturing i.e., outside Romania, are relevant to evidence the qualification of a fixed establishment of the company into the manufacturing country state i.e., Romania; and,
- no fixed establishment exists in a Member State other than a company's Member State of business, if there is **a confusion between local human and technical resources used both to supply and to receive the said service**, or, if these same **human and technical resources solely perform preparatory or auxiliary activities**.

The aforementioned decision seems to follow directly from the ECJ's earlier rulings**.** Indeed, **ECJ has just reaffirmed its position again** (through the *Adient* case) under which **a group company does not constitute a VAT fixed establishment of another foreign group company** under certain circumstances.

Right by you in Luxembourg

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