# Newsletter June 2014

BSP BONN STEICHEN & PARTNERS

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THIS NEWSLETTER IS INTENDED ONLY AS A GENERAL DISCUSSION OF THE TOPICS WITH WHICH IT DEALS. IT SHOULD NOT BE REGARDED AS LEGAL ADVICE. IF YOU WOULD LIKE TO KNOW MORE ABOUT THE TOPICS COVERED IN THIS NEWSLETTER OR OUR SERVICES PLEASE CONTACT US.

## CAPITAL MARKETS

### CONSULTATION ON FX FINANCIAL INSTRUMENTS

We reported in our Newsletter of March 2014 that on February 14th 2014, ESMA, in the context of the European Market Infrastructure Regulation (EMIR), sent a letter to the European Commission (Commission) asking for clarifications on the classification of foreign currency (FX) financial instruments.

Under Directive 2004/39/EC on Markets in Financial Instruments (MiFID) a contract considered as a financial instrument may give rise to authorisations and other obligations. Whether or not an FX contract can be defined as a financial instrument has therefore important implications as regards authorisation requirements under MiFID, but also as regards the scope of application of other EU financial regulations including EMIR, the Capital Requirement Directive and Regulation (CRD4) and the Market Abuse Regulation since they all cross-refer to the definition of financial instruments under MiFID.

Recognising a lack of harmonisation between the EU Member States, the Commission, on April 11th 2014, published a consultation paper (Consultation) with the narrow scope to define FX financial instruments and determine the boundaries between an FX financial instrument and a spot FX contract.

The purpose of the Consultation is to assist the Commission in preparing a formal proposal to ensure clear, adequate and consistent application of the relevant financial regulation across the EU.

The Consultation included 10 questions ranging from the use of FX, settlement periods, developments in the FX market, risks, transitional periods and interaction with regimes outside of the EU.

The Consultation closed on May 9th 2014. The Commission explained that the Consultation took less than 12 weeks because this topic is a technical issue which, for reasons of legal certainty and need for consistent application of financial regulation across the EU, requires a swift regulatory response.

Although no timeline has been indicated it is expected that the proposal on this topic will soon be made available as the demand for a regulatory response is high.

For the full text of the Consultation, please see the following link:
http://ec.europa.eu/internal_market/consultations/2014/foreign-exchange/index_en.htm

### PROSPECTUS DIRECTIVE – DELEGATED REGULATION

On April 15th 2014 Commission Delegated Regulation (EU) No. 382/2014 supplementing Directive 2003/71/EC with regard to regulatory technical standards for publication of supplements to prospectuses (the "Delegated Regulation") was published in the Official Journal of the European Union.

This Delegated Regulation specifies the minimum situations where the publication of a supplement is mandatory.

Some of the specified situations relate only to issuers of equity securities or issuers of underlying shares in case of depositary receipts, in particular:

1. where new annual audited financial statements are published;
2. where an amendment to a profit forecast or a profit estimate already included in the prospectus is published;
3. where there is a change in control;

4. where there is any new public takeover bid by third parties and the outcome of any public takeover bid.

In addition, the following situations (which are not restricted to issuers of equity securities or issuers of underlying shares in case of depositary receipts) require the publication of a supplement:

1. where there is a change in the working capital statement included in a prospectus when the working capital becomes sufficient or insufficient for the issuer's present requirements;
2. where an issuer is seeking admission to trading on an additional regulated market in an additional Member State or is intending to make an offer to the public in an additional Member State other than the one(s) provided for in the prospectus;
3. where a significant financial commitment is undertaken which is likely to give rise to a "significant gross change";
4. where the aggregate nominal amount of the offering programme is increased.

The Delegated Regulation entered into force on May 5th 2014.

## MARKET ABUSE – RECENT DEVELOPMENTS

On June 12th 2014 Regulation No 596/2014 on market abuse (MAR) and Directive 2014/57/EU on criminal sanctions for market abuse (CSMAD) were published in the Official Journal of the European Union. MAR shall be applicable from July 2016. Member States have two years to transpose the CSMAD into their national law.

MAR and CSMAD aim to update and strengthen the existing market abuse framework to ensure market integrity and investor protection, in particular by:

- extending the scope of the current market abuse regime to new markets and trading strategies;
- explicitly banning the manipulation of benchmarks (such as LIBOR);
- introducing offences of attempted insider dealing and market manipulation;
- reinforcing the investigative and administrative sanctioning powers of national competent authorities; and
- establishing a harmonised regime of minimum criminal and administrative sanctions across the EU Member States for market abuse offences.

The texts of MAR and CSMAD are available at http://ec.europa.eu/internal_market/securities/abuse/index_en.htm

## ECJ JUDGMENT ON ACCESS TO PROSPECTUSES IN ELECTRONIC FORM

It is rare that a ruling of the ECJ deals with the interpretation of the Prospectus Directive regime (composed of inter alia Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading (the Prospectus Directive) and the related Commission Regulation (EC) No 809/2004 (the Prospectus Regulation). On May 15th 2014 the ECJ gave a ruling in the Michael Timel v Aviso Zeta AG case (C-359/12).

A number of questions were raised by the referring court on prospectus content and publication. In the ECJ's responses to these queries they have clarified the following points:

1. Art. 22(2) of the Prospectus Regulation is to be interpreted as meaning that information required under Art. 22(1) which, although not

known at the time of publication of the base prospectus, nevertheless was known at the time of publication of a supplement to that prospectus must be published in that supplement if the information involves a significant new factor, material mistake or inaccuracy capable of affecting the assessment of the securities, within the meaning of Art. 16(1) of the Prospectus Directive.

2. The requirements of Art. 22 of the Prospectus Regulation are not satisfied by the publication of a base prospectus which omits the information required under Art. 22(1), in particular the information referred to in Annex V to the Prospectus Regulation, if no final terms are published.
3. Art. 29(1)(1) of the Prospectus Regulation is to be interpreted as meaning that the requirement that a prospectus must be easily accessible on the website on which it is made available to the public is not fulfilled where there is an obligation to register on that website, entailing acceptance of a disclaimer and the obligation to provide an email address, where a charge is made for that electronic access or where consultation of parts of the prospectus free of charge is restricted to two documents per month. (Some such restrictions previously applied where a prospectus was published on the Luxembourg Stock Exchange, which was where the documents were made available in the present case; since June 13th 2014, all published prospectuses on the website of the Luxembourg Stock Exchange are available without restriction).
4. Finally, Art. 14(2)(b) of the Prospectus Directive is to be interpreted as requiring the base prospectus to be made available to the public both at the registered office of the issuer and at the offices of the financial intermediaries. The question arose due to a translation discrepancy in different versions of the directive. The clarification of the ECJ affirmed the wording of the English language version (amongst others).

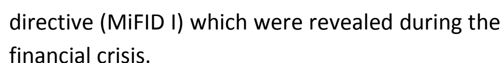
The judgment of the ECJ is available at the following link:
http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1403732229838&uri=CELEX:62012CJ0359

## MIFID II

On June 12th 2014 the Directive 2014/65/EU on Markets in Financial Instruments repealing Directive 2004/39/EC and the Regulation No 600/2014 on Markets in Financial Instruments (together "MiFID II") have been published in the Official Journal of the European Union. Member States have two years to transpose the new rules which will be applicable from January 2017.

In respect of the "level 2" legislation, on May 22nd 2014, ESMA published two consultation papers: (i) a consultation paper relating to technical advice to be provided by ESMA in respect of investor protection, transparency, data publication, trading venue requirements, commodity derivatives and portfolio compression, and (ii) a discussion paper dealing with technical standards to be developed by ESMA relating to investor protection, transparency, data publication, trading venue requirements, commodity derivatives, organisational requirements for investment firms and trading venues, market data reporting and post-trading requirements. The "level II" texts are due to be adopted by June 2015.

The new framework aims to make financial markets more efficient, resilient and transparent and to address the loopholes of the initial



directive (MiFID I) which were revealed during the financial crisis.

Some of the interesting developments under MiFID II include:

- A greater range of products and activities are within the scope of MiFID II;
- A prohibition on inducements for firms providing “independent” advice or portfolio management has been introduced;
- Firms will be required to comply with new obligations to enhance investor protection (e.g. suitability test, greater oversight of senior management, segregation of duties to prevent conflicts of interest);
- In order to capture inter-broker dealing systems which are not regulated markets or multilateral trading systems (MTFs), a new trading venue, an Organised Trading Facility (OTF) has been introduced (limited to non-equity instruments);
- A new harmonised regime for the provision of services by third country firms has been created;
- Equity market transparency has been increased and a principle of transparency for non-equity instruments such as bonds and derivatives has been introduced; and
- Supervisory powers of competent authorities have been strengthened.

The texts of MiFID II are available at: http://ec.europa.eu/internal_market/securities/isd/mifid2/index_en.htm.

# CORPORATE

## EUROPEAN COOPERATIVE SOCIETY (SCE)

In March 2014, the Luxembourg parliament adopted a new law introducing a new corporate form, the European Cooperative Society (the "SCE") and amending the Luxembourg law of August 10th 1915 on commercial companies (the "Law").

The law of March 10th 2014 regarding the SCE took effect on March 24th 2014 (the "New Law") and transposes into Luxembourg law the Council Regulation (EC) N° 1435/2003 of 22 July 2003 relating to the Statute for a European Cooperative Society (the "Regulation").

The main characteristics of an SCE are the following:

- It has legal personality and is formed by at least five (5) natural or legal persons resident in at least two (2) Member States;
- It has a variable capital and the members' shares are not transferable;
- The subscribed capital requirement must not be less than thirty million EUROS (EUR 30,000,000.-);
- The subscribed capital is divided into shares and each member is liable only up to the amount of its contribution;
- The activities of the SCE should serve the mutual benefit of the members and allow them to develop their economic and social activities in accordance with their participation in the cooperative;
- All members of the SCE are involved in the activities of the cooperative, as customers, employees or suppliers or by any other means;
- During liquidation, the net assets and reserves are distributed according to the principle of disinterested distribution, meaning to another cooperative pursuing similar aims or general interest purposes unless otherwise provided for in the articles of incorporation of the SCE;
- It is a fully taxable entity.

Why choose an SCE?

- The establishment of an SCE creates equal opportunities among cooperatives and other corporate forms and fosters the development of cooperative activities on a transnational scale;
- An SCE can be operated by physical persons or legal persons residing or established in different Member States with a reduction of existing cross-border obstacles;
- An SCE can be created by merger of existing cooperatives or an existing cooperative can be converted into a SCE without being liquidated beforehand, where that cooperative has its registered office and head office in one Member State and an establishment or subsidiary in another Member State;
- An SCE provides the flexibility to be managed by either a supervisory body and a management body (two-tier system) or a single administrative body (one-tier system), depending on the form chosen in the articles of incorporation.

To sum up, the SCE is a corporate form combining different characteristics of capital companies and personal companies and shall in each Member State be treated as if it were a national cooperative.

# INVESTMENT FUNDS

## GUIDELINES ON ETFS AND OTHER UCITS ISSUES

### UPDATED Q&A

On March 24th 2014 the European Commission issued an updated Q&A (Q&A) to clarify certain aspects of its guidelines on ETFs and other UCITS which were issued on December 18th 2012 (ESMA/2012/832) and which became effective a year later.

The clarifications relate to aspects of financial indices for which two new questions have been added to the Q&A. These two aspects cover the calculation methodology of a UCITS and commodity indices.

#### Calculation methodology

According to paragraph 55 of the guidelines, UCITS should not invest in financial indices for which the full calculation methodology to, inter alia, enable investors to replicate the financial index, is not disclosed by the index provider. Such information should be easily accessible, free of charge.

ESMA has clarified that the information to be disclosed and provided must be publicly available to investors and prospective investors and published in such a way that direct access to this information is possible. ESMA has indicated that such information may be so accessed, for instance, as a direct publication or via a source which directly links to a public website or other public forum which is not password protected, encrypted or in any way hinders or impedes immediate and direct access.

#### Commodity indices

Paragraph 50 of the guidelines prohibits investment by UCITS in commodity indices that do not consist of different commodities and applies a correlation factor to be considered in this regard.

ESMA has clarified that a UCITS may invest in a commodity index for which a particular commodity component does not have 5 years of price history available for the purposes of the correlation observation, provided that a similar asset serves as an adequate proxy.

ESMA has further indicated what the conditions for such an asset being considered as an adequate proxy are. It needs to be supported by both qualitative and quantitative data. Those qualitative and quantitative data should be documented by UCITS management companies. The proxy asset cannot constitute more than 3 years of the 5 years of data for the purposes of the calculation. The proxy must be a single commodity (rather than a component of a basket or other amalgam/hybrid product) asset.

For the full text of the Q&A, please see the following link: http://www.esma.europa.eu/system/files/2014-295_qa_on_guidelines_on_etfs_and_other_ucits_issues.pdf

### DIVERSIFICATION OF COLLATERAL - REVISED ESMA GUIDELINES

On March 24th 2014 the European Securities and Market Authority (ESMA) issued a final report on the revision of the provisions on diversification of collateral in ESMA’s guidelines on ETFs and other UCITS issues (the Final Report).

Annex II to the Final Report modifies the rules on collateral diversification as set out in the Guidelines on ETFs and other UCITS issues published by ESMA in December 2012 (ESMA/2012/832). Concerns had been expressed that the rules had an adverse impact on UCITS’

collateral management policies and in particular limited the extent to which UCITS (particularly UCITS Money Market Funds and UCITS Short Term Money Market Funds) may enter into reverse repurchase agreements.

The general principle is that collateral should be sufficiently diversified in terms of country, markets and issuers and that there be a maximum exposure to a single issuer of 20% of the UCITS NAV. In derogation to this the new guidelines allow all UCITS, in the context of OTC financial derivative transactions and efficient portfolio management techniques, to be fully collateralised in different transferable securities and money market instruments issued or guaranteed by a Member State, one or more of its local authorities, a third country, or a public international body to which one or more Member States belong.

A diversification requirement is maintained in that the new guidelines provide that such a UCITS should receive securities from at least six different issues and securities from any single issue should not account for more than 30% of the UCITS NAV.

ESMA has sought to mitigate the fact of having a less diversified basket of collateral by prescribing additional disclosure to investors and potential investors.

Thus, the annual report shall now indicate whether the UCITS has been fully collateralised in securities issued or guaranteed by a Member State and, where the collateral received from an issuer exceeds 20% of the NAV of the UCITS, disclose the identity of such issuer.

### Next steps

The revisions to the Guidelines on ETFs and other UCITS issues will be translated and published by ESMA on its website. Following this publication, Member States competent authorities must notify ESMA within two months on whether they intend to comply with the guidelines. Existing UCITS will have to comply with the provisions on the transparency of collateral by the earlier of twelve months after the application date of the guidelines or the first occasion after the application date of the guidelines on which the prospectus is revised, replaced or published, for any other purpose.

For the full text of the Final Report, please see the following link:
http://www.esma.europa.eu/content/Final-Report-Revision-Guidelines-ETFs-and-other-UCITS-issues

## AIFMD – UPDATED ESMA Q&A

The European Securities and Markets Authority (ESMA) published on February 2nd 2014 a "Questions and Answers" document (FAQ Document) on the practical application of the Directive 2011/61/EU on alternative investment fund managers (AIFMD). See our newsletter of March 2014.

The aim of the FAQ Document is to promote common supervisory approaches and practices in the application of the AIFMD and its implementing measures by providing answers to questions posed by the general public and competent authorities.

On March 25th and June 27th 2014 ESMA updated the FAQ Document. The main amendments in March relate to the reporting requirements under article 24 of the AIFMD. ESMA has provided clarifications relating to among others:

- the consideration of repurchase transactions as financing operations.

- the use of the residual maturity as of the reporting date when reporting information on 'instruments traded and individual exposures'.
- the date to submit the last report of an alternative investment fund (AIF) that has been liquidated or put into liquidation; such report should be submitted no later than one month after the end of the quarter in which the AIF has been liquidated or put into liquidation.
- investors liquidity shall be calculated by dividing the AIF's net asset value among the period buckets depending on the shortest period within which investors are entitled, under the fund documents, to withdraw invested funds or receive redemption payments.
- the meaning of inception date; it shall be the date of authorisation of an AIF or of its establishment if authorisation is not necessary or if the AIF is only subject to registration obligations.
- the language of the reporting; ESMA recommends that it be English.
- the extent of the identification of the 5 biggest counterparties to whom the AIF has exposure; if they do not have BIC or LEI codes, in such case only the full name of the counterparty needs to be reported.
- the necessity to reply to questions 296 to 301 of the consolidated reporting template; this is only required by AIFMs managing AIFs employing leverage on a substantive basis.

The amendments made in June include the following:

- a new question 5 has been added to the section on remuneration clarifying when portfolio managers can be excluded from the scope of identified staff.
- 3 new questions are added to the section dealing with reporting clarifying what countries are covered by the term "EEA" and the "Union" and what the terms "mandatory", "optional" and "conditional" mean in the technical guidance.
- Certain clarifications have been made around notifications of AIFMs under article 33 of the AIFMD.
- A new Section V on MiFID services has been added. The first question highlights the amendment to the AIFMD included in Directive 2014/65/EU (MiFID 2) on AIFMs authorised to provide MiFID investment services under article 6(4) of the AIFMD. Pursuant to the amendment such AIFMs have the right to provide those services on a cross border basis. Member States must allow such passporting of services from July 2015 but are recommended to do so even before.

The updated FAQ Document can be found at:
http://www.esma.europa.eu/system/files/esma_2014-714_-_qa_on_aifmd_june_update_for_publication.pdf

## EUVECA AND EUSEF REGULATIONS - UPDATE

Regulation No. 345/2013 on European Venture Capital Funds (EuVECA) and Regulation 346/2013 on European Social Entrepreneurship Funds (EuSEF) became applicable on July 22nd 2013 (see our newsletter of June 2013 and our legal alert of July 2013).

On February 11th 2014 the European Securities and Markets Authority (ESMA) published two draft implementing regulations laying down technical standards with regard to the format of the notification that the competent authority of

the home Member State notifies to the competent authorities of the host Member States relating to the passport of the managers of EuVECA and EuSEF. The regulations set out the format of the notification and specify that the notification shall be done by email. The draft implementing regulations can be consulted at:

- http://www.esma.europa.eu/system/files/2014-esma-161_draft_its_on_notification_-_eusef.pdf
- http://www.esma.europa.eu/system/files/2014-esma-160_draft_its_on_notification_-_euveca.pdf

On March 26th 2014 ESMA published a Questions and Answers document on the application of the EuSEF and EuVECA regulations. The document is aimed at competent authorities to promote common supervisory approaches and is also intended to help managers of EuVECA and EuSEF. The document is intended to be continually updated and edited. The first questions relate to the treatment of managers of EuVECA and EuSEF that subsequently exceed the thresholds set out in the alternative investment fund managers directive (AIFMD), whether such managers have to register twice (once under the AIFMD regulations and once under the relevant EuVECA or EuSEF regulation) and whether EuSEF and EuVECA managers can manage and market Alternative Investment Funds.

The Questions and Answers document can be found at:
http://www.esma.europa.eu/system/files/2014-311_qa_eusef-euveca.pdf

## CROWDFUNDING – ESMA POSITION PAPER

Following the responses received to the consultation on EuVECA AND EuSEF REGULATIONS closed on December 31st 2013, as well as on the consultation on long-term financing, the European Commission (EC) published on March 27th 2014, the communication "Unleashing the Potential of Crowdfunding in the European Union" where it clarified that it did not intend to prepare legislation to govern crowdfunding activities but rather to promote, increase confidence in, and supervise the sector with the aim to develop a common understanding of crowdfunding at EU level so as to prepare the ground for possible future actions.

The paper of the EC was followed by the publication of a position paper issued by the securities and markets stakeholders groups of ESMA on the regulation of crowdfunding at the European level (the Position Paper) on April 10th 2014.

This Position Paper looks at the crowdfunding categories and activities, the benefits and risks of crowdfunding and the approaches to crowdfunding regulation. It further lists the different definitions of crowdfunding provided by different European and US institutions and identifies three main common elements:

- the small amount of money each participant provides (crowd);
- the online nature of calls for participation;
- the presence of a platform to facilitate contact between providers and users of funds.

Nonetheless in the Position Paper the working group admits that under these common terms differences may arise in relation to the type of crowdfunding and its nature (financial or not) which makes it harder for the legislator to identify the volume of activity falling under this new type of investment.

After listing the advantages and risks of crowdfunding the Position Paper describes how

legislators are currently dealing with the increased interest for crowdfunding and stresses that if some legislators place emphasis on the need for transparency and disclosure others seek to protect prospective investors and lenders for instance by limiting the amount that they can invest or lend.

In the Position Paper the working group considers that ESMA together with EBA "should be proactive in giving advice to the EC regarding specific regulation on crowdfunding especially on the investor or consumer protection aspects".

The group considers that "ESMA's priority should be to try to get the maximum homogenization and clarification about crowdfunding across European countries". The Position Paper emphasises the central role of the crowdfunding platforms and suggests that such platforms should be the target of any future regulation to be implemented at the European level.

Finally, the Position Paper also makes reference to the possibility of a future European label "to be granted to crowdfunding platforms meeting more exigent and harmonized requirements at European level" with the aim to promote confidence in crowdfunding platforms having met determined standards designed to mitigate the risks linked to the investment in these type of platforms.

The full text of the Position Paper can be found at:
[http://www.esma.europa.eu/content/SMSG-position-paper-Crowdfunding](http://www.esma.europa.eu/content/SMSG-position-paper-Crowdfunding)

## PRIIPS UPDATE

On April 3rd 2014, the European Council published a final compromise on the proposed regulation on key information documents (KID) for packaged retail investment and insurance based investment products (PRIIPs).

On April 15th 2014, the European Parliament (EP) in plenary session voted to adopt the final compromise.

The full text is available at:
[http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2014-0357#BKMD-35](http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2014-0357#BKMD-35)

It is expected that the Council will endorse the EP's position so that the regulation will apply two years after the date of its entry into force (i.e. in mid-2016).

## EMIR

### EMIR - CONSULTATION PAPER ON DRAFT REGULATORY TECHNICAL STANDARDS

On April 14th 2014 the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) issued a consultation paper on draft regulatory technical standards (Consultation Paper) on risk-mitigation techniques for OTC-derivative contracts not cleared by a central counterparty (CCP) under Article 11(15) of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR).

Under EMIR a legal obligation to clear certain types of OTC derivatives through CCPs has been introduced. However, not all OTC derivative transactions will be subject to the clearing obligation and therefore it is essential, also for the purposes of preventing systemic risk, that counterparties apply robust risk mitigation techniques to reduce counterparty credit risk.

The European Supervisory Authorities (ESAs) were mandated to develop common draft regulatory technical standards (RTS) covering three main topics: (1) risk-management procedures for the timely, accurate and appropriately segregated exchange of collateral; (2) procedures concerning intragroup exemptions; and (3) the criteria for the identification of practical or legal impediments to the prompt transfer of funds between counterparties.

As part of the process, the Consultation Paper seeks stakeholders' views on the RTS proposal.

The draft RTS consider the minimum international standards on margin requirements for non-centrally cleared derivative transactions issued by the Basel Committee for Banking Supervision (BCBS) and the International Organisation of Securities Commissions (IOSCO) in September 2013 which to the extent possible have been transposed into the RTS.

Comments to the Consultation Paper are requested to be submitted by July 14th 2014 at the latest.

Following this Consultation Paper, and on the basis of the relevant input received, the ESAs have indicated that they shall finalise their jointly developed draft RTS and submit them to the Commission before the end of 2014.

For the full text of the Consultation Paper, please see the following link: http://www.esma.europa.eu/content/EBA-ESMA-and-EIOPA-consultation-paper-draft-technical-standards-under-EMIR

### EMIR - Q&A UPDATE

The European Securities and Markets Authority (ESMA) published on May 21st and June 23rd 2014, two updates of its questions and answers document (Q&A) on the Implementation of Regulation No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR).

The updated Q&A of May clarifies, inter alia, the following issues:

- Derivative transaction entered into at the level of the sub-fund of an AIF or UCITS: the sub-fund is the one that should be considered the counterparty and not the umbrella fund. As a result, the sub-fund would need a Legal Entity Identifier (LEI) and be responsible for the reporting duties under EMIR. Otherwise the umbrella fund should be identified as the counterparty and declare its sub-fund as the beneficiary (General Question 1).

- Status of counterparties covered by AIFMD: The Q&A now enumerates more clearly which entities covered by the AIFMD fall under EMIR (EU AIFs, Non-EU AIFs, AIFs managed by authorised or registered AIFMS, securitisation SPVs etc.) (General Questions 3 and 4).

- Intragroup exemption: when a contract between a financial counterparty (FC) and another counterparty is entered into, the intragroup exemption may apply if the other counterparty, while not consolidated under the Capital Requirements Directive (CRD), is part of the same consolidated non-financial group as the FC (OTC Question 6).

- Public Register: A public register containing a list of the classes of OTC derivatives notified to ESMA was first published on ESMA's website on March 18th 2014 and is updated after each central counterparty (CCP) authorisation. The public register will also include a list of classes subject to the clearing obligation after the entry into force of the RTS

specifying the classes of OTC derivatives subject to the clearing obligation.

The update of June focuses on the reporting requirements (in the section Trade Repositories (TR)).

In particular, the amendments brought to TR questions 3a and 3b are of relevance to all financial counterparties trading OTC derivatives.

Regarding question 3a, on the information on collateral to be reported to TRs, the Q&A clarifies that:

- the collateral should be reported at the total market value that has been posted by the counterparty responsible for the report. Therefore any haircuts or similar used by the receiver of the collateral and any fees or similar amounts should all be ignored;
- all collateral for a single portfolio should be reported in one single currency value;
- non-cash collateral should be reported as its current cash equivalent as evaluated at the moment of posting/amending the collateral;
- the collateral should be the sum of any initial margin (or similar) posted by the reporting counterparty and any variation margin (or similar) also posted by the reporting counterparty;
- the collateral reported should be just the collateral that covers the exposure related to the reports made under EMIR; and
- the collateral should be reported as the total market value that has been posted by the counterparty responsible for the report irrespective of whether certain types of collateral might take a couple of days to reach the other counterparty.

Question 3a also clarifies that the deadline of the reporting is extended by 180 days for the reporting of information referred to in Article 3 of Regulation (EU) 148/2013, i.e. data on exposure. The resulting date is therefore August 11th 2014 with the first reports being due no later than the end of August 12th 2014 including the valuations and collateral as at the end of August 11th 2014.

Question 3b clarifies that:

- the mark to market value should be based on the End of Day settlement price of the market (or CCP) from which the prices are taken as reference;
- the mark to market value should represent the absolute value of the contract;
- whenever a price is available for the valuation such valuation is to be considered as “mark to market”; and
- when counterparties delegate the reporting, including valuations, they retain the responsibility for ensuring reports are accurate.

In addition to the foregoing five new questions have been added: the reporting valuations of swaps on structured products, the population of the collateralisation fields, the treatment of contracts with no maturity date, the way to fill in the notional amount field and the reporting on OTC Derivatives Novations.

For the full text of the Q&A, please see the following link: http://www.esma.europa.eu/content/QA-IX-EMIR-Implementation

**EMIR– FRONTLOADING REQUIREMENT**

On May 8th 2014 the European Securities and Markets Authority (ESMA) sent a letter to the European Commission (EC) proposing that the frontloading obligation for OTC derivatives in the

European Market Infrastructure Regulation (EMIR) is made significantly less strict.

In its letter ESMA seeks the EC's view on the suggested approach of frontloading.

The frontloading requirement is the obligation to clear OTC derivative contracts entered into after a central counterparty (CCP) has been authorised under EMIR and before the date of application of the clearing obligation.

According to ESMA this requirement may introduce significant uncertainties in the market with legal, operational and financial consequences which will be mainly borne by derivatives end-users.

ESMA has analysed that the over-all effect could be a reduction in the incentive to hedge risks during a certain period (to avoid the consequences of the frontloading effect), which would in turn increase the un-hedged risks and would impact negatively on financial stability.

In these circumstances ESMA considers that the sreduction of systemic risk can be questioned if this obligation introduces at the same time risks to market functioning and financial stability.

A first notification was received by ESMA on March 18th 2014 of a CCP authorised under EMIR to clear certain classes of OTC and since that date, the counterparties which trade OTC derivatives contracts within those classes could become subject to the frontloading requirement and therefore resolving this issue is becoming urgent.

The frontloading window can be divided into two different timeframes:

- Period A: between the notification of the classes to ESMA and the entry into force of the regulatory technical standards (RTS) on the clearing obligation;
- Period B: between the entry into force of the RTS and the date of application of the clearing obligation. Period B is equivalent to the phase-in period to be defined in each RTS for each category of counterparty.

In its letter ESMA stresses that the uncertainty and negative impact of frontloading are most significant in Period A and it considers that a way to mitigate the negative impact of this requirement could be to apply the frontloading obligation only to contracts entered into during Period B since, during this period, counterparties will have the certainty on the scope and the date of application of the clearing obligation but also on the CCPs available.

ESMA will consider possible solutions in a public consultation paper which will be released prior to the finalisation of the draft regulatory technical standard on the clearing obligation.

The letter can be found at: http://www.esma.europa.eu/system/files/2014-483_letter_to_european_commission_re_frontloading_requirement_under_emir.pdf

## UCITS V – FINAL POSITION OF EU PARLIAMENT

Political agreement between the European Parliament (EP) and the Council was reached on February 25th 2014 on the proposals made for the directive on the coordination of laws, regulation and administrative provisions relating to UCITS as regards depositary function, remuneration policies and sanctions (UCITS V Directive).

On April 15th 2014, the EP adopted the UCITS V Directive. The new rules of the UCITS V Directive will strengthen the protection of investors in relation to the managers of UCITS funds and their depositaries.

## KEY ELEMENTS OF UCITS V DIRECTIVE

### Depositaries

- The depositary status is aligned with that of a depository under the AIFMD with an enhanced duty of care.
- The conditions to be allowed to act as depositaries for UCITS funds will be strengthened and restricted to some specific entities with adequate infrastructure.
- Depositaries will, in principle, not be allowed to re-use assets for their own account except under exceptional conditions and generally either for the account or to the benefit of the UCITS.

The UCITS V Directive introduces the principle of segregation of assets so as to protect the UCITS assets in the event of insolvency.

### Remuneration

- Remuneration policies for all risk takers involved in the management of UCITS funds have been introduced in order to discourage excessive risk-taking.
- 50% of any variable remuneration must consist of units of the UCITS concerned.
- Variable remuneration will be deferred for an amount of at least 40% over 3 years.
- The finalised text does not contemplate to cap the ratio between variable and fixed remuneration and there is no ban on performance fees.

In relation to this particular point ESMA is expected to issue Guidelines on the remuneration rules applicable under the UCITS V Directive to provide clarification on the interpretation of the principle of proportionality and the definition of "identified staff".

### Administrative sanctions

The UCITS V Directive aims at a greater cooperation between authorities to harmonise and increase the transparency on sanctions. The European Securities and Markets Authority (ESMA) will keep a central database of all sanctions communicated to it by national competent authorities and which shall only be available to such authorities.

## NEXT STEPS

The text will now have to be formally approved by the Council. When approved the directive will need to be transposed into national legislation within 18 months from its entry into force.

For the full text of the UCITS V Directive as approved by the EP, please see the following link: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT%20TA%20P7-TA-2014-0355%200%20DOC%20XML%20V0//en

## EUROPEAN LONG-TERM INVESTMENT FUNDS

On June 26th 2013, the European Commission published a proposal for a regulation on European Long-term Investment Funds (ELTIF).

The aim of this proposal is to stimulate long-term investment in the real economy through ELTIFs. ELTIF funds are designed for either professional/institutional investors (insurance companies, pension funds) wishing to place their capital in long-term infrastructure companies and projects in exchange for regular income or retail investors wishing to save for their retirement.

On April 17th 2014, the EP adopted amendments to the proposed regulation (the Amended

Proposal). The Amended Proposal sets out the following key elements:

- An ELTIF fund is an alternative investment fund (AIF) domiciled in the European Union and managed by an authorised alternative investment fund manager (AIFM) within the meaning of the AIFM Directive (AIFMD). The proposal sets out product rules applicable to AIFs that meet the characteristics of ELTIFs.

- All the rules of the AIFMD apply to ELTIF managers, including the need to appoint a depositary.

- Authorisation: only EU AIFs should be eligible to apply for and to be granted authorisation as an ELTIF. The application for authorisation as an ELTIF shall include information on the identity of the proposed ELTIF manager, its current and previous fund management history and experience relevant to long term investments. For retail ELTIFs, the application should include a description of the procedures and arrangements in place to deal with retail investors' complaints.

- European passport: once authorised in accordance with the regulation an ELTIF may be marketed to professional (and semi-professional) and retail investors throughout the European Union pursuant to a passport mechanism similar to that for AIFs and UCITS.

- Eligible assets: at least 70% of the capital of the ELTIF must consist of
  i. equity or quasi-equity instruments or debt instruments issued by a qualifying portfolio undertaking and/or loans granted to a qualifying portfolio undertaking by the ELTIF; and/or
  ii. shares or units in EuVECAs or in EuSEFs or in other ELTIF, provided that those funds have not themselves invested more than 10% of their capital in ELTIFs; and/or
  iii. direct holdings of individual real assets requiring up-front capital expenditure of at least 10 million EUR at the time of the expenditure/acquisition (e.g. property, ships, infrastructure, aircraft, etc.).

  Up to 30% of capital may be invested in assets which are eligible for UCITS (money market instruments, transferable securities admitted for trading on a regulated market or MTF, sovereign securities) within the following limits:
  i. 10% of the non-voting shares of a single issuing body;
  ii. 10% of the debt securities of a single issuing body;
  iii. 25% of the units of a single UCITS or UCI;
  iv. 10% of the money market instruments of a single issuing body.

  ELTIFs are prohibited from short selling of assets, exposure to commodities, securities lending/borrowing agreements, repurchase agreement and using financial derivative instruments, except to hedge the duration and exchange risks.

  Projects financed by a public-private partnership shall be granted priority by the competent authorities when examining an application.

- Redemption policy: the proposal precludes an ELTIF from offering a redemption right to its investors before the end of the life-cycle of the ELTIF. The EP has proposed offering redemption rights to retail investors during the life of the ELTIF. However the European Council disagree with them on this point.

- Qualifying portfolio undertaking: to be eligible, an undertaking must, *inter alia*:
  i. not be a collective investment undertaking;
  ii. not be admitted to trading on a regulated market or MTF unless it has a market capitalisation of no more than EUR 1

billion or is considered to be a small or medium enterprise (SME);

iii. have its head office in the EU or in a third country that is not on the FATF blacklist;

iv. have signed an agreement with the home Member State of the ELTIF manager and with every other Member State in which the units or shares of the ELTIF are intended to be marketed which provides that the third country is not a country: (i) where there are no or nominal taxes, (ii) where there is a lack of effective exchange of information with foreign tax authorities, (iii) where there is a lack of transparency in legislative, judicial or administrative provisions, (iv) where there is no requirement for a substantive local presence; (v) which acts as an offshore financial centre;

v. not be a financial undertaking, except a company dedicated to financing infrastructure projects or acquiring/developing/building real assets.

The Amended Proposal is still subject to negotiation at the level of the EP and the European Council and there are already indications that the Council does not agree with all of the amendments proposed by the EP. The final version is therefore still subject to change.

The full text of the Amended Proposal is available at:
http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2014-0448

# TAX

## FATCA

### FATCA: ALFI Q&A DOCUMENT

Release of the first edition

Following the signature of the model 1 agreement (IGA Model 1) between Luxembourg and the United States on March 28th 2014 (See our newsletter of March 2014) implementing the Foreign Account Tax Compliance Act (FATCA), the association of the Luxembourg fund industry (ALFI) released on April 15th 2014 its questions and answers document (Q&A Document). The Q&A Document has been drafted by a working group comprising representatives of asset managers, management companies, securities service providers, audit firms, law firms and other financial actors active in Luxembourg.

The aim of the Q&A Document is to help the financial actors subject to FATCA to implement the reporting obligations that are imposed on them.

In order to clarify the scope of FATCA and the IGA Model 1 on Luxembourg law, the Q&A Document gives a brief description of all relevant terms and concepts used.

The Q&A Document comprises three main parts:

1. Introductory note;
2. FATCA status and Registration requirements; and
3. Due Diligence.

The first part deals with the main features of a standard IGA Model 1 agreement, the most favoured nation clause applicable to all IGA Model 1 agreements, the applicability of FATCA provisions from a Luxembourg point of view, the interpretation of applicable FATCA rules in Luxembourg, the prevailing FATCA rules applicable to Luxembourg entities and the need for registration with the U.S. tax authorities (IRS).

The second part goes into more detail and draws a distinction between Luxembourg Reporting Financial Institutions and Non-reporting Financial Institutions (both terms as defined in the Q&A Document). As a general reminder, Reporting Financial Institutions are financial Institutions, which report certain data on U.S. reportable accounts to the relevant tax authority and thus are registered with the IRS, while Non-reporting Financial Institutions do not report such information to tax authorities (and thus do not need to be registered). An entity qualifies as a Non-Reporting Financial Institution because it falls under one of the categories of entities which make it a Deemed Compliant entity or an Exempt Beneficial Owner. The main inconvenience for a Non-reporting Financial Institution is the fact that it has to prove its FATCA-compliant status to its counterparties.

In this respect, the Q&A Document aims to provide the above Financial Institutions with answers to the most frequently asked questions arising from their status.

The third part describes the due diligence procedures that are applicable to both Reporting Financial Institutions and Non-Reporting Financial Institutions. The purpose of such due diligence is to ensure that any Financial Institution complies with its FATCA obligations regarding the identification of account holders.

Release of the second edition

ALFI has already updated the Q&A Document on May 6th 2014.

The main changes are:

- Deletion of the Luxembourg standard self-certification form for Luxembourg Financial Institutions;
- Deadline for Luxembourg Reporting Financial Institutions and other relevant entities to register fixed at December 22nd 2014 in order to avoid the risk of a withholding tax applicable to payments received on or after January 1st 2015;and
- Clarification of the concept of "investment vehicle for unrelated parties".

### FATCA: ABBL GUIDANCE NOTES

On May 20th 2014, the Luxembourg Banker's association (ABBL) issued its ABBL Guidance Notes on the implementation of FATCA rules in Luxembourg (Guidance Notes).

The Guidance Notes are not intended to supersede the Q&A Document released by ALFI. On the contrary, the Guidance Notes provide useful definitions and clarifications which are complementary to the principles stated in the Q&A Document.

In particular, the Guidance Notes clarify, among others, the following concepts:

- Financial Institution, which include
  1. Depository Institutions,
  2. Custodial Institutions,
  3. Specified Insurance Companies, or
  4. Investment Entities;
- Expanded Affiliated Group;
- Exempt beneficial Owner;
- Investment Entities;
- De minimis rules.

In addition, the Guidance Notes provide useful guidelines on how to register with the IRS and state what deadlines are applicable to the relevant financial actors.

The Guidance Notes also describe the accounts (or products) that are excluded from the definition of "Financial Account" within the meaning of FATCA and therefore are not treated as U.S. Reportable Accounts for the purpose of the IGA Model 1 agreement and thus are not subject to the FATCA requirements.

The Guidance Notes further determine the due diligence obligations imposed on Luxembourg Financial Institutions in respect of pre-existing or new financial accounts held by entities or individuals.

Lastly, the Guidance Notes explain the applicable reporting obligations and further detail the practical steps to be undertaken for the following reporting years starting with 2014. Non-compliance with such reporting obligations may lead to detrimental withholding obligations. However, such withholding obligations are not being enforced for the moment, considering the fact that the verification of the global intermediary identification number is not required for payments made prior to January 1st 2015. In addition, even after January 1st 2015, a Reporting Financial Institution will validly identify its status to a withholding agent by informing the said withholding agent that it is a Reporting Model 1 Foreign Financial Institution, unless it is treated by the competent public authorities as a Non-Participating Financial Institution.

### EU FINANCIAL TRANSACTION TAX

On April 30th 2014 the European Court of Justice released its decision (C-209/13) in relation to the challenge by the United Kingdom to the proposal for an EU Financial Transaction Tax (FTT)

published by the Commission in February 2013 (see our newsletter of June 2013). The ECJ rejected the challenge on the basis that it was premature. A challenge should only have been made once there was a final adopted directive on the EU FTT. This leaves the door open to the United Kingdom to mount a challenge in the future should it wish to do so.

At the ECOFIN meeting held on May 6th 2014 it was noted that it was still the intention of 10 of the original 11 participating Member States to proceed with an EU FTT. A deadline of January 2016 has been set for implementation and the focus initially is to be on taxation of shares and certain derivatives. It is now up to the Commission to come up with a new proposal for the EU FTT.

## AMENDMENT OF THE EU PARENT-SUBSIDIARY DIRECTIVE

On June 20th 2014, the Council of the European Union has agreed to an amendment to the the EU Parent-Subsidiary Directive 2011/96/EU (the Directive), as proposed by the European Commission on November 25th 2013.

As outlined in our newsletter dated January 2014 (the Previous Newsletter which is available at the following link http://www.bsp.lu/sites/default/files/publication/file-docs/bsp_newsletter_201403.pdf), the proposed amendments focus on closing a loophole deriving from the use of hybrid loan arrangements. The objective of the new rules is to prevent cross-border companies from planning their intra-group payments in such a manner as to benefit from the provisions of the Directive in order to enjoy double non-taxation. In the future, the benefit of the tax exemption to income from a participation in an EU subsidiary will be denied if such income is deductible in the jurisdiction of the subsidiary.

After finalisation of the text, legislation is planned to be adopted at a forthcoming Council session, whereas Member States will have until December 31st 2015 to implement it into national law.

The political agreement reached on June 20th 2014 only concerns the new rules on hybrid loans whereas work is still to be continued on the second aspect described in our Previous Newletter, namely the introduction of a common anti-abuse provision.

## NEW EXIT TAX RULES AND AMENDMENT OF THE ROLL-OVER REGIME

With the law of May 26th 2014 (the Law), the Luxembourg legislator introduces new provisions in the Luxembourg income tax law (LITL) regarding exit taxation for companies leaving or migrating from Luxembourg to another State of the European Economic Area (EEA). These new provisions were included in the Draft Law n° 6556 (see our newsletter March 2013) and have been introduced particularly to render the national tax law compliant with EU-Law and further to case law of the European Court of Justice on the compatibility of exit tax rules with the freedom of establishment guaranteed by the Single European Market.

According to the Law, the tax liability is determined upon the migration of the Luxembourg company or the transfer of a Luxembourg-based permanent establishment to another State in the EEA. The tax is, however, only payable when the taxpayer effectively ceases to be the owner of the company or the permanent establishment (Transferred Assets). In order to continue to benefit from the tax deferral, which is

available upon request, the taxpayer has to provide evidence to the Luxembourg Tax Authorities that he is still the owner of the Transferred Assets. Capital losses realised on the Transferred Assets after the migration of the business can be taken into account and decrease the capital gain tax in Luxembourg (provided that such capital losses have not already been taken into account in the other State).

The Law also extends the scope of the Luxembourg tax deferral regime provided in article 54 LITL. Pursuant to this article, the taxation of the capital gains realized upon the disposal of buildings or non-depreciable assets (e.g. land, shareholdings) which were part of a business can be deferred if the sale proceeds are reinvested in fixed assets located in Luxembourg. The condition regarding the localisation of the reinvestments was not compliant with the general principles of the Single European Market and the Law therefore extends the deferral to a reinvestment in fixed assets located in the EEA Area. The deferral regime works as follows: the acquisition cost of the new investments is reduced by the amount of the capital gain and consequently for fixed assets that must be depreciated the annual deductible depreciation expense is reduced accordingly. For fixed assets that are not depreciated the taxation will be deferred until the disposal of the newly acquired fixed asset. According to the Law, this roll-over mechanism is also available if the reinvestment is made in assets attributed to a permanent establishment located in a country of the EEA.

## THE DRAFT LAW N°6680: A NEW PROCEDURE FOR THE EXCHANGE OF INFORMATION UPON REQUEST

The draft law N°6680 (the Draft Law) has been submitted to the Luxembourg parliament on April 3rd 2014 in response to the report of the Global Forum on Transparency and Exchange of Information rendered in December 2013 giving a global negative rating to Luxembourg for the legal framework and application of the international standards on exchange of information on demand.

In 2009, Luxembourg decided to apply the international standards on exchange of information as provided for in article 26 of the OECD Model Tax Convention and hence to also exchange information held by banks. As a result, not only the new double tax treaties concluded by Luxembourg but also many of the existing double tax treaties which were amended now allow exchange of information in line with the provisions of article 26 of the OECD Model Tax Convention. The procedure applicable for the exchange of information within the frame of these double tax treaties was detailed in the law of March 31st 2010. This procedure should be superseded by the procedure included in the Draft Law.

The Draft Law shall apply to a request of exchange of information from a tax authority of any treaty country and hence also from treaty countries where article 26 of the tax treaty has not been amended and extended to information held by banks (for the latter countries the Draft Law does however not provide for an exchange of information held by banks). The new procedure will also apply to the requests of information based on the laws introducing the EU Directive of March 16th 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures, the EU Directive of February 15th 2011 on administrative cooperation in the field of taxation and the convention on mutual administrative assistance in tax matters developed jointly by the OECD and the Council of Europe.

Before submitting a request of information to the taxpayer or the holder of the information, the Luxembourg tax authorities shall verify that the request complies with the formal conditions required by the relevant double tax treaty or applicable law such as the legal basis, the identity of the taxpayer subject to the request or the tax purpose for which the information is sought.

The Luxembourg tax authorities will no longer verify that the requested information is foreseeably relevant before submitting a request of information to the taxpayer or the holder of the information. They are however authorised to perform an “a posteriori” control once they have collected the information and before they communicate them to the requesting State.

The Draft Law aims to ensure an exchange of information as large as possible. The holders of information must provide all the information requested without any alteration even if they relate to third parties who are not concerned by the request of information. An exchange of information for a period before the entry into force of the double tax treaty or the applicable laws will be allowed if the requested information is foreseeably relevant for the determination of the taxable income of a year post-entry into force of such double tax treaty or such laws.

In certain circumstances, the requesting State may also instruct the holders of information, if it is a bank, not to communicate to the client or a third party the existence and content of the request of information.

Taxpayers or holders of information, to the extent they are allowed to be informed of the request of information, will be entitled to initiate proceedings against the Luxembourg tax authorities’ demand. Legal action will be limited to claims relating to the formal conditions of said demand. The Draft Law further outlines that in the event of legal action the request of information will not be disclosed or made available to the parties to the proceedings.

This Draft Law aims to ease the exchange of information in order to make Luxembourg compliant with the OECD standards on exchange of information. However, concerns may be expressed about the rights of the taxpayers which are significantly reduced. In particular, they will no longer be able to appeal against a request of information on the grounds of the foreseeably relevance which grounds, up until now, have formed the basis for most of the cases before the Luxembourg administrative courts.

## TAX CHARACTERISATION OF INCOME DERIVED FROM AN AUSTRIAN PRIVATE FOUNDATION

The Luxembourg Administrative Court (*Tribunal Administratif* ) had to rule (Decision n° 32037) on the characterisation of the allocations made to a Luxembourg individual by an Austrian law governed private foundation (*österreichische Privatstiftung*, hereafter the “Foundation”). The Foundation was founded in the year 2000 by the taxpayer’s parent and grand-parent who contributed real estate and other assets to the Foundation. In 2010, the Foundation, which had a legal personality and was taxable in Autria, was liquidated further to the passing away of the grant-parent and an amount of EUR 21,000 was allotted to the taxpayer in order to cover the expenses for the liquidation of the Foundation. This allocation was taxed by the Luxembourg tax authorities as investment income (*Revenu de capitaux mobiliers)*.

- The tax payer challenged the position of the tax authorities on the basis of the following elements:

- The Foundation has a legal form that does not exist in Luxembourg and therefore cannot be assimilated to a Luxembourg-resident company in the sense of Art. 159 and 160 Luxembourg Income Tax Law (LITL) and hence make distributions in the sense of Art. 97 LITL.
- The taxpayer had no legal or economic ties with the Foundation. He never made any contributions to the Foundation nor did he participate in the management of the Foundation. He never was a beneficiary of the Foundation and only became entitled to the allocation after the passing away of his grandparent.
- An income would only be characterised as investment income in the sense of Art. 97 LITL if it constitutes the result derived from the placement of capital.

In the view of the Court, although a private foundation does not exist in Luxembourg one has to determine which existing legal form has the most similarities with the Foundation. Having reviewed the main features of the Foundation it concluded that it can be assimilated to an “other private undertaking” in the sense of Art. 159 (1) A 7. a) LITL, so that this legal form qualifies to make distributions in the sense of Art. 97 LITL (i.e. investment income). However, in order to characterise income as investment income, the allocations must be (i) characterised as dividends, profit shares or other similar income and (ii) must be distributed on the basis of shares, securities, units, certificates of participations or other participations in whatsoever form held in the Foundation. Given that the tax office did not demonstrate the (economic) link between the allocation and a participation in the Foundation by the taxpayer on the basis of which the payment has been made, the allocations cannot be characterised as investment income.

## CIRCULAR OF THE LUXEMBOURG TAX AUTHORITIES ON THE FUNCTIONAL CURRENCY REGIME

The Luxembourg tax authorities issued a new circular on June 14th 2014 (the Circular) setting forth the conditions to be met by Luxembourg taxpayers for the use of a currency other than Euro for the determination of their taxable business income.

Taxpayers having their share capital and annual accounts prepared in a currency other than Euro should, in principle, prepare a fiscal balance sheet in Euro for the determination of their taxable income. With the new Circular, the taxpayers are allowed to determine their taxable result on the basis of their commercial accounts and convert this taxable result into Euro (the Functional Currency).

The taxpayer must submit a written request to the Luxembourg tax authorities at least three months before the end of the first financial year as from which the taxpayer wants to use the functional currency. The taxpayer opting for the use of the functional currency will be bound by this option as long as its share capital is denominated in such currency.

In case of fiscal unity, as from the first year of the fiscal unity, all the companies which are part of the fiscal unity shall use the Functional Currency.

The conversion rate can either be the average rate of the accounting year or the exchange rate applicable on the date the taxpayer closes its annual accounts. The choice of the taxpayer for the average or year-end exchange rate is irrevocable and binds the taxpayer for the future. The exchange rate used for the conversion shall be the rate published by the European Central Bank. Carried forward losses and recapture amounts are determined in the functional

currency and converted into Euro on the year during which they are used.

The Circular confirms that for the application of the participation exemption regime the minimum acquisition cost for the shareholding threshold test is determined at the historical exchange rate.

For net wealth tax purposes, the assets and liabilities in the foreign currency are converted into Euro using the exchange rate applicable as at December 31st. Companies having a diverging financial year will use the exchange rate applicable at the end of their financial year unless they opt for the use the exchange rate applicable as at December 31st. This option is irrevocable.

The amount of the net wealth tax credit is determined on the basis of the net wealth tax reserve expressed in the foreign currency and converted into Euro applying the exchange rate which is used for the conversion of the net assets.

The Circular also provides guidance for taxpayers that currently prepare a tax balance sheet in Euro and which would, going forward, apply the Functional Currency.

## REAL ESTATE CAPITAL GAINS - ABOLISHMENT OF THE TAX DEFERRAL FOR INDIVIDUALS

Under the tax laws currently in force, the taxation of the capital gains realised by individuals upon the disposal of the real estate part of their private wealth may, under certain circumstances, be deferred.

The taxation of the capital gain realised during a given year is deferred if the taxpayer uses the proceeds from the disposal of the real estate to acquire certain immovable property. The newly acquired real estate which would allow a tax deferral are, for instance, newly built property which will be used exclusively for rental to individuals (as opposed to a business lease). In addition the deferral is applicable only with respect to newly acquired immovable property located in the Grand-Duchy of Luxembourg.

In the framework of an infringement proceeding, the European Commission considered that the provision requiring that the newly acquired immovable property shall be located in the Grand-Duchy of Luxembourg is a restriction to the free movement of persons and capital.

The control by the Luxembourg tax authorities of the effective use of the real estate would generate practical difficulties for real estate located outside Luxembourg. A Grand-Ducal decree of June 18th 2014 has thus abolished the provisions allowing the tax deferral. This measure will be effective as from the January 1st 2015.

## AMENDMENTS TO THE VAT LAW – LAW OF MAY 26TH 2014

On May 13th 2014, the Luxembourg Parliament adopted the law implementing article 5 of the Council Directive 2008/8/EC (the Directive) and amending the Luxembourg VAT law of February 12th 1979 on several other technical points (the Law).

The Law dated May 26th 2014 modifies the place of supply of electronically supplied services and completes the implementation of the Directive. From January 1st 2015 onwards, all supplies of telecommunications, radio-broadcasting, television and electronic services to private consumers domiciled in the EU will be taxable in the customer's country of residence. The underlying reason for these changes was to bring the VAT treatment of these services in line with one of the main principles of VAT that, as a

consumption tax, revenues should accrue to the Member State in which goods or services are consumed. For further details please refer to the next item of this newsletter on the VAT Mini One Stop scheme.

In connection with the Law, it is to be noted that an important regulation has been adopted by the Council of the European Union on October 7th 2013. This Implementing Regulation 1042/2013 *inter alia* establishes presumptions for the location of the customer in order to provide legal certainty to taxable persons and to avoid conflicts of different Member States' jurisdiction.

Besides the new rules on the place of supply of services, the Law also introduced the possibility to apply for relief from the effects of the expiration of the time limit in cases where the taxpayer was, through no fault of his own, unable to appeal against the tax assessment within three months. This new provision has been introduced upon recommendation of the Luxembourg Ombudsman.

## VAT MINI ONE STOP SHOP SCHEME FOR ELECTRONICALLY SUPPLIED SERVICES

On May 13th 2014, the Luxembourg Parliament adopted the law implementing article 5 of the Council Directive 2008/8/EC of February 12th 2008 amending Directive 2006/112/EC as regards the place of supply of services. From January 1st 2015 onwards, the provision of telecommunications, radio-broadcasting, television and electronic services (the Services) by taxable persons (businesses) to private consumers domiciled in the EU are taxable in the country of residence of the customer. This rule is applicable regardless of the place of establishment of the supplier.

Without the mini One Stop Shop, the supplier would be required to register in each Member State in which it supplies Services to its customers. The optional mini One Stop Shop scheme allows taxable persons to avoid this administrative burden and choose one Member State of identification where they declare and pay the VAT due in respect to all their supplies in any of the Member States.

The simplification measure is available to taxable persons which are established (place of business and/or fixed establishment) in the EU (the Union Scheme), as well as to taxable persons which are not established within the EU (the Non-Union Scheme).

Under the Union Scheme, the Member State of identification has to be the Member State in which the taxable person has established its business (*i.e.* head office, place of business). However, if the taxable person does not have its business establishment in the EU, but still falls under the Union Scheme because it has one or more fixed establishments in the EU, it may choose any Member State in which it has a fixed establishment to be its Member State of identification. Under the Non-Union Scheme, the taxable person is free to choose any of the Member States for its identification.

A taxable person using the mini One Stop Shop is required to submit by electronic means a mini One Stop Shop VAT return for each calendar quarter, containing the details of supplies made to customers in each Member State of consumption. The Member State of identification splits the mini One Stop Shop VAT return and forwards the details to each Member State of consumption. It is important to note that, where a taxable person has an establishment in a Member State, all supplies of electronically supplied services made to private consumers in that Member State have to be declared via the

domestic VAT returns of that establishment, and not on the mini One Stop Shop. Supplies to private consumers in Member States where the taxable person has a VAT registration, without having any fixed establishments, are however included in the mini One Stop Shop return.

The mini One Stop Shop is an all-in or all-out scheme. The taxable person is not authorised to apply the system to the Services supplied in some Member States and not the others.

Member States will make their registration procedures available as from October $1^{st}$ 2014. Any registration during the period from October $1^{st}$ 2014 to December $31^{st}$ 2014 will come into effect from January $1^{st}$ 2015. Luxembourg's indirect tax administration will make available a user-friendly web-interface providing businesses a complete and coherent overview of their activities.

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