Deloitte. Private Equity - Top priorities 2018

Regulatory aspects

Anti-money laundering and counter-terrorist financing IV (AML IV)

Scope

- Credit institutions
- Investment firms
- Investment funds & Hedge funds
- Insurance companies
- Management companies
- Central counterparties
- Central securities depositories

Background

The law transposing the main part of the 4th AML Directive into Luxembourg law has been published on the Memorial A on 14 February 2018.

Pursuing the implementation of the 4th directive, two additional draft laws (7216 and 7217) have been submitted to the Chamber of Deputies on 6 December 2017, introducing two distinct registers of Ultimate Beneficial Owners (UBOs):
- A central register for the UBOs of legal entities (REBECO)
- A central register for trusts and fiduciaries

The Beneficial Owner register requires Luxembourg entities to:
- Obtain and keep information on their beneficial owners at their place of business
- Register the information concerning their beneficial owners with REBECO
- Provide information on their legal owners and beneficial owners to national authorities upon request; to self-regulatory bodies in the exercise of their AML/CFT supervisory duties; as well as professionals in the context of their vigilance toward customers if both have justified motivations

The Trustees Register requires Luxembourg entities to:
- Obtain and keep information at their place of business on the beneficial owners of any trust for which they act as trustee
- Provide information to national authorities, upon request, regarding these trusts
- Declare their status as trustees to professionals and provide them with certain information when, as a trustee, they enter into a business relationship with them or perform occasional transactions for an amount exceeding the thresholds set out in the AML Act of 12 November 2004
- Register any trust that generates tax consequences in the national trust register

Next steps
- **Q2 2018:** Expected adoption of the two distinct registers of UBOs

Benchmark Regulation (BMR)

Scope

- Credit institutions
- Investment firms
- Management companies

Background

The EU Benchmark Regulation (BMR) was issued on 29 June 2016; its entry into application is set for 1 January 2018. This regulation introduces a regime for benchmark index administrator, contributor, and user that will ensure the accuracy and integrity of benchmarks across the EU.

The BMR will impose new requirements for firms:
- Administrating (i.e., creating) a benchmark
- Contributing to the elaboration of a benchmark
- Using a benchmark to reference the price of a financial instrument or contract, or measure the performance of an investment fund

The key implications of the BMR are the following:
- No financial instruments, financial contracts, or measurements of the performance of an investment fund will be able to add a reference to the "existing EU benchmark" after 1 January 2020 unless administrator is authorized or registered if it is a third country entity.
- Non-EU benchmark administrators need to meet one of the three options under the third country regime in order for those non-EU benchmarks to be used in the EU.

Throughout 2017, ESMA published a series of RTS and Q&As to clarify certain aspects on the BMR, such as:
- The definition of benchmark and notably the meaning of the "benchmark made available to the public"
- The transitional arrangements applicable to benchmarks existing prior to 1 January 2018 (existing benchmarks)

However, some aspects of the Benchmark Regulation are yet to be clarified, regarding the Register of Administrators and Benchmarks that ESMA must establish and maintain under Article 36 of the Benchmark Regulation. Moreover, no specification was issued on the format of the written plan that sets out the actions that benchmark users would take in the event that a benchmark they are using in their contracts materially changes or ceases to be provided, as set under article 28(2).

Next steps
- **1 January 2018:** The regulation becomes applicable to "new" benchmarks, created after 1 January 2018
- **Q2 2018:** The ESMA Register of administrators and benchmarks will be operational
- **1 January 2020:** End of the transitional arrangements. The regulation applies to all the benchmarks. "Existing" benchmarks, administrators providing benchmarks before 1 January 2018, have until 1 January 2020 to apply to their EU NCA for authorization or registration.

Directive on Administrative Cooperation (DAC5 and DAC6)

Scope

- Investment funds & Hedge funds
- Credit institutions
- Insurance
- PSF (Financial Sector Professionals)
- CSP (Corporate Service Providers)

Background

DAC5

On 6 December 2016, the EU Council has adopted Directive 2016/2258, also known also as DAC 5. That directive amends the EU Directive 2011/16/EU regarding access to anti-money-laundering information by the tax authorities.

Following the transposition of the directive into the national systems, the tax authorities will be able to access mechanisms, procedures, documents, and information referred to in Articles 13, 30, 31, and 40 of the Council Directive 2015/849.

The information exchange will concern:
- Customer due diligence information
- Beneficial ownership for trusts and corporate entities
- Records of transactions
- Other documents specified in Articles 13, 30, 31, and 40 of EU Directive 2015/849

DAC6

On 21 June 2016, the European Commission has published Proposal 2017/0138—DAC 6—to further amend the Council Directive 2011/16/EU. The proposal aims to set new transparency rules for intermediaries such as accountants, banks, lawyers, and tax advisers, which design and promote tax-planning schemes for their clients. In order to achieve this goal, DAC 6 introduces a set of obligations on the member states, that will have to transpose it into their national systems in case DAC 6 is adopted.

The obligations include:
- A duty on the intermediaries to report cross-border arrangements that contain specific indicators (hallmarks), which may suggest that the arrangement has been set up for tax avoidance purposes
- A duty on the member states to automatically share the information received from intermediaries with all other member states on a quarterly basis
- Information sharing in a standardized format through a centralized database

Next steps
- **1 January 2018:** Application date of DAC5 and deadline for transposition
- **2018:** DAC6 should be adopted at the EU level

European Market and Infrastructure Regulation (EMIR)/ Securities Financing Transaction Regulation (SFTR)

Scope

- Credit institutions
- Investment firms
- Investment funds & Hedge funds
- Insurance companies
- Management companies
- Central counterparties
- Central securities depositories
- Non-financial counterparties in derivatives trades

Background

EMIR

On 3 May 2017, the European Commission released its proposed draft update of the European Market Infrastructure Regulation (EMIR II). The Commission intends to improve the transparency of OTC derivative positions and exposures as well as simplify and better balance the clearing and reporting obligations for market participants.

Among the main updates of the proposed new regulations, we have the following aspects:

Definitions: AIFs and SPVs will be considered financial counterparties. UCITS ManCos and AIF managers will be liable for ensuring EMIR reporting is done for the funds they manage.

Clearing: The calculation of the clearing thresholds for Non-Financial Counterparties (NFCs) will be based on the aggregate month-end average positions for the months of March, April, and May
for both FCs and NFCs. New concepts are introduced for Small Financial Counterparties (SFCs), with the same clearing thresholds as NFCs. For NFCs, the clearing obligation will only concern the classes of derivatives that breach the clearing threshold. The front loading obligation for new OTC contracts onto a clearing platform is removed; clearing will start at the live date of the first clearing; and the pension scheme exemption is further extended by three years.

Reporting: Intra-group transactions where at least one of the counterparties is a NFC will be exempted from the reporting obligation; CCP becomes responsible and liable for reporting on behalf of both the trading parties for ETD; and FCs are responsible and liable for reporting the transactions they perform with NFCs not subject to the clearing obligation.

SFTR

The Securities Financing Transactions and Reuse (SFTR) entered into force on 12 January 2016. Under the SFTR regime, the reporting usually follows the model for derivative reporting under the European Market Infrastructure Regulation (EMIR). The reporting regime requires both parties to a trade (financial or non-financial counterparties) to report new, modified, or terminated SFTs to a registered trade repository by T+1. SFT records must be kept at least for five years after the termination of the transaction.

Next steps
- **12 February 2019:** EMIR new backloading deadline
- **Q1 2019:** SFTR reporting starting date for investment firms and credit institutions
- **Q2 2019:** SFTR reporting starting date for other financial counterparties, insurance, UCITS, and AIFs
- **Q3 2019:** SFTR reporting starting date for NFCs

General Data Protection Regulation (GDPR)

Scope

- Any organization processing personal information, including credit and large investment firms

Background

GDPR

The EU Regulation on General Data Protection (GDPR) enters into force in 2018. GDPR creates a unified and coherent data protection framework in the EU, which protects individuals and allows the development of the digital economy across the internal market.

Organizations will be required to:
- Adopt technical and organizational measures such as designating a Data Protection Officer in certain cases
- Keep records of data processing taking place
- Conduct Privacy Impact Assessments (PIAs) and if required consult the Data Protection Authority (DPA)
- Organize training and awareness sessions
- Review privacy compliance (e.g., audits)
- Report data breaches to the local DPA within 72 hours

Under the new regulation, DPAs have investigative, corrective, advisory, and authorization powers. They are entitled to impose administrative fines ranging from two to four percent of the group's worldwide annual turnover of the preceding financial year, or up to €10 to 20 million, whichever is higher, for infringements of data subjects' rights, non-compliance with an order of the DPA, or with the obligations of the controller and processor.

One of the key elements of the new regulation is the introduction of the notion of "accountability," which means that a data controller has to be able to demonstrate how he intends to be compliant with GDPR.

Additionally, GDPR implements and creates:
- The right to be forgotten, which is the right for consumers to erase their data. A consumer or data subject can request to erase the data held by companies at any time, even if it has been passed on to any third parties.
- In certain cases, companies will have to appoint a Data Protection Officer (for public authorities, when a large scale of sensitive data is processed as a core activity, or when data subjects are regularly and systematically monitored on a large scale as core activity). The DPO is responsible for creating a data security policy and report any breaches.

Next steps
- **25 May 2018:** Application date of the General Data Protection Regulation
- **Q2 2018:** Deadline for the transposition of GDPR into national law

Investment fund initiatives: Money Market Funds (MMFs)/ Omnibus initiative on cross-border barriers to distribution of funds / Private Placement Regimes (PPR) revision under AIFMD

Scope

- Investment funds & Hedge funds

Background

Money Market Funds

Regulation EU 2017/1131 of 14 June 2017 on Money Market Funds (MMFs) was published in the Official Journal of the European Union on 30 June 2017. The regulation aims at harmonizing the EU legal framework for MMFs to safeguard the integrity of the internal market. The MMF regulation will apply to all MMFs using the designation "Money Market Fund" or "MMF" that are established, managed, or marketed in the EU. The regulation covers authorization, eligible investments, portfolio composition, internal credit quality assessment, valuation rules, transparency and reporting, as well as liquidity risk management.

Cross-border barriers to distribution of funds

The European Commission has launched an initiative to reduce barriers to cross-border distribution of investment funds. The Commission has identified six categories of national barriers:Lack of harmonization of what constitutes marketing and of marketing requirements and practices
- Lack of harmonization of what constitutes marketing and of marketing requirements and practices
- Regulatory fees
- Administrative requirements (the need to appoint a local agent differs from one member state to another one)
- Notification requirements
- Online distribution (lack of clarity over application rules for online distribution)

In June 2017, the EC launched an impact assessment of these barriers to evaluate the opportunity to adopt a legislative proposal to facilitate the cross-border distribution and supervision of UCITS and AIFs. The results of this impact assessment is planned for the first quarter of 2018.

Private Placement Regimes (PPR) revision

Pursuant to the AIFMD, European managers are required to obtain authorization in order to "passport" the AIFs they manage throughout the European Union. Until a "third country passport" is introduced, non-European managers can market their AIFs in the EU using national placement regimes.

The AIFMD includes a provision stating that by 22 July 2017, the EC should start a review on the application and the scope of the directive. However, the Commission's review has been delayed.

European Long-Term Investment Fund (ELTIF)

The ELTIF is a product aimed at promoting sustainable long-term investment in the European economy (infrastructure, sustainable energy, new technologies). ELTIFs fall under AIFMD but are open to both retail and institutional investors. ELTIFs represent an alternative to UCITS for retail investors seeking to invest in illiquid assets over the longer term.

European venture capital funds (EuVECA)/ European social entrepreneurship funds (EuSEF)

The EuVECA regulation covers a subcategory of alternative investment schemes that focus on startups and early stage companies.

The EuSEF regulation covers alternative investment schemes that focus on social enterprises. These companies are set up with the explicit aim to have a positive social impact and address social objectives, rather than only maximizing profit.

Next steps
- **9 December 2015:** Application date of the ELTIF
- **1 March 2018:** Application of the amended Regulation on EuVECAs and EuSEFs
- **Q1 2018:** Expected draft for reducing barriers to the cross-border distribution of investment funds
- **21 July 2018:** MMF regulation enters into application for "new" MMFs (created after 21 July 2018)
- **21 January 2019:** "existing" MMFs (created before 21 July 2018) will have to comply with the regulation

Markets in Financial Instruments Directive and Regulation (MiFID II/MiFIR)/ Packaged Retail and Insurance-based Investment Products (PRIIPs)

Scope

- Investment firms
- Market operators
- Data reporting services providers

Third-country firms providing investment services or performing investment activities through the establishment of a branch in the EU

Background

MiFID II/MiFIR

The Directive 2014/65/EU and Regulation N°600/2014 on markets in financial instruments (MFID II & MiFIR) were published in the Official Journal of the EU on 12 June 2014. MiFID II seeks to improve the transparency and regulation of more opaque markets, such as derivatives. The key themes include the following:
- Increased investor protection, transparency requirements on product and service costs
- Inducements
- Robust requirements for corporate governance
- Market structure: additional financial instruments in scope for non-equity instruments and third-country firms have to establish a branch in each EU country (when serving retail clients) or register with ESMA to gain EU passport (for professionals)
- Extended reporting to prudential authority and additional publication rules apply
- Reinforced supervisory powers to permanently ban financial products or activities and impose dissuasive administrative sanctions, fines, and penalties that will be made public

With its application on 3 January 2018, several challenges still need to be addressed by MiFID firms:
- **Knowledge & certification** of financial advisers by 3 January 2018.
- **Prohibition of inducements** requiring most firms to review their business model.
- **Systematic internaliser (SI)** regime applying from 1 September 2018, however it is possible to opt-in for the SI regime from 3 January 2018.
- **Disclosure of costs and charges** to investors at any point of the relationship.

PRIIPs

The implementation Regulation N°1286/2014 on Key Investor Information Documents for Package Retail and Insurance-based Investment Products (PRIIPs) has also been delayed by one year and aligned to MiFID II / MiFIR. PRIIPs aims to provide investors with sufficient information prior to making their investment decision. Insurance companies and banks will soon be required to use a similar document to the Key Investor Information Document (KIID) introduced under the UCITS IV Directive.

Next steps
- **3 January 2018:** Application date of MiFID II & MiFIR
- **1 January 2018:** Application date of PRIIPs

Shareholder's Rights Directive

Scope

- EU-listed companies
- Investment firms
- Institutional investors
- Asset managers
- Proxy advisers

Background

The Directive (EU) 2017/828 on Shareholders' Rights was published in the Official Journal of the European Union on 20 May 2017.

The new directive establishes specific requirements in order to encourage shareholder long-term engagement and increase transparency.

The Shareholders' Rights Directive recast adds new requirements on:
- **Identification of shareholders:** companies must be able to identify their shareholders and obtain information regarding shareholder's identity from any intermediary in the chain that holds the information. Member states may provide that companies in their territory be only allowed to request identification with respect to shareholders holding more than a certain percentage of shares or voting rights, which will not exceed 0.5 percent.
- **Exercising shareholders rights:** Intermediaries, such as banks, are required to spread the information from the company to the shareholders and vice-versa.
- **Disclosing information:** Intermediaries will have to publicly disclose any charges related to the new rules for processing this information.
- **Remunerating directors:** the remuneration policy will be submitted to the vote of the shareholders who will be able to assess the performance of the directors based on financial and non-financial performance criteria.
- **Transparency for institutional investors, asset managers, and proxy advisers:** They will either have to develop and publicly disclose a policy on shareholder engagement or explain why they have chosen not to do so. This policy will describe how they integrate shareholder engagement in their investment strategy and the engagement activities they carry out.

Many institutional investors and asset managers use the services of proxy advisers who provide research, advice, and recommendations on how to vote in general meetings of listed companies. In view of their importance, proxy advisers will be subject to transparency requirements and will be subject to a code of conduct.

Next steps
- **10 June 2019:** Application date of the Shareholder's Rights Directive

Prudential Framework

Infrastructure investment within Solvency II

Scope

- Insurance companies
- Reinsurance companies

Background

The European Commission has amended the Solvency II regulation in September 2015 and June 2017 to consider traditional markets of infrastructure investments as a factor in the calculation of Solvency Capital Ratio (SCR).

To benefit from a lower capital requirement for SRC, the investment needs to fit in one of these categories:
- Qualifying Infrastructure Investments
- Qualifying Infrastructure Corporate Investments

To enter into these categories, the investment must satisfy a number of specific criteria, which as a whole have been deemed sufficient in defining infrastructure investments. These criteria are divided into four families:
- Infrastructure and location
- Revenues
- Investor protection
- Credit quality

IFRS 9, IFRS15, IFRS16

Scope

- Credit institution
- Large investment firms

Background

Key changes as a result of the following IFRS updates:

IFRS 9:

The key changes for real estate and private equity entities are summarized below:

Classification and measurement: IFRS 9 revises the classification and measurement of financial assets. It will require financial assets to be measured at fair value or amortized costs. Fair value changes will go either through profit or loss or through other comprehensive income with no recycling. The classification is based on the business model for managing financial assets and the financial assets contractual cash flow characteristics. The private equity and real estate companies will need to reassess the classification of financial assets that may have significant impacts.

The classification and measurement of financial liabilities will not change under IFRS 9, but requires gains and losses for certain financial liabilities designated as FVTPL to be split into the amount of change in fair value attributable to changes in the entity's own credit risk, as well as to be presented in other comprehensive income, and the remaining amount should be presented in profit and loss (with certain exceptions).

Impairment: IFRS 9 moves from an incurred loss model to an expected credit loss model, which could result in earlier recognition of losses.

IFRS 9 requires the entity to base the measurement of expected losses on reasonable and supportable information that is available without undue cost and effort. It also introduces a three-stage model for the recognition of impairment losses depending on changes in credit quality (credit deterioration model).

Hedge accounting: Hedge accounting, which remains optional, has been simplified. One of the key changes are that IFRS 9 aligns more hedge accounting with risk management activities and strategy.

IFRS 15: The profile of revenue and profit recognition will change for some entities, as the new standard is more detailed and more prescriptive than the existing guidance. It introduces a five-step model for revenue recognition.

Private equity and real estate companies will need to consider:
- Whether revenue should be recognized over time or at a single point in time
- The extent to which distinct goods or services are supplied, which should be accounted for separately
- Whether the contract includes a significant financing arrangement and, if so, to adjust for the time value of money
- The impact of new guidance where pricing mechanisms include variable amounts

The new standard requires significantly more disclosures relating to revenue and entities will need to ensure that appropriate processes are in place to gather the information.

IFRS 16: The distinction between operating and finance leases is eliminated for lessees but lessor accounting remains largely unchanged.

The main practical impacts of IFRS 16 will be the following:
- It will eliminate almost all off-balance sheet accounting for lessees.

There will be a potential increase in net debt and EBIDTA and it will redefine financial metrics.

Next steps
- **IFRS 9**, endorsed by the EU, shall be applied for annual periods beginning on or after 1 January 2018 (early application permitted).
- **IFRS 15**, endorsed by the EU, shall be applied for annual periods beginning on or after 1 January 2018 (early application permitted).
- **IFRS 16**, endorsed by the EU, shall be applied for annual periods beginning on or after 1 January 2019 (early application permitted).

Tax aspects

Base erosion profit shifting (BEPS)

Scope

- Alternative investment asset managers

Background

Base erosion profit shifting (BEPS):

The base erosion and profit shifting (BEPS) initiative has been launched and closely followed for some years now by the OECD. The underlying principles guiding this initiative are (i) the introduction of a new set of tax standards designed to avoid double non-taxation, (ii) transparency between taxpayers and tax administrations, and (iii) aligning taxation with substance continuing to prevent double taxation. The initiative is set as a group of 15 measures (Action Plans) spanning across a number of corporate tax areas and—via recommendations and new standards—likely imply a technical shift in the tax treatment of current and future cross-border structures.

Next steps

Close monitoring of all BEPS implementation in the Investor, holding and investment countries

Multilateral Instrument (MLI)

Scope

- Alternative investment asset managers

Background

Some of the BEPS actions relevant for the purposes of alternative asset managers deploying their capital in Private Equity assets are due to be implemented via the:

Multilateral Instrument (MLI).

The intention is that the MLI will override and complement certain provisions in existing double tax treaties. In particular, and regarding the so-called Action 6 of BEPS, it should result in either a principal purpose test (PPT) or limitation of benefits (LOB) being included in all treaties to which it is applied. The purpose of these tests is to deny treaty relief where the recipient of the income or gain does not meet certain conditions. Other Actions with a noteworthy impact on current structures will also be implemented via the MLI.

So far, the MLI has been signed by 78 countries, of which 5 have already ratified this instrument. Among these 5 countries, the MLI will enter into force on 1 July 2018 and for each next country, it will become applicable 3 months after its respective ratification.

As part of the process, most of the signing countries have also specified to which of their existing treaties they intend the MLI to apply. Further, since the MLI gives some flexibility, these countries made reservations and stated whether or not they intended to follow certain provisions, and, where there was a choice of options, they have stated which option they intend to follow.

Next steps

Close monitoring of MLI ratification procedures and the choices made by all the Investor, holding and investment countries.

Anti-Tax Avoidance Directive (ATAD)

Scope

- Alternative investment asset managers

Background

Simultaneously, asset managers should also carefully analyze the implementation of the so-called **Anti-Tax Avoidance Directive (ATAD)** in each European country. The ATAD is a directive sourced from European legislative bodies aiming to introduce some of the BEPS Actions at the European level, notably regarding controlled foreign companies, interest limitation rules, and hybrid mismatches. The directive extends the scope of implementation to areas outside of the BEPS initiative, notably by introducing a general anti-abuse rule and exit taxation rules. The generic guidelines offered by this directive will need to be transposed into national law by each member country starting on 1 January 2019.

Finally, on 29 May 2017, the European Council adopted the Council Directive 2017/952 of 29 May 2017 amending Directive 2016/1164 regarding hybrid mismatches with third countries (ATAD 2). Member states will need to transpose the provisions of ATAD 2 by 31 December 2019 and apply them by 1 January 2020. By way of derogation, the reverse hybrid entity rule will need to be transposed by 31 December 2021 and applied by 1 January 2022.

Hence, private equity players who have invested and are planning to invest at the EMEA level or worldwide should carefully assess the impact of ATAD on their structures. In particular, they should focus on its impact on withholding taxes on dividends and interest, non-resident capital gains tax on exit (direct or indirect sale), and other areas that imply interest deduction restrictions and controlled foreign companies rules.

Next steps
- Transposition of ATAD into national law by 31 December 2018 and application per 1 January 2019
- Transposition of ATAD 2 into national law by 31 December 2019 and application per 1 January 2020
- Transposition of reverse hybrid entity rule into national law by 31 December 2021 and application per 1 January 2022

Recent changes in the Luxembourg Double Tax Treaty network

Scope

- Alternative investment asset managers holding Real Estate Assets in the UK and in France

Background

United Kingdom

Recent changes in the UK domestic Transactions in Land rules may be the origin of reported discussions between Luxembourg and the UK for a Double Tax Treaty renegotiation. To date, negotiations on the UK/Lux DTT have not yet been reported as finalized and no potential developments, which might affect the private equity sector, have so far been identified.

France

On 20 March 2018, the governments of Luxembourg and France signed a new double tax treaty and its additional protocol (hereinafter together referred to as "the new DTT") to replace the current agreement between the two countries. The new DTT has been completely reshaped to include provisions that reflect the latest OECD standards and its wording gets closer to the wording of the MLI. Several provisions of the new DTT will affect the private equity investment structures.

The new DTT expressly precludes trustees and fiduciaries from its benefits. It applies however, under certain conditions, to income derived by or through transparent entities, even if they are established in a third country, as well as to collective investment funds of one contracting state assimilated to funds of the other contracting state.

The new DTT would however revise the definition of a permanent establishment by lowering the threshold at which a taxable presence of an enterprise will arise in the other country.

In terms of dividend payments, if the recipient company would hold at least 5 percent of the capital of the company paying the dividends for a minimum of 365 days, and would be the beneficial owner of these payments, dividends would be taxable only in his state of residence. In case the exemption would not be applicable, the withholding tax could not exceed 15 percent.

Interest would be taxable only in the state of residence of the recipient, free from withholding tax, while royalties, may be taxed in the residence state, but also in the source state at a rate up to 5 percent of the gross amount.

The new DTT also includes various anti-abuse rules, such as the preamble wording and PPT in line with the MLI. Another of these provisions would allow France to apply some of its internal anti-abuse rules to transactions in scope of the treaty. Taxpayers undertaking Luxembourg-France transactions may want to assess their tax position in view of the entry into force of the new DTT, which may become applicable at the earliest on 1 January 2019 (depending on the time required for its ratification by both countries), otherwise probably on 1 January 2020.

Next steps
- **UK:** Luxembourg and UK Treaty renegotiations to be carefully followed and some restructuring steps may need to be taken as soon as possible
- **FR:** Careful consideration of the LUX / FR ratification of the new treaty protocol.

Transfer pricing and VAT

Scope

- Transfer pricing encompasses all intra-group transactions

Background

Transfer pricing:

Article 56 LITL

Effective 1 January 2015, Article 56 LITL outlines the arm's length principle and is aligned with the OECD Model tax convention. Under this article, conditions agreed between related parties must correspond to market conditions agreed between independent businesses. No distinction is made between cross-border and domestic transactions.

Article 56bis LITL

Article 56bis LITL, effective 1 January 2017, codifies the arm's length principle and introduces the latest development of the OECD work on Actions 8-10 of the OECD /G20 BEPS Project "Aligning Transfer pricing Outcomes with Value Creation."

Circular n°56/1-56bis/1

On 27 December 2016, in light of the new Article 56bis and effective from 1 January 2017, the Luxembourg Tax Authorities published a new Transfer Pricing Circular aiming to clarify the transfer pricing rules for companies performing intra-group financing transactions. In the frame of this circular, the Luxembourg Tax Authorities expect a company involved in intra-group financing activity to show evidence that it:
- Realizes an arm's length margin commensurate to the risk borne in the frame of such activity
- Has the adequate level of equity to cover the risk borne in the frame of such activity
- Has an adequate level of substance to control the underlined transaction

Article 171 of Abgabenordnung

Article 171 of Abgabenordnung, as modified by the law of 19 December 2014, essentially states that all taxpayers must be able to justify the financial information appearing in their tax returns, including the transfer prices applied on controlled transactions, i.e., transactions between related parties. This provision allows the Luxembourg Direct Tax Authorities to request Transfer pricing documentation from taxpayer sustaining the arm's length character of its intra-group transactions.

VAT:

VAT grouping:

On 16 April 2018 the Luxembourg government has lodged with the Parliament the draft bill to introduce in the Luxembourg legislation the possibility for Luxembourg taxpayers to set up VAT group.

This scheme should enable to consider any persons, who, while legally independent, but closely bound to one another by financial, economic and organizational links as a single taxable person with a single VAT Id Nr. The main features of such arrangement would be the following:
- Any supplies between the members of such VAT group would fall outside the scope of VAT;
- Members will be jointly liable for the VAT liability of the VAT group;
- One single consolidated VAT return of the VAT group;

The draft bill includes 31 July 2018 as a date of entry into force. However, the consultation of the EU VAT Committee and the advice of the Council of State may delay the legislative process and the vote of the law.

Responsibility of directors:

The Luxembourg VAT Law has introduced a personal liability of the people in charge of the daily management of a taxpayer entity (managers, directors, etc., including "de facto" managers).

These people must ensure that this taxpayer complies with its VAT obligations.

In the case where the person responsible for daily management of the taxpayer entity would commit an error in exercising his tasks, he may become jointly liable for the payment of the VAT due by the taxpayer entity, when this fault leads to the taxpayer entity not respecting its legal obligations.

Treatment of the supply of services connected with immovable properties:

Under the current VAT principles, place of supply for services connected with real estate property is where the property is located.

The EU regulation adopted on 7 October 2013 makes new rules applicable as of 1 January 2017 regarding the place of supply of services connected with immovable properties. These services must have a sufficiently direct connection with immovable property.

Director fees:

In accordance with Circular No. 781 of 30 September 2016, it includes taxation of all director fees (17 percent), including those paid to individuals starting 1 January 2017.

Next steps
- Close monitoring of transactions between related parties.
- With respect to VAT grouping, identifying potential clients and assessing the benefits and challenges for the implementation of VAT grouping at the level of our clients from a VAT, transfer pricing, corporate tax and operational perspectives.
- When identifying potential clients, specific focus should be on the ones who had an IGP scheme in place under which they shared costs "at cost" level.
- Assistance with the actual implementation of the VAT grouping.

More information

Please contact one of our partners

Lize Griffiths
Partner
Real Estate Leader & Real Estate Audit Leader
+352 451 452 693
lizgriffiths@deloitte.lu

Benjamin Lam
Partner – EMEA Real Estate Funds Leader
+352 451 452 429
blam@deloitte.lu

Pierre Masset
Partner – Real Estate Consulting Leader
+352 451 452 756
pmasset@deloitte.lu

Basil Sommerfeld
Partner – Global Real Estate Consulting Leader
+352 451 452 646
bsommerfeld@deloitte.lu

Alexandre Prost-Gargoz
Partner – Cross-Border Tax
+352 451 454 407
aprostgargoz@deloitte.lu

Karine Thil
Partner – Consolidation and IFRS Specialist
+352 451 452 452
kthil@deloitte.lu

Francisco da Cunha
Partner – Real Estate Tax Leader
+352 451 452 337
fdacunha@deloitte.lu

Xavier Zaegel
Partner - Capital Markets Leader
+352 451 452 748
xzaegel@deloitte.lu

Simon Ramos
Partner - Advisory and Consulting IM Leader
+352 451 452 702
siramos@deloitte.lu

Annick Elias
Partner - Strategy Regulatory & Corporate Finance
+352 45145 4386
aelias@deloitte.lu