

CSSF Circular 20/744

Regulatory Alert

28 October 2020

Dear Ladies and Gentlemen,

We are pleased to provide you with our Regulatory Alert focusing on CSSF Circular 20/744.

On 3 July 2020, the CSSF published Circular 20/744 complementing CSSF Circular 17/650 "Application of the Law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended (hereinafter "AML/CFT Law") and Grand-ducal Regulation of 1 February 2010 providing details on certain provisions of the AML/CFT Law ("AML/CFT GDR") to predicate tax offences".

This Regulatory Alert highlights the amendments to CSSF Circular 17/650 ("the Circular") implemented by CSSF Circular 20/744.

Kind regards,



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Compliance Officer



Yann Power
Regulatory Expert

This alert is intended to provide general information on recent legal developments. It does not cover every aspect of the topics with which it deals.

This alert is not designed to provide legal or other advice and it is not a substitute for legal or any other type of advice.

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CSSF Circular 17/650 as amended by CSSF Circular 20/744

Introduction

CSSF Circular 20/744 of 3 July 2020 complements CSSF Circular 17/650 of 17 February 2017 which provides guidance on the extension of the offence of money laundering to aggravated tax fraud (fraude fiscale aggravée) and tax evasion (escroquerie fiscale) and on applicable anti-money laundering and counter-terrorist financing (“AML/CFT”) professional obligations.

Annex 1 of CSSF Circular 17/650 lists indicators of predicate offences of aggravated tax fraud or tax evasion to be taken into account in the context of collective investment activities.

This Regulatory Alert lists the changes to Annex 1 of CSSF Circular 17/650 (the “Circular”).

Investment funds and their managers may wish to consider:

- Updating their list of applicable regulations
- Updating their AML/CFT policies and procedures to take into account the changes to the Circular
- Taking into account these indicators in their risk assessments and when designing risk mitigation measures
- Making members of staff and managing/governing bodies aware of these indicators

Annex 1 of the Circular

Annex 1 of the Circular provides two lists of indicators to be taken into account in the context of collective investment activities in relation to the obligation to report suspicions of predicate offence of laundering of an aggravated tax fraud or tax evasion.

These indicators are likely to reveal a possible laundering of a predicate tax offence to the professionals of the financial sector subject to the AML/CFT supervision of the CSSF.

A single indicator, or even several indicators, do not necessarily constitute a suspicion of laundering.

If an indicator or a combination of indicators raises doubts, the professional must examine the business relationship/transaction more thoroughly in order to verify if these doubts are justified given the context of the transactions and the professional's knowledge of the customer's situation (KYC – know-your-customer – and KYT – know-your-transaction). Where doubts remain, the professional must report these suspicions to the FIU.

The following lists of indicators are neither exhaustive, nor do they exclude other criteria, and may change over time.

Common indicators (“List I.”)

- The customer is a legal person or a legal arrangement set up in a jurisdiction that is not subject to AEOI/CRS/FATCA reporting and this “entity” has no economic, asset or other reality, except where:
 - The customer demonstrates that its establishment complies with the legal provisions of the country of residence of the customer/beneficial owner
or
 - The existence of the entity is in effect known to the tax authorities of the country of residence of the beneficial owner based on supporting evidence
- The customer is a company or uses companies in which a multitude of statutory changes (unexpected and short-term changes) have taken place, for example with the purpose of appointing new managers, moving the registered office to a jurisdiction which is not subject to AEOI/CRS/FATCA reporting, amending the corporate purpose or corporate name, not justified by the economic situation of the company
- The use of companies or legal structures located in a jurisdiction other than the tax residence or place of regular economic or professional interests of the beneficial owner, except where:
 - The customer demonstrates that its establishment complies with the legal provisions of the country of residence of the customer/beneficial owner
or
 - The existence of the legal person is in effect known by the tax authorities of the country of residence of the beneficial owner based on supporting evidence
- Completion of a commercial transaction at a price that is obviously underestimated, overestimated or inconsistent
- Findings of anomalies in the documentation justifying the transactions, and notably atypical or unusual transactions (e.g. no VAT number, no invoice number, no address, all of which may put into question the supporting evidence of the document supplied)
- The customer's refusal to provide the tax compliance documentation or information needed for tax reporting or the presence of indications raising suspicions regarding fiscal non-compliance (e.g. refusal to communicate the tax identification number or the fiscal address, refusal to complete the

AEOI/CRS/FATCA self-certification, refusal to receive a tax reporting, the AEOI self-certification signed by the customer states a fiscal address in Luxembourg while the postal address and/or telephone number and/or any other information shows that the customer does not reside in Luxembourg)

- Substantial increase, over a short period, of movements on banking account(s) which was (were) until then scarcely active or inactive, without this rise being justified, notably by a verified development of economic or business activities of the customer
- Observation of inconsistencies between the business volume (e.g. based on company accounts) and movements on bank accounts
- Substantial and/or irregular transactions linked to professional activities on personal/private accounts
- Payment or reception of fees to or from foreign companies without business activities or without substance or link between the counterparties and whose purpose seems to be economically unjustified re-invoicing
- Classification of a company or legal structure as “Active Non-Financial Entity” based on CRS regulations and without the change being justified by the development of the business of the company or legal structure
- Requests for assistance or provision of services whose purpose could be to foster circumvention of the customer’s tax obligations
- Use by the customer of complex structures without economic or asset purpose, except where e.g.:
 - The customer demonstrates that its establishment complies with the legal provisions of the country of residence of the customer/beneficial owner
 - or
 - The existence of the legal person is in effect known by the tax authorities of the country of residence of the beneficial owner based on supporting evidence
- Unjustified refusal of any contact or unjustified request of hold mail and more particularly if the customer is domiciled in a jurisdiction that is not subject to AEOI/CRS/FATCA reporting (e.g. the unjustified request of a customer not to be contacted ever in writing (post and/or email); the customer states that tax obligations are fulfilled and has signed a tax compliance statement, but has never collected its post or consulted its account online. The customer does thus not have the necessary elements to fulfil its tax obligations)
- The transfer of funds from a country that according to the professional could be considered as being risky from a tax transparency point of view, except for example where the customer provides evidence that the funds have been declared
- Inconsistent information available to the professional concerning the tax residence of the customer
- Use of so-called back-to-back loans, without valid justification
- Move of the tax residence from a jurisdiction that is not subject to AEOI/CRS/FATCA reporting to a jurisdiction that is subject to such reporting without notifying the professional, in order, potentially, to escape reporting
- Financial transactions that are inconsistent with the usual activities of the customer or with its profile or with the asset situation stated by the customer or suspect operations in sectors that are prone to VAT or other tax fraud, in a generally cross-border context
- Withdrawal or deposit of cash that is not justified by the level or nature of the commercial activity or known professional or asset situation
- Documentation on tax compliance leaving room for doubt as it was issued by a person close to the final customer and there being a potential conflict of interests

Specific indicators concerning collective investment activities ("List II.")

Complex investment structuring

- The Fund has recourse to a complex investment structure, involving one or more legal entities or one or more legal investment structures interposed between the Fund and the ultimate target investment, located in different jurisdictions with some of them not complying with international transparency standards, except where this investment structure complies with the tax provisions of the country of residence of these companies or legal investment structures

Tax base erosion

- The IFM business model results in a significant decrease of the IFM's taxable earnings by using cross-border transfers, triggering questions regarding compliance with transfer pricing rules and more generally with Luxembourg laws implementing directly or indirectly BEPS related actions. Such cross-border transfers can be:
 - Financial flows (e.g. management or marketing commissions and/or retrocessions but also interest or dividend flows) and/or
 - Intangible assets

Investment transactions

- The Fund performs investment transactions on unregulated markets where the economic beneficiaries of the counterparties to the transaction and/or their intermediaries are located in a jurisdiction not subject to AEOI/CRS/FATCA reporting or which present risk factors similar to those specified under point 79 of the FATF Guidance for a Risk-Based Approach for the Securities Sector dated October 2018
- Transactions do not have apparent economic rationale in a specific context (e.g. Private Equity/Real Estate context)
- Frequent transactions result in losses for which the professionals or the counterparty appears to have no concern

Efficient portfolio management techniques

- The Fund uses efficient portfolio management techniques such as securities lending transactions which may create tax arbitrage or tax refund that have been or could be considered as aggravated tax fraud/tax evasion as highlighted, inter alia, by ESMA in its report "ESMA70-154-1193 - Preliminary findings on multiple withholding tax reclaim schemes"

SICAR

- The Fund, under the SICAR Law of 15 June 2004, is not in a position to fulfil the requirement of investing in securities representing "risk capital" and in particular, to create value at the level of the portfolio companies/of developing the target entities in accordance with the requirements of CSSF Circular 06/241 specifying aforementioned law. Not fulfilling these requirements would have as a consequence that the company uses illegally the SICAR status which could have a significant tax impact

Subscription tax

- The Fund or the IFM is not in possession of adequate and sufficient information on the quality and status of the investors in order to make the subscription tax declarations to the Administration de l'enregistrement, des domaines et de la TVA in an appropriate manner and in accordance with the legal requirements applicable to it, unless it can be justified that:
 - These legal or tax statuses of the investors comply with the legal requirements governing the subscription tax
and
 - The investors' status comply with the legal provisions of the country of residence of these investors

Investor tax reporting

- The Fund or the IFM distributes its units in a country which has in place a set of obligations for investor tax reporting. The reporting is based, among other things, on various requirements such as:
 - The registration with the tax authorities
and/or
 - The tax reporting of tax data

This will not qualify as an indicator where the Fund or the IFM can justify that:

- It has taken the necessary steps to ensure that such steps taken by the Fund or the IFM and/or by a service provider comply with the rules and principles of the local tax laws
and
- The Fund or the IFM has taken the necessary steps to provide information to investors or foreign tax or regulatory authorities on a timely manner as required by the local laws of the country of distribution

The aforementioned requirements will be used by the investors (or the final investors in case of a fund of funds structure) for their tax returns or by the paying agents to deduct or levy withholding taxes that may be considered equivalent to tax advances to their personal or corporate tax return.

Regulatory references

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CSSF, 3 July 2020

<https://www.cssf.lu/en/document/circular-cssf-17-650/>

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