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Luxembourg - a bridgehead for your expansion into Europe and global electronic payment business

The electronic payment markets have been growing in an unprecedented pace over the last two decades globally. According to EY Global FinTech Adoption Index 2019, 96% of global consumers are aware of at least one money transfer and payment FinTech service; 75% global consumers use a money transfer and payments FinTech service.

China is leading the pace for FinTech innovation. The adoption rate of money transfer and payments FinTech services is 95% in China as a result of pervasive money transfer and payment apps aided by integration with China's powerful and ubiquitous ecommerce and social media platforms. Most observers expect Chinese players will proactively extend their reach beyond China to scale to new markets and serve even more customers. Europe has been a popular targeted market with the increasing cross-border business.

Luxembourg is the bridgehead for the expansion of electronic payment business into Europe and global markets. In this article, we aim to give a brief introduction in the form of Questions and Answers on the Luxembourg payment institutions (PI) and electronic money institutions (EMI) for Chinese payment institutions which are thinking expanding their business into Europe or globally.

1. What are the business opportunities and market size for Luxembourg PI and EMI?

Luxembourg might seem to be only a small local market but its interconnection with its European Union (EU) larger neighbors and its business-friendly environment make it the perfect place to develop a European head office and enter the European market.

Luxembourg is the EU base of some of the largest e-commerce and FinTech companies in the world. Once settled in Luxembourg, Luxembourg PI and EMI can reach one of the largest open markets in the world with 27 countries and 446 million consumers. The three direct neighbors of Luxembourg (France, Belgium and Germany) represent one-third of these business opportunities with a market size of 161 million consumers. In 2018, 51 billion of cashless transactions were processed in Luxembourg and its three neighbors.

The PI and EMI present in Luxembourg mainly operate across EU or globally. They are part of the largest payments and TMT companies and are all targeting new business opportunities from e-wallet services, instant payments to innovative payment methods using biometrics data or “invisible” transactions. Currently, Luxembourg has 14 PI and 9 EMI.

Below is a summary of companies which have obtained PI and EMI based on public information¹.

Company name	Industry	Country of origin
Alipay	Payment	China
Amazon Payments	Online retailer & Payment	USA
Airbnb Payments	Payment	USA
Bitstamp	Cryptocurrencies	Slovenia
eBay	Online retailer	USA
MangoPay	Payment	France
PingPong	Payment	China
Primeiro Pay	Payment	Brazil
Rakuten	Online retailer	Japan
Snapswap	Cryptocurrencies	Luxembourg
Skype	Online communication	USA
Volkswagen Payments	Car manufacturer	Germany

¹ Source: Commission de Surveillance du Secteur Financier

2. What kind of business activities can Luxembourg PI and EMI be engaged in?

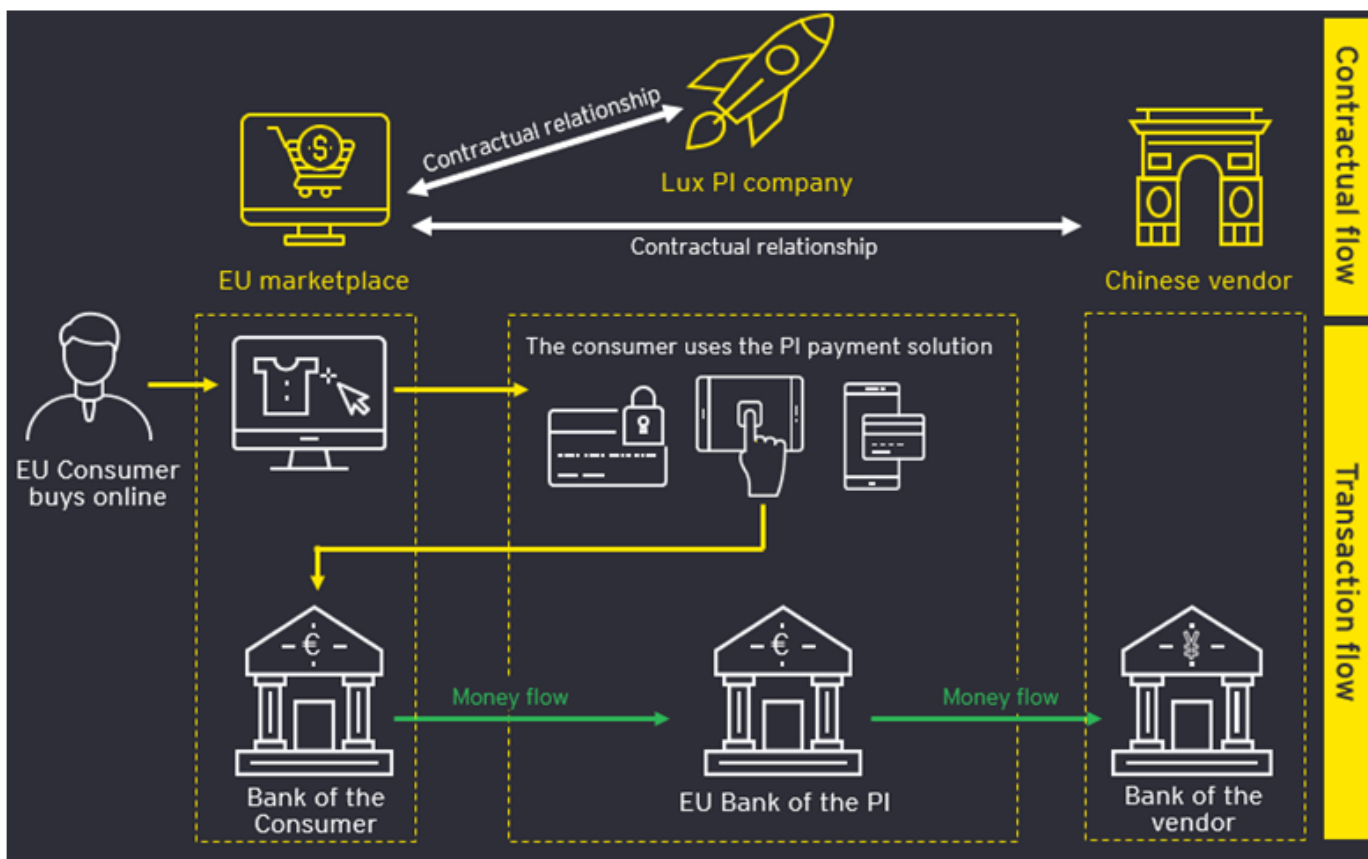
Luxembourg PI and EMI can perform various activities ranging from account information and aggregation services to innovative payment solutions such as request-to-pay, QR code and biometrics payment. As per regulation, a PI and an EMI can deliver the following services:

- ▶ Services enabling cash to be placed on a payment account as well as all the operations required for operating a payment account
- ▶ Services enabling cash withdrawals from a payment account as well as all the operations required for operating a payment account
- ▶ Execution of payment transactions, including transfers of funds on a payment account with the user’s payment service provider or with another payment service provider:
 - (a) execution of direct debits, including one-off direct debits;
 - (b) execution of payment transactions through a payment card or a similar device;
 - (c) execution of credit transfers, including standing orders.
- ▶ Execution of payment transactions where the funds are covered by a credit line for a payment service user
- ▶ Issuing of payment instruments and/or acquiring of payment transactions
- ▶ Money remittance
- ▶ Payment initiation services
- ▶ Account information services

In addition to the above, EMI is allowed to issue electronic money. It can therefore store e-money and execute transactions within its own network.

Upon obtaining the license, the PI and EMI can ask the Commission de Surveillance du Secteur Financier (CSSF), the Luxembourg regulator, to “passport” its services in one, several or all EU countries that the company wishes to target. The “host” regulator, in this case the CSSF, will supervise activities provided by Luxembourg license holders in Luxembourg and in Europe.

Below is a simplified version of an operating model of a PI in Luxembourg.



3. What are the advantages of applying for PI and EMI in Luxembourg?

Luxembourg is one of the leading European financial centers. Ideally located at the center of Europe, Luxembourg displays a vibrant international environment attracting a competent and multilingual community coming from all over the world (IT professionals, legal, finance and accounting, sales and marketing, supply chain management, R&D and IP management, etc.).

Luxembourg's legal framework is one of the most flexible legal frameworks in continental Europe. Moreover, the CSSF is accessible facilitating the process for overseas companies planning to enter the EU market.

With Brexit, we have seen that some companies which are authorized by the Financial Conduct Authority in the UK to conduct PI business have considered or started to apply for the PI and/or EMI license in other EU member states such as Luxembourg to access to the EU market without having to bear the risks of "no-deal".

Luxembourg is the ideal starting base for the development of a wider EU strategy at a later stage.

4. Does it require the setting up of a Luxembourg company to apply for a PI and EMI license?

A Luxembourg company should be set up to apply for a PI and EMI license. Nevertheless, the application process for a PI and EMI license can start while the company is still in the process of incorporation.

To apply for a PI and EMI license in Luxembourg, a company should define its future Target Operating Model and perform feasibility analysis before it initiates the application procedures with the CSSF.

5. What are the procedures for applying for PI and EMI license?

First of all, there will be an introductory meeting with the CSSF to present the general overview of the project. After this meeting, the applicant has to prepare an authorization file consisting of 17 sections covering various topics from the Business Plan and Operating Model to the Risk Management framework, the Anti-Money Laundering policies and the IT infrastructure.

Based on our experience, we estimate the time to obtain a license to be between 6 to 12 months but we have seen some recent well-prepared cases to be validated in a shorter time frame.

6. Is there any capital, IT infrastructure and personnel requirements for the application of PI and EMI license? Can the company outsource certain functions?

There are capital, IT infrastructure and personnel requirements for a PI and EMI. Some of these requirements can be alleviated by outsourcing some capabilities (mostly for non-essential staff and IT infrastructure). All planned outsourcing arrangements should be disclosed as early as possible and if certain regulated activities need to be outsourced, additional authorization should be submitted to the CSSF (e.g., usage of cloud services).

There are minimum requirements (mostly capital and management functions) that should be met by the company when applying for such license.

7. What are the tax implications for operating PI and EMI business in Luxembourg?

Accounting profits are subject to corporate income tax of 24.94% if the entity is located in Luxembourg city. However, IP regime may apply granting a 80% corporate tax exemption on the IP income embedded in revenues obtained from the supply of goods and services and a 100% exemption of qualifying IP rights from net wealth tax.

Tax losses can be carried forward and are deductible during 17 tax years and there is a possibility to prepare tax returns based on financial statements in a foreign currency.

When operating from Luxembourg, an entity can have access to an extensive network of tax treaties (currently around 82); while Luxembourg does not impose withholding taxes on interest, royalties, or liquidation proceeds; and provides for a broad withholding tax exemption regime for dividends paid to companies resident in the EU and treaty countries, including China.

The provision of financial services is exempt for VAT purposes. This implies that a portion of the input VAT may not be creditable depending on the amount of VAT taxable transactions performed as well by the companies.

Additionally, the advance tax clearance (ATC) practice is codified in the tax law, allowing for the approval of ATCs with a validity of 5 years. Luxembourg exceptional economic and political stability offers a foreseeable tax environment and no major tax reform are expected in the near future.

8. Are there any reporting and disclosure requirements for Luxembourg PI and EMI?

There are three types of reporting in relation to PI and EMI license that should be provided to the regulator on an ad-hoc or regular basis, including

- ▶ Fraud reporting
- ▶ Operational and security risk assessment reporting
- ▶ Major Incident reporting

9. How can EY help to navigate the application process and ongoing operations for Luxembourg PI and EMI?

EY Luxembourg has a team dedicated to the payment and smart commerce industry, combining skills in financial services and telecom industries. Our team comprise required fields of expertise who work in a seamless way, providing support to our clients from business, regulatory, tax, operational and technological perspectives.

We have helped our clients in the PI and EMI application successfully from end-to-end and our experience is an accelerator. Besides, we also have a longstanding experience of professional relations with the local regulators and public authorities, which should help our clients in smoothening communication with regulators and public authorities.

We are proud to have among our clients in Luxembourg the most important players of the digital payment and smart commerce industry. We are statutory auditors of 60% of regulated PI and EMI.

EY teams in China and Luxembourg offer cross-border holistic team approach to support seamless communication and coordination during PI and EMI establishment projects for our Chinese clients. If you are interested to know more or are considering pursuing the PI and EMI license in Luxembourg, please feel free to contact us and we are happy to discuss with you.

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