



Luxembourg Funds Industry: Hot Topics

London – 3 October 2019

Agenda

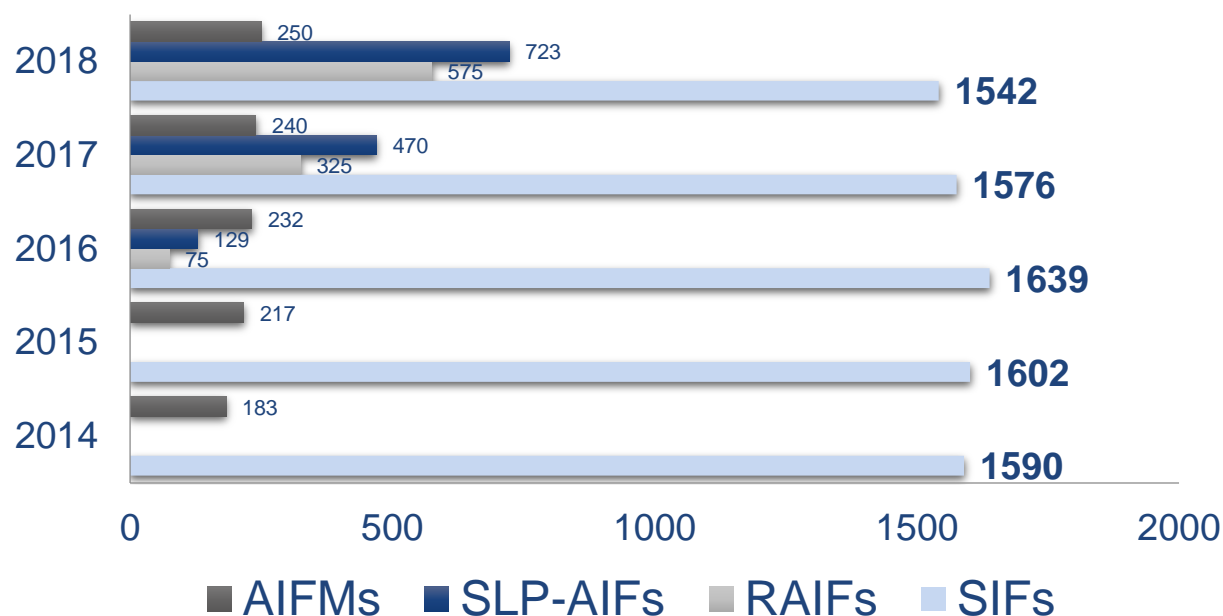
- Luxembourg funds industry: a few numbers
- Tax update:
 - ATAD II
 - Substance
- Brexit update:
 - CSSF approach
 - Impact on UK-based marketing/sales teams
- CSSF focus:
 - On-site visits
 - AML



LUXEMBOURG FUNDS INDUSTRY: A FEW NUMBERS

Luxembourg funds industry: a few numbers

- Number of SIFs, RAIFs, SLPs managed by an AIFM and AIFMs

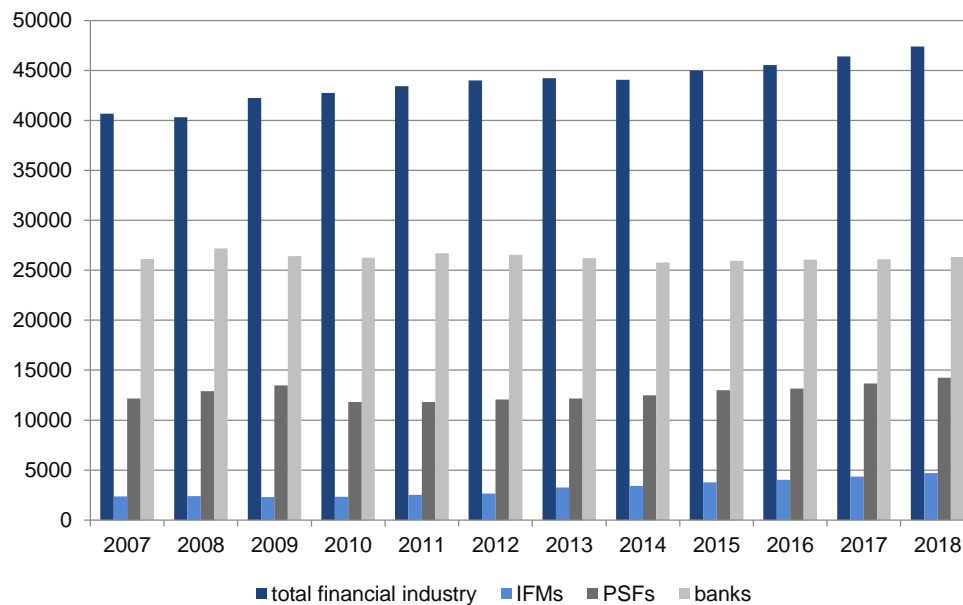


Source: ALFI. For the SLP: Monterey Reports 2017,2018 and draft 2019

- RAIFs today: 681

Luxembourg funds industry: a few numbers

■ Employment within the Luxembourg financial industry



Source: CSSF



TAX UPDATE

Bill on ATAD 2 - Overview

<p>Hybrid mismatches covered</p>	<ul style="list-style-type: none"> ▪ In line with ATAD 2: Deduction/ Non-Inclusion (D/NI) and Double Deduction (DD) ▪ Hybrid mismatches with EU and non-EU countries ▪ Hybrid mismatches relevant for Funds are essentially: <ul style="list-style-type: none"> - Payment under a financial (hybrid) instrument (D/NI) - Payment to a hybrid entity (D/NI) - Payment by a hybrid entity (D/NI) - DD outcome ▪ Rule on reverse hybrids
<p>Scope</p>	<ul style="list-style-type: none"> ▪ Associated enterprises ▪ Structured arrangement
<p>Specific measures for investment funds</p>	<ul style="list-style-type: none"> ▪ Acting together – <i>de minimis</i> threshold (10%) ▪ Reverse hybrids – exception for CIVs
<p>Entry into force</p>	<ul style="list-style-type: none"> ▪ Applicable to financial years starting as from 1.1.2020 ▪ Exception: rules on reverse hybrids (1.1.2022)

Bill on ATAD 2 - Scope

Associated enterprise

- Entity or individual
- General threshold: **50%** (voting rights / capital / profit share)
- Threshold for hybrid instruments: **25%**
- Same consolidated group for financial accounting purposes
- **Persons acting together must be added for the computation of relevant thresholds**
- **Significant influence**

Acting together

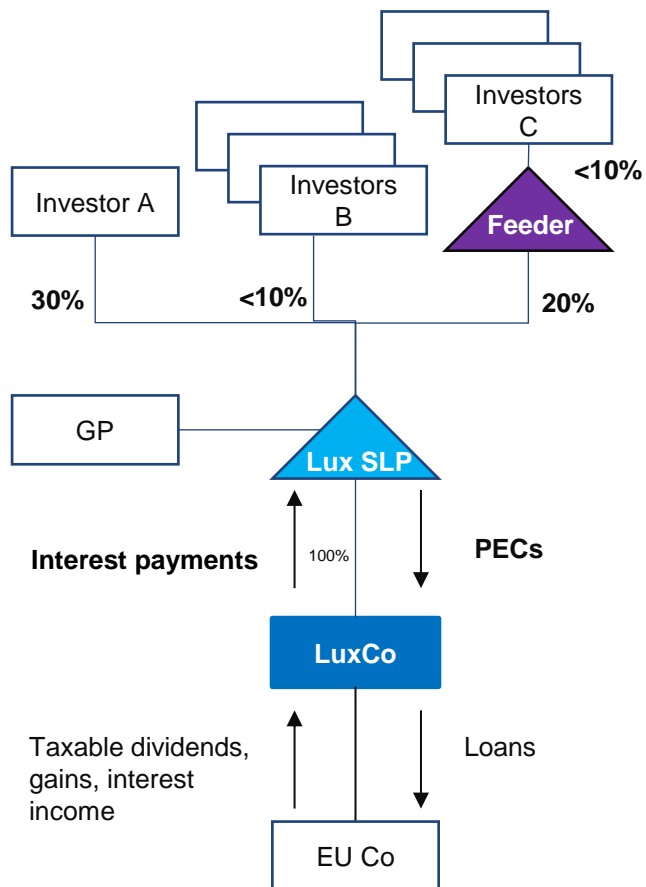
- **Simplification measure for investment funds:** investor holding directly or indirectly less than 10% in the interest of the fund and which is entitled to less than 10% of the profits of this fund will not (unless proved otherwise) be considered as acting together with another investor in the fund

Structured arrangement

- Mismatch outcome is priced into the terms of the arrangement
- or an arrangement that has been designed to produce a hybrid mismatch outcome,
- unless the taxpayer or an associated enterprise could not reasonably have been expected to be aware of the hybrid mismatch
- and did not share in the value of the tax benefit resulting from the hybrid mismatch

Impact on Fund structures

Example 1 – hybrid instrument



Applicable test

Interest payments under PECs will be caught by the rule if **tax deductible** at LuxCo level and not included in the taxable base of the investors => look-through approach

It should further be determined if the investors are **associated enterprises** with LuxCo, which encompasses a minimum participation of **25%** (voting rights / capital / profits) directly or indirectly in LuxCo

If such threshold is not met, application of the **acting together** concept to be considered. However, investors holding less than **10%** (shares / profits) directly or indirectly in an **investment fund** (Lux SLP) should in principle be ignored

Concepts of **significant influence / structured arrangement** also to be considered (Quid for a check-the-box election on LuxCo?)

Consequences in the presence of a hybrid mismatch

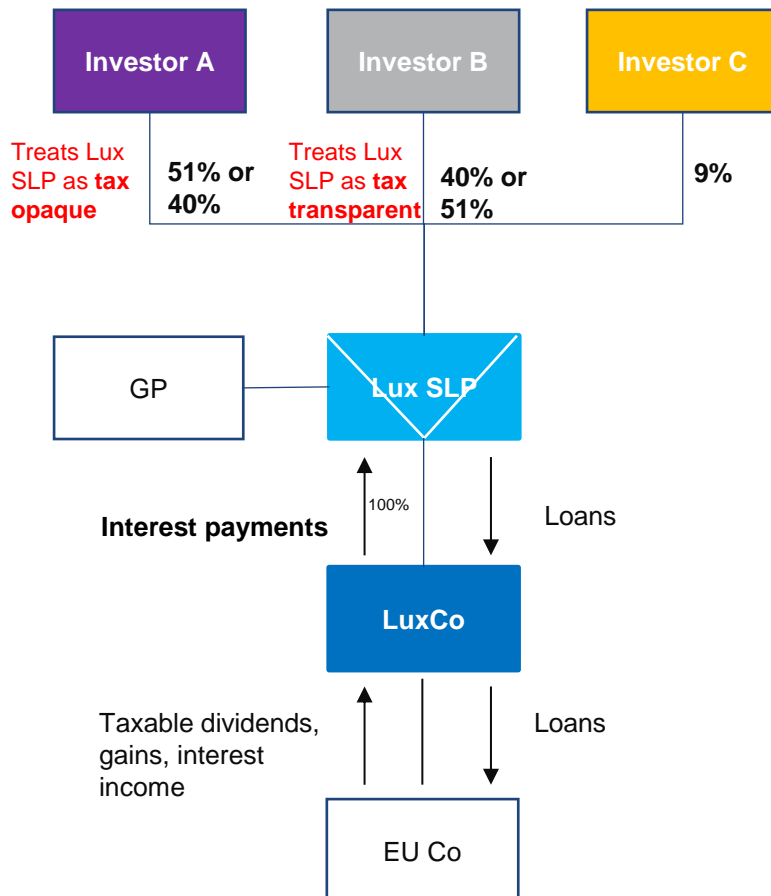
LuxCo: no tax deduction on interest (*pro rata* application), unless:

- inclusion by the investors within a reasonable period of time; or
- the mismatch is only attributable to the LP's **tax exempt status** or the fact that the instrument is held subject to the terms of a special regime

EU Co: imported mismatch rules to be considered

Impact on Fund structures

Example 2 – reverse hybrid



Applicable test

Interest payments made to Lux SLP will fall under the scope of the rule if **tax deductible** at LuxCo level and Lux SLP is treated as tax transparent in Luxembourg and tax opaque in the investors' jurisdictions

It should further be determined if the investors are **associated enterprises** with Lux SLP, which encompasses a minimum participation of **50%** (voting rights / capital / profits) directly or indirectly in Lux SLP

If such threshold is not met, application of the **acting together** concept to be considered => quid if only Investor A treats Lux SLP as tax opaque?

Significant influence / **structured arrangement** concepts also to be considered

Consequences in the presence of a hybrid mismatch

As from 1.1.2020: no tax deduction in LuxCo (*pro rata* application), unless the mismatch is only attributable to the investor's tax exempt status

As from 1.1.2022:

- Lux SLP's income subject to corporate income tax, to the extent not otherwise taxed under the laws of another jurisdiction
- Rule not applicable if Lux SLP is a **CIV**

EU Co: imported mismatch rules to be considered

Substance – ECJ « Danish cases » of 26 February 2019



- **Facts***
 - Interposition of EU SPV between Non-EU investment funds and Danish companies to benefit from WHT exemption in Denmark on interest and dividends under the interest and royalties Directive (IRD) and the parent subsidiary Directive (PSD)
 - Refusal from the Danish tax authorities to grant the WHT exemption on the grounds that EU SPV is not the beneficial owner of the interest / dividends & is acting as mere conduit company
- **ECJ decision**
 - Application of the PSD / IRD refused in the case of abusive practices (such as the interposition of conduit companies without economic justification, or in cases where almost all of the dividends or interest are rapidly passed on to entities which cannot benefit from the WHT exemption)
 - Emphasis on Beneficial Ownership
- **Practical consequences**
 - Tax authorities (EU) : revisit their approach & increase scrutiny of holding companies in Fund structures
 - Local managers : Claim of PSD / treaty application in certain situations can expose local managers to sanctions
- **Recommandations**
 - Seek confirmation of EU Directives / tax treaties application from advisers in source countries
 - **Ensure appropriate operational and economic substance** in the Luxembourg companies on a day-to-day basis

* Overview of ECJ cases C-116/16 & C-117/16 / C-115/16, C-118/16, C-119/16 & C-299/16



BREXIT UPDATE

Brexit – CSSF approach

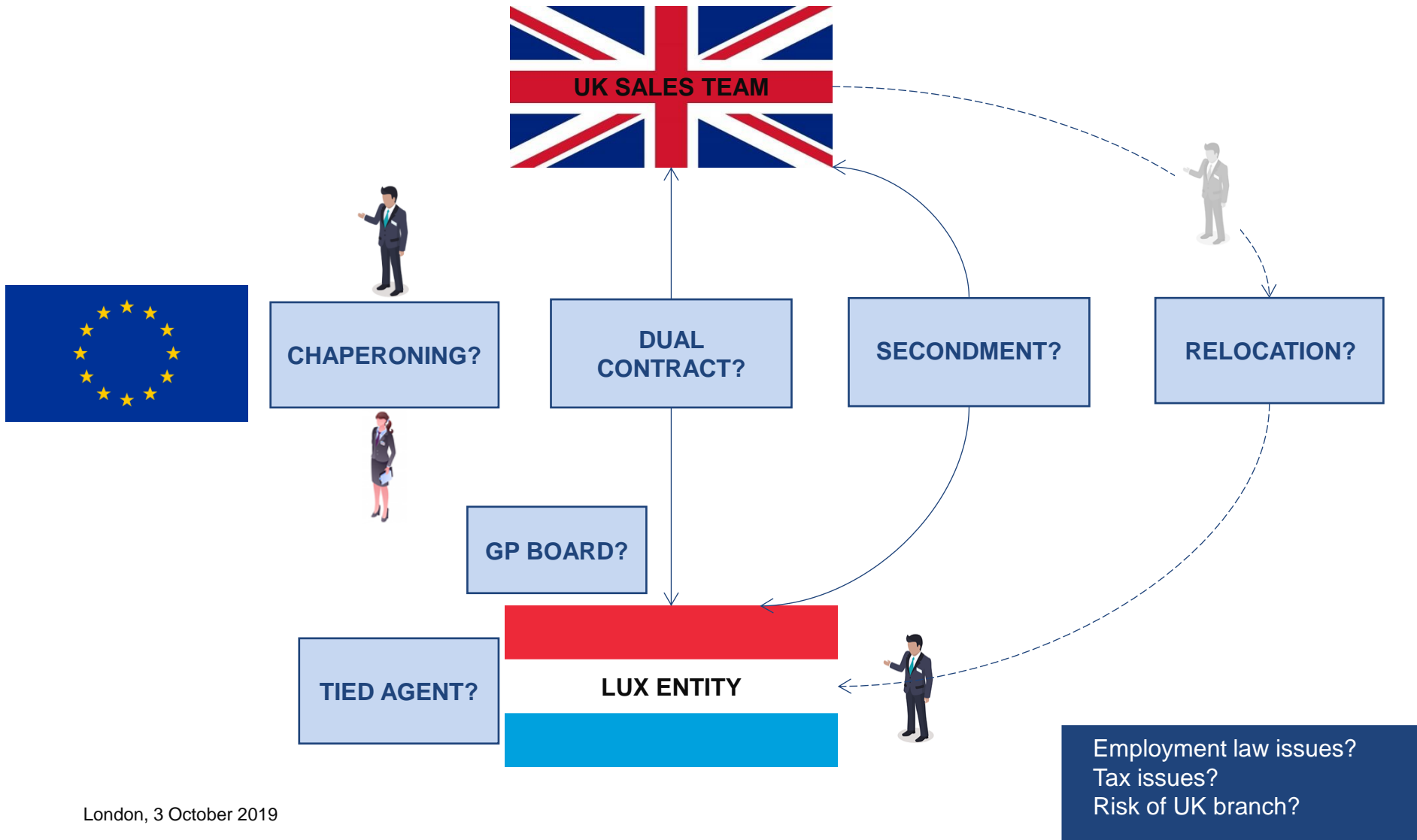
- Lux AIFMs delegating portfolio management to UK firms:
 - Sector specific exemptions (AIFMD/UCITS):
 - ✓ MoU is in place
 - ✓ Applies to advisory / MiFID top-up / RTOs activities as well

- UK MiFID firms delivering services into Lux:
 - Mapping exercise:
 - ✓ CSSF wants to understand which firms make use of the passport and what their post Brexit plans are
 - Temporary third country regime in place in Luxembourg (pending EU wide third country regime)
 - In the meantime, no impact on firms delivering services to “funds”

Brexit – CSSF approach (cont'd)

- Transitional regime:
 - Potentially needed for:
 - ✓ UK AIFM becoming a third country AIFM (vs. third country AIFM *ab initio*)
 - ✓ RAIFs with UK AIFM
 - ✓ MiFID firms delivering services to “non-funds” (managed accounts, securitisation vehicles...)
 - Case by case analysis (investors consent, etc.)
 - Procedure/timing
 - Impact on the marketing passport?

Brexit – Impact on UK-based sales teams





CSSF FOCUS ON ON-SITE VISITS / AML

CSSF update – On-site visits

- Thematic on-site inspections on managers – 2018 statistics

Theme	Number of visits
NAV errors	4
MiFID	1
AML/FT	13
Money market funds	3
Risk management	4
Governance	20

- 24 on-site inspections at depository banks and central administrations

CSSF update – On-site visits



- Typical shortcomings identified:
 - Follow-up of delegated activities
 - ✓ Absence of due diligence process when entering into a business relationship
 - ✓ Absence of follow-up
 - Follow-up of audit recommendation
 - Update of procedures manual
 - Management information is incomplete
 - Management of access rights/maintenance of business continuity plan

CSSF update – AML/CFT focus



▪ Increased focus:

- *April 2018*: new questionnaires relating to the fight against ML/TF
 - Sector specific questionnaires supporting:
 - ✓ Identification of ML/TF risk factors (related to clients, countries, geographical areas, delivery or distribution channels, products and services of supervised entities etc.);
 - ✓ Measures put in place to mitigate these risks
 - Questionnaires opened for 2 rounds. Second round completed in April 2019.
- *September 2018*: request of documents and informational letters on AML/CFT:
 - Types of docs required: board minutes, conducting officers meetings, MLRO / compliance reports, latest risk-based approach plan,...
 - 5 days to respond!
- *May 2019*: AML/CFT investment fund market entry form for SIF/Part II/SICAR/ELTIF (amended July 2019)
- *August 2019*: requests of AML supporting documents to registered AIFMs

▪ Increased CSSF staff

CSSF update – AML/CFT focus



- CSSF findings following review of the various documentations:
 - Need to increase the frequency of the controls of customer identification and business relationships (delegates and service providers) against the lists of financial sanctions (Targeted Financial Sanctions)
 - Need to have an automated system to detect unusual transactions as well as the necessary analysis documentation of all the alerts
 - Obligation to perform enhanced due diligence on intermediaries located outside Luxembourg (cross-border relationships) – nominee arrangements
 - Importance for managers to perform AML/CFT due diligence on the investments of their funds
 - Importance to adapt procedures and training of employees to the specificities of investment funds

Questions?



Luxembourg



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