

# LUXEMBOURG

## Law and Practice

### Contributed by:

Isabelle Lebbe, Pierre Beissel, Rodrigo Delcourt and  
Claudia Hoffmann

**Arendt & Medernach see p.19**



## CONTENTS

<b>1. General</b>	<b>p.2</b>	<b>3. Managers</b>	<b>p.11</b>
1.1 General Overview of Jurisdiction	p.2	3.1 Legal Structures Used by Fund Managers	p.11
<b>2. Funds</b>	<b>p.2</b>	3.2 Regulatory Regime	p.11
2.1 Types of Alternative Funds	p.2	3.3 Tax Regime	p.12
2.2 Fund Structures	p.3	3.4 Rules Concerning "Permanent Establishments"	p.12
2.3 Regulatory Regime	p.3	3.5 Taxation of Carried Interest	p.12
2.4 Loan Origination	p.3	3.6 Outsourcing of Investment Functions/ Business Operations	p.12
2.5 Non-traditional Assets	p.4	3.7 Local Substance Requirements	p.13
2.6 Regulatory Approval Process	p.4	3.8 Local Regulatory Requirements for Non-local Managers	p.13
2.7 Requirement for Local Investment Managers	p.5	<b>4. Investors</b>	<b>p.14</b>
2.8 Other Local Requirements	p.5	4.1 Types of Investor in Alternative Funds	p.14
2.9 Rules Concerning Other Service Providers	p.6	4.2 Marketing of Alternative Funds	p.14
2.10 Requirements for Non-local Service Providers	p.6	4.3 Rules Concerning Marketing of Alternative Funds	p.15
2.11 Tax Regime	p.7	4.4 Local Investors	p.16
2.12 Double-Tax Treaties	p.8	4.5 Regulatory Regime	p.16
2.13 Use of Subsidiaries for Investment Purposes	p.9	4.6 Disclosure Requirements	p.17
2.14 Origin of Promoters/Sponsors of Alternative Funds	p.9	4.7 Tax Regime	p.17
2.15 Origin of Investors in Alternative Funds	p.9	4.8 FATCA/CRS Compliance Regime	p.17
2.16 Key Trends	p.9		
2.17 Disclosure/Reporting Requirements	p.10		
2.18 Anticipated Changes	p.11		

## 1. GENERAL

### 1.1 General Overview of Jurisdiction

Luxembourg is the largest fund domicile in Europe, with a market share of 27% at the end of 2020 (source: *EFAMA Fact Book 2021*). Managers, sponsors and investors profit from the broad range of alternative investment vehicles that the Luxembourg legislative environment has to offer.

With the early implementation of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (AIFMD), Luxembourg became a gateway to Europe for alternative funds, using its experience in undertakings for collective investment in transferable securities (UCITS) distribution and its trusted relationship with the local regulator.

Luxembourg has been steadily developing its alternative funds sector by introducing new tools to adapt to market demands (in particular, the reserved alternative investment fund (RAIF) and two types of partnerships).

Moreover, Luxembourg has cultivated a business-friendly environment with specialised service providers that adapt perfectly to the needs of the fund industry and react rapidly to the new regulatory requirements of their clients. Luxembourg also benefits from the responsiveness of the Luxembourg legislator to practitioners' needs, having an accessible and multilingual regulator and an established relationship between the authorities and the alternative investment industry, being a stable and trusted jurisdiction, and having established experience in servicing alternative assets.

Furthermore, Luxembourg also benefits from a predictable tax environment (notably, tax-neutral fund vehicles, access to EU tax directives, a wide double-tax treaty network, the lowest VAT

rate in the EU, and comprehensive VAT exemption on management services).

Nowadays, most top global private equity and real estate companies and top hedge fund managers have a constantly growing presence in Luxembourg.

## 2. FUNDS

### 2.1 Types of Alternative Funds

Luxembourg alternative investment funds (AIFs) may be set up as regulated or unregulated structures, closed-end or open-end funds, contractual or corporate vehicles. Depending on the regulatory regime opted for, managers also have the possibility to choose between standalone fund structures and platforms with multiple compartments.

Private equity and real estate managers often set up their closed-end AIFs as unregulated limited partnerships. Luxembourg company law allows unregulated limited partnerships to be structured in a very similar way to Delaware or Cayman partnerships. Such partnership structures are used to establish parallel AIFs that give access to the European AIFMD marketing passport.

Whereas only 54 new specialised investment funds (SIFs) supervised by the regulatory authority of the financial sector in Luxembourg (*Commission de Surveillance du Secteur Financier* or CSSF) were set up in 2020, approximately 400 unregulated RAIFs were established in 2020 (source: *EFAMA Fact Book 2021*).

AIFs may further be set up as undertakings for collective investment (UCIs) under Part II (Part II UCIs) of the Luxembourg Law of 17 December 2010 on undertakings for collective investment ("UCI Law") or as investment companies in risk capital (SICARs).

## 2.2 Fund Structures

The most commonly used structure for unregulated partnerships is the special limited partnership (SLP), which does not have a legal personality. Managers may also choose a common limited partnership (CLP), which does have a legal personality.

RAIFs and SIFs can take either a corporate form or a contractual form as a mutual fund (FCP). They may be set up as a standalone fund or a platform with multiple compartments. The corporate form with variable capital (SICAV) remains the most-used way to set up a RAIF or SIF. As a corporate form, managers often choose, aside from limited partnerships, the form of a public company limited by shares (SA) or a corporate partnership limited by shares (SCA).

SICARs would typically take the form of an SCA, an SA, or a limited partnership. SICARs can be structured as standalone funds or have multiple segregated compartments.

Private equity and real estate managers typically use special purpose vehicles (SPVs), often incorporated in the form of private limited companies (SARL), to structure their investments.

## 2.3 Regulatory Regime

### Unregulated Limited Partnerships

Unregulated limited partnerships are not subject to any specific product law and are therefore not obliged to comply with any investment restrictions or risk-spreading requirements. Furthermore, unregulated limited partnerships are not subject to authorisation by the CSSF.

### RAIFs

RAIFs are governed by the Law of 23 July 2016 on reserved alternative investment funds (RAIF Law) and can invest in all types of assets, either directly or via controlled intermediate companies subject to minimum risk-spreading requirements

aligned with those of SIFs. RAIFs should appoint an authorised AIFM, but are not themselves subject to authorisation by the CSSF.

### SIFs

SIFs are governed by the Law of 13 February 2007 on specialised investment funds (SIF Law), and can invest in all types of assets. In accordance with the risk-spreading principle set out in CSSF Circular 07/309, a SIF may not invest more than 30% of its assets or commitments in securities of the same type issued by the same issuer, nor respectively in one property.

### SICARs

SICARs are governed by the Law of 15 June 2004 relating to the investment company in risk capital (SICAR Law) and may only invest in risk capital. Risk capital is the direct or indirect contribution of assets to entities in view of their launch, development or listing on a stock exchange. Investments made by a SICAR must be high risk and must contribute to the development of the entities in which they are invested. Funds of fund investments are allowed for SICARs provided that they fulfil the same criteria. A SICAR is not required to comply with any risk-spreading requirement and, as a result, a SICAR may invest in a single target company.

## 2.4 Loan Origination

Pursuant to the final report of the International Organisation of Securities Commissions (IOSCO), dated February 2017, Luxembourg is one of the most important markets for loan funds in Europe. Ever since, the loan fund market in Luxembourg has been in constant development.

In addition to loan participation investments, Luxembourg funds are also permitted to originate loans, and the majority of debt fund managers include loan origination as part of their strategy.

Luxembourg investment fund vehicles engaging in loan origination are not subject to any specific loan fund rules. The CSSF will base their review of regulated investment vehicles that are engaging in loan origination on the basis of the European Securities and Markets Authority (ESMA) opinion on loan origination dated 11 April 2016 (ESMA/2016/596).

Unregulated investment vehicles should be careful not to fall within the scope of the Luxembourg Law of 5 April 1993 on the financial sector (1993 Law), ie, to avoid engaging in any business of granting loans to the public. In June 2021, the CSSF provided greater regulatory certainty on situations where the CSSF does not consider a lending activity to be directed towards the public. This is true where:

- loans are granted to a limited circle of previously determined persons; or
- the nominal value of each loan amounts to at least EUR3,000,000 (or the equivalent in another currency) and the loans are granted exclusively to professionals.

For this purpose, a “professional” is defined as any natural person or any legal person, irrespective of whether privately or publicly owned, that is acting, including through any other person acting in its name or on its behalf, for purposes relating to its commercial or industrial activity, craft or profession.

If the manager contemplates a lending activity that is not per se excluded by the above, or has any other doubts as to whether the respective loan origination investment strategy falls within the category of granting loans to the public, it may still obtain a confirmation letter from the CSSF; or analyse whether the jurisdiction of the borrower permits such alternative lending.

## 2.5 Non-traditional Assets

Fund structures established as SIFs, RAIFs or unregulated limited partnerships are not subject to any asset eligibility requirements and may therefore generally be used to invest in non-traditional assets, such as digital assets, cryptocurrencies, consumer credit and other loan portfolios, cannabis/cannabis-related investments and litigation funding.

Further to any fund product-specific requirements, regulated investment fund structures that will invest in any virtual currencies may, in accordance with a CSSF warning of 14 March 2018, only be addressed to professional investors within the meaning of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (MiFID II).

The legal framework for Luxembourg investment funds is generally not setting any restrictions with respect to the kind of investment. However, the scope of permissible investments would be restricted by the public order (*ordre public*). This could in particular have an impact on the structuring of investments in cannabis/cannabis-related investments and litigation funding.

Also, refer to **2.4 Loan Origination** with respect to investments in consumer credits and other loan origination activities.

## 2.6 Regulatory Approval Process

The approval process of the CSSF to set up a new Luxembourg regulated alternative fund follows a prescribed process.

1) Digitalised file submission via the eDesk platform, including certain information on the new structure to be provided to the regulator (eg, information on the promoter, strategy(ies) and policy(ies) used, on the manager and other service providers, on delegation arrangements, etc).

2) The CSSF acknowledges receipt of the application file and assigns a responsible officer to be in charge of examining the application.

3) The CSSF usually contacts the applicant within ten working days of receiving the application file for feedback. Additional documentation or information may be requested at this stage. Certain clarifications may also be sought by the CSSF. This is a chance to provide any missing information or documentation that has been identified. A few rounds of comments need to be taken into account at this stage. This step generally lasts four weeks.

4) At this point, applicants are advised that no further changes may be made in the scope of the application and no further alterations may be made to the final draft versions of the documents on the basis that the examination has been terminated. Any changes imply a reopening of the examination phase in step 2.

5) Upon satisfactory receipt of all final and executed documents as requested, the CSSF will register the alternative fund on the official list. The CSSF will issue the official letters and the CSSF identification codes. The CSSF will register the documentation and return an electronic visa-stamped version of the full prospectus within five working days of the date of receipt by the CSSF.

The whole process typically takes two months for a file of average complexity.

Launching new sub-funds within existing umbrella funds (for SIFs, SICARs and Part II UCIs) follows a similar structure but only with respect to the sub-fund. Therefore, the process of approval takes much less time.

If time-to-market is crucial for the promoter, an unregulated fund can be set up instead. The

CSSF approval process does not apply in such a case, which means that such a fund can be launched as soon as constitutive documents as well as the arrangements with the service providers are in place.

## **2.7 Requirement for Local Investment Managers**

FCPs should be managed by a Luxembourg management company authorised in accordance with Chapter 15 or 16 of the UCI Law. The management company should not necessarily act as AIFM and may appoint an external AIFM to perform the portfolio management and risk management of the FCP.

RAIFs are required to appoint an authorised Luxembourg AIFM or an AIFM that is authorised in another EEA state, by exercising the AIFMD management passport rights.

Portfolio management is often delegated to a non-Luxembourg investment manager (see **3.6 Outsourcing of Investment Functions/Business Operations**).

## **2.8 Other Local Requirements**

Generally, AIFs do not have any staff. AIFs set up in a corporate form have directors or managers, whose number and role depends on the corporate structure. In the case of regulated AIFs, the CSSF requires the appointment of at least three directors or managers, whom it must then also approve.

AIFs are rarely set up as self-managed vehicles and internally managed AIFs. Such self-managed AIFs are subject to further substance requirements determined by the CSSF. In particular, self-managed AIFs have to appoint at least two conducting officers who must, in principle, reside permanently in Luxembourg. This does not, however, prevent the conducting officers from being domiciled in a place permit-

ting them, in principle, to travel to Luxembourg every day.

According to Article 4(1) of the law of 12 November 2004 on the fight against money laundering and terrorist financing (AML Law), AIFs should appoint:

- a person among the members of their management bodies, responsible for compliance with the professional obligations as regards the fight against money laundering and terrorist financing (“*responsable du respect des obligations* “ or RR); and
- a compliance officer at appropriate hierarchical level (“*responsable du contrôle du respect des obligations* “ or RC).

## 2.9 Rules Concerning Other Service Providers

The central administration of SIFs, RAIFs, Part II UCIs and SICARs must be based in Luxembourg:

- the accounts must be compiled and the accounting documents must be available in Luxembourg;
- issues and redemptions of units/shares must be carried out in Luxembourg;
- the register of unit-holders must be kept in Luxembourg;
- the prospectus, financial reports and all other documents intended for investors must be established in co-operation with the central administration in Luxembourg;
- the correspondence and dispatch of financial reports and of all other documents intended for shareholders or unit-holders must be carried out from Luxembourg and in all cases under the responsibility of the central administration in Luxembourg; and
- the calculation of the net asset value must be carried out in Luxembourg.

Unregulated limited partnerships are not required to have their central administration in Luxembourg. However, from a corporate law perspective, unregulated limited partnerships should ensure that their main decision centre is in Luxembourg so as not to jeopardise the nationality of the partnership.

In addition, an AIF must appoint a Luxembourg depositary which is, among other things, responsible for the safekeeping of assets. The eligible depositaries are Luxembourg credit institutions and also Luxembourg investment firms that fulfil certain requirements laid down by the 1993 Law, as amended.

## 2.10 Requirements for Non-local Service Providers

Portfolio management is often delegated to a non-Luxembourg investment manager (see **3.6 Outsourcing of Investment Functions/Business Operations**).

In relation to investment services provided to eligible counterparties and professional per se clients, Article 32-1 of the 1993 Law provides for a temporary regime in accordance with Article 46(4) of MiFIR, ie, in the absence of an equivalence decision at the level of the European Commission. Pursuant to this regime, a third-country firm wishing to provide investment services and activities to eligible counterparties and professional per se clients based in Luxembourg may be authorised to do so without having established a branch, provided that:

- they are authorised to provide the relevant services in their jurisdiction of establishment;
- they are subject to supervision and to authorisation rules deemed equivalent to those in the 1993 Law by the CSSF; and
- the co-operation between the CSSF and the supervisory authority of the relevant third-country firm is ensured.

Additional to requirements in the specific product law and under the AIFMD concerning the delegation of functions, the CSSF requires third-country firms to formally request approval from the CSSF to use the third-country access regime of Article 32-1 of the 1993 Law.

The CSSF clarified in their Circular 20/743 when the investment service is considered to be provided in Luxembourg and that Article 32-1 of the 1993 Law does not apply where an investment service is provided based on reverse solicitation.

Alternatively, AIFMs may appoint investment advisers who do not have decision-making powers. Where the investment adviser is established in a third country, it also has to analyse whether it falls under Article 32-1 of the 1993 Law.

## 2.11 Tax Regime

### Income Tax

#### *Corporate income tax (CIT) and municipal business tax (MBT)*

The net profits of a financing and holding company (SOPARFI), a SICAR or a SICAR-like RAIF (ie, a RAIF subject to the SICAR tax treatment), established as an opaque fund, are subject to CIT and MBT at a maximum aggregate rate of 24.94% for the fiscal year 2021 if the fund is established in Luxembourg-City. However, such funds are typically exempt from CIT and MBT with regards to:

- dividends, liquidation proceeds and capital gains derived from qualifying participations in the case of SOPARFIs; and
- profits derived from:
  - (a) risk capital securities; and
  - (b) funds to be invested within 12 months in risk capital securities in the case of SICARs and SICAR-like RAIFs.

- The net profits of an ordinary CLP or SLP, as well as those of a SICAR or a SICAR-like RAIF established as a CLP or SLP, are not subject to CIT given that the CLP and SLP are tax transparent for CIT purposes. Accordingly, profits realised by the CLP and SLP are deemed to have been immediately realised by their partners, irrespective of any actual distribution thereof. CLPs and SLPs are only subject to MBT if:

- they perform a commercial activity; or
- at least 5% of their interests are held by a general partner that is established as a Luxembourg company limited by shares.

The Luxembourg tax authorities have further clarified in a circular letter that a CLP or an SLP that qualifies as an AIF is deemed not to carry out any commercial activity.

With effect as from tax year 2022, funds established as CLPs or SLPs may become subject to CIT if they fall under the scope of the reverse hybrid rules deriving from the application of the Luxembourg law implementing Council Directive 2017/952/EU of 29 May 2017 (ATAD 2), unless they qualify as collective investment vehicles, ie, if they are widely held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established.

Funds established under the SIF or a SIF-like RAIF regime are not subject to CIT or MBT, but only to an annual subscription tax of 0.01% calculated on their net asset value. However, various exemptions from the subscription tax are available.

### Withholding Tax (WHT)

The distribution of dividends by a CLP or an SLP is recognised and performed for corporate reasons only, but such distribution is disregarded

for tax purposes. Consequently, such dividends are not subject to WHT.

Dividends distributed by an opaque fund established in the form of a SICAR/SICAR-like RAIF and a SIF/SIF-like RAIF are not subject to WHT.

Dividends distributed by a SOPARFI established as an SA, an SARL or an SCA are, as a general rule, subject to 15% WHT, but typically these dividends:

- are exempt under the participation exemption regime if, inter alia, they are distributed to a qualifying parent company; or
- benefit from a reduced WHT rate under double-tax treaties.

### **Other withholding taxes**

Liquidation proceeds, arm's length interest (assuming the beneficiary of the payments is not a Luxembourg-resident individual, and the debt instrument is not a profit-sharing bond) and royalties are not subject to WHT in Luxembourg.

### **Net Worth Tax (NWT)**

Funds established as SOPARFIs are subject to NWT at a rate of 0.5% computed yearly on their net asset value as determined on 1 January (0.05% for net worth exceeding EUR500 million, with a minimum payment of EUR4,815). However, SOPARFIs are exempt from NWT with regard to qualifying participations and may reduce NWT through the creation of a specific five-year NWT reserve.

SOPARFIs, as well as SICARs and SICAR-like RAIFs, are subject to a minimum NWT amounting to EUR4,815.

### **Subscription Tax**

SIFs and SIF-like RAIFs are subject to an annual subscription tax of 0.01% computed on their net

asset value. However, various exemptions from subscription tax are available.

### **Registration Duties**

The incorporation of any type of fund through a contribution in cash to its share capital, as well as further share capital increases paid in cash, are generally only subject to a fixed registration duty of EUR75.

### **Real Estate Levy**

The Luxembourg budget law of 19 December 2020, with effect from 1 January 2021, introduced a lump-sum 20% real estate levy on gross rental income and capital gains derived from real estate assets located in Luxembourg by UCIs, SIFs and RAIFs. The rule applies in respect of real estate assets located in Luxembourg, held either directly or indirectly through one or a series of tax-transparent entities, in proportion to the stake held. Reporting formalities and information requirements also apply. CLPs and SLPs remain unaffected by this measure.

### **VAT**

A SOPARFI that qualifies as an AIF, as well as SICARs, RAIFs and SIFs, benefit from a VAT exemption in Luxembourg for services qualifying as fund management services.

## **2.12 Double-Tax Treaties**

Luxembourg has a wide-reaching tax treaty network with 84 tax treaties currently in force and additional tax treaties under negotiation, review or pending coming into force.

### **Multilateral Instrument (MLI)**

On 9 April 2019, having passed the law on 14 February 2019, Luxembourg deposited its instrument of ratification of the Multilateral Instrument (MLI) with the OECD. The MLI aims to swiftly implement certain tax treaty measures contained in the OECD-BEPS (base erosion and profit shifting) project. For Luxembourg, the MLI came into



force on 1 August 2019 and mainly resulted in the inclusion of the principal-purpose test clause and an improved dispute resolution mechanism within the double-tax treaties covered. Other provisions may be introduced via bilateral negotiations. Whether the MLI's provisions for each double-tax treaty covered have or will come into effect will depend on whether the MLI for the other country has come into force, and on the type of taxes concerned.

### **Tax Residence**

SOPARFIs and opaque SICARs/SICAR-like RAIFFs are tax residents from a Luxembourg tax perspective and are therefore entitled to benefit from double-tax treaties. Tax-residence certificates from the tax authorities are available upon request if the entity is in good standing as regards its tax compliance. Eligibility for a double-tax treaty should also be checked from the perspective of the other contracting state. Eligibility for double-tax treaty benefits of CLPs and SLPs should be checked on a case-by-case basis. SIFs or SIF-like RAIFFs established in a corporate form might benefit from double-tax treaty entitlement to a limited extent.

### **2.13 Use of Subsidiaries for Investment Purposes**

In alternative funds, instead of the direct acquisition of assets, SPVs are quite often set up for structuring purposes in order to facilitate the administration of the investments and the financing structuring; to create a liability blocker and a cross-collateralisation blocker; for co-investment and management participation purposes and also in order to take advantage of double-tax treaties, among others, whereby the company holding the asset can be acquired or sold. The purchaser will acquire the shares of the target company and will therefore indirectly take ownership of all the target company's assets.

### **2.14 Origin of Promoters/Sponsors of Alternative Funds**

The origin of promoters of alternative funds in Luxembourg is diverse. Promoters and sponsors from Switzerland, Germany, the UK, Luxembourg, France and the United States, in particular, are using Luxembourg structures to create their alternative funds.

### **2.15 Origin of Investors in Alternative Funds**

The investor base of Luxembourg-domiciled funds is global, with the EU/EEA holding a significant share. Third-country managers are using Luxembourg funds to market their investment strategies to EU/EEA investors. Luxembourg funds are attracting an increasing number of Asian and Middle Eastern investors and are becoming global fund platforms for international managers.

### **2.16 Key Trends**

Debt funds are constantly growing and have become even more important since the COVID-19 crisis, given that the crisis has increased the need for alternative financings. The trend to set up unregulated alternative funds and parallel fund structures in Europe is also still continuing.

Furthermore, the following trends in the AIF market have been noted:

- an increase in the number of ESG and impact funds, which are in high demand from investors;
- an increase in interest in AIFs for non-professional and retail investors (eg, the European long term investment funds, ELTIFs);
- a move from offshore to onshore structures driven by investor demand; and
- an interest in digitalisation (artificial intelligence) in asset management.

## 2.17 Disclosure/Reporting Requirements

### Regulatory Disclosure and Reporting Requirements

The main disclosure requirements in respect of alternative funds have their origin in EU law. Article 21 of the AIFM Law requires AIFMs to disclose certain information, in respect of each alternative fund they manage, to prospective investors in the EU before such prospective investors invest in the relevant alternative fund. Such information includes, inter alia:

- a description of the investment strategy and the objectives of the relevant alternative fund;
- the procedures by which such alternative fund may change its investment strategy or investment policy;
- the identity of the AIFM;
- the alternative fund's depositary, auditor and any other service providers, and a description of their duties and the investors' rights; and
- a description of any delegated management function.

Additionally, SIFs, RAIFs, Part II UCIs and SIC-ARs must establish an offering document that includes the information necessary for investors to be able to make an informed judgement on the investment proposed to them and the risks attached thereto. The disclosure requirements under Article 21 of the AIFM Law are seen as such necessary information and should therefore be included in the offering document. The essential elements of the offering document must be up to date when new interests are issued to new investors.

Since March 2021, specific ESG disclosure requirements apply to all AIFs in accordance with regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

The AIFM is further required to provide retail investors with a Packaged Retail and Insurance-based Investment Products Key Information Document (PRIIPs KID) whenever an alternative fund is offered to a retail investor.

Each Luxembourg AIFM is required to report information to the CSSF on a regular basis regarding, inter alia, the main instruments and markets in which the assets of the alternative funds they manage are invested, along with information on liquidity and risk management in respect of the alternative funds.

AIFMs must also provide the CSSF with annual and quarterly reports on each EU alternative fund they manage or each alternative fund they market in the EU. Specific information on leverage must be provided on a regular basis to the CSSF by AIFMs managing alternative funds that use leverage on a substantial basis.

AIFMs are also required to notify the CSSF when certain thresholds are exceeded by the alternative funds they manage in relation to the voting rights/ownership of underlying portfolio companies.

### DAC 6

#### *Exchange of information on reportable cross-border arrangements*

Following the adoption of the Luxembourg law of 25 March 2020 (the "DAC 6 Law") implementing Council Directive (EU) 2018/822 of 25 May 2018, certain intermediaries and, in certain cases, relevant taxpayers will have to report to the Luxembourg tax authorities, within a specific timeframe, certain information on reportable cross-border arrangements.

A reportable cross-border arrangement covers any cross-border arrangement that contains at least one hallmark (ie, a characteristic or feature

that indicates a potential risk of tax avoidance) as set out in the DAC 6 Law.

The reported information will automatically be exchanged by the Luxembourg tax authorities with the competent authorities of all other EU member states.

Late, incomplete or inaccurate reporting, or non-reporting, will be subject to a maximum fine of EUR250,000.

The analysis as to whether any transaction carried out by a Luxembourg fund, a Luxembourg fund manager, or an investor falls within the scope of the DAC 6 Law, as well as the related reporting obligations, has to be made on a case-by-case basis.

## **2.18 Anticipated Changes**

During a consultation period between October 2020 and January 2021, the European Commission aimed to gather views from AIFMs, AIF distributors, industry representatives, investors and investor protection associations, financial markets authorities and citizens on potential changes to the AIFMD. The proposal for a directive to adapt the AIFMD is planned to be published in November 2021.

## **3. MANAGERS**

### **3.1 Legal Structures Used by Fund Managers**

Alternative fund managers in Luxembourg enjoy great flexibility regarding legal structures, depending on the investments, investors or structuring of their managed funds.

AIFMs whose assets under management do not exceed the thresholds determined in the AIFMD – ie, the assets under management, including any assets acquired through the use of lever-

age, do not exceed a total threshold of EUR100 million; or the assets under management do not exceed EUR500 million where the AIFs are not leveraged and do not have redemption rights for a period of five years – are not required to comply with the obligations of the AIFMD and may only register with the CSSF. However, registered AIFMs do not have access to the marketing passport. AIFMs exceeding the threshold and sub-threshold AIFMs that opt in, are required to be authorised by the CSSF and will have access to the EEA marketing passport.

Under certain circumstances and in a case where the legal form of the AIF allows for internal management, a self-managed or internally managed AIF may itself be considered to be the AIFM. However, such form remains exceptional in Luxembourg.

In addition to the primary choice of the type of regulatory regime, managers can go further in tailor-making structuring according to their needs, eg, by appointing committees within their structures (such as investment committees).

While some promoters choose to have their alternative funds managed by group managers, others opt to purchase the services of a third-party AIFM.

Managers usually set up their AIFM as an SA, SARL or SCA.

### **3.2 Regulatory Regime**

The AIFM regime is provided in the AIFMD and was quickly implemented, without gold plating, in Luxembourg law by the AIFM Law.

In addition to these two primary and general legislations, AIFMs must comply with EU-delegated acts and Luxembourg regulations, as well as CSSF circulars and administrative practice.

AIFMs must first obtain the approval of the CSSF before starting their management activities. In order to obtain a licence from the CSSF, authorised AIFMs must comply with various requirements, including capital requirements, operating conditions (which include delegation of functions, rules on the mandatory depositary, remuneration policies, etc), marketing and rules in relation to third countries and transparency requirements.

Luxembourg-authorized AIFMs hold a European passport allowing them to market their managed AIFs within the EEA to professional investors.

Since March 2021, AIFMs must disclose specific ESG information and data relating to their management activities in accordance with regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial sector.

### 3.3 Tax Regime

An alternative fund manager established in a corporate form is a fully taxable entity. The net profits of such an alternative fund manager are subject to CIT and MBT at a maximum aggregate rate of 24.94% for companies established in Luxembourg-City in 2021. Furthermore, the alternative fund manager would also be subject to NWT.

### 3.4 Rules Concerning “Permanent Establishments”

An authorised AIFM should have at least two conducting officers in Luxembourg who conduct the business of the AIFM on a day-to-day basis. Conducting officers are not required to reside in Luxembourg; however, the conducting officers should have their domicile in a place allowing them, in principle, to come to Luxembourg every day.

AIFMs may establish a branch, which has to be previously approved by the CSSF. To the extent that the branch qualifies as a Luxembourg permanent establishment or the conducting officers as permanent representatives, the profits and wealth of the branch are subject to Luxembourg taxation. Appropriate transfer-pricing documentation may be requested by the Luxembourg tax authorities to review the allocation of profits and wealth between the branch and the head office. Bilateral advance pricing agreements are recommended in such cases.

### 3.5 Taxation of Carried Interest

Regarding SICAR/SICAR-like RAIFs and SIFs/SIF-like RAIFs, as well as CLPs and SLPs, carried interest is generally structured as shares or units. Tax treatment in the hands of non-resident beneficiaries is to be analysed on a case-by-case basis.

### 3.6 Outsourcing of Investment Functions/Business Operations

The main functions of AIFMs are divided into three types of activities:

- investment management (compulsory), ie, portfolio and risk management, as well as the valuation function;
- additional management activities (optional), ie, administration, marketing and activities related to the assets held in the portfolio of the AIFs; and
- non-core services (optional), ie, discretionary portfolio management (eg, portfolio of pension funds), investment advice, safe-keeping and administration of shares/units of UCIs, reception and transmission of orders.

AIFMs can delegate some of their functions to third parties in order to increase the efficiency of their business under certain conditions listed below. However, a delegating AIFM must never be a letterbox entity, which is the case if the

AIFM is no longer in a position to supervise the delegate or no longer has the power to take key decisions.

### **Delegation Conditions**

Firstly, AIFMs must notify the CSSF and justify the entire delegation structure, demonstrating that the delegate is qualified and has sufficient resources. Where the delegation concerns portfolio or risk management (which cannot both be delegated in full at the same time), the delegate must be authorised and subject to supervision in its home country, and if it is located in a third country, a co-operation agreement must be signed between the competent authorities. In practice, while risk management usually remains in Luxembourg, portfolio management activities are often delegated outside Luxembourg.

Secondly, no delegation may be conferred on the depositary or any other entity whose interest may conflict with that of the AIFM or the investors of the AIF.

Thirdly, the AIFM remains responsible towards the AIF and its investors and should therefore monitor the delegate (or, where applicable, the sub-delegate) and be able to terminate the delegation with immediate effect, if this is in the interest of the AIF's investors.

Also refer to **2.10 Requirements for Non-local Service Providers**.

### **3.7 Local Substance Requirements**

Depending on the complexity of its activities and the nature of its business, an AIFM must have adequate financial, technical and human resources as set out by the CSSF in their circular CSSF 18/698 on substance-related aspects concerning both UCITS management companies and AIFMs ("Substance Circular").

The main section of the Substance Circular sets out detailed rules concerning shareholding, the minimum equity requirements, corporate bodies, administrative organisation, internal governance and internal controls.

For instance, licensed AIFMs must have at least two conducting officers dedicated to management on a full-time basis, who have sufficient competence and professional experience, and who must also be permanently based in Luxembourg or in a place allowing them to travel to Luxembourg every day, in principle, and must be contactable by the CSSF at any time.

An AIFM must furthermore have qualified staff members with sufficient experience in relevant subjects, depending on the management activities provided by the AIFM. The size of the AIFM in terms of human capital also depends on the nature of its activity.

In case of delegation, as mentioned in **3.6 Outsourcing of Investment Functions/Business Operations**, AIFMs should also be able to supervise the delegates and retain the power to take key decisions.

### **3.8 Local Regulatory Requirements for Non-local Managers**

EU/EEA-authorised AIFMs have a cross-border passport that allows them to market and manage AIFs in Luxembourg through the freedom of establishment (eg, establishment of a branch, which however does not itself benefit from the passport) or the free provision of services. EU/EEA AIFMs are not subject to any authorisations in Luxembourg or any additional requirements, since their home regulators remain competent to ensure compliance with their own regulatory requirements.

However, such EU/EEA AIFMs must notify their home regulator of their intention to carry out

activities in Luxembourg and provide it with information regarding the company, including the structure, risk management, etc.

Third-country AIFMs may manage Luxembourg funds provided they are not marketed in the EU. Third-country AIFMs wishing to manage Luxembourg funds and market them in the EU need to comply with Article 45 of the AIFM Law, namely:

- compliance with Articles 22–24 and 26–30 of the AIFMD;
- appropriate co-operation between the regulators of the AIFM and the AIF, or the state where it is marketed; and
- such third country may not be listed as a Non-Co-operative Country and Territory by the Financial Action Task Force (FATF).

## 4. INVESTORS

### 4.1 Types of Investor in Alternative Funds

All types of investors, including retail investors in some circumstances, can invest in Luxembourg alternative funds, subject to restrictions and conditions for specific types of funds (see **4.2 Marketing of Alternative Funds**).

Investors are mainly institutional investors such as pension funds, insurance companies, financial intermediaries, family offices or other funds, as well as eligible high net worth individuals. Geographically, Luxembourg AIFs are attractive to global investors, starting with local investors (see **4.4 Local Investors**), EU/EEA investors and third-country investors.

### 4.2 Marketing of Alternative Funds

Investor eligibility criteria depend on the type of AIF. Eligibility could be limited to institutional and professional investors, or could also target retail investors.

Part II UCIs, irrespective of whether they are AIFs, are not subject to any restrictions regarding investor eligibility in Luxembourg. Furthermore, any entity qualifying as an AIF can benefit from the AIFMD passport for marketing to professional investors within the meaning of MiFID II, while local rules apply to retail sales.

SIFs, RAIFs and SICARs are available to “well-informed” investors, a category which includes:

- institutional investors: firms and organisations managing substantial funds and assets (ie, banks and other professionals of the financial sector, insurance and reinsurance undertakings, pension funds, large groups in industry, or the financial sector or their dedicated structures, etc);
- professional investors within the meaning of the SIF, RAIF and SICAR Law are:
  - (a) entities which are required to be authorised or regulated to operate in the financial markets (credit institutions, insurance companies, etc);
  - (b) large undertakings which meet two of the following criteria on a company basis:
    - (i) balance sheet total of EUR20 million;
    - (ii) net turnover of EUR40 million; and
    - (iii) own funds of EUR2 million;
  - (c) some states or international bodies or institutions and other institutional investors, the main activity of which is to invest in financial instruments, including entities dedicated to the securitisation of assets or other financing transactions; and
  - (d) for funds that qualify as AIFs and are marketed by fully authorised AIFMs, investors will have to qualify as professional investors within the meaning of Annex II of Directive 2004/39/EC; and
- any investor which confirms in writing that it fulfils the status of a “well-informed” investor (such investor must also invest at least

EUR125,000 or provide confirmation from one of the financial sector entities listed in the SIF, RAIF or SICAR Laws that it has the necessary expertise, experience and knowledge to adequately appraise an investment in risk capital).

Managers and others involved in the management of SICARs, SIFs and RAIFs are exempt from the above-mentioned eligibility criteria.

### 4.3 Rules Concerning Marketing of Alternative Funds

Luxembourg is a world leader in cross-border fund distribution. Different rules apply, however, in marketing to professional or retail investors.

For marketing in the EU/EEA, funds qualifying as AIFs (including RAIFs) benefit from a passport allocated to their authorised EU AIFM and can use a simple notification procedure. Such passport is valid only for professional EU-based investors. EU/EEA AIFs can also be marketed in Luxembourg using the passport.

#### Marketing to Professional Investors

AIFMs are able to market AIFs to professional investors in Luxembourg subject to the following conditions:

- marketing of EEA AIFs managed by EEA-authorized AIFMs (with passport) – marketing in Luxembourg is subject to notifying the CSSF for Luxembourg AIFs or the home regulator for non-Luxembourg EEA AIFs (Luxembourg-domiciled AIFs subject to CSSF supervision are automatically authorised to be marketed in Luxembourg);
- marketing of non-EEA AIFs managed by EEA AIFMs (without passport) – marketing is possible in compliance with the national private placement rules under Article 36 of the AIFMD, and marketing in Luxembourg can start on notification to the CSSF;

- marketing of AIFs by non-EEA AIFMs (without passport) – marketing is possible under Article 42 of the AIFMD under national private placement rules, and marketing in Luxembourg can start on notification to the CSSF; and
- marketing of AIFs by EEA-registered AIFMs (without passport) – these AIFMs can opt in to make use of the marketing passport, and private placement rules are available for them in Luxembourg.

#### Marketing to Retail Investors

AIFMs are able to market AIFs to retail investors in Luxembourg subject to the following conditions:

- for foreign funds, they must appoint a paying agent in Luxembourg;
- they must comply with Article 46 of the AIFM Law;
- for open-end non-Luxembourg AIFs, they must comply with Article 59 (foreign funds must, firstly, appoint a credit institution to ensure that facilities are available in Luxembourg for the payment, repurchase or redemption of units and, secondly, ensure that the required information is made available to Luxembourg investors); Article 100 (foreign funds must be under the supervision of both their home state supervisory authority and the CSSF); and Article 129 (funds must be authorised by the CSSF) of the UCI Law;
- they must comply with CSSF Regulation 15-03, which details the rules regarding application for marketing authorisation with the CSSF and the conditions for such authorisation in relation to Article 46 of the AIFM Law; and
- they must issue a PRIIPs KID.

Before closed-end foreign funds that are not classified as AIFs can be marketed in Luxembourg, they need to issue a prospectus in com-

pliance with the law of 16 July 2019 on prospectuses for securities (“Prospectus Law”), unless certain conditions therein apply.

Furthermore, the Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on ELTIFs allows AIFMs to market an AIF to retail investors under the AIFMD marketing passport, provided that the AIFM and the AIF comply with the requirements set out in the ELTIF Regulation. According to ESMA’s ELTIF register, nine Luxembourg ELTIFs have been authorised and launched up until now.

## Definition of Marketing

With no guidance at EU level, marketing itself is subject to local discretion. In Luxembourg, marketing occurs when the AIF, AIFM or an intermediary of the AIF or AIFM, seeks to raise capital by actively making shares of any AIF available for sale to potential investors. To fall under the local definition, this also needs to take place in Luxembourg, or remotely targeting a Luxembourg-based investor. The various marketing scenarios are described above. There are also established examples of what would not be considered as marketing, ie:

- reverse solicitation (subject to strict rules itself);
- providing investors with draft documents that cannot be used to subscribe or commit; or
- investments made in the context of UCI or AIF collective portfolio management, investment advisory agreements or discretionary portfolio management of individual investment portfolios.

## 4.4 Local Investors

Both local and foreign investors can invest in alternative funds established in Luxembourg, subject to the fulfilment of specific investor eligibility criteria for SICARs, SIFs and RAIFs (see **4.2 Marketing of Alternative Funds**).

However, Part II UCIs which are distributed to retail investors in Luxembourg will fall within the scope of the more stringent UCITS-like depositary regime.

Local AIF investors are mainly institutional (including other funds) with local family offices playing an increasing role.

## 4.5 Regulatory Regime

For marketing with a passport, regulator-to-regulator notification (between the home country regulator of the AIFM and the CSSF) is required under the AIFM Law, in order to start marketing in Luxembourg.

Luxembourg-regulated AIFs are automatically authorised for marketing in Luxembourg but need to take into account specific product rules. Subject to product eligibility criteria, this applies to both professional and retail investors.

When marketing AIFs to professional investors without a passport (see **4.3 Rules Concerning Marketing of Alternative Funds**), the AIFM must notify the CSSF prior to any marketing activity. This is a simple notification with no need for acknowledgement of authorisation from the CSSF. Marketing can start in Luxembourg from the day of notification.

Finally, rules on marketing non-Luxembourg but regulated AIFs to retail investors in Luxembourg are set out in **4.3 Rules Concerning Marketing of Alternative Funds**. Such AIFs must be subject to permanent supervision by their local authority to ensure the protection of investors and provide guarantees that such protection is at least equivalent to that in Luxembourg law for retail distribution.

Since 2 August 2021, and following a notification procedure by the EU AIFM, AIF structures may be pre-marketed in the European Union.



The information presented to potential investors may not be:

- sufficient to allow investors to commit to acquiring units or shares of a particular AIF; or
- a subscription form or similar document either in a draft or final form; or
- a prospectus or offering document of a not-yet-established AIF in a final form.

#### **4.6 Disclosure Requirements**

The main disclosure requirements for Luxembourg alternative funds are set out in **2.17 Disclosure/Reporting Requirements**.

SIFs, RAIFs and SICARs must have an issuing document, unless the SIF or RAIF has set one up under the Prospectus Law. If they are not AIFs, their issuing documents must only include the information necessary for investors to be able to make an informed assessment of the investment proposed to them and of the associated risks. In addition, the first page of a RAIF issuing document clearly states that it is not subject to the supervision of the CSSF. Such issuing document needs to be up to date when securities are issued to a new investor. SIFs, RAIFs and SICARS must issue an audited annual report within six months of the end of their financial year, but do not have to prepare consolidated financial statements.

With further reference to **2.17 Disclosure/Reporting Requirements**, SIFs qualifying as AIFs, RAIFs and SICARS are subject to additional disclosures under Article 21 of the AIFM Law, which transposes Article 23 of the AIFMD. AIFMs managing AIFs are subject to additional reporting requirements, depending among other things on the type of AIF (open or closed-end) and the assets under management. Such reporting includes the following: risk profile of the AIF and related risk management, liquidity manage-

ment changes, and special arrangements for illiquid assets.

Part II UCIs are subject to UCITS-like disclosure requirements and need to provide investors with a semi-annual report as well as an annual one.

For AIFs offered to MiFID II-type retail investors, a PRIIPs KID must also be provided.

The issuing document of SIFs, Part II and SIC-ARs UCIs is reviewed by the regulator.

Unregulated limited partnerships, managed and marketed under the AIFMD, should make the respective information required in Article 21 of the AIFM Law (equivalent to Article 23 of the AIFMD Law) available to potential investors prior to their investment.

#### **4.7 Tax Regime**

Luxembourg resident investors are generally subject to income taxes and net worth tax (net worth tax does not, however, apply to individuals) depending on their tax regime in Luxembourg. Resident investors benefiting from an income tax and net worth tax exemption include those investing as UCIs, SIFs, SIF-like RAIFs and SPFs.

Non-resident investors which do not have a Luxembourg permanent establishment or permanent representative to which or whom the interests in the fund are allocated, are generally not liable for any Luxembourg income or net wealth taxes, except in limited cases when investing in a SOPARFI.

#### **4.8 FATCA/CRS Compliance Regime** **FATCA**

Luxembourg entered into a so-called Model I Intergovernmental Agreement with the USA and implemented FATCA through the Luxembourg law of 24 July 2015 (“FATCA Law”). Luxembourg

entities that qualify as Luxembourg Reporting Financial Institutions (FFIs) fall within the scope of FATCA. Luxembourg custodial institutions, depository institutions, specified insurance companies or investment entities are FFIs and are subject to registration with the US Internal Revenue Service, due diligence obligations with the identification of reportable account holders and annual reporting obligations. Luxembourg FFIs need to report the relevant information concerning reportable accounts and account-holders to the Luxembourg Tax Authorities (LTA).

## **CRS**

The OECD Common Reporting Standard (CRS) is largely inspired by FATCA and has been transposed into Luxembourg domestic law by the

Luxembourg law of 18 December 2015. Although similar to FATCA with three principal obligations (ie, registration, due diligence and reporting), the CRS requires a significant upgrade of due diligence and reporting processes, in particular, in terms of the volume of information and the number of account-holders in scope.

Luxembourg FFIs, while remaining liable, are allowed to delegate FATCA and/or CRS obligations to a third-party service provider.

For both FATCA and the CRS, the LTA may issue different penalties to Luxembourg FFIs that either do not respect the due diligence rules or have not put in place mechanisms to report information.

**Arendt & Medernach** is a leading independent business law firm in Luxembourg. Its international team of 350 legal professionals represents clients in all areas of Luxembourg business law, with representative offices in Dubai, Hong Kong, London, Moscow, New York and Paris. The team offers end-to-end specialist advice, covering all legal, regulatory, taxation

and advisory aspects of doing business in Luxembourg. The fund formation group at Arendt & Medernach covers both traditional and alternative investment fund strategies and has private and public funds specialists in addition to a market-leading UCITS practice. Over 160 fund experts and 22 partners make this group the largest fund formation team in Luxembourg.

## AUTHORS



**Isabelle Lebbe** is a partner in the investment management practice of Arendt & Medernach. She specialises in a wide range of investment funds, with a focus on regulated funds. She

advises clients on the corporate, regulatory and tax aspects of the creation, marketing and operation of investment funds and management entities. She also works on regulatory complaints and judicial proceedings involving regulated funds or their service providers. Isabelle regularly speaks at conferences. She is chairman or a member of a number of committees and sub-committees established by the Association of the Luxembourg Fund Industry (ALFI) and by the CSSF, the regulatory authority of the financial sector in Luxembourg.



**Pierre Beissel** is a partner and a member of both the corporate law, mergers & acquisitions and the private equity and real estate practices of Arendt & Medernach. He advises private

equity firms, hedge funds and real estate funds on funds structuring and formation as well as on the structuring and financing of international buyout transactions, joint ventures, corporate reorganisations and corporate governance matters. He is an active member of the Luxembourg Private Equity Association (LPEA) and of the American Bar Association.



**Rodrigo Delcourt** is a partner in the private equity and real estate practice of Arendt & Medernach. He advises fund sponsors and managers on all legal and regulatory aspects related to the

structuring, setting up and ongoing operation of regulated and unregulated alternative funds, with a special interest in real estate, private equity, infrastructure, renewable energy and private debt, as well as related acquisition structures. Rodrigo is a regular speaker at national and international seminars and conferences. He is also a member of several committees at the Association of the Luxembourg Fund Industry (ALFI) and the Luxembourg Private Equity Association (LPEA).



**Claudia Hoffmann** is a counsel in the investment management practice of Arendt & Medernach. She represents international sponsors and investors in the regulatory, corporate and

organisational aspects of structuring and creating regulated and unregulated alternative investment funds. She has a broad range of experience across asset classes, advising on open-end and closed-end funds, the structure of carried interest vehicles, employee vehicles, funds of funds and parallel funds, as well as liquidity mechanisms and other regulatory matters in connection with managing, advising and marketing private funds.

---

## Arendt & Medernach SA

41A Avenue JF Kennedy  
L-2082  
Luxembourg

Tel: +352 40 78 78 1  
Email: [info@arendt.com](mailto:info@arendt.com)  
Web: [www.arendt.com](http://www.arendt.com)

