# Luxembourg Alternative Investment Funds – A tax perspective

Webinar

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# Agenda

- Implementation of ATAD 2 in Luxembourg
- Impact of the ECJ “Danish cases”

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# Implementation of ATAD 2 in Luxembourg

# Bill on ATAD 2 - overview

| | |
|---|---|
| **Hybrid mismatches covered** | ▪ **In line with ATAD 2: Deduction/ Non-Inclusion (D/NI) and Double Deduction (DD)**<br>▪ Hybrid mismatches with **EU and non-EU countries**<br>▪ Hybrid mismatches relevant for Funds are essentially:<br>- **Payment under a financial (hybrid) instrument (D/NI)**<br>- **Payment to a hybrid entity (D/NI)**<br>- **Payment by a hybrid entity (D/NI)**<br>- **DD outcome**<br>▪ Rule on **reverse hybrids** |
| **Scope** | ▪ Associated enterprises<br>▪ Structured arrangement |
| **Specific measures for investment funds** | ▪ Acting together – *de minimis* threshold (10%)<br>▪ Reverse hybrids – exception for CIVs |
| **Entry into force** | ▪ Applicable to financial years starting as from 1.1.2020<br>▪ 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**

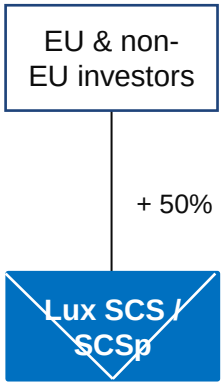
## Acting together

- **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

# Bill on ATAD 2 - reverse hybrids




⇒ Luxembourg reverse hybrid entity subject to **corporate income tax** (no net worth tax), to the extent income not otherwise taxed in Luxembourg or in another jurisdiction

**Exclusion of Collective Investment Vehicles (CIV)**

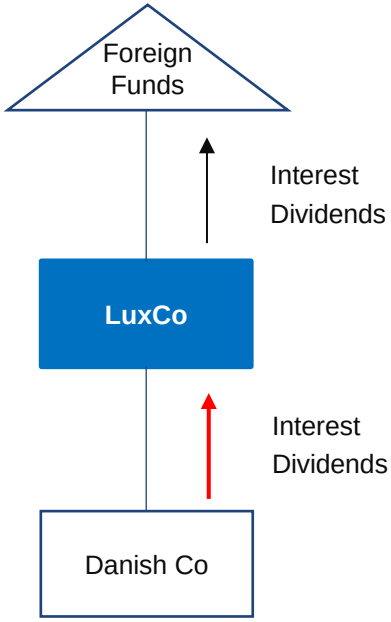
- Investment funds or vehicles that are widely held, hold a diversified portfolio of securities and are subject to investor-protection regulation
- UCITS, Part II funds, SIF, RAIF, certain AIF

# ATAD 2 – overview of implementation status in key EU jurisdictions

- France
- Germany
- Ireland
- Italy
- Luxembourg
- Portugal
- Spain
- United Kingdom

# Impact of the ECJ "Danish cases"

# Background *




- Interposition of LuxCo 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:
  - LuxCo is not the beneficial owner of the interest / dividends
  - LuxCo is acting as mere conduit company

* Overview of ECJ cases C-116/16 & C-117/16 / C-115/16, C-118/16, C-119/16 & C-299/16
Not all cases actually relate to the interposition of a LuxCo

# Key findings

- The tax authorities of the investment country **should refuse the application of the PSD / IRD** in the case of abusive practices, even if no anti-abuse measures (of such Directives) have been implemented in domestic tax law

- Indications as to whether there is an **abuse of rights**:
  - Interposition of conduit companies without economic justification
  - Artificial arrangement
  - Almost all of the dividends or interest are rapidly passed on to entities which cannot benefit from the WHT exemption

- Factors to determine whether there is a **conduit company** :
  - The company's sole activity is the receipt of dividends or interest and their transmission to the beneficial owner or to other conduit companies
  - Absence of actual economic activity analysed based on factors such as the management, the balance sheet, the structure of the costs and expenditure, the staff and the premises and equipment

- Application of the IRD is restricted to **Beneficial Owners** of the interest : designate an entity which actually benefits from the interest that is paid to it, i.e. only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorized signatory, for some other person, and which, accordingly, has the power to freely determine the use to which it is put

# Impact in France

- No significant impact of these cases in French law since:
  - Beneficial owner condition implicitly contained in all DTT
  - *Conseil d'Etat* has ruled that the traditional abuse of law concept is implicitly contained in all DTT
  - Criteria materially in line with existing French case law
  - No withholding tax on interest
- Recent developments : artificiality of the scheme / holdings qualifies both subjective and objective criteria of the anti abuse provision
- ATAD / PSD AAR have been implemented verbatim into French law
- In practice, key that holding have :
  - functional substance (EU investment platform, joint venture etc.) and / or
  - operational substance in connection with their assets (staff, other means etc.)

# Impact in Germany

- Germany's tax administration has not yet commented the ECJ decisions of 26 February 2019
- The ECJ declared Germany's strict anti-treaty and anti-Directive shopping rules incompatible with the freedom of establishment as well as with the Parent-Subsidiary-Directive on 20 December 2017 (C-504/16 and C-613/16 – *Deister Holding* and *Juhler Holding*)
- Following the ECJ's decision, the German tax administration published a decree in 2018 which restricts the application of the anti-treaty and anti-Directive shopping rules
- However, the German tax administration applies the ECJ's decisions only to cases which are covered by the Parent-Subsidiary-Directive; the German tax authorities continue to apply the strict domestic anti-treaty and anti-Directive shopping rule to reimbursement claims based on tax treaties/re WHT on interest
- In the near future, Germany could introduce new anti-treaty and anti-Directive shopping rules as part of a comprehensive law on corporate tax (a draft bill of which is expected to be published)

# Impact in Ireland

- No legislative change / no change in published Revenue practice
- Ireland's own application of beneficial ownership concept
- Interaction with OECD / MLI principles
- Irish funds are typically opaque
- Outbound domestic exemptions – limited reliance on PSD / IRD

# Impact in Italy

- Prohibition of abuse, even absent a GAAR, consistently applied by the Italian Supreme Court. Following enactment of the GAAR (10/2015) specific procedural rules must be followed in avoidance cases

- Indicia of a «conduit» in paras. 130-133 (CJEU on IRD) and in paras. 103-106 (CJEU on PSD) are those generally used by Italian Tax Authorities when challenging the b.o. status

- In this context, significant clarification from the CJEU: «*The absence of actual economic activity must, **in the light of the specific features of the economic activity in question**, be inferred from an analysis of all the relevant factors*» (paras. 131 CJEU on IRD / 104 CJEU on PSD) → reinforcing domestic case-law (see Italian Supreme Court No. 27113 of 28 December 2016 on holding companies)

- What about IRD/PSD if EuMidHoldCo lacks of substance, but EuTopHoldCo does have substance? EuMidHoldCo is not established for tax purposes: are paras. 134 ff. (CJEU on IRD) and paras. 107 ff. (CJEU on PSD) on DTTs useful? And is it Example M of OECD Comm. to new Art. 29 in the area of IRD/PSD?

# Impact in Portugal

- Brief overview on legal framework and current practice.
- Increased attention of Portuguese tax authorities to cross-border payments of dividends and interest expected:
  - *What can investors learn from Danish Cases ?*

# Impact in Spain

- Spain already has strong anti abuse provisions in its implementation of the PSD.
- Both the tax administration and the courts already use a restrictive interpretation of the PSD exemption.
- Interest payments to EU residents have benefited from a simple domestic exemption since many years that basically asks for EU residency without any further requirements.
- Recent high court judgements have uphold this very simple approach.
- But: incidence of Spanish GAAR
- Uncertainty about future developments due to legislative inaction.

# Impact in the UK: limited for UK assets

- The Demark decision has limited direct relevance to UK specific deals because:
  - No dividend withholding tax under UK domestic law so no need to rely on Treaty or Directive.
  - UK withholding tax on interest but industry practice is to provide shareholder debt using a quoted Eurobond, which provides complete exemption.
  - Gains made by non-UK residents are outside the scope of UK tax (except for certain property-rich vehicles).
- Therefore there is no UK tax reason for the use of intermediate holding vehicles and little focus on “beneficial ownership” concepts in the UK.

# Impact in UK: significant for UK asset managers

- A number of European asset managers locate their deal teams in the UK even if:
  - the fund vehicle is an offshore / non-UK vehicle; and
  - fund assets are not held through a UK based holding structure.
- Most European jurisdictions impose one or more of interest WHT, dividend WHT or non-resident gains taxation, which has typically be mitigated through the use of a Treaty qualifying fund holding vehicle.
- Luxembourg remains the industry standard fund holding jurisdiction, with most funds using master holding companies as a result of BEPS Action 6.
- The general trend has been to increase Luxembourg people substance.
- *Denmark* is part of a trend that has seen UK based asset managers :
  - re-assess the benefits of continued investment in Luxembourg based people substance (although specific responses have varied);
  - consider alternative ways to mitigate the risk of source country taxation, particularly in 'higher risk' jurisdictions; and
  - in certain cases, investigate the use of alternative holding company jurisdictions (e.g. the UK).

# Concluding remarks

For any questions, please contact BusinessDevelopment@arendt.com

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