



## Luxembourg Private Equity & Venture Capital Association

# LPEA Newsletter

Issue: #10

June 2013

### Dear LPEA Member, Dear Reader:

It has been another volatile year for the industry and the global economy thus far. During the first months of the year we have witnessed other European member states knee under the pressure of fickle financial markets and unbalanced banking systems. The immediate and long term benefits of the imposed austerity measures and interest rate manipulation as a lever of economic improvement are being questioned and with that the quest for solutions continue.

I am pleased to report that LPEA and the state of Luxembourg have long embraced a proactive plan and have been investing time in search of resolutions. One of them is the impending Limited Partnership Law (LP Law), which will have immediate positive impact on the Private Equity and Venture Capital market. As the industry representative in Luxembourg, LPEA has been heavily vested in the drafting of the law and as a result, is presenting its own technical book, explaining the law in details ([read more about it here](#)). In addition to that, LPEA's technical committees are working tirelessly to ensure LPEA members are up to speed on technical topics. I hope that you'll take advantage of their work and read the technical updates listed below.

On the social side, the association continues to launch new initiatives to encourage communication, networking and best practice sharing. Stay on the look-out for additional details on **LPEA's Annual PE Survey**, the first **"GP's Club"** meeting, and the upcoming **LPEA Roundtable**...I look forward to connecting with all of you at one of these initiatives!

As always, let me extend a special appreciation to our members and supporters for their contributions. LPEA could not be the success story it has become without them.

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### FUTURE EVENTS

#### LPEA

**June 13 2013**  
["Venture Lounge"](#)  
Luxembourg

**June 19 2013**  
[LPEA Seminar, Limited Partnership Book: "Les Commandites en droit Luxembourgeois"](#)

Chambre de Commerce de Luxembourg

With best regards,

Hans-Jürgen Schmitz, Chairman of LPEA

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## EuVECA Label: New Opportunities for Venture Capital and Luxembourg

On 21 March 2013 the European Council adopted the final text of the Regulation on European Venture Capital Funds ("VCF"). Pending its publication in the Official Journal of the European Union, it will concurrently apply to Directive 2011/61/EU on Alternative Investment Fund Managers (the "AIFMD") from 22 July 2013.

The purpose of the Regulation is to facilitate the access of small and medium-sized enterprises ("SMEs") to financing, with the purpose of growth and sustainable development, by establishing a single rulebook that applies to venture capital fund managers ("VCFM"), which are established within the European Union, are registered with the competent authority of their home Member State in accordance with the AIFMD, and want to market the units of European venture capital funds ("VCF") to eligible investors within the European Union.

The Regulation is addressed to the managers of alternative investment funds ("AIFM"), which are subject to the registration procedure set forth under Article 3 of the AIFMD, and whose assets under management do not exceed EUR 500 million in total. VCFM willing to use and distribute qualifying VCF across the European Union will be conducting their activities by using the designation "EuVECA".

For additional details, please [CLICK HERE](#).

The Office of LPEA

## "Why Luxembourg is a safe jurisdiction"

Earlier in the year, Luxembourg found itself compared to other small European states. To defend its position as a stable

**July 11 2013**

"GP Club",  
Luxembourg

**July 15 2013**

LPEA Board of  
Directors Meeting,  
Luxembourg

**July 2013**

LPEA Roundtable:  
"FATCA"  
(details TBA)

**September 2013**

LPEA Roadshow:  
Paris France  
(details TBA)

## EVCA

**June 26-28 2013**

EVCA

Symposium

Istanbul, Turkey

**November 7-8  
2013**

EVCA Venture  
Capital Forum

Germany

For additional  
information [CLICK  
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financial jurisdiction with a first class banking center, the prominent Luxembourg banking trade association, **Association des Banques et Banquiers, Luxembourg ("ABBL")** issued a special paper, titled **"Why Luxembourg is a safe jurisdiction?"** The report provides a detailed overview of the make up and the current state of the Luxembourg financial industry as well as a comparison to major European and Global banking centers. **To access the publication, please [CLICK HERE](#).**

## The Office of LPEA

### Luxembourg Securitization: a Flexible Vehicle to Acquire Debt

Due to the ongoing financial crisis, a tidal wave of regulatory requirements has swept over the global banking industry including the likes of Basel III, meaning increased capitalization standards, liquidity ratios and reporting requirements. As a result, new opportunities have arisen for Private Equity houses to acquire debt from banking groups, particularly, distressed debt or non-performing loans ("NPLs"). With NPL portfolios, investors seek below par-value acquisitions and can afford to wait it out until market conditions recover, without facing the same capitalization and liquidity restraints as the selling financial institutions. This investment strategy aims to increase returns offered to investors.

When making an investment into NPLs, Luxembourg is well positioned to offer a variety of efficient vehicles such as securitization vehicles ("SVs"). This article provides a brief overview of the benefits of SVs.

- **What is a securitization vehicle?**

An SV is considered as a vehicle that acquires or assumes certain risks, related to claims, assets or obligations assumed by third parties or linked with the activities of third parties, including NPL portfolios. When acquiring the NPLs, the operation is financed by the issuance of securities, whose value and yield depends on the risks assumed.

Under the securitization law of 22 March 2004 ("Securitization Law"), the formation of SVs is very flexible whereby they can be structured as a fund or as a company, such as a public limited liability company ("société anonyme"), a corporate partnership limited by shares ("société en commandite par actions"), a private limited liability company ("société à responsabilité limitée") or a co-operative company organized as a public limited liability company.

- **How is an SV regulated?**

SVs may be non-regulated entities, which are not subject to any authorization or supervision from the Luxembourg Supervisory Commission for the Financial Sector ("Commission de Surveillance du Secteur Financier", "CSSF"), unless the SV is issuing securities to the public on a continuous basis[1].

In addition, whereby the SV is performing debt securitization, the CSSF distinguishes between the traditional activities of acquiring loans on the secondary market and the direct granting of loans by the SV itself. The CSSF expressly notes that SVs carrying out the latter activity may be impacted by future regulatory and legislative developments in this area (e.g. current discussions on shadow banking, etc.)[2]. This needs to be analyzed in detail based on the individual facts of each case[3].

- **Luxembourg tax treatment**

The SVs organized as corporate entities are liable to corporate income tax and municipal business tax (29.22% in 2013 for Luxembourg City).

However, the commitments of a securitization company ("SC") to remunerate investors qualify as interest on debt (even if paid as return on equity) and they are regarded as tax deductible (Art. 46 (14) of the Luxembourg Income Tax Law of 4 December 1967 ("LITL")). This makes SVs particularly interesting for investments in NPLs, since returns in excess of the acquisition price may be offset against tax deductible remuneration to bondholders and shareholders. Payments to investors arising from debt and equity securities are not subject to withholding tax (Art. 97 (6) and Art.146 LITL).

SCs enjoy full exemption from Luxembourg net wealth tax (§3 (1) (4) of the Luxembourg Net Wealth Tax Law of 16 October 1934).

Since SCs are fully taxable resident companies, they benefit from Luxembourg's large tax treaty network (64 treaties are currently in force).

Management services rendered to SCs within the scope of the Securitization Law are in principle VAT exempt.

The overall regime applicable to SCs allows a tax neutral treatment in Luxembourg, with a high degree of flexibility, especially in terms of funding of the SC through any type of equity and debt securities. That is why the SCs are a very popular and attractive tool for Private Equity houses launching debt funds.

[1] Considered to be more than three issuances per year according to the CSSF's "Frequently Asked Questions: Securitisation", published on 19 July 2012.

[2] According to the CSSF's "Frequently Asked Questions: Securitisation", published on 19 July 2012

[3] Ibid.

**Julien Bieber and Tobias Wieczorek,  
LPEA Associate Members**

## **FATCA: only 7 months to become compliant!**

On 17 January 2013, the final regulations related to the Foreign Account Tax Compliance Act ("FATCA") were published. The Luxembourg government is currently negotiating an Intergovernmental Agreement ("IGA") with the US government in order to facilitate FATCA implementation. With the effective date as of 1 January, 2014 for the withholding tax on US source income, all concerned entities should now take steps to ensure compliance in due time.

### **Overview of the FATCA provisions**

FATCA imposes obligations on two sets of financial income recipients: Foreign Financial Institutions ("FFIs") and Non-Financial Foreign Entity ("NFFE"). The objective of FATCA is mainly to encourage FFIs to enter into an agreement with the US tax authorities (IRS) directly or by way of a registration procedure (in IGA countries) in order to acquire from them due diligence and identification of their US account holders or investors, reporting on such US persons and withholding (where relevant). Any entity not defined as an FFI will be a NFFE, and will need to identify its substantial US owners according to the FATCA Law, or certify that it has none.

In case of non-compliance, FFIs, passive NFFEs and recalcitrant account holders would be subject to 30% withholding tax on US source income as of 1 January 2014, and on gross proceeds from the sale of US securities as of 1 January 2017.

FFIs include notably: (i) investment entities, which trade in money market instruments for or on behalf of a customer, (ii) entities realizing portfolio management activities, or (iii) entities that invest in, administer or manage collective investment vehicles. FFIs also include entities which activity is to invest or trade in financial assets and are "professionally managed" by such investment entities.

### **Impacts for the Private Equity industry**

Regulated or non-regulated investment funds may therefore qualify as FFIs. Investment entities include more generally any entity that functions or holds itself as a collective investment vehicle. As a result, a holding company professionally managed by investment entities or formed by a private investment fund to facilitate its investment structure may be subject to FATCA compliance, same as an FFI. PE houses need in a first stage to analyse their shareholding structure to determine the status of each entity - either as FFIs or NFFEs. They should also analyse whether an alternative deemed-compliant FFI status would be available, implying less administrative burden on a yearly basis.

Luxembourg has recently opted for a Model 1 IGA (implying automatic exchange of information). As a result, Luxembourg FFIs will now have no other choice but to become FATCA compliant. They will need to foresee a registration (if and as required by the local implementation law), as well as prepare for regular due diligence, reporting and withholding procedures. They would need to review pre-existing shareholder accounts, analyse AML/KYC programs performed internally or by third party service providers to confirm compliance with FATCA requirements, and create a FATCA compliance program that contains the policies, procedures and controls required.

Passive NFFEs (NFFES having mainly passive income) will need to identify their substantial US owners, with an increasing reliance on current AML/KYC provisions in this respect based on the IGA model.

**Raymond Krawczykowski, LPEA Associate Member**

## **Improving portfolio management through a master holding co**

In order to properly manage investments within a private equity group, it is a common understanding that adequate economic, human or infrastructure resources are required. To that end, positive solutions have been developed for years now. One of them is the Luxembourg master holding ("Master Luxholdco"), which is an evolution of the single Luxembourg company structure, used on a standalone basis ("Single Luxco").

The set-up of a Master Luxholdco provides rationalization by a concentration of people and optimization of the economic resources. In general rules, these results are more difficult to reach in the context of Single Luxcos. Therefore, the Master Luxholdco as a "hub" for all the investments can improve the

management of the portfolio.

If the set-up costs are slightly higher at inception, it definitely provides some savings in the subsequent transactions. Among examples, one can consider that a Master Luxholdco structure will allow single employment agreement per employee, and also avoid multiple rental lease agreement (or sub-lease agreements). The determination of the board of managers and of its duties, which are always key considerations, will also be structured once, in the strongest way, at the level of the Master Luxholdco. The pooling of the investments in the Master Luxholdco would subsequently benefit and grant sustainability to the private equity group and to any additional special purpose vehicles that would be set up in Luxembourg. All of those considerations would limit the risk of beneficial ownership issue or application of General Anti-Abuse Rules. Finally, one indirect advantage of a Master Luxholdco in comparison to a Single Luxco would be the better implementation of the transfer pricing rules, related to the financing activities. The arm's length remuneration would be determined by considering the full amount of the financing flowing through the Master Luxholdco, and, in general, would give lower spread (depending on proper transfer pricing review).

This type of structure is running well now. At the beginning, it may have been challenged by some practitioners for the "tainting effect" that may occur when an investment is under-performing or in a loss position. The reasoning was that a loss on one investment might have an impact on other profitable investments or limit the repatriation capacity. With the long standing experience of the structure, it can now be safely stated that those risks are remote or can be easily managed from a legal perspective. Practitioners know how to transfer those risks and ensure that a Master Luxholdco would remain an efficient repatriation entity for a private equity group.

Should we conclude that the Master Luxholdco is a "philosophical stone"? From the view of best practice, it is one of the most appropriate instruments - assuming, of course that the proper resources to manage it are in place. However, some practicalities are still to be improved. From an accounting perspective, the consolidation rules need to be simplified or fine-tuned for this type of structure. Also, the possibility to create compartments in a Master Luxholdco (being a non-regulated vehicle) will definitely provide an interesting evolution.

**Raymond Krawczykowski and Raphaël Louage,  
LPEA Associate Members**

Sincerely,

Paul Junck  
Managing Director, LPEA

## About LPEA

LPEA is a non-profit organization serving a threefold mission:

- Towards its members, represent and promote the interests of Private Equity and Venture Capital players based in Luxembourg;
- Towards Luxembourg, support government and private initiatives to enhance the attractiveness, competitiveness and efficiency of the Luxembourg economic, legal, regulatory and operational framework as an international hub for carrying out Private Equity and Venture Capital business and / or servicing the industry in all its dimensions.
- Towards the European Venture Capital and Private Equity Association (EVCA) and other relevant international industry bodies, represent the interests of the members of the LPEA and the industry as well as Luxembourg as a place for doing Private Equity and Venture Capital business.

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