Bill of Law implementing AIFMD now deposited with Luxembourg Parliament

On 24 August 2012, the bill of law (the "**Bill**") transposing the AIFM Directive[1] was submitted to the Luxembourg Parliament for approval.

The Bill purports to faithfully transpose the provisions of the AIFM Directive while also introducing a number of innovations which are designed to facilitate and improve the development of the alternative investment funds industry as a whole.

The Bill is expected to be adopted at the end of 2012, which is 6 months before the deadline for the AIFM Directive to be implemented and applied in all EU Member States. By transposing the AIFM Directive into law still in 2012, Luxembourg authorities intend to allow enough time for the industry to prepare for complying with any new requirements.

We have selected from the Bill a few topics which we consider of particular interest and have, for each of them, briefly developed what we deem to be their salient points and features:

- the overall structure of the Bill;
- the new regime applicable to Managers;
- the new regime applicable to Depositaries;
- the new Special Limited Partnership;
- the new Carried Interest regime.

For the purpose of this Newsflash, a "**Full Scope AIF**" refers to an alternative investment fund which qualifies as alternative investment fund ("**AIF**") under the AIFM Directive and which, on the basis of the provisions of the Bill, is required to be managed by a duly authorised AIFM (including AIF the AIFM of which benefits from, but has made no use of, the "small manager" derogation provided for in Article 3.2 of the AIFM Directive which has introduced certain *de minimis* thresholds).

[1] AIFM Directive means Directive 2011/61/EU of 8 June 2011 on alternative investment fund managers.

I. The overall structure of the Bill

Although the AIFM Directive is more a "manager" directive than a "product" directive, it comprises a number of provisions which impact not only the managers but also the investment vehicles (the AIF) they manage.

This is principally the reason why the Bill does not only transpose the AIFM Directive (Articles 1-59), but also amends a number of other existing laws such as Part II of the UCI Law (Articles 60-125), the SIF Law (Articles 126-152), the SICAR Law (Articles 153-172) and the Pension Fund Laws (Articles 173-177).

The changes made by the Bill to Part II of the UCI Law, the SIF Law and the SICAR Law aim to a large extent at distinguishing between, on one hand, those Part II Funds, SIFs and SICARs that are Full Scope AIF (where the "product" requirements of the Directive apply) and, on the other hand, those Part II Funds, SIFs and SICARs that are either not AIF (this can only be the case for SIFs and SICARs because the Bill provides that all Part II Funds qualify as AIF) or, that are AIF but are managed by a manager with assets under management less than the *de minimis* thresholds introduced by the Directive. For the latter Part II Funds, SIFs and SICARs, the requirements remain substantially unchanged compared to their current regimes (including their depositary regime, see Section III of this Newsflash).

A new non-UCITS and non-AIFM management company regime is introduced by the Bill through an amendment of the current Chapter 16 of the UCI Law (see Section II.4. of this Newsflash).

The Law on the Financial Sector is also amended (Articles 178-179) principally to introduce a new type of Depositary (see Section III. of this Newsflash). Amendments are also made to the Company Law (Articles 182-194) principally to introduce the new Special Limited Partnership (see Section IV of this Newsflash). Finally, amendments are made to certain tax laws (Articles 202-208) in order to introduce a new carried interest regime (see Section V of this Newsflash).

Overall, the Bill reflects a consistent approach to avoid any so-called super equivalence or gold plating, meaning that the AIFM Directive is implemented substantially without any provisions which are more restrictive than the terms of the AIFM Directive. On the other hand, in those areas which are not covered by the AIFM Directive, changes have been proposed to increase the efficiency of the Luxembourg legal, tax and regulatory framework.

II. The new regime applicable to Managers

Upon the transposition of the AIFM Directive, and in combination with the UCITS provisions, different regulatory regimes will be available to managers established in Luxembourg and providing collective portfolio management services:

1. UCITS Management Companies

   UCITS Management Companies, as regards their authorisation and permitted activities, remain governed by the UCITS laws and the Bill does not impact these, except as mentioned under 3. below.

2. AIFM

   This is the new regime introduced by the AIFM Directive and pursuant to which all managers managing and/or acting as management company to Full Scope AIFs with assets exceeding the *de minimis* thresholds introduced by the Directive need to be authorised as AIFM. Managers managing and/or acting as management company to AIFs with assets below the *de minimis* thresholds can opt-in into this regime to have the benefit of the EU passport which the AIFM Directive confers to AIFM.

3. UCITS Management Companies also authorised as AIFM.

   This is the "super licence" permitting a manager to manage and act as management company to both UCITS and AIF.

4. Other Management Companies

   This is to some extent the equivalent of the current non-UCITS management companies under Chapter 16 of the UCI Law (which is repealed under the Bill) but with extended types of activities. These management companies may, in summary:

   (a) act as manager or management company to any type of investment vehicle which does not qualify as AIF, including therefore investment vehicles, whether regulated or not, whether Luxembourg or foreign, that do not fall under the definition of an AIF under the AIFM Directive;

   (b) act as management company for one or more FCP, SICAV or SICAF that are Full Scope AIF, provided it has designated, on behalf of such Full Scope AIF, a fully authorised AIFM;

(c) act as manager or management company to AIFs the aggregate assets of which are less then the *de minimis* thresholds introduced by the Directive. In the case where the aggregate assets under management would exceed the *de minimis* thresholds or if the manager would like to opt-in into the AIFM regime, it would have (i) to seek authorisation as AIFM (as per 2. above), and (ii) cease the activities under (a) above, as these (management of non AIF) are not activities permitted to be undertaken by an AIFM.

The Bill provides that these management companies may not provide the services under (a) without also providing the services under (b) or (c), unless the investment vehicles referred to under (a), e.g. not qualifying as AIF, are Part II Funds, SIFs or SICARs. This restriction aims at avoiding that a management company authorised by the CSSF would solely manage non regulated investment vehicles (such as SOPARFIs).

These other management companies, if they pursue the activities under (c) above, are subject, in addition to the CSSF authorisation procedure set forth by the Bill, to the specific reporting requirements provided for by the AIFM Directive.

III. The new regime applicable to Depositaries

1. The Bill introduces a new depositary regime for Full Scope AIFs, whilst maintaining the current regime for those funds that are not Full Scope AIFs.

   - The Bill introduces a new depositary regime by transposing almost *expressis verbis* the text of the relevant AIFM Directive provisions and to which will only be subject the depositaries of Full Scope AIFs.

   - Subject to a few adjustments (investment firms and non-EU Luxembourg branches, e.g.), the Bill maintains the current depositary regime for those Part II Funds, SIFs and SICARs that are not Full Scope AIFs.

   <u>*Note*</u>*: The "common depositary regime" applicable to all non-UCITS funds proposed in early working drafts of the Bill has been abandoned to avoid super equivalence or gold plating in respect of funds that are not impacted by the AIFM Directive .*

2. The Bill extends the list of eligible depositaries.

   - The Bill exercises the option given by the last paragraph of Article 21(3) of the AIFM Directive and introduces the professional depositary of assets other than financial instruments.

The activity of this new specialised PSF is defined as that of providing depositary functions for funds which (i) are closed-ended for a period of 5 years from the date of their initial investments and (ii) do generally not invest in assets to be held in custody within the meaning of Article 21 (8) (a) of the AIFM Directive or generally seek to acquire the control over the issuers or non-listed companies (e.g., mainly private equity and real estate funds).

This activity is among other compatible with that of communication, register, administration and/or domiciliary agent, and is subject to a minimum capital requirement of 500,000 Euros.

- In addition to the new specialised PSFs described in the previous paragraph, the eligible depositaries are Luxembourg established credit institutions (as in the current depositary regime), but also (contrary to what had transpired from early working drafts of the Bill) Luxembourg established investment firms fulfilling the requirements of Article 21 (3) (b) of the AIFM Directive and certain additional requirements set forth in Article 19 (3) i) of the Bill.

IV. The new Special Limited Partnership

The Bill introduces a new type of investment vehicle, namely the Special Limited Partnership (the "SLP"), in French the *société en commandite spéciale*.

The SLP is a partnership entered into by one or more general partners (GP) with unlimited and joint and several liability for all the SLP's obligations, with one or more limited partners (LPs) contributing only a specific amount pursuant to the provisions of the limited partnership agreement (LPA). It does not constitute a legal person separate from that of its partners.

The SLP may be used by regulated and non-regulated entities whether qualifying as alternative investment funds under the AIFM Directive or not. Thus, regulated investment vehicles such as the SIFs and SICARs may adopt the legal form of the SLP with the inherent structural and tax advantages which this new type of investment vehicle will entail. Similarly, non-regulated SOPARFIs may also adopt this legal form.

(a) Few mandatory rules - Predominance of the LPA

The mandatory provisions relate inter alia to (i) the keeping and content of a register of partners, (ii) information (excluding on LPs) to be published, (iii) limited causes of voidance only and (iv) the manner inscriptions and other formalities regarding the SLPs's assets are made.

All other aspects of the SLP such as inter alia the type of partnership interests, timing, method and type of contributions, timing and extent of distributions and reimbursements or exclusions therefrom, claw back rules, political rights, LP matters and information, reduction and redemption of partnership interests, can be determined by the LPA to be agreed upon by the partners.

(b) *Management of the SLP and role of LPs*

The new regime gives GPs the right to manage the SLP, but not the obligation to do so. If the appointed manager is not a GP, the manager is considered as an agent (*mandataire*) liable only for the execution of its mandate (with the possibility to arrange for delegation) and for any misconduct in the management of the SLP's affairs.

The new regime contains a non-exhaustive list of actions that may be taken by LPs that shall not be considered as management actions and thus shall not jeopardise their limited liability.

(c) *Tax features of the SLP*

The SLP is tax transparent for Luxembourg income and net wealth tax purposes. Further, if the GP is a Luxembourg limited liability company holding less than 5% of the partnership interests, the SLP is not subject to Luxembourg trade tax either.

Management services rendered to a regulated SLP (such as a SIF or a SICAR) are exempt from Luxembourg VAT.

It is expected that this new type of vehicle will put Luxembourg on equal footing with those jurisdictions which offer the anglo-saxon type limited partnership which has traditionally been the favoured investment vehicle for structuring private equity investments.

V. The new Carried Interest regime

The Luxembourg government has proposed to introduce a new framework for taxation of "carried interest" income from AIFs consisting in profit participations paid to employees of management companies of AIFs or employees that carry out management functions as employee or managing director of an AIF or AIFs manager ("Qualifying Persons").

The new rules concern any share in capital gains made by an AIF granted to Qualifying Persons ("*intéressement aux plus-values*") and gains realised by the Qualifying Persons upon the sale of securities of the AIF which they may be holding.

The proposed tax regime provides that such income linked to gains realised by the AIF is taxed at a favourable tax rate which is 25% of the marginal tax rate, but eligibility for this tax regime is subject to a number of conditions (including among others, full return of committed capital to investors prior to payments to employees and conditions pertaining to tax residency). It is also proposed to limit the favourable rate in time, in principle to a maximum period of 11 years from the first year where it has been applied to an individual. The proposed rules for taxation of gains realised by Qualifying Persons upon the sale of securities of the AIF merely duplicate the existing tax treatment with respect of sale of securities.

The proposed new rules applying to such income are complex and the applicable tax rate may be less advantageous than the taxation of capital gains derived from the sale of securities of the AIF subscribed by such Qualifying Persons. Indeed, in the latter case Qualifying Persons will benefit from tax exemption (with the exemption of holding a substantial shareholding i.e. a holding in excess of 10% of the capital). A problem may still arise if Qualifying Persons receive shares or other securities for which no real subscription price was paid, since such allocation would normally qualify as salary and be fully subject to tax at normal rates.

The main merit of the proposal is to clarify that for the carried interest which satisfies the conditions set out in the proposed law, the Luxembourg tax authorities will not be allowed to consider that such income should be re-characterised as salary and be taxed at the normal marginal rates.

The Bill is still to be discussed by the Parliament and amendments may still be proposed by various bodies that advise on the proposed law until it is finally adopted.

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The Bill is currently only available in French (click here to consult the Bill). An English translation will be available on our website shortly.