Certain hallmarks are subject to the main benefit test[29]. According to the International Securities Lending Association ("ISLA"), there is a general consensus among its members that ordinary securities lending transactions are not structured with a main benefit of obtaining a tax advantage[30].

As securities lending transactions do not in general involve related parties[31], we would not expect hallmarks C (concerning cross-border transactions between related parties) and hallmarks E (related to transfer pricing) to be applicable. Hallmarks D should also not be relevant for securities lending transactions provided that counterparties provide all relevant common reporting standard documentation. This obviously needs to be analysed and tested on a case-by-case basis.

As far as swaps are concerned, they can also result in a conversion of income due to the payment under the swap that could somehow convert any type of income received by an entity into a swap payment. If the parties engaged in the swap agreement are related parties in the meaning of DAC 6, certain DAC 6 hallmark may be impacted.

Bear in mind that under DAC 6 the reporting obligation mainly lies on intermediaries. Financial institutions facilitating or helping with the implementation of financial products may be acting as intermediaries involved in the set-up or implementation of a potentially reportable cross-border arrangement as defined under DAC 6 and may seek to leverage on existing tax risk governance procedures to identify arrangements that may trigger a reporting obligation under DAC 6[32].

29 This test will be satisfied if it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage.

30 Please refer to the ISLA DAC 6 Position Paper issued in 2020.

31 In accordance with the definition of the DAC 6 Directive, "associated enterprise" means a person who is related to another person in at least one of the following ways: (a) a person participates in the management of another person by being in a position to exercise a significant influence over the other person; (b) a person participates in the control of another person through a holding that exceeds 25 % of the voting rights; (c) a person participates in the capital of another person through a right of ownership that, directly or indirectly, exceeds 25 % of the capital; (d) a person is entitled to 25 % or more of the profits of another person.

Conclusion

As already mentioned in the first part of this contribution, more than ever before, the use of securities lending transactions and swap instruments needs to be monitored and adapted to be aligned with new requirements stemming from the changing international and European tax environment. Although these technics remain efficient financial instruments in period of low return or when a market player wishes to hedge risks or minimize the uncertainty of certain operations, it is fair to state that today the rules are stricter and require taxpayers and tax professionals to manage some tax risks. Tax authorities now benefit from a broader arsenal of legislation and mechanisms that help them protect their tax base. In addition, some reporting obligations could induce taxpayers to reconsider the use of such instruments.

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CIV exemption in ATAD II: Is it worth the hype?

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According to the Association of the Luxembourg Fund Industry (ALFI) the total assets under management in Luxembourg domiciled investment funds hit an all-time record of EUR 5,050.132 billion as at 31 January 2021, which confirms again, despite the COVID-19 impact on the global economy, the leading position of Luxembourg in cross-border distribution of funds and the country's attractiveness as an international centre for investment funds.

Luxembourg has consolidated its leading position for structuring alternative investment funds by being one of the first countries to implement the Alternative Investment Fund Managers Directive[1] (AIFMD) into domestic

1 Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers, amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

law[1] in 2013 and by revamping the limited partnership regime to make it more efficient and attractive for the fund industry with the introduction of the Special Limited Partnership ("SCSp"). As the tax and legal transparency of the SCSp offers wide structuring flexibility and enables sponsors to tailor the fund structure to fit their specific needs, the SCSp has significantly expanded in popularity and quickly became the vehicle of choice for both regulated and unregulated funds. According to the 2020 ALFI survey on Luxembourg Real Estate Investment Funds, the SCSp and the Common Limited Partnership ("SCS"), (another form of Luxembourg tax-transparent entity) have continued to increase in popularity since the 2013 Luxembourg law, with 52% of the surveyed funds incorporated under these legal forms (against 46% in 2019).

Not surprisingly, the introduction into Luxembourg law of the second Anti-Tax Avoidance Directive ("ATAD II")[2] providing for an arsenal of anti-hybrid mismatches which targets – amongst others – Luxembourg tax transparent entities that are treated as tax opaque from the perspective of the investors' jurisdiction, was immediately a matter of concern for the Luxembourg fund industry. First, because these questions can be extremely complex to tackle in the context of multi-jurisdictional structures (taking into account the wi+de variety of investors and investment jurisdictions) and have an impact on the financial performance of the funds, but also because one of the possible tax adjustments called to neutralise this hybrid mismatch would trigger the taxation of the fund vehicles themselves, which is obviously a major concern for fund managers and distributors.

This results from the so-called "reverse hybrid entity rule" ("RHER") which can be particularly detrimental for collective investments as they are supposed to rely on tax neutrality which is key for international tax policy considerations. Tax neutrality means that investors should not be subject to additional taxation beyond what they would have incurred had they invested directly into the relevant assets. This is likely the reason why ATAD II provides for a carve-out for collective investment vehicles ("CIV") which has been faithfully incorporated in the Luxembourg implementation law. However, the notion of CIV has always struggled for a clear definition since the launch of the Project on Taxation of CIV by the Organisation for Economic Co-operation and Development (OECD) in 2006[3].

This article intends to further delineate the notion of CIV in the context of ATAD II and most specifically of the RHER as implemented in Luxembourg law. Before analysing in detail the exact scope of the carve-out provided for CIV, the authors will focus on the root of the notion of CIV to shed some light on the rationale behind the CIV exemption.

1. The Scope of the RHER in Luxembourg law

The law dated 20 December 2019 ("ATAD II Law") introduced the RHER in the Luxembourg income tax law[4] ("LITL") through Article 168*quater*. It provides that established Luxembourg tax transparent entities - such as the SCS and SCSp - that are treated as tax opaque in the jurisdiction of their *associated enterprises*[5], holding in aggregate a direct or indirect interest of 50% or more of the voting rights, capital interests or rights to a share of profit in these tax transparent entities, shall be subject to corporate income tax on their income to the extent that such income is not otherwise taxed in Luxembourg or in any other jurisdiction.

However, tax transparent entities such as SCS/SCSp that qualifies as CIV as defined in Article 168*quater* LITL, remains outside the scope of the RHER and will thus not be subject to any tax adjustment as a result of its hybrid tax qualification (the "CIV Exemption"). This important derogation, which is in line with ATAD II, defines CIV as investment funds or vehicles that are "*widely held, hold a diversified portfolio of securities and are subject to investor-protection regulations in the country in which they are established*".

It follows that an investment fund or a vehicle must have the following three cumulative characteristics to qualify as a CIV:

(i) It is widely held;
(ii) It holds a diversified portfolio of securities; and
(iii) It is subject to investor-protection regulations in the country in which it is established.

The introduction of the CIV Exemption was first highly welcomed by the Luxembourg fund industry but the enthusiasm faded as it brought along many questions that remain outstanding.

ATAD II Law definition of CIV is only a *verbatim* transposition of the definition provided in ATAD II without adding further details and the latter only itself replicates the one provided in the 2010 OECD report on treaty eligibility for investors in CIV[6] (the "2010 Report") which already left

1 Luxembourg Law of 12 July 2013 on alternative investment fund managers.
2 EU Council Directive 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.
3 See Mandate of the informal consultative group on taxation of collective investment vehicles and procedures for tax relief for cross-border investors dated May 2007, which defines the CIV as "*funds that are widely held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are organized.*"
4 Luxembourg Income Tax Law of 4th December 1967, as amended.
5 Within the meaning of Article 168*ter* of the LITL
6 See paragraph 4 of the OECD report "*The granting of treaty benefits with respect to the income of collective investment vehicles*" (adopted by the OECD committee on fiscal affairs on 23 April 2010).

governments back at that time with the same queries unanswered, e.g. what would be the threshold for determining that a fund is *widely held*; to what extent a portfolio could be considered as *diversified*; what exact type of assets could be considered as *securities*; what level of investor-protection legislation is required to be present, etc..

Eventually, no clear guidelines could be found in ATAD II Law, ATAD II or the 2010 Report regarding the scope of each of the above three criteria.

Nonetheless, some comments made by the ATAD II Law legislator as well as the OECD's extensive work on CIV and non-CIV treaties entitlement may put some flesh on the CIV concept in the context of the RHER. As mentioned in the base erosion and profit shifting (BEPS) report for Action 2 delivered in 2014[7], the 2010 Report contains extensive analysis of the application of treaty provisions to CIV and includes mismatch situations, where a CIV may be viewed as a hybrid entity.

2. The rationale underpinning the CIV Exemption

2.1. In the context of treaty access

The treaty access of CIV has been highly discussed over the last decade. Investing through a CIV brings several advantages for small investors (cost efficiency, diversification of risk, liquidity of investment…) that could not be obtained in the context of a direct investment.

In this context, the starting point of the OECD work on the eligibility of CIV to treaty benefits was to preserve the governing principle of tax neutrality of investments funds and address under which conditions the latter may have access to treaty benefits. Tax neutrality in the jurisdiction where the fund is established averts a duplication of taxation, maintaining the attributes of an investor investing directly rather than through an investment fund.

It is true that a fund should be seen as an aggregation of capital rather than a distinct taxable entity and such perspective underlies many of the rules allowing exemption for funds in general. Indeed, most CIV tax regimes provide exemption from corporate taxes at the fund level, either explicitly (e.g. the Luxembourg funds that are subject to a subscription tax) or through broad exemptions from tax on types of income. Where investors would be able to obtain treaty benefits in the case of a direct investment, they should not be penalised when investing collectively. However, in a cross-border context, such exemption from corporate taxes may undermine the tax residency of the fund and entail difficulties in claiming treaty benefits. Further complications may also appear where some States have diverging views on the tax residency of the same fund for treaty purposes due its legal form (tax transparent *vs* tax opaque entity). As taxation can significantly affect the financial performance of a CIV, these questions are a crucial issue for investors.

This said, double tax treaties are also meant to prevent tax avoidance. Thus, the challenging part of the OECD work was also to ensure that CIV, which are generally not subject to substantial taxation in their home jurisdiction, do not serve as vehicles for treaty shopping.

Against this background, the OECD opened the door for CIV to claim treaty access for as long as 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*" with the underpinning rationale that these CIV would not create opportunities for treaty shopping since (i) they are not principally used in order to obtain treaty access and (ii) they should always meet the "genuine activity" criteria.

This definition totally fitted with the common conception of investment funds at that time. At European level, this definition typically covered CIV set up as Undertakings for Collective Investments in Transferable Securities (UCITS), the only type of investment funds which benefit from a European regulatory framework until the advent of the AIFMD which provides an indirect regulatory framework for alternative investment funds (AIF).

However, different fund archetypes (i.e. funds that, at first glance, may not comply with the three criteria mentioned above) continue to develop for institutional and sophisticated investors, such as pension funds, sovereign funds, private equity houses... These "unrecognised" CIV are highly diverse in structure and asset classes and subject to different levels of regulations and tax regimes depending on their country of origin. This observation led the OECD to include these non-CIV funds in its work stream on treaty entitlement[8], but it derives from the OECD-related documents[9] that there is no consensus so far on a clear distinction between CIV and non-CIV structures. As a result, the OECD failed to find an all-encompassing definition for Non-CIV structures that would be acceptable to all countries.

At the end of the day, it results from the Trace Implementation Package approved by the OECD Committee on Fiscal Affairs on 23 January 2013 (the "Trace Implementation Package")[10] that governments are free to determine

7 OECD (2014), Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, introduction, para. (37).

8 See Public discussion draft on treaty entitlement of non-CIV funds, 24 March 2016.

9 See for instance, Comments received on Public Discussion Draft, Treaty entitlement of non-CIV funds, 22 April 2016.

10 Trace Implementation Package for the adoption of the authorised intermediary system, a standardised system for effective withholding

strada lex

the types of vehicles that may be considered as CIV by giving a list or a general definition[11].

2.2. In the context of the RHER

RHER of Article 168*quater* LITL stems from the specific recommendation 5.2 of the BEPS report for Action 2 which would apply where "*a tax transparent person is controlled or otherwise owned by a non-resident investor and that investor is not required to take into account payments of ordinary income allocated to them by that person. The rule effectively encourages jurisdictions to turn off their transparency rules when those rules are* primarily used to achieve hybrid mismatches *(emphasis added)*."[12] Recommendation 5.2 has therefore been specifically designed to cope with tax avoidance attempts by non-resident investors. Having considered this, the Article 168*quater* LITL (being itself a reproduction of Article 9a of ATAD II) provides for the CIV Exemption likely for the same rationale that underpins the CIV eligibility to treaty, that is those CIV are not considered as enabling tax avoidance.

Not to mention that it would be an undue overwhelming administrative burden for such CIV to track the residence and tax status of each of its investors to find out if the latter benefit from a mismatch in tax outcomes arising from countries' different tax treatment.

3. Detailed review of the three criteria of the CIV definition

3.1. Opening comments

As previously mentioned, eventually, it will be up to the governments to determine which funds qualify as CIV. However, while most Member States implemented ATAD II's hybrid rules as from 1 January 2020, the application of the RHER can be delayed further by two years (i.e. till 1 January 2022) and with half a year to go before the implementation deadline, there still seems to be a lot of uncertainty about the scope of the CIV notion and impact of the RHER. Some Member States, (e.g. Germany, France) have not yet provided any drafts on the implementation of these rules, while others, such as Belgium or Italy, did not give any further indication as to the meaning of this CIV concept within the context of the implementation of the RHER[13]. The UK, which implemented anti-hybrid rules way before Member States, has not yet implemented specific rules for reverse hybrids either and although the existing rules would catch reverse hybrid situations in some circumstances, there is no CIV Exemption in these rules.

With respect to Luxembourg, the Luxembourg legislator specifies in the commentaries to the draft ATAD II Law[14], that Luxembourg regulated investment funds, i.e. Undertakings for Collective Investments (UCIs) established under part I and II of the law of 17 December 2010 on UCIs, specialised investment funds (SIF) governed by the law of 13 February 2007 on SIFs and reserved alternative investment funds (RAIF) governed by the law of 23 July 2016 on RAIFs, qualify as CIV by contrast with AIF as defined by the law of 12 July 2013 on AIFM (and not covered by any of the above-mentioned product laws), which are CIV to the extent that they feature the three related criteria mentioned above (i.e. *widely-held*, diversified portfolio of *securities* and investor protection rules).

This position is actually consistent with the one taken by Luxembourg with respect to tax treaties as it considers UCIs, SIF and RAIF (of course, in opaque form) as tax resident for tax treaty purposes and managed to include an explicit provision to deal with the application of the tax treaty to CIV in a certain number of its double tax treaties. As documented in a Circular[15] issued by the Luxembourg tax administration in 2017, double tax treaties with 56 jurisdictions should be applicable to a Luxembourg SICAV (some double tax treaties also provides an opportunity for FCP, as tax transparent funds, to obtain certificates of residence under certain conditions).

For the purpose of this article, the authors will therefore not further elaborate on the CIV Exemption with respect to UCIs, SIF and RAIF which appear to be considered *per se* as CIV by the Luxembourg legislator in the context of the RHER.

For AIF, however, the Luxembourg legislator clearly states that the three tests (*widely-held*, diversification portfolio of *securities* and investor protection rules) must be passed in order to qualify as CIV.

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tax relief procedures for cross-border portfolio income, approved by the OECD Committee on Fiscal Affairs on 23 January 2013, p. 113.

11 The Trace Implementation Package is part of the Trace Project which has been implemented in 2006 by the Committee on Fiscal Affairs and the Business and Industry Advisory Committee in order to improve the process by which portfolio investors may claim treaty benefits. This led to the creation of:

(i) An Informal Consultative Group ("ICG") which releases two reports: (a) the 2010 Report and (b) the Report on "Possible Improvements to Procedures for Tax Relief for Cross-Border Investors".

(ii) The Pilot Group's mandate was to develop standardised documentation for the implementation of the best practices as recommended in the ICG's reports. The Pilot Group prepared a draft "Implementation Package". The Implementation Package (approved by the OECD in 23 January 2013) was a self-contained set of all of the agreements and forms that would pass between a source country and the financial intermediaries and investors participating in the system.

12 See paragraph 175 of BEPS report for Action 2.

13 It can be noted, however, that the Belgian tax authorities have granted rulings in the past on the distinction between investment vehicles and ordinary holding vehicles in which the key elements have been (i) plurality of investors, (ii) plurality of investments, (iii) a short term investment outlook (i.e. no intention to hold on to the investments long term), and (iv) no intention to form a group with the underlying companies in which the investment vehicle invests. One may expect that these elements would be the main criteria assessed by the Belgian tax authorities to establish whether a vehicle can qualify as a CIV.

14 Commentaries to the Bill of law n° 7466 implementing ATAD II into domestic legislation, p. 28.

15 Circular L.G-A n° 61 of 8 December 2017.

While other investment funds (insofar as they do not qualify as AIF), such as investment companies in risk capital (SICARs), have not been specifically mentioned by the ATAD II Law legislator, in the author's view, this should not be interpreted in a restrictive way and as for AIF, such a fund could also benefit from the CIV Exemption as long as it meets the three related criteria.

The authors shall therefore examine the scope of the three criteria of the CIV Exemption more specifically from an AIF (not subject to any product laws[16])'s perspective. To this end, the follow-up work carried on by the OECD further to the issuance of the final report on Action 6, focusing on the treaty entitlement for non-CIV, brings some interesting perspective.

3.2. The *widely-held* test

It results from the OECD documents relating to CIV and non-CIV entitlement to tax treaty[17] that the *widely-held* criterion is included repeatedly and extensively discussed, which would suggest that this feature is the cornerstone of the CIV definition.

This approach is clearly sensible in that a *widely-held* fund is not suitable for treaty shopping purposes since the risk that a single investor or a group of investors could control or influence the fund or investments of the fund to derive tax benefits is anecdotal. It results from the Public Discussion Draft on Treaty Entitlement of Non-CIV Funds dated 24 March 2016 ("OECD 2016 Draft") that some contributors even consider that the mere fact that a fund would be *widely held* would offer sufficient protection against treaty abuse[18].

This rationale could undeniably apply to the CIV Exemption.

Furthermore, as mentioned previously, *widely held* funds will face practical issues that they may not overcome if they are required to track the tax position of the underlying investors where there are investments through other funds or nominees e.g. platforms, wealth managers, brokers, so that the beneficial owner of the investment returns may change on a daily basis. This is particularly important where the fund is *widely held* since it would be unrealistic or uneconomical to perform tax enquiries for every investor.

This is why an exemption from the RHER would be particularly relevant for *widely held* funds.

That said, it must be determined to what extent a fund could be considered *widely held* as there is no concrete definition taking into account the fund structure, the nature of the fund and its investors, the time of assessment, etc.

- Type of investors

First regarding the type of the investors, it is worth noting that the ATAD II Law legislator did not exclude funds that are restricted to a certain type of investors from the scope of the CIV Exemption. Reference is indeed made to a SIF or a RAIF for which the Luxembourg legislator seems to take the stand that they qualify as CIV so that an AIF whose securities are only distributed to sophisticated investors (as is the case for the SIF/RAIF), could still be considered as *widely held*.

- Minimum threshold

Another challenge is to find out what would be the most appropriate approach to determine if a fund is *widely held* knowing that investment funds are established in a wide variety of ways, depending on the circumstances, catering for different types of investors and often involving different types of feeder funds and intermediaries for various commercial reasons.

Besides, one should not overlook the fact that the *widely held* criterion (i) is a first bulwark for tax avoidance and (ii) expresses the practical difficulties for *widely held* funds to trace their investors and the administrative costs they would bear to do that.

Having regard to these specificities, the *widely held* test should in the authors' view, rely on an intentional component as much as on a factual component.

– The intentional component: the *widely held* test should consider the genuine marketing intention of the fund. The in-scope scenario would be a fund that is being actively marketed with a view to becoming *widely held* - even though to a specific intended category of investors.
  In order to assess this intentional component, the UK test on the "genuine diversity of ownership" for property authorised investment funds, tax elected funds and qualified investor schemes could be of some interest. According to HMRC[19], this test protects against tax manipulation using funds controlled by a small number of investors[20]. There are three requirements for the "genuine diversity of ownership" condition to be met:
  - The fund's documentation must state that the fund will be marketed and made available to a target market, which includes a large number of unconnected persons;

16 The law of 17 December 2010 on UCIs, the law of 13 February 2007 on SIFs and the law of 23 July 2016 on RAIFs.

17 See inter-alia, Trace Implementation Package; Public discussion draft on Treaty Entitlement of non-CIV Funds dated 24 March 2016; Comments received on Public Discussion Draft on Treaty Entitlement of non-CIV Funds dated 22 April 2016; Public Discussion Draft BEPS Action 6 discussion draft on non-CIV examples; Comments received on Public Discussion Draft BEPS Action 6 - Examples on Treaty Entitlement Of non-CIV Funds, 3 February 2017.

18 See point 8 of the OECD 2016 Draft.

19 Her Majesty's Revenue & Customs.

20 HMRC's published International Manual IFM17100.

- The terms and conditions of the fund should not be set in such a way as to limit investors to a select group within the stated categories of investors by deterring a reasonable investor within the target market from investing in the fund (e.g. where charges differ for particular investors and the charges are such that a potential investor within a target category could not reasonably be expected to invest);
- The fund must be marketed and made available sufficiently widely to reach, and in an appropriate manner to attract, the intended categories of investors (e.g advertisements mentioning the fund in relevant publications, online or on posters, direct mail packs sent to the target market and/or their advisers which specifically promote the fund, events for intended categories of investors and/or their advisers featuring content relating to the fund).

The above three criteria could be well applied for purpose of the *widely held* test.

The key advantage of this approach is that it includes scenarios that would wrongly and unfairly fail the *widely held* test if the latter was only a matter of number or percentage. This would be the case for funds in a start-up period when they are "seeded" by a selected group of investors or when the fund is in the wind-up period prior to termination or funds that face the commercial challenges in attracting funding. Those periods or events can limit the number of actual investors.

Furthermore, this approach would not undermine the mainspring of the CIV Exemption which is to carve out a case representing a low risk of tax avoidance. In effect, investors would not generally seek opportunities for tax avoidance in a fund that is meant to be *widely held* because there is obviously no guarantee that they would have any control over the fund.

– The factual component: In some cases, however, the fund is restricted to a limited number of investors but those investors themselves turn out to be *widely held* entities. This is typically the case for institutional investors (such as pensions funds and sovereign wealth funds) that would be acting as nominees on behalf of other investors. Those institutional investors should not be considered as single investors. This is also the case for funds held through tiered structures. For instance, in a master/feeder structure, a single direct investor may be acting as a feeder fund for a large number of unconnected third-party investors. In this respect, the 2010 Report specifically addresses this issue considering that the CIV definition also covers *"master" and "feeder" funds that are part of "funds of funds" structures where the master fund holds a diversified portfolio of investments on behalf of the feeder funds"*. Furthermore, it is not uncommon that limited partnerships or other entities invest in parallel in underlying investments in proportion to the investors' commitments to each fund vehicle. These "parallel funds" are often formed to accommodate specific regulatory, legal or other commercial considerations in respect of certain groups of investors.

  Having regard to those cases, the *widely held* condition should be set by reference to the nature of the investor so that interests held by institutional investors or investors in parallel funds, feeder funds and other related fund entities, should be taken into account when evaluating the investor composition of a particular fund and determining whether such a fund is *widely held*.

For practical purposes, a minimum threshold could be fixed by reference to a number or a percentage. Many commentators on the OECD 2016 Draft[21] suggested laying down a minimum threshold by reference to both a number and a percentage in order to avoid a risk of control concentration.

It is interesting to note that the UK concept of "Close company", which has been reported several times in the comments received on the OECD 2016 Draft, illustrates this overall approach. In the UK, for the purposes of the investment manager exemption, HMRC applies a widely held test for purposes of showing the independence of the fund and its UK investment manager. In this context, a fund is widely held "*if either no majority interest in the fund is ultimately held by five or fewer persons and persons connected with them, or if no interest of more than 20% is held by a person and persons connected with him. The fund may need to establish a track record before new investors are obtained and will therefore have 18 months from the commencement of trading in the UK to meet the widely held test*."[22] The fund could also meet the test if it is being actively marketed with a view to becoming widely held. Furthermore, there would have other ways of demonstrating independence, some of which may include consideration of the widely held status of ultimate investors.

This would be, in our view, a realistic and fair approach to the *widely held* criterion.

As previously mentioned, the UK has not yet implemented specific rules for reverse hybrids so it remains to be seen whether it will provide an exemption for CIV in the future and if so, if the *widely held* test will include similar thresholds.

21 Comments received on Public Discussion Draft on Treaty Entitlement of non-CIV Funds dated 22 April 2016.

22 HMRC's published International Manual INTM269100.

3.3. The diversified portfolio of securities requirement

- Level of requirement

AIF are not subject to any risk diversification requirements from a regulatory perspective.

Obviously, if the AIF complies with existing regulatory risk diversification requirements applied to funds subject to a Product Law, they should be considered as passing the *diversification* test for RHER purposes.

For instance, if the AIF is intended to be distributed to sophisticated investors (which is generally the case in practice), the risk-spreading requirements applicable to a SIF/RAIF resulting from the Commission de Surveillance du Secteur Financier (CSSF) Circular n° 07/309[23] would then be considered the highest standard of requirements applicable in this case[24].

However, in the author's view, the diversification requirements for the purposes of the CIV Exemption do not have to be patterned after existing regulatory requirements since this would not provide better protection against tax avoidance.

Indeed, the *diversification* criterion is not as relevant as the *widely held* one in the context of the RHER because no matter what the investments strategy is, this should not influence the tax qualification of the reverse hybrid entity. Conversely, in the context of treaty eligibility, depending on the jurisdiction of the investments, the investors may not have treaty access if they had invested directly which is more conducive to tax avoidance strategies.

The *diversification* test in the context of the RHER would rather be to ensure that the fund is genuine to the extent that one of the main purposes and advantages of investing through a fund is to blend different investments in a single portfolio so as to earn the highest plausible return while reducing overall risks in a cost-efficient way.

[23] Circular of the Commission de Surveillance du Secteur Financier on risk-spreading in the context of SIF dated 3 August 2007.

[24] According to the CSSF Circular No. 07/309, a SIF may not invest more than 30% of its assets or commitments to subscribe securities of the same type issued by the same issuer. This restriction does not apply to (i) investments in securities issued or guaranteed by an OECD Member State or its regional or local authorities or by EU, regional or global supranational institutions and bodies and (ii) investments in target UCIs that are subject to risk-spreading requirements at least comparable to those applicable to SIFs.

- Short sales may not, in principle, result in the SIF holding a short position in securities of the same type issued by the same issuer representing more than 30% of its assets.
- When using financial derivative instruments, the SIF must ensure, via appropriate diversification of the underlying assets, a similar level of risk-spreading. Similarly, the counterparty risk in an OTC transaction must, where applicable, be limited having regard to the quality and qualification of the counterparty.

- Level of assessment

In the same way as the *widely held* test, the *diversification* test should rely on an intentional component as much as on a factual component.

The *diversification* test should consider the genuine investment strategy as described in the marketing material of the fund. Both the *widely held* and the *diversification* criteria are intrinsically linked from an economic perspective. The more investors invest in the fund, the more the fund has the financial capabilities to diversify its portfolio. Thus, all start-up or wind-up phases should be disregarded for the *diversification* test purposes.

Furthermore, the diversification test should also consider investments held through tiered structures so that in a master/feeder fund structure where the master fund holds a diversified portfolio of investments on behalf of the feeder funds, the latter should be considered as passing the *diversification* test. Interestingly, this has been stressed upon the legislative history of the ATAD II implementation in the Netherlands, where the Dutch legislator specified that each case will be tested from an economic perspective (i.e. not formally). Consequently, there may also be a diversified portfolio if, for example, this portfolio is held indirectly.

- The term "securities"

It is uncertain how the diversification criterion may be met in respect of *securities* and what would amount to *securities*.

As already mentioned, the CIV definition included in ATAD2 and ATAD2 Law derives from the one provided in the 2010 Report which is worded in English and no OECD French translation of this definition seems to exist.

However, a French translation of the CIV definition is provided by ATAD2, according to which the term *securities* has been translated in French by "*titres*". The ATAD Law is also worded in French and therefore took over the French definition provided by ATAD2.

The Luxembourg law does not provide any general definition of the term *titres*.

The law of 5 April 1993 on financial sector (the "Financial Sector Law") which applies to "*titres et instruments financiers*", clarifies that such terms must be understood in the broadest sense covering "*titres et instruments financiers*" that are "*deposited or held on a securities account with an account keeper and that are or have been declared fungible, be they materialised or dematerialised, in bearer, order or registered form, Luxemburgish or foreign, and regardless of the form in which they have been issued according to the law that applies to them*".

The Law of 6 April 2013 on dematerialised securities gives the broadest sense to the term *titres* which covers:

"(a) capital securities issued by joint-stock companies under Luxembourg law, including shares and stock, beneficiary shares, subscription rights and common fund units;

(b) debt securities subject to Luxembourg law such as financial instruments likely to be in the form of bearer instruments and public debt instruments."

For the purpose of this above-mentioned law, the following are not considered as *titres*:

- bills of exchange;
- securities redeemable by number-based draws;
- shares and stock issued by pension savings companies with variable capital.

Many other laws mention the term *titres* but without providing a definition[25].

When English version of those laws are provided by the CSSF, the term *titres* is translated as *securities*.

However, the English term of *securities* has not always been used to translate the French term *titres*. Actually, it has been almost always used for the translation of the French term of "*valeurs mobilières*".

For tax purposes, this is for instance[26] the case of the English translation provided by the CSSF of the SICAR Law[27], where the term *valeurs mobilières* (Article 34 of the SICAR Law) has been translated as *securities*. The SICAR Law did not define such term but the parliamentary works provide with a list of examples of *securities/valeurs mobilières*. For the purpose of this law, the Luxembourg legislator clarified that *securities/valeurs mobilières* must be understood widely and includes shares, bonds and other debt instruments, as well as other negotiable instruments giving the right to acquire such securities.

In a fund regulatory context, the CSSF also uses the English term of *securities* to translate the French term of *valeurs mobilières* provided in its Circular 05/225[28]. The English and French terms are streamed from the wordings of MIFID[29] which defines *securities/*"valeurs mobilières" as "*those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:*

i) shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;
ii) bonds or other forms of securitised debt, including depositary receipts in respect of such securities;
iii) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.[30]"

This definition is broadly aligned with the definition of "transferable securities" within the meaning of Article 2(1)(n) of the UCITS Directive[31] which has been recognised as a guidance in the legislative implementation process of the CIV Exemption in the Netherlands, where the term "diversified securities portfolio" must be interpreted in accordance with this Directive.

Interestingly, the term of *valeur mobilières* has not always been translated as *securities*. For instance, the Financial Sector Law used the term "transferable securities*"* to define the French term of *valeur mobilières* which covers "*those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:*

(a) shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;
(b) bonds or other forms of securitised debt, including depositary receipts in respect of such securities;
(c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures."[32]

In light of the above, there is obviously a mist of confusion on the notion of *titres/securities* in Luxembourg law.

It results from an analysis of the relevant laws that the definitions of the terms *valeurs mobilières* or *titres* (all translated in English as *securities*) provided therein, are each time, tailored for the specific needs of such laws so that they will be more or less restrictive depending on the goal pursued by those laws[33]. This has led to an absence of general definition of those terms in Luxembourg law.

25 See in particular, the Law of 1st August 2001 on the circulation of securities.

26 The Law of May 11, 2007 related to the creation of a Luxembourg private wealth management holding company (SPF), refers in its Article 2(2) to the definition of "financial instruments" (in French: "*instruments financiers*") provided in the law of 5 August 2005 on financial collateral arrangements which covers amongst others, *valeurs mobilières*. For purpose of this law, the CSSF has translated *valeurs mobilières* as *securities*.

27 Law of 15 June 2004 relating to the investment company in risk capital.

28 CSSF circular 05/225 dated 16 December 2005 regarding the notion "offer to the public of securities" as defined in the law on prospectuses for securities and the "obligation to publish a prospectus" that may ensue.

29 Directive 2004/39/EC concerning markets in financial instruments. The MIFID definition of *securities* has been used by the CSSF in its Circular 05/225 to clarify the notion of "offer to the public of securities" as defined in the law on prospectuses for securities.

30 See Article 4.1.(18) of MIFID.

31 Directive 2009/65/EU, as amended by Directive 2014/91/EU.

32 See Article 1(33).

33 See *Les titres et Instruments Financiers innommés, aspects juridiques et fiscaux*, Sadrine Conin et Jean Schaffner, Bulletin Droit et Banque, 2004, pp. 1419. See in particular par. 41-47.

According to the legal dictionary of Dalloz[34], the term *titres* refers to "*a written statement of a legal or a material act producing legal effects, equivalent to the term instrumentum. In this sense, it is referred to debt title, property title or transport document*"[35]. In this sense, it is thus related to any *instrumentum* that could evidence a right, irrespective of whether such *instrumentum* is negotiable of not.

Given the confusion on the notion of *titres /securities* and absent any general definition in Luxembourg law, a teleological interpretation of the CIV Exemption should help to clarify this notion. In this regard, in line with the extensive approach taken by the Luxembourg legislator to the CIV Exemption which is not restricted to UCITS, the term *titres /securities* should also be untied to the UCITS framework for purpose of the CIV Exemption.

3.4. The investor-protection regulation requirement

Given that the Luxembourg legislator considers the RAIF as a CIV while this type of fund is only subject to indirect supervision by the CSSF (investor protection is placed on the alternative investment fund manager only), it should be acceptable to consider that an AIF being also subject to indirect supervision by the CSSF, meets the investor-protection regulation requirement set out in the CIV Exemption.

This position is supported by ALFI[36].

Fund managers are subject to several requirements under the AIFMD. In addition to be authorised as alternative investment fund managers, they have to ensure regulatory reporting to government authorities and disclosures to investors; use third-party depositaries; and comply with various requirements in terms of procedures and policies regarding, for instance, valuation of investment fund assets, conflicts of interest and risk management. Notably, the AIFMD applies to managers of AIF, which the Directive defines as "*collective undertakings, including investment components thereof, which: (i) raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (ii) do not require authorisation* [under the UCITS Directive]." As such, these regulatory requirements provide a useful framework for determining that an investment fund is subject to regulation and engaged in meaningful activities as an investment fund, similar to UCIs funds.

Furthermore, the legislator has expressly admitted that an AIF could be a CIV provided that the three criteria were met. Obviously, the legislator makes reference to an AIF not subject to a Product Law, otherwise its clarification vis-a-vis the AIF would not be relevant. Therefore, the legislator has admitted that AIF are, in principle, subject to investor-protection regulation for purposes of the CIV Exemption.

4. Critical assessment

It is of course welcome that the European Council thought about carving-out investment funds from the RHER when adopting ATAD II and that this was implemented in Luxembourg law. However, to ensure the effectiveness of the CIV Exemption, certain clarifications are necessary.

It was supported in the comments to the OECD 2016 Draft that the CIV notion was intentionally broadly defined so as to leave the governments with great flexibility to decide which would be the in-scope funds.

The legislator of the ATAD II Law gave some hints on his understanding of the CIV notion by taking a stand vis-à-vis SIF, RAIF and AIF. It appears that the Luxembourg legislator has a realistic and modern approach to the investment fund industry and does not restrict the CIV notion to a UCITS-like model.

However, a number of major grey areas need to be addressed more concretely.

This is particularly the case for the criterion related to the notion of *securities*. It would be critical that the CIV Exemption is not tied to the holding of a portfolio of *transferable* securities which would otherwise make the CIV Exemption clearly useless and unrealistic.

Also, regarding the *widely held* test, whatever the approach that would be taken in the future either by the Luxembourg tax authorities or maybe, the Luxembourg legislator, it is important that such a test would not overlap the so-called "*de minimis* rule" failing which the CIV Exemption would be rendered pointless. As a reminder, the RHER applies if (amongst other conditions) the *associated enterprise* test within the meaning of Article 168*ter* LITL is met. To that purpose, voting rights or capital ownership of investors *acting together* must be aggregated. However, investors in "investment funds" which hold (individually) less than 10% (directly or indirectly) of the capital interests in such *investment fund* and are entitled to less than 10% of the profits are presumed not to be *acting together* with other investors in the *investment fund*, unless proven otherwise. The term *investment fund* is broader than the CIV notion as it refers to an undertaking for collective investments raising capital from a certain number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors. Therefore, under the *de minimis* rule, *investment funds* (whether the latter invest

34 Lexique des termes juridiques 2019-2020, Dalloz, 2019.

35 "*Ecrit constatant un acte juridique ou un acte matériel producteur d'effets juridiques, équivalent au terme instrumentum. En ce sens, on parle de titre de créance, titre de propriété ou titre de transport.*"

36 See ALFI ATAD 2 FAQs, January 2021, p. 22.

in a diversified portfolio of securities or not, whether it is subject to investor protection regulation or not) with investors' interests that do not reach the 10% threshold are safeguarded from the RHER.

Finally, the interplay between the RHER, most particularly the CIV Exemption and the general hybrid entity rule, must be cleared up.

As mentioned, the RHER is applicable as from 2022 only and specifically targets Luxembourg-established hybrid entities. However, the ATAD II Law also provides a general rule applicable since 2020 that enable targeting payments to hybrid entities whether these are established in Luxembourg or in another jurisdiction[37].

It results from the commentary to the draft ATAD II Law that as from 2022, both rules will continue to exist concurrently[38]. However, the RHER should prevail over the general rule. On this point, the commentary to ATAD II Law makes directly reference to ATAD II preamble No. 29 according to which: "*The hybrid mismatch rules in Article 9(1) and (2) only apply to the extent that the situation involving a taxpayer gives rise to a mismatch outcome. No mismatch outcome should arise when an arrangement is subject to adjustment under Article 9(5) or 9a and, accordingly, arrangements that are subject to adjustment under those parts of this Directive should not be subject to any further adjustment under the hybrid mismatch rules.*"[39]

Conversely, where the RHER does not apply, for instance because the fund could benefit from the CIV Exemption, the question arises as to whether the general rule would apply again. If so, the CIV Exemption would be much less effective in practice since the general rule does not provide for a carve-out for investment funds. This reading of ATAD II Law seems not to be relevant as the CIV Exemption would, in this case, be stripped of its meaning and purpose.

37 See Article 168*ter* 2.b. LITL.
38 See commentary to Article 2, 4°, p. 28.
39 The primacy of the specific rule over the general rule is also reflected in BEPS Action 2, paragraph 175: "*Recommendation 5.2 provides that the establishment jurisdiction should treat the reverse hybrid as if it were a resident taxpayer. By treating the entity as a resident taxpayer, this will eliminate the need to apply the reverse hybrid rule to such entities and the investor jurisdiction could continue to include such payments in income under Recommendation 5.1 but provide a credit for any taxes paid in the establishment jurisdiction on the income that is brought into account under such rules.*"

DAC 6 : 1 an après, où en est-on ?

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Au 1er juillet 2021, l'Organisation pour la coopération et le développement économique (ci-après « OCDE ») s'est félicitée[1] que 130 pays et juridictions ont adopté un nouveau plan, reposant sur deux piliers, qui vise à réformer les règles fiscales internationales et à faire en sorte que les entreprises multinationales paient une juste part d'impôt partout où elles exercent des activités. Cette nouvelle avancée s'intègre dans un mouvement d'harmonisation fiscale et fait écho au projet BEPS[2], à l'initiative du G7 de 2013 qui avait demandé à l'OCDE de réfléchir à des actions concrètes permettant de rationaliser la fiscalité internationale. Les 15 actions de l'OCDE qui en ont découlées, ont débouché sur un certain nombre de réglementations contraignantes.

L'Union européenne (« UE ») ayant choisi de transposer l'action 12 de BEPS, a de ce fait mis à jour la directive 2011/16/CE sur la coopération administrative, connue sous le nom de « DAC » et qui a connu en 2018 sa cinquième version dite « DAC 6 » liée à l'échange automatique et obligatoire d'informations dans le domaine fiscal en rapport avec les dispositifs transfrontières devant faire l'objet d'une déclaration.

Alors que cette directive est régulièrement modifiée[3], nous nous sommes interrogés sur le bilan de DAC 6, dont nous célébrons la première année d'application théorique. DAC 6 a été votée le 15 juin 2018 et devait être transposée dans les différents États membres de l'UE pour le 31 décembre 2019 afin de voir les premières déclarations déposées sur le site des administrations fiscales locales dès le 1er juillet 2020.

Une transposition malaisée

Rappelons que l'article 288, alinéa 3, du Traité sur le fonctionnement de l'Union européenne (« TFUE ») dispose que « la directive lie tout État membre destinataire quant au résultat à atteindre tout en laissant aux instances nationales la compétence quant à la forme et aux

1 https://www.oecd.org/fr/presse/130-pays-et-juridictions-adherent-a-un-nouveau-cadre-ambitieux-pour-la-reforme-du-systeme-fiscal-international.htm.
2 BEPS: Base Erosion and Profit Shifting.
3 La directive 2011/16/CE a été modifiée par la directive 2021/514/UE du 22 mars 2021 (plus connue sous le nom de DAC 7) concernant l'échange automatique et obligatoire des informations déclarées par les opérateurs de plateformes et va être rapidement remodifiée une 7e fois pour y intégrer des réflexions sur la cryptomonnaie (DAC 8).