

Luxembourg

Taxation

HEDGE FUNDS 2009

Hedge fund managers/advisors

Taxation

Tax rates applying to hedge fund managers/advisors

Open-ended mutual funds in Luxembourg, take the form of either unit trusts without legal personality (Fonds commun de placement (FCP)) or investment companies (usually joint stock companies or limited liability companies) with or without variable share capital (SICAV or SICAF). The latter companies have a legal personality distinct from that of the unitholders of the fund.

Taxation of management companies

The management companies in terms of chapter 14 of the law of 2002 of FCPs created under Luxembourg law are exempt from Luxembourg income and capital taxation if they manage only one Luxembourg based investment fund. For tax purposes the management company is deemed to form one entity with the FCP, which is liable to the subscription tax at an annual rate of 0.05 percent (respectively 0.01percent) per year on its net asset value.

No tax exemption is available for companies that administer either more than one Luxembourg fund or one or more non-Luxembourg based funds.

Taxation of advisory companies

A SICAV/SICAF may use the services of a Luxembourg advisory company. However, due to changes in legislation, starting 1 January 2007, advisory companies of SICAVs/SICAFs are not allowed anymore to opt for the status of a Luxembourg holding company (as organized under the law of 31 July 1929), which is exempt from withholding tax and from taxes on income and on net worth; existing companies that benefit from the 1929 holding status can however carry on until end of 2010.

Newly incorporated advisory companies whose shares would have been disposed of during the transaction period will be subject to normal taxation regimes.

The effective tax rate usually suffered by hedge fund managers/advisors

See above

Tax concessions, allowances, or exemptions specifically available to hedge fund managers/advisors

See above

Details of anti-avoidance tax rules that could bring the profits of an offshore hedge fund into tax

The taxation of an offshore hedge fund depends on whether the effective place of management lies in Luxembourg and also on the status of the hedge fund in the offshore country. No CFC-rules exist in Luxembourg.

Requirements to charge VAT and the rate

Under Luxembourg VAT law, a supply of services should be subject to Luxembourg VAT if the place of supply is in Luxembourg.

Where a Luxembourg fund manager is providing an offshore fund with investment management services, the place of supply should be, based on Article 17.2 e) of the Luxembourg VAT law (VATL), where the recipient is located, that is, where the offshore fund is established.

On the other hand, where a Luxembourg fund manager is providing a Luxembourg fund with investment management services, the place of supply of investment services is in Luxembourg. Therefore the provision of investment management services by a Luxembourg fund manager to Luxembourg funds falls within the scope of the Luxembourg VAT. According to Article 44, 1 d) VATL, management of investment funds such as, subject to Luxembourg financial and insurance supervisory bodies, is VAT-exempt without any input VAT recovery right. Where the services provided by the fund manager are not covered by Article 44, 1 d) VATL, the fund manager should apply Luxembourg VAT on the services and should be entitled to recover input tax paid at least partly.

See below for further details.

Hedge fund structures

Taxation

Tax rates applying to the fund

Open-ended mutual funds in Luxembourg, take the form of either unit trusts without legal personality (Fonds commun de placement (FCP)) or investment companies (usually joint stock companies or limited liability companies) with or without variable share capital (SICAV or SICAF). The latter companies have a legal personality distinct from that of the unitholders of the fund.

Investment funds established under the law of 30 March 1988 (UCITS and non-UCITS) and the law dated 19 July 1991 (which makes reference to the 1988 law) based in Luxembourg are exempt from Luxembourg income and capital taxes except for registration duty and annual subscription tax. Those investment funds remained subject to this law until February 2007. Funds created more recently, and management companies, are subject to the law of December 2002 and suffer the same taxes as the funds created under the previous law.

On 13 February 2007, the Specialized Investment Fund (SIF) law was adopted by Parliament and abrogated the law of 19 July 1991 on Institutional Funds (those securities may not be offered to the public) because of its link to the 1988 law.

The law on SIF will enlarge the concept of eligible investors to professional investors and any other qualified investor, that is, those which have declared their status as experienced investors in writing, and invest at least EUR 125,000 into a SIF, or if they benefit from an assessment by the financial institution that certifies the necessary experience and knowledge of the client.

The law also provides for a large amount of flexibility with regards to the assets the SIF will be allowed to invest in. No specific investment restrictions will be imposed although the overriding principle of risk spreading will still be applicable.

As from 2009, the former proportional capital contribution tax of EUR 1,250 on formation of a Luxembourg investment fund has been abolished.

An annual subscription tax, at the rate of 0.05 percent per year is levied on the net assets of the fund on the last day of each quarter.

Funds which invest in money market instruments and/or in banks deposits (cash funds) are subject to this tax at a reduced rate of 0.01 percent.

Private investment funds (the so-called special or dedicated funds reserved to institutional investors) and SIFs are also subject to this tax at a reduced rate of 0.01 percent per year whereas subscription tax exemptions may apply depending on the underlying investment.

Access to double tax treaties

A foreign fund will only be entitled to benefit from the provisions of a double tax treaty concluded with Luxembourg if it is not expressly excluded from the treaty and if it satisfies the requirement that the recipient of the income is resident in the other State for tax purposes.

If the fund is transparent and the unitholders qualify as resident for tax purposes, the latter will in theory be able to benefit from the double tax treaty provisions applicable between the country of investment and the country of residence of the shareholders.

According to the Luxembourg tax administration's official Web site, and based on a tax circular (n° II/1425-S38 HE/CG) issued on 24 October 2001 by the Director of the Luxembourg Tax Administration, the following distinction can be made with respect to the application by foreign authorities of their tax treaties to corporate investment funds (SICAV/ SICAF).

The authorities of Germany, Austria, China, Denmark, Finland, Indonesia, Ireland, Israel, Korea, Malaysia, Malta, Mongolia, Morocco, Poland, Portugal, Romania, Singapore, Slovenia, Spain (under conditions), Thailand, Trinidad and Tobago, Tunisia, Turkey, Uzbekistan, and Vietnam accept the application of their tax treaty concluded with Luxembourg, to Luxembourg corporate investment funds.

The authorities of Belgium, Brazil, Canada, Czech Republic, Estonia, the United States, France, Hungary, Iceland, Japan, Latvia, Lithuania, Mauritius, Mexico, the Netherlands, Norway, the United Kingdom, South Africa, and Sweden have announced that they would deny the application of their tax treaties to Luxembourg incorporated investment funds.

During 2008 Luxembourg signed further double tax treaties with India and Kazakhstan. However, the said DTT's do not contain explicit provisions with reference to the application of SICAV and SICAF corporate fund structures. This statement is also applicable to already existing double tax treaties concluded before 2008 like Bulgaria, Greece, Italy, Russia, Switzerland, United Arab Emirates, Hong Kong, and San Marino.

Where the treaties are not applicable to Luxembourg investment funds, or where the applicable treaties do not cover capital gain taxes, alternative solutions with specific structures agreed by the supervisory authority or financial instruments, may be used.

The unitholders of transparent investment funds that is, FCP's may benefit directly from the provisions of Luxembourg's tax treaties if they are qualifying residents.

Value-added tax registration and charging requirements

On 29 December 2006, the Luxembourg VAT authorities (VAT authorities) published their Circular N°723 (the Circular) regarding the interpretation of the European Court of Justice (ECJ) cases BBL (C-8/03) and Abbey National (C-169/04). These cases concerned the VAT status of investment vehicles (BBL case) and the scope of the VAT exemption applicable to management of investment vehicles (Abbey National case). The Circular entered into force on 1 April 2007.

In accordance with the decision pronounced in the BBL case, the VAT authorities explicitly recognized that all investment vehicles or similar bodies cited under Article 44, 1 d) VATL (SICAV, SICAF, SICAR, SIF, pension funds subject to Luxembourg financial and insurance supervisory bodies and securitization vehicles governed by the law of 22 March 2004) are taxable persons for VAT purposes. In the particular case of a FCP, the VAT authorities consider that the management company invests the capital raised from the subscribers and is therefore the taxable person for VAT purposes. The fund itself is only regarded as a single grouping of securities.

Pursuant to the specifications of the VAT authorities, investment vehicles carry out VAT exempt activities according to Article 44, 1 d) VATL. Hence, the investment vehicle's status as taxable person for VAT purposes does not automatically trigger the obligation for the company to register for VAT purposes in Luxembourg.

A registration for VAT purposes is mandatory for investment vehicles considered as taxable persons only if they are liable to self-account for VAT on services or goods purchased from foreign suppliers (reverse-charge mechanism, intra-Community acquisition of goods above the threshold of EUR 10,000). In such a case, the investment vehicle must comply with the standard obligations foreseen in the VATL (simplified registration, filing of simplified returns).

The question whether investment vehicles can carry out taxable activities with a resulting input VAT recovery right and ensuing obligation to regularly register for VAT purposes in Luxembourg is currently subject to intensive discussions. The regular registration possibility in Luxembourg should at least apply to real-estate funds established in Luxembourg, which opted for VAT on the generally VAT exempt sale or renting out of real estate. The real estate funds thus should be entitled to recover input VAT incurred in relation with their taxable supplies.

In accordance with the decision taken by the ECJ in Abbey National case, the VAT authorities confirmed in the Circular that the scope of the VAT exemption

for the management of investment vehicles covers the operations which are specific to the activities of the investment vehicles such as investment management and administration activities of such vehicles, as covered by the annex II of Directive 85/611 (daily management of the portfolio, accounting, calculation of the NAV, domiciliation services, etc.).

Besides, the concept of accomplished services was confirmed by the Circular. Services performed by a third-party manager in respect of the administrative management of the vehicles are similarly covered by the exemption if they form a distinct whole, and are specific to, and essential for, the management of the investment vehicle.

However, the Circular also confirms the decision of the ECJ concerning supervisory services, which are not covered by the exemption. In Luxembourg, these services included in the depositary bank function were previously exempt. As from 1 April 2007, they are subject to VAT at the rate of 12 percent.

As a consequence, the depositary banks have to issue invoices to investment vehicles distinguishing between VAT exempt and services subject to VAT. With respect to VAT on these supervisory services, the VAT authorities consider that it will be up to each taxable person for VAT purposes to determine a tax base for the supervisory services it supplies on a case-by-case basis and taking objective elements into account.

In view of a possible VAT exemption for parts of services rendered by a depositary bank, it is possible to summarize both the safekeeping and transactional services as Global Custody and treat the latter as ancillary (and hence VAT exempt) to a VAT exempt main service. A determining precondition for the treatment of these services as ancillary is that several services (specifically including a VAT exempt main service such as the management of investment vehicles) are rendered and invoiced overall.

Withholding tax on dividends or interest payments

Distributions made by Luxembourg funds are not subject to withholding taxes.

Other considerations: EU savings directive

As hedge funds are non-UCITS, SICAV will be out of scope of the EU Savings Directive. However, FCPs will fall under the Directive as they automatically opt to be treated as a UCITS. Therefore the EUSD status for FCP hedge funds should be analyzed based on the investment policy or the effective composition of the assets (asset test).

Tax reporting requirements

There is no specific tax reporting except for the annual subscription tax.

Investors

Taxation

Specific anti-avoidance tax legislation applying to an investor in an onshore fund

Not applicable

Specific anti-avoidance tax legislation applying to an investor in an offshore fund

Not applicable

Tax information needs of investors

Not applicable

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