# Securitisation vehicles

## A) Background

Based on the Luxembourg law of 22nd March 2004 on securitisation, as amended (hereinafter, "Securitisation Law"), a securitisation vehicle (hereinafter, "SV") is a vehicle which "*acquires or assumes, directly or through another undertaking, risks relating to claims, other assets, or obligations assumed by third parties or inherent to all or part of the activities of third parties and issues securities, whose value or yield depends on such risks*".

Stated differently, it is a financial tool consisting in transferring the risks linked to certain underlying assets of a company (the originator), to a special purpose vehicle (the SV), which finances the acquisition of these underlying assets by issuing transferable securities to investors. By converting non-readily marketable assets into securities, SVs allow an improvement of the originator's balance sheet and financial ratios and make it possible to raise cheaper and longer-term financing.

### 1) Who is involved in the securitisation process?

- The originator: transfers assets or receivables to the SV.
- The SV: issues bonds/ fund units in the private/ public market.
- The investors (no restrictions, institutional investors or individuals): buy securities issued by the SV, which will reimburse the originator.


### 2) Types of assets falling within the scope of the Securitisation Law

There is almost no limitation of eligible assets, any asset generating cash flow can be securitised without being bound by any diversification rule. The assets can be movable or immovable, tangible or intangible.

As soon as the parties agree on the assets to be transferred and the investors are informed, the SV is able to assume all kinds of risk.

## 3) Incorporation

The SV can be incorporated either as a company or as a fund managed by a management company.

Both securitisation companies and securitisation funds may be subdivided into autonomous compartments, each of them corresponding to different assets and liabilities. The compartment segregation allows a reduction of the costs and of the formalities, in case multiple and recurrent transactions are initiated by the same Originator.

### 3.1 The Securitisation Company

A securitisation company can be incorporated as a public limited liability company (S.A.), a partnership limited by shares (SCA), private limited liability company (S.à r.l.), or a co-operative company organised as a public limited company (SCOSA). In the majority of cases, securitisation companies take the form of a S.A., with at least one shareholder.

A securitisation company is subject to the same requirements in terms of minimum share capital as ordinary companies (e.g. EUR 30,000 for S.A. and EUR 12,000 for S.à r.l.).

### 3.2 The Securitisation Fund

The SV can also take the form of a securitisation fund, managed by a management company, which is a commercial company registered in Luxembourg. In contrast to the securitisation company, the securitisation fund has no legal personality. It is either a co-ownership of assets with the liabilities of the investors limited to the amount of their participation, or a fiduciary agreement, under which the assets are held by a fiduciary. In this case, the minimum share capital requirements apply to the management company.

## 4) Regulation

The SV is usually unregulated, unless the number of issuances of securities to the public is more than three per calendar year. In such cases, the authorization of the CSSF is required.

In addition, SVs are generally AIFMD (Alternative Investment Fund Managers Directive) exempt, unless the Luxembourg SV either applies for an authorization from the CSSF or registers with the CSSF (depending on the assets under management).

### 5) Management

Securitisation funds have to be managed by Luxembourg management companies, whereas securitisation companies have to have their central administration and registered office in Luxembourg.

The accounts of an SV have to be audited by independent auditors.

## B) Tax facts

### 1) Securitisation Fund

The tax treatment of a securitisation fund is straightforward as it is tax transparent. The taxation will occur at the level of the investors, in accordance with the rules applied in their countries of residence. In contrast to the other investment funds, the securitisation funds are not subject to subscription tax at the level of the fund.

There is no withholding tax on distributions made by the fund and no benefit from the double tax treaties signed by Luxembourg.

### 2) Securitisation Company

The securitisation company is a fully taxable company. However, payments done to investors are fully deductible, which generally lead to a taxable basis close to zero.

**Company incorporation and share transfer**

***Capital duty***

There is no stamp duty on subscription of share capital or transfers of shares, except a fixed registration fee of EUR 75 (i.e. incorporation or amendment of the by-laws of a Luxembourg securitisation vehicle).

Concerning Securitisation funds, they are treated as investment funds in Luxembourg, thus exempt from a subscription tax.

According to the Securitisation Law, agreements concluded in the context of a securitisation transaction, including the deeds related to those transactions, are exempt from registration formalities if they do not have the effect of transferring rights pertaining to Luxembourg real estate, aircraft or ships. However, those agreements should be presented for registration, thus subject to a fixed charge of EUR 12.

## General tax features

### *Corporate Income Tax*

A securitisation company is subject to Corporate Income Tax ("CIT") on its worldwide income at a global rate of currently 18.19% (including 7% of solidary surcharge).

However, the company benefits from an attractive tax regime, where any commitments to investors and other creditors are considered as deductible expenses for tax purposes. The income realized by the company is therefore offset by tax deductible expenses, leading to a taxable basis close to zero.

| Taxable income | CIT rate 2021 |
|---|---|
| < EUR 175,000 | 15% |
| ≥ EUR 175,000 and ≤ EUR 200,001 | EUR 26,250 + 31% of the basis above EUR 175,000 |
| > EUR 200,001 | 17% |

Concerning securitisation funds, they are treated as investment funds in Luxembourg, thus not subject to Corporate Income Tax and Municipal Business Tax. From the investors' tax point of view, the securitisation funds are likely to be treated as tax transparent vehicles.

### *Municipal Business Tax*

A securitisation company is subject to Municipal Business Tax ("MBT"). The MBT rate is 6.75% for companies located in Luxembourg-City (the MBT rate varies from one municipality to another). The taxable basis is similar to the one computed for CIT purposes, i.e. close to nil for securitisation companies.

The overall combined rate of corporation taxes (including CIT, MBT and the solidarity surcharge) for the year 2021 amounts to 24.94% in Luxembourg-City.

***Net Wealth Tax***

The securitisation company is exempt from Net Wealth Tax (NWT) but liable to the minimum NWT.

The securitisation company is subject to a minimum NWT of EUR 4,815 on an annual basis if the sum of financial assets, amounts owed by affiliated undertakings and companies with participating interest, transferable securities and cash at bank exceed both 90% of its total balance sheet and EUR 350,000.

Otherwise, a progressive minimum NWT depending on the total assets of the balance sheet of the tax year will apply. This minimum amount ranges from EUR 535 to EUR 32,100.

| Balance sheet total ≤ 90 % of total assets in financial assets | Minimum NWT |
|---|---|
| Up to EUR 350,000 | EUR 535 |
| EUR 350,001 up to EUR 2,000,000 | EUR 1,605 |
| EUR 2,000,001 up to EUR 10,000000 | EUR 5,350 |
| EUR 10,000,001 up to EUR 15,000,000 | EUR 10,700 |
| EUR 15,000,001 up to EUR 20,000,000 | EUR 16,050 |
| EUR 20,000,001 up to EUR 30,000,000 | EUR 21,400 |
| More than EUR 30,000,000 | EUR 32,100 |

***Value Added Tax***

SVs are considered as taxable persons for VAT purposes. However, management fees are VAT exempt.

## C) Withholding Tax

Interest and dividend payments to investors by SVs are not subject to withholding tax.

## D) Thin capitalization rules

There is no thin capitalization rule or debt to equity ratio to be respected for SVs.

## E) Transfer Pricing aspects

Assuming that a securitisation company does not hold loan receivables from related parties, and thus does not perform intra-group financing activities, there is no impact of respective transfer pricing rules on securitisation companies.

## F) Anti-Tax Avoidance Directive (ATAD) measures

Since 1st January 2019, anti-tax avoidance measures have been implemented in Luxembourg.

***Interest limitation rules***

The interest limitation rules provide that the "exceeding borrowing costs" deductible for tax purposes are limited to 30% of EBITDA (Earnings Before Interest, Tax, Depreciation and Amortization). For that purpose, the exceeding borrowing cost is defined as interest expenses (or other economically equivalent financing costs) in excess of taxable interest revenues.

There are some exceptions to this rule, as the deduction of the following borrowing costs will not be limited in case of:

- the first EUR 3 million of exceeding borrowing costs;
- the borrowing costs related to loans concluded before 17 June 2016 (limited to the original terms of the loan);
- the borrowing costs incurred by a standalone entity (defined as a taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprise, or non-Luxembourg permanent establishment).
- the borrowing costs incurred for long-term public infrastructure projects with the EU;
- the borrowing costs incurred by financial companies (credit institutions, AIFs, insurance and reinsurance companies, pension funds, UCITS and **securitisation companies within the meaning of the European Securitisation Regulation 2017/2402**).

Additionally, securitisation funds (set up in the form of FCPs) are not subject to the new interest deduction limitation rules, because they only apply to entities subject to Luxembourg corporate tax.

On the contrary, those new interest limitation rules are applicable to securitisation companies, as they are fully taxable, unless an exemption applies. Please note that the commitments of a securitisation company made by the purchaser to remunerate its investors qualify as interest on debt.

***Hybrid mismatches rules***

These rules cover intra-EU hybrid instruments and hybrid entity mismatches. Hybrid mismatches result from differences in the legal characterisation of payments or entities in different EU member states, leading to a deduction of the same expense in two member states (double deduction), to a deduction of expenses in one member state and no corresponding inclusion of the income in the taxable basis of the other member state (deduction without inclusion). In both cases, the business expense cannot be deducted in Luxembourg for tax purposes.

On 19$^{th}$ December 2019, the Luxembourg Parliament adopted the law transposing the Anti-Avoidance Directive on hybrid mismatches (ATAD2), which extends the scope of existing anti-hybrid rules to cover a wider variety of mismatches and mismatches with third countries. These rules apply for tax years starting on or after 1$^{st}$ January 2020, except for reverse hybrid rules which apply only as of tax year 2022.

The mismatches that are targeted by the new law include the previously mentioned (a) deduction without inclusion, (b) double deduction, and also (c) double non-taxation or double tax credit (i.e. mismatch in the allocation of income related to permanent establishment, or when the same income generates a tax credit in the hands of two different taxpayers), which result from the hybridity of a financial instrument, a legal entity or a permanent establishment. As a consequence, the tax base of Luxembourg taxpayers increases, by denying deductible payments or by requiring the inclusion of income which were so far deductible or exempt.

Reverse hybrid rules refer to Luxembourg entities treated as transparent for Luxembourg tax purposes and opaque in the partner’s jurisdiction, which shall become subject to corporate income tax on part or all of their income.

*General anti-abuse rule (GAAR)*

This rule allows Luxembourg Authorities to ignore non-genuine arrangements for tax purposes.

An abuse exists if the following conditions are met:

i. The use of forms and institutions of law (a transaction);
ii. The main purpose or one of the main purposes is to obtain a tax advantage that defeats the object or purpose of the applicable tax law;
iii. The transaction is not genuine, i.e. it was not chosen for valid commercial reasons that reflect economic reality (having considered all relevant facts and circumstances).

***Exit taxation***

Since 1st January 2020, indefinite deferral of payment of the exit tax is no longer possible. The exit tax due must be paid in instalments over a five-year period (without interest) in the case of a transfer to an EU or EEA country with which Luxembourg or the EU has concluded a mutual assistance agreement for the recovery of tax claims. For transfer to any other jurisdiction, deferrals are no longer permitted.

## G) Double Tax Treaties

Currently Luxembourg has signed Double Tax Treaties with more than 80 countries.
Securitisation companies (contrary to securitisation funds), in general, can benefit from the protection of Double Tax Treaties, as they are fully taxable resident companies.

## H) Multilateral Instrument

The Multilateral Instrument (MLI) is a multilateral convention to implement Tax Treaty related measures to prevent Base Erosion Profit Shifting. The MLI does not replace existing tax treaties, it functions as a supplement to the bilateral tax treaty in force, provided that the relevant countries have ratified the MLI. The countries are also in a position to designate which tax treaties they wish to modify with the MLI (Covered Tax Agreements – “CTA”).

In February 2019, Luxembourg submitted its position on this subject and provided a list of 81 tax treaties as CTA. However, an existing CTA will only be modified by the MLI if the counterparty has also designated the bilateral treaty with Luxembourg as a CTA.

The MLI provisions entered into force on 1st August 2019 in Luxembourg, being the first day of the month following three calendar months after the date of deposit of the instrument of ratification by Luxembourg, which took place on 9th April 2019. As at 15th January 2021, Luxembourg has 83 double tax treaties in force, of which 69 are CTAs.

For withholding taxes, the MLI applies as from 1st January 2020 to the tax treaties concluded by Luxembourg with other jurisdictions that have completed the MLI ratification process prior to 1st October 2019. In contrast, if the other jurisdictions deposit their instruments after that date, withholding tax provisions will not be effective before 1st January 2021.

For other taxes, the MLI will take effect on taxable periods beginning on or after the expiration of six calendar months after the date at which the MLI entered into force. Thus, for taxpayers who have a taxable period that follows the calendar year, the MLI provisions would apply by 1st January 2021.

## I) Mandatory disclosure rules and automatic exchange of information on tax planning cross-border arrangements (DAC6 reporting)

A new reporting obligation in relation to reportable cross-border arrangements is introduced in Luxembourg as from 1st July 2020, following the transposition of EU Directive 2018/822 on the mandatory automatic exchange of information.

Primarily, it is up to the intermediaries (banks, accountants, tax advisors, domiciliation agents etc.) to comply with the reporting measures, but in specific cases – e.g. an intermediary can claim a professional privilege – the reporting obligation can fall on the taxpayer itself.

An arrangement becomes reportable if it concerns direct taxes, it has a cross-border element and it includes a characteristic (so-called “hallmark”) that presents an indication of potential risk of tax avoidance. The deadline for disclosure to the Tax Authorities in case of reportability is very tight: the concerned intermediaries or the taxpayer have to file the reportable information within 30 days from:

a) the day after the reportable arrangement is made available for implementation;
b) the day after the reportable arrangement is ready for implementation; or
c) the day when the first step in the implementation of the reportable arrangement has been made;

whichever occurs first.

Late, incomplete or inaccurate reporting, non-reporting or non-compliance with the notification obligations might result in a maximum fine of EUR 250,000 per infringement.

## J) Advance Tax Agreements

As from 1st January 2020, advance tax agreements (ATA) granted by the Luxembourg Tax Authorities and issued before 1st January 2015 are no longer valid. However, taxpayers may introduce another request for an ATA under the procedure applicable since 2015 (according to this procedure the validity of an ATA is restricted to five years).

## K) Conclusion

SVs are operationally flexible and fiscally efficient investment vehicles. They allow the spread of risk linked to non-monetary assets, the improvement of solvency ratios, etc., by offering a very attractive tax treatment, with almost no tax to be paid by the SV.

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