LUXEMBOURG PRIVATE EQUITY & VENTURE CAPITAL ASSOCIATION

LIMITED PARTNERSHIP IN LUXEMBOURG

A comprehensive Q&A for all practitioners

2014

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Luxembourg Private Equity
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Foreword

The Luxembourg government took the opportunity of the transposition of the AIFMD into Luxembourg law in July 2013 to revamp the limited partnership regime with the aim at making it more attractive for fund managers - in particular, private equity managers.

In a nutshell, the new law revamps the existing limited partnership regime ("CLP" - common limited partnership or "SCS" - *société en commandite simple*) and introduces a new type of partnership ("SLP" - special limited partnership or "SCSp" - *société en commandite speciale*).

The purpose of this user guide is not to provide an exhaustive accounting, legal and tax framework but rather to answer some of the typical questions private equity managers and service providers may have when setting up and administering a Luxembourg limited partnership vehicle.

About the Luxembourg Private Equity & Venture Capital Association

The Luxembourg Private Equity and Venture Capital Association (LPEA) is a member-based, non-profit trade association established in 2010, covering the whole range of private equity, from venture capital (seed, start-up and development capital), to buy-outs and buy-ins. LPEA represents, promotes and protects the interests of the Luxembourg private equity and venture capital industry. It is both a contributor to the country's private equity regulation and a key player in the preparation of the market players to the sector's challenges. LPEA is a member of the Luxembourg for Finance initiative and represents Luxembourg within the European Private Equity and Venture Capital Association (EVCA).

The current document was compiled by LPEA's Accounting and Valuation Technical Committee. LPEA expresses its recognition to all those who actively contributed to the preparation and review of this technical publication.

1. What accounting principles are acceptable?

Unregulated vehicles

The requirements are different depending on the turnover of the SCS.

The SCS with a turnover below EUR 100,000 (which should be the case for most private equity SCS, as dividend income, gain on participations and interest income are not considered as turnover) will not be subject to the Chapter 2 of the RCS 2002 law and therefore the accounting principles will not be imposed by a regulation. This SCS as well as the SCSp will be allowed to apply any accounting principles as described in the Limited Partnership Agreement (LPA) and will therefore be allowed to use Lux GAAP, IFRS, UK GAAP, US GAAP or "Other GAAP" to meet investors' wishes or requirements of any other stakeholders (e.g. banks...).

Most SCS/SCSp do not have accounting principles imposed by Luxembourg Law

The SCS with a turnover above EUR 100,000 will have to follow the GAAP foreseen by the law dated 19 December 2002 as amended, meaning Luxembourg GAAP under historical cost convention, Luxembourg GAAP with fair value option or IFRS as adopted by the European Union.

Regulated vehicles

Applicable accounting principles and filing

Regulated vehicles need to follow their own product law (SIF, SICAR, Part II funds). The accounting principles applicable to these vehicles should be Luxembourg GAAP or IFRS as adopted by the European Union. The use of other GAAP might be possible under certain conditions and subject to an authorisation process with the Commission des Normes Comptables.

SIF and SICAR organized as SCS or SCSp need to opt either for Luxembourg GAAP or IFRS

2. Where does the booking/documentation need to take place?

Regulated vehicles

The article 3 of the SIF Law of February 13, 2007 as amended states that "Specialised investment funds subject to this Law shall be deemed to be situated in Luxembourg if the registered office of the management company of the common fund or the registered office of the investment company is situated in Luxembourg. The head office must be located in Luxembourg."

Article 1(3) of the SICAR Law of June 15, 2004 as amended provides that "The registered office and the head office of a Luxembourg SICAR must be situated in Luxembourg".

"The administration of an undertaking for collective investment (UCI) includes all back-office functions in the widest sense of the term, notably:

- fund accounting;
- calculation of the net asset value;
- performance calculation;
- preparation of reports;
- executing sales and redemption of fund shares and units;
- maintenance of the shareholder register;
- administration of client accounts;
- communication with shareholders and unit holders.

Luxembourg law requires that tasks belonging to the central administration be carried out in the Grand Duchy."

Unregulated vehicles

The office of the Special Limited Partnership (SCSp) is located at its head office (Article 22-1(7) of Luxembourg Law of 10 August 1915 on commercial companies, as amended ("1915 Law")). The head office is assumed to be located at the same place as its registered office (as stated in its Limited Partnership Agreement).

3. Is consolidation required?

The present section solely covers consolidation requirements applicable to limited partnerships having their registered office in Luxembourg under Luxembourg legal and regulatory provisions. The purpose of the section is not to analyze additional consolidation requirements or exemptions resulting from the application of specific accounting frameworks (foreign or international GAAPs).

Obviously, even if an undertaking is exempted by Law to draw up consolidated financial statements, a limited partnership still has the option to prepare consolidated financial statements on voluntary or contractual basis.

Furthermore an entity may be exempted to prepare consolidated financial statements according to Luxembourg laws and regulations but might be obliged to consolidate on the basis of the requirements arising under the application of foreign or international GAAPs.

The requirements are different depending on the limited partnership form and, as such, the present Q&A analyses separately the requirements under the common limited partnership ("SCS") regime and those applicable to the special limited partnership ("SCSp") regime.

Consolidation requirements under the common limited partnership ("SCS") regime

The Luxembourg legislation applicable to the preparation of consolidated financial statements is defined in section XVI of the 1915 Law, and is derived from the transposition of related European Directives into the Luxembourg Law.

Article 309 of the 1915 Law includes implicitly within the scope of the consolidation requirements the SCS but only if all members have either limited liability or their unlimited liability members are organized as limited liability companies

Considering that limited partners of an SCS have their liability limited to their contribution and that the unlimited general partner is generally organized as limited liability company, an SCS might fall within the scope of the consolidation requirements.

> *<Interpretation Consideration>*
>
> *Certain market participants interpret article 25 of the 2002 Law as to whether SCS with a turnover below EUR 100.000 (excluding VAT) are not subject to article 77 of the 2002 Law and consequently are not subject to consolidation obligations (turnover excludes dividend and interest income as well as unrealized or realized gains on financial assets).*

If article 77 of the 2002 Law is deemed to apply, the legislative actions require that all SCS (whose partners have all either limited liability or whose unlimited partners are set up as limited liability companies) that control another company, are obliged to prepare consolidated financial statements.

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[1]in reference to article 77 of the Law of 19 December 2002 on the Register of Commerce and Companies and on the accounting records and annual accounts of companies ("2002 Law").

Article 309 of the 1915 Law defines control as follows:

- an entity has a majority of the shareholders' or members' voting rights; or
- an entity has the right to appoint or remove the majority of the members of the administrative, management or supervisory body of another undertaking and is at the same time a shareholder or member of that undertaking; or
- an entity is the shareholder or member of an undertaking, and controls alone pursuant to an agreement with other shareholders or members of that undertaking, a majority of shareholders' or members' voting rights in that undertaking.

An official interpretation as to whether article 77 of the 2002 Law would not apply to SCS with a turnover below EUR 100.000 (excluding VAT) based on article 25 of the 2002 Law would be beneficial as it would enable SCS operating as Funds, generating no turnover, to avoid the obligation to prepare consolidated financial statements.

Exceptions to prepare consolidated financial statements

By way of derogation from the art. 309 paragraph (1) of the 1915 Law, a parent company is exempted from the obligation to draw up consolidated accounts in the following cases:

1. **Size exemption:** as provided by art. 313 of the 1915 Law, a parent company that, at its balance sheet date, together with the undertakings that would have to be consolidated, do not exceed the limits of two of the three following criteria:

   a. total balance sheet total: EUR 17.5 million,

   b. net turnover: EUR 35 million,

   c. average number of full-time staff employed during the financial year: 250 .

   The first two criteria may be increased by 20% if no intercompany eliminations have been made. The consolidation requirement only becomes effective if two of the three criteria thresholds are exceeded for two consecutive financial years.

   This exemption does not apply if one of the companies to be consolidated has issued securities that are admitted to official trading on an EU regulated market.

2. **Sub-group exemption:** as provided by art. 314 of the 1915 Law, a parent company, which is also a subsidiary, if its own parent company is governed by law of an EU member state and holds all shares issued in the exempted entity (or at least 90% of the shares and the remaining shareholders have approved the exemption). The exemption shall be conditional upon compliance of the following conditions:

   a. the exempted company and its subsidiaries are consolidated in the accounts of a larger body of undertakings, the parent company of which is governed by the law of an EU member state,

   b. the consolidated financial statements, the consolidated management report and the report of the auditor shall be published (according to art. 9 of the same

law), must be drawn up and audited according to the law of an EU member state (or in accordance with the provisions of the Luxembourg law or in a manner equivalent thereto),

c. the notes to the annual accounts of the exempted company must disclose the name and registered office of the parent undertaking which prepares consolidated accounts as well as the exemption from obligation to prepare consolidated accounts and consolidated management report.

This exemption does not apply to companies that have issued securities that are admitted to official listing on an EU regulated market.

3. **Extension to sub-group exemption:** as provided by art. 316 of the 1915 Law, any parent company which is also a subsidiary of a parent undertaking not governed by the law of an EU member state, is exempted from the obligation to draw up consolidated accounts and consolidated management report if all the following conditions are fulfilled:

    a. the exempted company and all of its subsidiaries are consolidated in the accounts of a larger body of undertakings,

    b. the consolidated accounts referred to above and the management report must be drawn up in accordance with the provision of the Luxembourg law or in a manner equivalent thereto,

    c. the consolidated accounts referred to above must be audited accordinng to the national law governing the undertaking which drew them up.

4. **Financial Holding exemption:** a financial holding has no obligation if it did not exercise control on its subsidiary. The Financial holding will be deemed as not excercising control under the following conditions:

    a. the parent company has not intervened directly or indirectly in the management of the subsidiary;

    b. the parent company has not exercised its voting rights in respect to the appointment of a member of the subsidiary undertaking's administrative, management or supervisory bodies during the year and the five preceding financial years;

    c. the parent company has granted loans to its subsidiaries only;

    d. an exemption has been granted by the Luxembourg authority for financial holding companies after fulfillment of the conditions has been checked.

Exclusions

For SCS, for which all partners have either limited liability or are set up as llimited liability companies, which do not meet one of the above exemption criteria and are required to prepare consolidated financial statements, may exclude a specific investment from the consolidation scope if it meets one of the following five exclusions set out by the Law on Commercial Companies:

1. Immateriality Considerations: an undertaking does not need to be included in the consolidated financial statements when it is not material either individually or collectively for the purposes of the true and fair view;

2. Severe Restrictions: an undertaking does not need to be included in the consolidated financial statements when severe long-term restrictions hinder the parent company in the exercise of its rights over the assets or management of that undertaking;

3. Disproportionate cost: an undertaking does not need to be included in the consolidated financial statements if the information necessary for the preparation of consolidated financial statements in accordance with the law cannot be obtained without disproportionate expense or undue delay;

4. Temporary holding: an undertaking does not need to be included in the consolidated financial statements if the shares of that undertaking are held exclusively with a view to their subsequent resale, reference is made here to the Luxembourg Private Equity Consolidation Exemption described below.

The Luxembourg Private Equity Consolidation Exemption

On 18 December 2009, the Luxembourg Accounting Standards Commission has released Notice CNC 2-1 consisting of an official clarification on the interpretation of the exclusion from the consolidation scope for Temporary holding in the specific case of investment companies in risk capital (venture capital/risk capital) which also applies to SCS.

To benefit from the consolidation exemption under analysis and as specified in the notice drafted by the Accounting Standards Commission, six applicability criteria will have to be met:

1. The company is a company subject to Luxembourg law pursuant to article 2 of the law of 10 August 1915 held by one or several well-informed investors ;

2. The company's exclusive corporate object is to invest its assets in one or more securities representing risk capital, which is defined as direct or indirect contribution of funds to one or several entities in view of their launch, their development and their listing on a stock exchange. These investments are held by the company with the intention to resell them at a profit;

3. Its management or administration body formally defines ex ante in a written document, that is communicated to its investors, an exit strategy which is part of its investment policy and which implies the intention of divestment on a mid-term basis, generally within three to eight years. This investment policy should be distinguished from a strategic investment that has no predefined termination;

4. Its objective is to provide its investors with the benefit of the investment(s) management in return of the risk borne by the investors;

5. If the investment(s) is (are) not carried at fair value on the face of the balance sheet, the fair value shall be made available in the disclosure notes of the financial statements in order to provide relevant information to investors;

6. Any event, guarantee or uncertainty that might have a significant impact on the entity's ability to continue its activities as going concern, or which may raise any concern related to its cash-flows situation, available liquidities or its solvency has to be disclosed adequately in the disclosure notes to the annual accounts.

Consolidation requirements under the Special limited partnership ("SCSp") regime

The specificity of the SCSp is the absence of legal personnality. The 1915 Law and more particularly the relevant consolidation requirements are derived from European Directives.

The general interpretation is that the absence of legal personality puts the SCSp regime out of the scope of Directive 2013/34/UE and related national transpositions. Furthermore article 77 of the 2002 Law only refers to common limited partnerships (SCS) and does not include an explicit reference to special limited partnerships (SCSp).

Consequently no consolidation obligations pertain for SCSp under Luxembourg legal and regulatory requirements.

An official formal validation of this general interpretation with the provisions of Directive 2013/34/UE would be considered as advantage.

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[2]The entities are undertakings which take one of the following legal forms: *société anonyme* (public company limited by shares); *société à responsabilité limitée* (private limited liability company); *société en commandite par actions* (corporate partnership limited by shares), *société coopérative* (co-operative company); *société européenne* (European company); *société en nom collectif* (unlimited corporate partnership); *société en commandite simple* (limited corporate partnership).

[3]A 'well-informed investor' is defined in the SICAR Law and in the SIF Law as qualified investors, including not only institutional and professional investors but also private individuals fulfilling certain conditions (for example, a EUR 125.000 minimum investment and written acknowledgement of risk awareness).

Figure 1 Consolidation decision tree

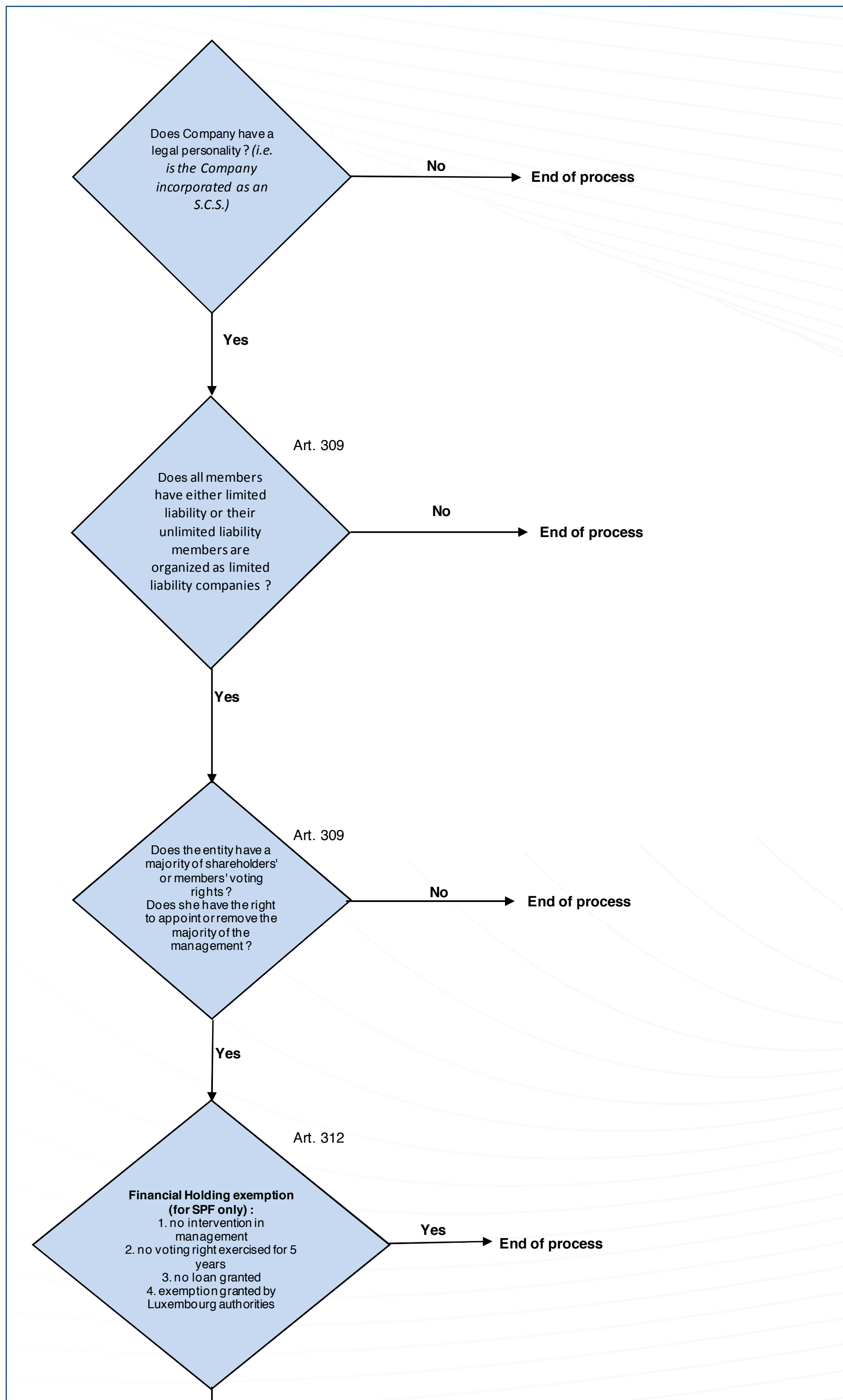
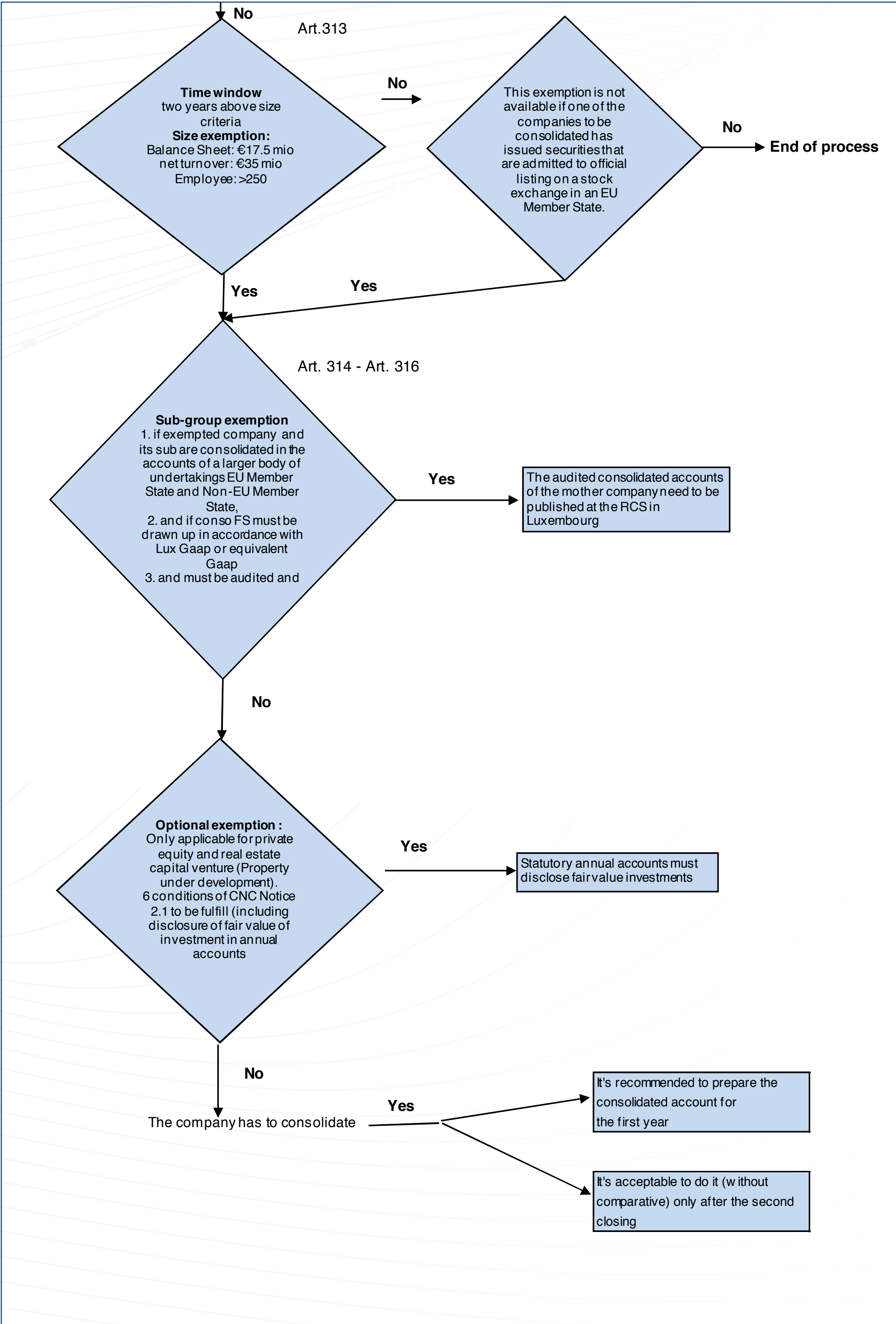


Figure 1 Consolidation decision tree (continued)



4. What valuation policies need to be followed?

The purpose of the present discussion is to consider the accounting valuation policies applicable in the framework of the new Limited Partnership regime in Luxembourg. Indeed the law dated July 12, 2013 revamped the Common Limited Partnership (*Société en Commandite Simple,* SCS) and enacted a new legal form: the Special Limited Partnership (*Société en Commandite Spéciale,* SCSp).

Valuation Policies:

The present paper will consider the use of the following valuation policies:

- Fair value, defined as the arm length realisable value of the securities/assets;
- Historical cost less impairment;
- Lower of cost or fair market value.

The flexibility in the valuation policy to be used mostly depends on whether the Limited Partnership is regulated or not.

Regulated Limited Partnerships:

Regulated Limited Partnerships can be established under the SIF or the SICAR regime.

Article 9 of the SIF law of February 13, 2007 as amended states that the fair value shall be used as a valuation policy unless otherwise stated in the Limited Partnership Agreement and thus subject to the partners' choice.

However, if the vehicle is considered as an investment company in risk capital (SICAR), article 5(3) of the Law of June 15, 2004 as amended provides that the appraisal of the Company's assets is based on fair value although the Valuation Methodology is to be defined in the Limited Partnership Agreement.

Unregulated Limited Partnerships:

For the unregulated entities the valuation policy is to be defined by the GAAP used or in the Limited Partnership Agreement.

Examples of valuation policies include (non-exhaustive list):

- Fair value, defined as the arm length realisable value of the securities/assets;
- Historical cost less impairment;
- Lower of cost or fair market value.

Valuation Methods:

As mentioned above, although the valuation methodology is to be defined in the Limited Partnership Agreement and therefore are freely to be agreed upon by the partners, it is to be noted that the most widely accepted valuation methods are the ones set forth by International Accounting Standard Board (IFRS13) as accepted by the EU, by the European private equity and Venture Capital Association (EVCA) or by the International Private Equity and Venture Capital board (IPEV).

Where a quoted price is not observable, it has to rely on valuation methodologies:

IFRS recognise three types of approaches: the Market approach, Cost approach and the Income approach.

- The Cost approach reflects the amount that would be required currently to replace the service capacity of an asset (current replacement cost)
- The Market approach encompasses amongst other techniques the Market multiples;
- The Income approach includes the Discounted Cash Flow methodologies.

The IPEV recommends the following methodologies where private equity investments are reported at fair value:
- Price of Recent Investment;
- Multiples;
- Net assets;
- Discounted cash flows or earnings (of underlying Business);
- Discounted cash flows (from the Investment);
- Industry valuation benchmarks;
- Available market prices.

5. Are there any international guidelines that should be considered as best market practices?

The European Private Equity and venture Capital Association (EVCA) and the Institutional Limited Partners Associations (ILPA) published some guidelines regarding regular reporting to investors which include templates of capital accounts, distributions notices, capital call notices, among others. ILPA issued a "template" for quarterly reporting which may also be useful when preparing annual accounts (this includes balance sheet and profit and loss presentation, allocation between GP and LP and example of notes to the accounts).

Guidelines and templates for LP reporting have been published by EVCA and ILPA

The Global Investment Performance Standards (GIPS) for Private Equity are issued by the GIPS Executive Committee (a CFA Institute standing committee) and are another set of practitioners' guidelines gaining significant traction, especially among global investors active across multiple asset classes.

6. What are the rules in terms of distributions?

Article 1832 of the civil code sets out the general rule pursuant to which shareholders of a company are entitled to a right on dividends.

However, depending on the form of the company the rule is subject to some additional requirements or conditions, most of these requirement are listed in the law on commercial companies of 1915 (the LSC 1915).

Regulated vehicles

SIF are regulated by the law of 13 February 2007 (the SIF Law). In terms of distributions, under the SIF Law, a distinction must be made between common funds and SICAV (société d'investissement à capital variable).

- Common fund SIFs: As regards common funds, article 10 of the SIF Law sets out the general rule under which neither the holders of units nor the creditors of the SIF may claim for distribution.

  Therefore, article 15 specifies that, unless otherwise provided for in the management regulations, the net assets of the common fund may be distributed subject to the limits set out in article 21 of the SIF Law. Which itself provides that the net assets of a common fund may not be less than EUR 1,250,000.

  Hence it can be concluded, in common funds, that there is no rights of distribution and that the management company cannot allow distribution as long as the net assets of the fund are below EUR 1,250,000 threshold, unless some more flexible provisions of the management regulations prevail.

- SICAV SIFs: Contrary to common funds, the net assets of the SICAV may be distributed but still subject to the EUR 1,250,000 limits set out in article 27 of the SIF Law.

  SICAVs are not subject to any rules in respect of payment of interim dividends other than those set forth in their articles of association.

Should the SIF be established under Chapter 3 the rules applicable are those as set forth under the Commercial Company Law.

SICAR: Under article 6 of the SICAR Law, SICARs are regulated by the law of 15 June 2004; repayments and distribution of dividends to investors and interim dividends are not subject to any restriction other than those set forth in the articles of association or the limited partnership agreement.

Unregulated vehicles

Common limited partnership and special limited partnership: As regards to common limited partnership ("SCS") and the special limited partnership ("SCSp") articles 19 and 22-5 of the 1915 Law, respectively, provide that distributions and repayments to members, as well as the conditions under which the SCS and the SCSp may request their restitution, are subject to the partnership agreement.

Unless the partnership agreement provides otherwise, the share of each member in the company's gains and losses is proportional to its interests.

These provisions are designed to provide such partnerships with the highest level of flexibility.

In relation to the legal nature of the dividend a distinction must be made between the right, as a shareholder, to benefit from the distribution (droit social) and the right to claim for payment of the dividend (droit de créance) once the decision to distribute has been taken.

Accounting rules on distributions

Since the end of 2010, Luxembourg undertakings may choose on top of traditional Lux GAAP, IFRS or Lux GAAP plus fair value.

However the Commercial Law does not set clear guidelines for the determination of distributable reserves in case of fair value measurement.

The Limited Partnership agreement will determine the rules for distribution. If no specific rule is included in the agreement, then the Commercial Law will apply by default.

That is why the Law of July 30th 2013 has opted for the accounting restatement method (méthode du retraitement comptable) by clarifying the use of unrealised gains created by revaluation of assets at fair value (whether by application of IFRS or Lux GAAP). The new article 72ter of the 2002 Law provides for the deduction of unrealised positions from the accounting reserves to limit the amount of distributable reserves to the sole profits actually realised. Hence any unrealised position (with 2 exceptions as described under article 72ter (3)) shall be excluded from dividend distributions and booked as an un-distributable reserve.

There is no criminal sanction, but the claw-back provisions of article 72-4 of the 1915 Law have been extended so as to cover any violation of the new statutory limitations of article 72ter of the 2002 Law, in case the shareholders were aware of or could not reasonably ignore its irregular character.

7. Can different classes of shares be issued?

Various classes of shares may be created and that the biggest freedom is the rule since the parties can freely determine within the by –laws or the contract of incorporation the rights and obligations attached to the shares or to their corporate interests.

8. What are the main tax substance considerations for a Luxembourg common limited partnership ("SCS") or special limited partnership ("SCSp")?

SCSs/SCSps falling within the scope of the act introducing AIFMD ("AIFMD Act") in Luxembourg

In most countries, an alternative investment fund ("AIF") should be tax resident where it is effectively managed. In recent years tax residency has been increasingly challenged by Tax Authorities on the basis of substance. The location of the alternative investment fund manager ("AIFM") may influence the tax residency of the AIF which is determined based on the statutory seat or central administration, the place of effective management and ultimately on the specific facts and circumstances, including where key decisions are made, the board composition, the level and type of activities, office and employees.

The EU Passport for AIFMs may give rise to more complex taxation issues in cross-border situations when an AIFM located in a given jurisdiction manages AIFs in various jurisdictions, with this complexity increasing when AIFM functions are delegated. The question may arise as to whether the residence of AIFs is in their country of establishment or in the place of establishment of the AIFM. If the AIF is considered as being a tax resident of, or as having a taxable presence in, the country of establishment of the AIFM, the AIF and/or the investors may become subject to taxation in such country. In a worst case scenario, the AIF and/or the investors may be subject to taxation in the countries of establishment of both the AIF and the AIFM.

Finally, this separation may alter the ability of the investors to access double taxation treaties.

The specific tax provisions that accompany the AIFMD transposition into national law are decisive in relation to this tax risk. Similar to the approach taken when transposing UCITS IV into national law, the Luxembourg AIFM Act ensures Luxembourg tax neutrality when a foreign AIF is managed by a Luxembourg AIFM. In this case, a foreign AIF would be exempt of corporate income tax, municipal business tax and net wealth tax in Luxembourg. A Luxembourg AIF managed by a foreign AIFM may however be taxable abroad based on the approach taken by the foreign tax authorities while potentially remaining subject to tax in Luxembourg. In order to enable economies of scale, reduction of costs and concentration of key resources and expertise in one place, sponsors may prefer to concentrate substance in one jurisdiction (i.e. one AIFM to manage AIFs in several jurisdictions) . This may however trigger adverse tax consequences, as described above, compared to set-ups where the

An AIF should generally be tax resident where it is effectively managed.

A foreign AIF managed by a Luxembourg AIFM is exempt of tax in Luxembourg.

Proper advice is recommended for a Luxembourg AIF managed by a foreign AIFM.

AIFM is located in the jurisdiction of the AIF. An AIFM active in multiple jurisdictions should therefore need to carefully consider the tax implications in each jurisdiction when planning for a streamlining of their operating model.

SCSs/ SCSps falling outside the scope of the AIFMD Act in Luxembourg

For SCSs/ SCSps which are not covered by the AIFMD Act, the same issues as those described above arise. Typically, such SCSs/ SCSps have a Luxembourg-resident general partner ("GP"), which is managed in Luxembourg, so that the discussions about a potential tax residency of the SCSs/ SCSps outside of Luxembourg become not relevant. Although no specific substance is required at the level of the SCSs/ SCSps or of its GP, adequate measures should be taken to ensure that the GP is managed from Luxembourg (e.g. adequate board composition, regular meetings in Luxembourg...).

Typically, the GP of SCSs/SCSps is Luxembourg resident. Adequate measures should be taken to ensure that the GP is managed from Luxembourg.

9. What are the tax consequences for a Luxembourg Limited Partnership?

Direct tax – Non-regulated Limited Partnership

The new regime applicable to common limited partnership ("SCS") and special limited partnership ("SCSp") provides for full tax neutrality and tax transparency, subject to certain conditions. Indeed, under the following conditions, neither the SCS/SCSp, nor its non-resident limited partners should be subject to corporate income tax, municipal business tax and net wealth tax:

- the general partners of the SCS/SCSp taking the form of a Luxembourg limited company should hold less than 5% of interest in the SCS/SCSp;

- Moreover, the activity of the SCS and SCSp should be limited to private wealth management (which should generally correspond to the activity of private equity and real estate funds, but please see our below comment in this respect).

As mentioned above, one of the main conditions to benefit from the tax neutrality is that the activity of the SCS and SCSp should be limited to private wealth management. In case of doubt, it is strongly recommended to confirm with the tax authorities whether the contemplated activity is considered as being limited to the private wealth management.

If such conditions are not fulfilled, then the SCS should be subject to municipal business tax, and its non-resident/resident partners, in the case there is a permanent establishment in the meaning of Luxembourg law (subject to any applicable double tax treaties) should be subject to (i) corporate income tax on the SCS/SCSp's income (for corporations) or personal income tax on the SCS/SCSp's income (for individuals) and (ii) net wealth tax on the SCS/SCSp's worth, in proportion to their interest in the SCS/SCSp (in the ase of legal entities only, unless exemptions apply).

Full tax neutrality and tax transparency for the SCS/SCSp under certain conditions.

It is recommended to confirm with the tax authorities that the conditions, esp. the fact that the activity of the SCS/SCSp is limited to private wealth management, are fulfilled.

Regulated Limited Partnership

An SCS or SCSp set up as a SIF is subject to a subscription tax. In principle the subscription tax is 0.01% per annum, computed on its net asset value, payable and computed quarterly, subject to few exceptions.

An SCS or SCSp set up as a SICAR is, by law, not considered as carrying out a commercial activity. An SCS and SCSp set up as a SICAR would thus never be subject to municipal business tax and its non-resident partners will not be considered as having a permanent establishment in Luxembourg as a result of holding interests in the SICAR.

VAT

From a VAT perspective, management fees charged by an alternative investment fund manager to its alternative investment fund should under certain conditions not be subject to VAT, similarly to management fees charged in connection with the management of UCITS and securitization vehicles. However, the alternative investment fund is not entitled to recover any input VAT incurred.

Management fees charged by an AIFM to its AIF should under certain conditions not be subject to VAT.

10. What does a typical set of financial statements include?

The format of the financial statements mixes the following requirements:

- GAAP selected (Lux GAAP, IFRS or LPA GAAP)
- LPA specific conditions
- Applicable regulated regime (SICAR, SIF)
- Industry guidelines (IPEV, ILPA)

GAAP selected

The law offers a wide scope of option for choosing the accounting framework applicable to CLP and SLP.

The article of incorporation or the LPA could refer to Lux GAAP and would induce typically a set of financial statements including the following:

- Balance sheet
- Profit and loss accounts
- Notes to the accounts

The balance sheet, the profit and loss accounts and the notes to the accounts would need complying with the Law on companies register of December 19, 2002.

But the financial statements could be drafted as well under IFRS. Then, a typical set of financial statements would include the following:

- Statement of financial position
- Statement of income and comprehensive income
- Statement of cash flows
- Statement of changes in equity
- Notes to the accounts

The different statements would be prepared according to the different standards. Similarly, the minimum content of disclosures would be prescribed by the IFRS as accepted in the EU.

Finally, the financial statements could follow LPA GAAP which is an investor-defined accounting framework. It gives flexible accounting and disclosure rules based on what is described in the LPA. The underlying outcome is that there is no minimal content to expect from the financial information except the one agreed with the investors.

Regulated regime

By opting for a regulated regime, the CLP or the SLP will add a layer of requirements to align their disclosure requirements to what is expected from a SIF or a SICAR. Therefore, the vehicle will keep its accounting principles and disclosure rules and will enhance them with some further information required by the law or by the CSSF.

Industry guidelines

The two main Industry guidelines that set the scene in terms of what should be the critical investment information exchanged between GPs and LPs are:

- IPEV Investor Reporting guidelines endorsed by the EVCA that are promoted by the General Partners;

- ILPA Quarterly Reporting Standards Best Practices that represent the point of view of the Limited Partners.

These guidelines define good recommendation in the reporting process and reporting content and represent a helpful support if the financial statement content needs to be enriched.

11. Does the LP vehicle need to be audited?

Luxembourg's limited partnership regime can be structured as regulated vehicles such as SIF or SICAR, or in the form of unregulated vehicles, such as SCS and SCSp.

The audit of a regulated structure is required by law (legal audit) although for unregulated structures where no audit is mandatory, an audit of the annual accounts would be required because it is stated in the LPA or for group reporting purpose (contractual audit).

SCS and SCSp will have to prepare accounts for investors where this is required by specific laws such as the SICAR or the SIF Law, or when stated in the LPA.

Luxembourg GAAP, IFRS or "other" GAAP will be the most commonly used accounting frameworks in the preparation of accounts or regulated and unregulated SCS/ SCSp.

Regulated SCS/SCSp

SCS and SCSp vehicles set up through the two main specific fund-raising structures and laid out mainly in the following laws

- Law of 15 June 2004 on Investment Company in Risk Capital, as further amended ("SICAR Law");

- Law of 13 February 2007 on Specialised Investment Funds, as further amended ("SIF Law"),

are subject to the supervision of the CSSF and will have to prepare audited annual reports in accordance with Lux GAAP or IFRS, where allowed, and make these reports available to the CSSF within a period of six months from the year-end.

In addition, SCS and SCSp that are authorized AIFs required an audit in accordance with article 20 of the Law of July 12, 2013. For further explanation on what is considered as authorized AIFs, please refer to Article 3 of DIRECTIVE 2011/61/EU.

SCS and SCSp are considered as regulated if they are set up as a SIF, SICAR or are authorized AIF and will require their annual accounts to be audited by a *réviseur d'entreprises agréé.*

Unregulated SCS

Unregulated SCS having a turnover exceeding EUR 100,000 has a filing obligation of its accounts with the Trade and Companies' Register ("RCS") in accordance with the Law of 10 August 1915 on Commercial Companies, as further amended ("1915 Law").

The preparation and audit of the annual accounts of the SCS is required when on their balance sheet date it exceeds the limits of two of the following three criteria:

- balance sheet total: 4.4 million EUR
- net turnover: 8.8 million EUR
- average number of full-time staff employed during the financial year: 50.

As most of the unregulated CLP investment vehicles will not report any turnover, it is therefore expected that no legal audit would be required for such structure.

Consequently, as interest and dividend income and capital gain are not recognized as turnover, in many cases no legal audit will be required for unregulated investment fund SCS, a contractual audit of such accounts would typically take place if it is mentioned explicitly in the article of incorporation or required by article 69 (4) of 2002 Law.

Unregulated SCSp

The unregulated SCSp will not be subject to mandatory approval, registration and filing of the approved accounts with the RCS or other regulatory bodies. It will merely have to keep its books in accordance with general commercial accounting rules. Accordingly, accounts of unregulated SCSp are only prepared in cases where this is stated in the LPA or required by the investors. No legal audit is required and consequently, the contractual audit of such accounts will typically take place if the LPA explicitly mentions this or if investors require it.

The unregulated SCSp has considerably fewer obligations as regards the preparation, filing, registration and publication of the annual accounts and not obligation to have its eventual annual account audited.

Legal audit

In accordance with article 70 of the Law of 18 December 2009 on the audit profession, the use of International Standards on Auditing (ISA) is exclusively conferred on *réviseurs d'entreprises agréés* and *cabinets de révision agréés*, irrespective of whether they are performing a legal or contractual audit. In order to perform an audit in accordance with ISA, the *réviseur d'entreprises* shall be licensed by the CSSF.

The purpose of the legal audit is to obtain reasonable assurance whether the financial statements are free from material misstatement in accordance with International Standards on Auditing (hereafter "ISA") as adopted for Luxembourg by the CSSF together with Luxembourg legislation and the Practice Guidelines (*recommandations professionnelles*) issued by the CSSF and the Institut des *Réviseurs d'Entreprises* (hereafter "IRE").

In addition, for regulated vehicles, the *réviseur d'entreprises agréé* is required to promptly inform the CSSF whenever he become aware of any fact or decision that is likely to constitute a material breach of the SIF or SICAR Law or the regulations adopted for its execution, or affect the continuous functioning of the specialised investment fund, or lead to a refusal to certify the accounts or to the expression of qualifications.

Under the legal audit, the *réviseur d'entreprises agréé* will state in the audit report to the investors of the vehicle whether, in his opinion, the financial statements give a true and fair view of the financial position and of the results of its operation and changes in its net assets in accordance with one of the recognized accounting standards established by an organization that is authorized or recognized to promulgate standards by law or regulation i.e. Lux GAAP, IFRS, US GAAP and UK GAAP.

Contractual audit

Unlike legal audit, under a contractual audit, the management of an unregulated vehicle enjoys relative freedom in terms of GAAP to be used.

Under a contractual audit, the GP and the LP have the choice of GAAP which can significantly increase or reduce complexity in the reporting and accounting process of a limited partnership.

For an unregulated SCSp, the LPA may stipulate a number of options, depending on the way business is undertaken or based on any specific requirements from investors.

The LPA and the engagement letter may explicitly state the desired accounting framework it wishes to apply (including but not limited to US GAAP, UK GAAP, IFRS and even Lux GAAP as applicable to specific legal and regulatory vehicles) or, as will commonly be the case, state that:

"the accounts will be prepared in accordance with the accounting policies determined by the General Partner" or "the accounts will be prepared on the basis of the policies set out in note XX / in accordance with the Limited Partnership Agreement".

Both statements allow for a reasonable degree of flexibility in selecting accounting policies and disclosures.

They are typically referred to as "other" GAAP. It is advisable to consult with auditors when selecting accounting policies and disclosures at the early stages of drafting the LPA.

In applying other GAAP, in the audit report, the *réviseur d'entreprises agréé* will state that in his opinion, the financial statements of the vehicle are prepared in all material respects in accordance with the accounting rules set out in note XX to the financial statements and will also include in the audit report a specific statement highlighting to the users of the report that the financial statement is prepared in accordance with a specific financial reporting framework and that, as a result, the financial statement may not be suitable for another purpose.

Additional audit requirement for European venture capital fund (EuVeCA) and on European social entrepreneurship funds (EuSEF)

For unregulated SCS or SCSp that foreseen to apply for the label EuVeCA or EuSEF, the Regulation (EU) No 345/2013 and 346/2013 on European venture capital fund and on European social entrepreneurship funds, respectively will have to have their annual accounts audited by a *réviseur d'entreprises agréé* and will also to perform additional audit procedures as described in the article 12.2 below

"An audit of the qualifying venture capital fund shall be conducted at least annually. The audit shall confirm that money and assets are held in the name of the qualifying venture capital fund/ social entrepreneurship and that the manager of a qualifying venture capital/ social entrepreneurship fund has established and maintained adequate records and checks in respect of the use of any mandate or control over the money and assets of the qualifying venture capital/ social entrepreneurship fund and the investors therein."

12. Is there a requirement to disclose company portfolio information?

The level of disclosure will depend mainly on the two following aspects:

- The legal and regulatory requirements applicable to the vehicle
- The governance of the structure

Regulated SCS/SCSp

If the SCS and SCSp vehicles are set up as SIFs or SICARs, the financial statements will have to include a detailed portfolio line by line. The portfolio information displays the historical cost and the fair value of each investment line.

Unregulated SCS/SCSp

There is no specific requirement in the law as such for disclosing company portfolio in the financial statements. The requirements will come from the requirements which will be defined by the investors in the LP agreement.

13. What are the typical contents of the related party disclosure note?

Typically, the following information will be disclosed:

- Management fees calculations and details of the arrangement
- Performance fees calculations and details of the arrangement
- Name of the shareholder and ultimate controlling party (IFRS specific)
- Any transactions with the general partner or limited partners (as well as conditions of the transaction if these are related to loans for example)
- Fees paid to the directors or any financial transaction with the directors

Very similar between IFRS and Lux GAAP

Contractual arrangements with the shareholders/ directors

14. What are the requirements for risk disclosures?

The level of disclosure will depend mainly on the two following aspects:

- The legal and regulatory requirements applicable to the vehicle
- The governance of the structure

Regulated SCS/SCSp

Requirements are different depending on the regulation that is applicable.

For vehicles set up as Specialized Investment Funds under the Law of 13 February 2007, the risk disclosure is detailed in the CSSF Regulation N° 12-01.

For vehicles set up as Investment Company in Risk Capital under the Law of 15 June 2004, no such risk disclosure is foreseen in the law. Good governance should however promote relevant and transparent information in terms of risk management.

Unregulated SCS/SCSp

There is no specific requirement in the law as such for disclosing risk management in the financial statements. The requirements will come from the requirements which will be defined by the investors in the LP agreement.

15. Does the legal form of the LP impact the P/L and the disclosures in the accounts?

Regulated vehicles

A SCS and a SCSp, like SICAR and SIF, are required by specific laws (amended Law of 15 June 2004 on Investment Company in Risk Capital ("SICAR") and amended Law of 13 February 2007 on Specialized Investment Funds ("SIF") to prepare an annual report.

This annual report aiming to inform investors and the CSSF must include a balance sheet or a statement of assets and liabilities, a detailed income and expenditure account for the financial year and notes in the appendix, a report on the activities as well as any significant information enabling investors to make an informed judgment on the development of the activities and the results of the partnership. Additional disclosures may be required from regulated SCSs and SCSps qualifying as alternative investment funds. However, regulated SCSs and SCSps are exempted to maintain accounting records following the Luxembourg chart of accounts (PCN). Lux GAAP or IFRS are the most commonly used GAAP.

It must be underlined that SCSs has to file its accounts with the RCS whereas SCSps has not with as a consequence that certain disclosures will therefore remain mandatory towards the CSSF and investors but not accessible by the public.

Unregulated vehicles

Unregulated SCSs having a turnover exceeding EUR 100.000 are required to prepare and file annual accounts with the RCS. Turnover does not include financial income. However, SCS as well as SCSp with a turnover below EUR 100.000 are not required to maintain accounting records following the Luxembourg chart of accounts (PCN). The other SCS need to follow the PCN except if they opt for IFRS.

The annual accounts must include a balance sheet, a profit and loss accounts and notes prepared in accordance with Lux GAAP or IFRS. Depending on the size of the company, simplified accounts providing for a certain degree of confidentiality may be drawn up.

Additional information may be required by the LPA or required from regulated SCSs and SCSps qualifying as alternative investment funds.

Unregulated SCSps have neither an obligation to prepare annual accounts according to Lux GAAP or IFRS, nor an obligation to file annual accounts with the RCS.

Books must be kept in accordance with the provisions of the commercial code but annual accounts will only be prepared if it is required by the LPA and according the accounting policies or GAAP (Lux GAAP, IFRS or any other set of national accounting standards) determined by the investors, in accordance notably with their requirements.

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