

NEW LUXEMBOURG LAW ON PRIVATE EQUITY AND VENTURE CAPITAL INVESTMENTS (SICAR)

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Introduction

Luxembourg has established a good reputation as a jurisdiction for the incorporation of holding companies and special purpose vehicles (SPV's) that can be used in venture capital or private equity structures. Historically, venture capital and private equity houses have not used Luxembourg vehicles at the top of their investment structure.

Unregulated investment structures have been available through ordinary Luxembourg companies such as a Holding 1929 (a tax-exempt vehicle); and a Soparfi (a fully taxable holding company benefiting from the Luxembourg participation exemption regime). These companies are subject to rigid civil law provisions regarding share capital, variations of share capital, distributions and redemptions, which make them less viable for private equity or venture capital structures.

Regulated investment structures such as the tax exempt Undertakings for Collective Investments (UCI's) has been available since 1988. UCI's fall under the supervision of The Luxembourg Supervisory Authority for the Financial Sector ('CSSF'), and offer a strictly regulated environment for raising capital and investing these assets in transferable securities. The strict risk diversification rules and investment restrictions imposed on UCI's have made them unsuitable for private equity or venture capital structures.

The new Luxembourg law on SICAR (société d'investissement en capital à risque), introduced on the 15 June 2004, has been created to fill the gap between regulated investment funds and unregulated private investment companies.

The key features of the

SICAR are outlined below.

Eligible Investments

A SICAR is a vehicle whose main objective is investment in risk bearing values. Although the definition of investment in risk bearing values is vague, it can be taken to include venture capital (start-ups), investment in private unquoted companies, bridge/mezzanine financing, management buy-outs and buy-ins, convertible debts etc.

The SICAR regime does not impose any risk diversification requirements nor are there any lending or leverage restrictions. There are also no restrictions by geography, industry, maturity or currency. Therefore a SICAR could invest all its funds in one company.

Eligible Investors

The SICAR is targeted at experienced or accredited investors, and in essence aims to protect the small or inexperienced investor. The shares/units of the SICAR can only be offered/issued to institutional investors, professional investors and investors with a high level of expertise. These 'expert' investors have to declare in writing that they are an informed investor (i.e. aware of the risks being taken) and must invest a minimum amount of EUR 125,000; or they must obtain confirmation from a financial institution that the investor has the expertise, experience and knowledge to correctly appraise the risk of his VC/PE investments.

Investment in a SICAR is open to private investors and it is intended to attract high net worth individuals.

Legal Forms and Civil Law requirements

A SICAR can be established in the following legal forms:

- a public limited company (société anonyme or SA);
- a private limited company (société à responsabilité limitée or Sarl);
- a partnership limited by shares (société en commandite par actions or SCA);
- a limited partnership (société en commandite simple or ScS); or
- a co-operative company organised like a public limited liability company (société coopérative organisée comme une société anonyme or SCoop).

The CSSF requires the registered office and central administration of the SICAR to be located in Luxembourg.

Capital requirements

The law requires that a SICAR has within 12 months of establishment a minimum subscribed share capital of EUR 1 million (of which at least 5% must be paid up at subscription). Subscription may be in cash or in kind. A SICAR does not have an obligation to create a legal reserve.

There are no legal formalities or restrictions on the issue of new shares, (interim) dividend distributions or repayments, unless otherwise stipulated in the articles of association of the SICAR.

It is possible to provide for a variable share capital, which at all times will be equal to the net asset value of the SICAR. Capital calls and return of capital can be achieved without any formalities or restrictions. However it is not possible to set up a mutual fund as a co-ownership of assets, managed by a management company. The law does not provide for the possibility of organising several compartments within the same venture capital vehicle. It is possible in principle to list a SICAR on the stock exchange.

Custodians

A SICAR must appoint a CSSF approved custodian to safeguard the SICAR's assets. The custodian must be a credit institution regulated under the Luxembourg laws and have its registered office located in Luxembourg.

The custodian acts in the sole interest of the investors and must ensure that:

1. the subscription monies are collected in the time limits set by the constitutional documents of the company,
2. the company's income is applied in accordance with these documents.

Supervision of the SICAR

A SICAR will be subject to formal authorisation and supervision of the CSSF. The constitutional documents (including the articles of association and the prospectus) and directors of the SICAR must be approved by the CSSF. The CSSF must also approve the custodian and the auditor in the light of their reputation, expertise and professional integrity. However no approval is required for the promoter, investment manager or advisor of the SICAR.

The investment management may be delegated to parties established and operating outside Luxembourg. The official list of approved SICARs will be maintained by the CSSF and published in the Official Luxembourg Gazette. The SICAR election is irrevocable and cannot be reversed other than liquidating the company.

Reporting requirements and valuation principles

An independent certified Luxembourg auditor (accredited with the CSSF) must audit the annual accounts of the SICAR. There is an exemption which means the SICAR does not need to prepare consolidated annual accounts. The SICAR is required to publish a prospectus and annual report with the CSSF. The auditor is obliged to report any irregularities, breaches of law etc. concerning the business of the SICAR to the CSSF.

A SICAR must, at least every 6 months, inform those investors who so request the NAV of the shares valued in accordance with the foreseeable realisation value estimated in good faith and in accordance with the terms as provided for in the articles of association. The SICAR legislation does not impose other rules with regard to valuation methods. Therefore, guidelines from the European Venture Capital Association/BVCA or NVCA may be used.

Tax treatment of the SICAR

The SICAR legislation is designed to offer attractive tax benefits.

SICAR in a corporate form (non-transparent)

A SICAR established in a corporate form (SA, Sarl, SCA and SCoop) is only subject to a one off fixed capital duty rate of EUR 1,250 upon its formation irrespective of the amount of the equity contribution.

The SICAR will be subject to the standard Luxembourg corporate income tax on its worldwide profits. It is therefore entitled to treaty benefits and will qualify as a Luxembourg tax resident under Luxembourg's tax treaties. A SICAR will be able to obtain declarations of residence in order to apply for reduction of withholding taxes under the relevant tax treaties.

Any income derived from its investments, whether in the form of dividends, capital gains or interest will be exempt from Luxembourg corporate income tax (similarly any losses will not be deductible). Subject to certain conditions, income generated by the SICAR on funds waiting to be invested (up to 12 months) is not treated as taxable income. However, other income realised by the SICAR that is not connected with investments of risk bearing capital will be fully taxable.

There is an exemption from the annual 0.5% net wealth tax and subscription taxes.

The SICAR is exempt from any withholding taxes on dividend distributions, redemption or liquidation distributions.

Management services rendered to a SICAR are exempt from VAT.

Non-resident investors are not subject to any taxation in Luxembourg on the disposal of their interests in a SICAR.

Resident corporate investors who are subject to Luxembourg tax (i.e. a Luxembourg Soparfi) may benefit from the Luxembourg participation exemption regime assuming the minimum investment criteria are met (holding of at least 10% of the shares of the SICAR or an acquisition price of at least EUR 6 Million). In case these conditions are not met the resident corporate investor may still benefit from a 50% exemption on dividends received (capital gains are fully taxable).

SICAR in a limited partnership form (transparent)

A SICAR established in the form of a limited partnership (ScS) is transparent for Luxembourg tax purposes and therefore not subject to corporate income tax or net wealth tax in Luxembourg. The capital duty is fixed to EUR 1,250 irrespective of the amount of equity contribution. Management fees are exempt from VAT and no subscription taxes are payable.

For non-resident investors the limited partnership does not qualify as a permanent establishment in Luxembourg. Profits received or capital gains made at disposal of an interest in a limited partnership will not lead to any taxation in Luxembourg. Resident corporate investors again benefit from the Luxembourg participation if the investment criteria are met (see above).

Conclusion

A SICAR combines the advantages of a regulated investment structure, with a limited regulatory framework and supervision, without the strict rules as a traditional Undertaking for Collective Investment or the rigid civil law provisions of unregulated investment structures such as the Soparfi.

Although considered a fully taxable company, the SICAR offers favourable tax benefits as it can offer a lower tax burden in Luxembourg due to the participation exemption. Which makes an investment in a low tax jurisdiction possible. The absence of withholding taxes means the SICAR can offer a means of repatriation of profits to investors, resident outside the EU and in non-treaty countries.

AGASSI V UK TAXMAN *Justin Scott - MeesPierson Intertrust Isle of Man*

On the 19th November André Agassi won his Court of Appeal hearing against the UK Inland Revenue. The issue in the case was whether Agassi, a US tax resident, was liable to UK taxation in relation to endorsement income received by his US company from two non-UK resident companies, Nike Inc and Head Sports AG.

The layperson applying a common sense approach would probably assume in such a scenario that there would not be any liability to UK income tax due to the lack of any UK nexus. However, due to the fact that Agassi had appeared at Wimbledon in the year in question, he had a potential liability to UK taxation as he is treated as exercising a trade in the UK and is

therefore liable to UK income tax on the profits relating to the activities undertaken in the UK.

This case is interesting on a number of levels beyond just the celebrity aspect. On one level the case considers the interaction of a number of provisions being Section 18 ICTA 1988 (Schedule D taxation of income) and Sections 555 & 556 ICTA 1988 (taxation of entertainers & sportsmen). The question arising being whether the various sections have an either/or relationship or whether they are all just various methods by which to obtain the same result, i.e. a liability to UK taxation.

The case also considers the territorial concept of Section 555(2). Agassi's lawyers argued that the fact that the payments were made by non-UK resident companies meant that Section 555(2) could not apply.

The Inland Revenue, however, contended that firstly, Section 555(2) is not limited to UK tax resident payors and that in any case Sections 555 and 556 are just methods of enforcing Section 18. While the Inland Revenue won at the Special Commissioners and the High Court, the Court of Appeal agreed with Agassi that there was not a significant enough UK connection. When the case is reported in full it will be interesting to compare the analysis of the Court of Appeal Judges with the earlier decisions.

The Inland Revenue are looking to appeal to the House of Lords but they may instead have to be content with the UK tax collected indirectly through the VAT on the sales of Nike and Head goods in the UK.

IRISH HOLDING COMPANIES

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Traditionally, jurisdictions such as Luxembourg and the Netherlands have commonly been used as the location for international holding companies. The main benefit of these jurisdictions from a holding company perspective is that dividend income from underlying companies is generally exempt from taxation. In addition capital gains on the disposal of underlying companies will also generally be exempt from taxation.

Ireland, however, has not historically been seen as an optimum holding company location as the double tax relief on dividend income was limited and any gains arising on the disposal of investments was taxable at 20%.

In the Finance Act 2004 the Irish Government sought to address this issue and two changes were announced. Firstly, the amount of double tax relief that could be claimed as a credit against the Irish tax payable on dividend income was significantly extended. There is now far greater scope to claim double tax relief in relation to tax suffered by underlying subsidiaries particularly in relation to tax suffered by second and lower tier subsidiaries. Ireland has retained a credit system as opposed to an exemption system for double tax relief, but as the Irish tax rate on dividend income is only 25% in most cases there should be sufficient double tax relief to cover the Irish tax liability.

Secondly, Ireland introduced an exemption regime for capital gains arising on the disposal of shares in companies located in Ireland, the EU and Irish treaty jurisdictions. However, the stringent conditions to benefit from the exemption severely limited the applicability of the new regime. The new rules required a shareholding of at least 10% worth at least Euro 15 million or alternatively a shareholding of at least 5% worth at least Euro 50 million. However, in order to meet the European Commission's concerns about State Aid, the monetary thresholds have been removed and there is now just a flat shareholding requirement of at least 5%.

These two changes have therefore greatly enhanced the attractiveness of Ireland as a holding company location and Ireland is now a real alternative to other European holding company locations.

UK BUDGET REPORT 2005

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The March 2005 Budget is the final budget before the next UK general election in May. There were no

significant changes announced in relation to the tax rates and tax bands for Income Tax, Capital Gains Tax, Corporation Tax, VAT, and National Insurance.

In relation to Stamp Duty the 0% band for residential properties has been increased from £60,000 to £120,000. In relation to Inheritance Tax the nil rate band will increase from £263,000 to £275,000 and to £285,000 (2006-07) and to £300,000 (2007-08).

For Capital Gains Tax there were some technical changes to the establishment of the situs of assets, eg bearer shares in UK companies will now be treated as UK situs even if located outside of the UK. This will affect some tax planning currently in place for UK resident but non-domiciled individuals.

The Inland Revenue also stated that they no longer believe that they are prevented from taxing capital gains of individuals who become temporarily tax resident in a treaty jurisdiction such as Belgium and then return to the UK.

As part of the Government's ongoing action against what they perceive as abusive tax planning, a number of tax schemes have been blocked following disclosures made under the new disclosure regime. The regime has also been expanded to include schemes involving Stamp Duty Land Tax on commercial property and some additional VAT schemes.

New anti-avoidance provisions are also being introduced to (i) deny tax advantages gained through the arbitrage of different UK tax rules; (ii) prevent abuse of the double tax relief rules and; (iii) to block certain capital gains tax planning arrangements.

While the Chancellor is keen to increase the amount of UK tax collected by cracking down on artificial avoidance schemes used by UK tax residents, there is nothing in this Budget that changes the attractiveness of the UK as a location for trading and holding companies or as a jurisdiction of choice for foreign high net worth individuals.

IRISH BUDGET 2005

Danny Cox - MeesPierson Intertrust Dublin

The Irish Minister of Finance presented his 2005 Budget on 1 December 2004.

The changes announced mostly related to domestic Irish matters. However, a change of interest was the reduction of the Irish capital duty on the issue of shares by an Irish company from 1% to 0.5% as from 2 December 2004. This will be of benefit to clients incorporating Irish companies with large share capitals.

This change along with the introduction during 2004 of an exemption from tax for gains on qualifying shareholdings will enhance Ireland as a holding company location.

SPANISH INHERITANCE AND GIFT TAX ON REAL ESTATE HELD BY FOREIGN INVESTORS

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According to the Spanish Civil Code (article 9.8), succession to all property, whether movable or immovable and wherever situated is determined by the law of the deceased's nationality.

However, the Spanish tax legislation establishes different criteria of taxation, based on the beneficiary's residence in Spain, and not the residence or nationality of the deceased or donor.

Under Spanish tax legislation, individuals resident in Spain for tax purposes are subject to Spanish Inheritance and Gift Tax on the assets/rights acquired by inheritance, as testamentary gifts, or by any other means of succession.

Thus the Inheritance and Gift Tax applies in Spain to transfers of property (located in Spain or abroad) by reason of death or inter vivos gifts, to individuals resident in Spain for tax purposes.

Non resident beneficiaries are also subject to this tax as non resident payers when they receive a gift or inheritance of real estate or movable property located in Spain or rights that can or must be exercised in Spain.

The position in Spain is not the same as that in most other countries where the relevant factor for the inheritance or gift tax liability is the deceased's residence in that country. Different criteria can bring about situations of double taxation or of no taxation.

It is important to mention that Spain has signed inheritance tax treaties to avoid double taxation with France, Greece and Sweden and possible strategies in these cases can be adopted, although some of them may be inconvenient or impractical from the personal perspective of a family.

Calculation of the Tax

Where Spanish property and generally, the estate of a person is transferred by inheritance or donation, the Tax authorities charge a percentage on the tax base according to a sliding scale where different considerations are taken into account. The same scale is applicable to donations.

Inheritance and Gift Tax is progressive, the rates applicable are determined depending on the following circumstances:

- The amount transferred to the beneficiaries.

- His existing wealth.
- The beneficiary's relationship to the deceased (only applicable to inheritance not to donations).

The taxable base is determined by deducting certain allowable figures from the value of the gross estate. In case of inter vivos gifts, the law doesn't allow for any deduction of expenses nor to apply any reduction depending on the degree of kinship.

To assess the basis of a transfer it is necessary to value the assets (real estate) and liabilities (i.e. mortgage) at the time of death or donation at their real value. The valuation assigned to assets and rights by the taxpayer is subject to verification by the tax administration. The total sum after deducting the charges (i.e. servidumbres inevitable obligations), will be then liable to tax. Expenses such as the funeral and the costs of any litigation connected with the estate can also be deducted but only for inheritance, not for donations.

The basis of assessment is legally reduced depending on the degree of kinship between the testator and the transferee to arrive at the net taxable amount.

Reductions in the tax base in transmissions mortis causa

Acquirors Reduction		
Based on degree of kinship	Group I: Children and adopted children under 21	€15,956.87 plus €3,990.72 for each year under the age of 21 of the successor up to €47,858.59
	Group II: Children and adopted children aged 21 and over, spouses, ascendants and adoptive ascendants	€15,956.87
	Group III: Collateral family members in second and third degree of kinship, ascendants and descendants by affinity	€7,993.46
	Group IV: Collateral family members in fourth degree of kinship or further removed and nonfamily heirs	€0
Other compatible reductions	Physically, mentally or sensorially handicapped persons (disability of between 33% and 65%)	€0
	Physically, mentally or sensorially handicapped persons (disability greater than 65%)	€150,253.03
	Spouses, ascendants, descendants, adoptive or adopted, if beneficiary of insurance policy	100% of the amounts received under the insurance policy, up to €9,195.49, generally
	Spouses, descendants, adoptive or adopted in case of family businesses or habitual abode	UP to 95% under certain circumstances

A progressive table rate is applied to the net taxable amount to reach the gross tax payable.

The tax rates may differ from one Spanish region to another, some Spanish regions have drawn up different tables of rates, although they do not differ significantly from the State tariffs.

Tax Base (up to Euros)	Tax Payable (Euros)	Remaining Tax Base (up to Euros)	Applicable Rate
0.00		7,993.46	7.65%
7,993.46	611.50	7,987.45	8.50%
15,980	1,290.43	7,987.45	9.35%
23,968.36	2,037.26	7,987.45	10.20%
31,955.81	2,851.98	7,987.45	11.05%
39,943.26	3,734.59	7,987.45	11.90%
47,930.72	4,685.10	7,987.45	12.75%
55,918.17	5,703.50	7,987.45	13.60%
63,905.62	6,789.79	7,987.45	14.45%
71,893.07	7,943.98	7,987.45	15.30%
79,880.52	9,166.06	39,877.15	16.15%
19,757.67	15,606.22	39,877.15	18.70%
59,634.83	23,063.25	79,754.30	21.25%
39,389.13	40,011.04	159,388.41	25.50%
98,777.54	80,655.08	398,777.54	29.75%
97,555.08	199,291.40	Upwards	34.00%

When the amount is calculated a multiplicand is applied to the figure taking into account pre-existing wealth as well as relationship with deceased or donor. The existing wealth is calculated according to the Spanish wealth tax rules.

Coefficients based on degree of kinship and previous net worth

Previous net worth in Euros	Groups under article 20		
	I and II	III	IV
0-402,678.11	1.000	1,5882	2.0000
>402,678.11 - 2,007,380.43	1.500	1,6676	2.1000
>2,007,380.43 - 4,020,770.98	1.1000	1,7471	2.2000
>4,020,770.98	1.2000	1,9059	2.4000(1)

(1) The coefficient is applicable if the successors are not known, without prejudice to the refund of the respective amounts when they are known.

The resulting amount is the final tax payable. The law provides certain allowances which reduce the taxable value of gifts and inheritances received. The main allowances for real estate are:

- When a mortis causa transfers the habitual place of abode of the deceased to his spouse, an ancestor or descendant, or to a blood relative over 65 years old that had lived with the deceased for at least two years prior to their death, this attracts a reduction equal to 95% of the value, with a limit of €122,606.47 per taxpayer (provided that in all cases the acquirer retains ownership during a ten year period).
- Mortis causa transfers of a family business (e.g. economic activities, real estate activity) exempted of net worth tax, where the transfer is in favour of the taxpayer's spouse, a descendant or adoptee and the beneficiary retains the ownership of the family business for ten years after the death of the deceased, (unless the acquirer dies before the end of this

period) attract a reduction of the taxable amount equal to 95% of the value of the family business. In case of inter vivos transfers, the donor also has to be over 65 years old or legally incapacitated, has to resign from all management functions in the corporation and cease to receive any remuneration for such functions.

How to minimize the effects of this tax

Certain methods can be used to obtain tax exemptions or to apply allowances and rebates.

One of the possibilities is to become a resident in the Basque Country or Navarra, so that the respective inheritance and gift tax system would apply. In these autonomous regions, transfers by reason of death or inter vivos gifts on immovable property located in these territories can be of particular interest, as the relevant factor is the location of these assets in the Basque Country and Navarra, regardless of whether the transferor or the beneficiary is resident in those territories. The same is valid for Ceuta and Melilla which applies a 50% tax rebate as from 2003. Cantabria or La Rioja could be a good option too, because in these autonomous regions mortis causa acquisitions by ascendants, descendants and spouse of the deceased are virtually exempt since 2003 and 2004.

There are other legitimate ways to mitigate the Inheritance and Gift Tax, such as the split of the bare legal title and the usufruct of an asset. For example, on the purchase of a Spanish property, if its ownership is split between the bare legal title and the usufruct if parents only have the usufruct of a property and their children have the ownership of it, the Spanish inheritance tax will be minimal on the death of the usufruct holders. Proprietors cannot sell the property without full consent of the usufruct holders while they are alive.

Another way is to purchase a property financed by a sizeable mortgage. This reduces the inheritance tax, as the value of assets is the market value, less any charges levied on them.

Finally, the Government is considering the possibility of progressively eliminating this tax at central government level.

Several Autonomous Regions have announced a progressive abolishment of the Inheritance and Gift Tax in those regions in which it holds power, as regards mortis causa acquisitions by ascendants, descendants and the spouse of the deceased. From 2004, in many regions this measure is applicable to acquisitions in favour of descendants under 21 years of age, and it has been announced that it will progressively extend to the other beneficiaries in the next few years.

The Autonomous Region of Andalusia has reformed the Inheritance and Gift Tax in a different way. It has established an exempt minimum for estates whose minimum value does not exceed €125,000 per heir.

FUTURE UK TAX CHANGES

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It is no secret that the Labour Government need ever increasing tax receipts to cover the promised additional spending in the core areas such as Health and Education and also now in areas such as Defence. The Government is also not averse to floating possible Government policy through third parties and the media in order to gauge the public reaction.

Three tax proposals by Think Tanks reportedly close to the Government that have recently been reported by the UK press are of particular interest. Firstly it has been suggested that a new 22% Inheritance tax band should be introduced for chargeable assets between £263,000 and £288,000 with the 40% band starting for assets in excess of £288,000. However, this would be balanced with a new 50% rate for chargeable assets in excess of £763,000.

Secondly there have been reports that consideration should be given to a top rate of income tax of 50% for individuals earning in excess of £100,000.

Finally, there have been rumours of the introduction of US style rules whereby all UK citizens would be liable to UK taxation even if they are not UK resident, eg a UK citizen resident in the Isle of Man would be liable to Isle of Man taxation and also additional UK taxation, so that their final tax liability would be the same as if they were UK tax resident.

The question is how much weight, if any, should be attributed to these reports. The official line from the Treasury would appear to be that these proposals are not necessarily in line with the Chancellor's intentions but that nothing can be ruled out. With UK elections in the near future it would seem unlikely that the UK Government would dare to move into the currently uncharted waters of headline tax rate increases, as opposed to the preferred stealth taxes. Therefore in the short term we are unlikely to see these changes introduced, but in the event that the Government is re-elected these rumours seem to indicate that Labour may in the future be willing to reverse the trend of recent years for a stable/downward trend in headline tax rates.

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