THE LAWYER

BRIEFING:
Brexit

Private equity

Luxembourg stands ready to welcome PE with the RAIF

An enhanced alternative to the Anglo-Saxon limited partnership for funds could make Luxembourg a big part of the private equity solution after Brexit

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The post-Brexit play is unfolding at breakneck speed in the UK political arena. Mrs May has formed her cabinet and everyone is waiting for the inevitable Article 50 to be invoked.

However, not all eyes are on the UK. One of the topics generating media interest has been the position of European countries that may become a destination for UK firms relocating some or all of their headquarters. A few places have received serious attention in the financial sector, among them Amsterdam, Dublin, Frankfurt, Luxembourg and Paris. But what exactly can Luxembourg, nestled squarely between Belgium, France and Germany, bring to the table? The answer lies in its position as a serious player in the global financial sector, host to Europe's leading fund centre which is second only to the US on the world stage.

In this short article we explore one reason why Luxembourg stands out as an investment platform for UK private equity (PE) firms: the recent introduction of a new investment vehicle called the reserved alternative investment fund, or RAIF.

The go-to location for AIFs

Three decades ago Luxembourg's ambition was to become world's leading UCITS ('Undertakings for Collective Investment in Transferable Securities') centre and, with 75 per cent of UCITS funds distributed internationally now based in Luxembourg, this has been accomplished. Its aspiration now is to become the go-to location for alternative investment funds (AIFs). The recent introduction of new investment regimes is only the beginning.

In 2013 the Grand-Duchy created a new legal form: the special limited partnership (SLP). The success of the SLP was immediate, the 500-plus entities set up since then being proof of this. On 14 July 2016 Luxembourg's parliament approved the law introducing the RAIF. The advantages of the SLP legal form combined with the RAIF regime are compelling for private equity.

The SLP is attractive to PE investors for its tax-neutrality. When used as non-regulated investment vehicle the SLP is exempt from corporate income tax, ensuring the repatriation of profits with no or limited leakage. Similar to the Anglo-Saxon limited partnership (ELP), the SLP lacks legal personality and is tax-transparent. Also, the SLP offers more flexibility in determining partners' rights than the ELP.

When used as a RAIF, the SLP keeps similar advantages, but in a regulated vehicle.

The RAIF's tax regime is determined by its investment objective. When investing in all asset classes, the regime follows that of the regulated Luxembourg specialised investment fund. If however, it invests exclusively in risk capital the RAIF's legal form and taxation may be aligned on that of the Luxembourg SICAR, a private equity investment company, allowing better access to double tax treaties and EU Directives. In both cases investors receive distributions without incurring withholding tax in Luxembourg. The RAIF will certainly foster simplified funding structures.

The RAIF is not subject to approval by the Luxembourg financial sector supervisor (the CSSF), which significantly reduces its time-to-market. That's not to say investors are less protected. The RAIF must be an alternative investment fund within the EU Directive and it must appoint an external authorised manager, a custodian and an auditor. With a passport, the RAIF can be managed and distributed throughout the EU. If Brexit negotiations leave the UK outside the European Economic Area the RAIF will be able to maintain its EU character and tax benefits, notably being able to assist EU investors in CFC inquiries from their EU tax authorities.

While the SLP responds to a demand for a tax-transparent and operationally flexible vehicle the RAIF satisfies fund managers' appetite for a tax-efficient and more versatile investment fund. A RAIF set up as a SLP will offer the best of both worlds, providing all the benefits usually associated with the ELP.

Support along the fund value chain

Luxembourg has gained its reputation as the world's second-largest funds domicile not only because of the €3,000bn in net assets under management, but also thanks to strong organisational support along the fund value chain. Management companies, custodians, auditors, advisers and the regulatory authorities all employ a highly skilled, remarkably experienced, English-speaking and international workforce.

Now offering an enhanced alternative to the English LP for the set-up, management and distribution of AIFs, Luxembourg is ready, willing and able to be a part of the Brexit solution for private equity.