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ATOZ ALERT

Luxembourg further improves the flexibility and attractiveness of its securitisation regime

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Today, the law modifying the law dated 22 March 2004 on securitisation (the "Securitisation Law") was adopted (the "Law").

The Law provides with some adjustments of the Securitisation Law in order to improve the legal certainty by clarifying certain changed market practices, and to increase the flexibility of the Luxembourg regime towards other jurisdictions. New opportunities are created for the active management of securitisation vehicles. New or improved tools are now available to efficiently structure securitisation. These adjustments may also provide workable solutions to the interest deduction limitation rules conundrum faced by many existing securitisation vehicles.

Corporate structuring

The Law opens securitisation transactions to new legal forms of companies which have gained in popularity in recent years, in particular among private equity houses and real estate players:

- Partnerships: the common limited partnership (Société *en commandite simple*, "**SCS**"), the special limited partnership (Société *en commandite spéciale*, "**SCSp**") and the unlimited company (Société *en nom collectif*, "**SNC**"); and
- One additional type of corporation: the simplified joint stock company (*Société par actions simplifiée*, "**SAS**").

The possibility to use these new types of structures provides with a fertile environment for product development, allowing more flexibility and efficiency in the structuring of transactions, in particular through partnerships such as the SCS or the SCSp which are transparent for Luxembourg tax purposes (please refer to the "Tax consequences" part hereafter). The Law further confirms that securitisation partnerships will have to publish financial statements and shall no longer benefit from the existing exemption in this respect.

As far as securitisation vehicles with several compartments are concerned, the treatment of profit distributions where a compartment is financed by equity is clarified in the Law. The shareholders of a compartment have to approve the financial statements relating to such compartment only and the assessment of the distributable amounts and of the allocation to the legal reserve also has to be performed on a compartment basis. The Law provides with a set of subordination rules governing the rank of different classes of funding, with the option to opt for a different order. As a matter of principle, (i) debts are subordinated to shares, units, and beneficiary units, and (ii) non-fixed-rate debts are subordinated to fixed-rate debts issued by the securitisation vehicle.

Securitised assets

The Law confirms that a securitisation vehicle may acquire securitised assets directly or indirectly. The securitisation vehicle may then acquire the risks to be securitised indirectly through a wholly or partially owned subsidiary. Active management by the securitisation vehicle or a third party is now expressly allowed for Luxembourg securitisation vehicles for risks linked to loans (collateralised loan obligations, "**CLOs**"), bonds, or other debt instruments, unless the securitisation is offered to the public. This clarification removes uncertainty and offers an efficient framework for CLO structures. This improves the attractiveness of Luxembourg for CLO managers who historically implemented their structures in other countries.

The Law increases the flexibility to also allow to give securities for obligations of third parties to the extent that these obligations relate to the securitisation transaction.

Financing of the securitisation

The Law allows the securitisation vehicle to fund itself using financial instruments and also to incur indebtedness by borrowing via loans, provided that the value or return of such borrowing depends on the securitised underlying risk.

A securitisation vehicle issuing securities on a continuous basis to the public has to be authorised by the CSSF. The Law introduces a definition of the concept of "on a continuous basis to the public", whereby any vehicle which issues financial instruments to the public more than three times per year would need to be authorised.

The Law clarifies that the issuance will not be deemed to be offered to the public if any of the following criteria are met:

- the issuance is solely intended for professional clients within the meaning of the law of 5 April 1993 on the financial sector; or
- the denomination of the financial instruments is more than EUR 100,000; or
- the financial instruments are distributed in the form of a private placement.

Tax consequences

As mentioned above, the Law introduces the possibility for a securitisation vehicle to take the legal form of a partnership, namely an SCS or an SCSp. This has important tax consequences since such partnerships are normally considered as transparent for Luxembourg tax purposes, meaning that the income they realise is not taxable at the level of the securitisation vehicle itself, but is allocated directly to the investors.

So far, securitisation vehicles could be set up either as funds or as corporations (for example as a *société anonyme* or as a *société à responsabilité limitée*). As opposed to securitisation vehicles set up as partnerships, securitisation vehicles established under the form of a corporation are fully subject to tax on income and gains deriving from the assets they hold. Interest payments (e.g., on asset-linked notes issued by the securitisation vehicle), as well as certain commitments to investors, are however deductible under Luxembourg tax law, and, as a result, securitisation structures are meant and expected to achieve tax neutrality, while investors are ultimately subject to taxation based on their own tax status and residency.

With effect as from 1 January 2019, however, the interest limitation rules included in Article 168bis of the Luxembourg Income Tax Law ("**LITL**") as a result of the Council Directive (EU) 2016/1164 of 12 July 2016 (also known as the Anti-Tax Avoidance Directive "**ATAD**") established a new paradigm under which interest expenses and other costs economically equivalent to interest are only deductible up to certain thresholds. While certain carve-out and grandfathering provisions exist, the very broad and general scope of application of the interest limitation provision has brought a significant level of uncertainty as to which expenses of a securitisation vehicle are effectively subject to the interest limitation rules, and many have seen a need to reconsider the way certain securitisation transactions are structured and operated.

As a tax transparent entity, an SCS or an SCSp is normally not subject to the provisions of Article 168bis LITL, as it is not considered as an entity separate from its partners for Luxembourg tax purposes. Circular 168bis/1 issued by the Luxembourg tax authorities on 28 July 2021 confirms that the interest deduction rules apply to the holder of a participation into a tax transparent vehicle and not to the vehicle itself. Investors into securitisation partnerships will therefore need to apply these rules by monitoring the portion of income, gains and interest expenses allocated to them because of the tax transparency of the securitisation vehicle.

The Law introducing the option to use partnerships, which may benefit from a pass-through tax treatment in Luxembourg, may therefore be an interesting step towards increasing tax certainty for securitisation structures, but it will also require an accurate review of the tax position of each of the investors in such structures.

Do you have further questions?

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