

Luxembourg Real Estate Investment Vehicles



Contents



2 Preface

3 Luxembourg real estate market

4 Unregulated real estate investment vehicles

4 Corporate companies

5 Securitisation vehicles

7 Regulated real estate investment vehicles

7 Undertakings for collective investment (UCIs)

9 Specialised investment funds (SIFs)

11 Sociétés d'investissement en capital à risque (SICARs)



Preface

This brochure has been prepared jointly by *Luxembourg for Finance (LFF)* and the *Association of the Luxembourg Fund Industry (ALFI)* in order to provide general background information on the legal and taxation aspects of unregulated and regulated real estate vehicles domiciled in the Grand Duchy of Luxembourg.

The choice of a real estate vehicle will depend on the type of funding that needs to be raised, the proposed investor base, the type of investments to be made and any specific tax considerations.

The Luxembourg legal framework is diverse and flexible enough to fulfill a wide range of investor needs. The taxation regime is also a key factor when considering whether to establish an unregulated or regulated real estate investment vehicle for international investors.

This brochure is not intended to be a comprehensive study. Readers should seek the advice of qualified professionals before making any decision as to the most appropriate Luxembourg real estate investment.

This document reflects the legal situation as at 15 February 2009.

Luxembourg real estate market

The market for real estate investment vehicles is constantly developing to provide investors with flexible and innovative real estate investment products. The growth in the number of real estate investment vehicles set up in Luxembourg has outpaced the European average and all current market indicators show that this trend will continue for the future.

In 2008, Luxembourg was the leading European domicile for vehicles investing in international real estate. 29 regulated Luxembourg real estate investment funds were launched in 2008, bringing the total number of real estate funds established and operated out of Luxembourg to 118 (137 units) with total net assets of € 20.9 billion. Net assets have increased by 35.5% since 2007. These figures only refer to Luxembourg real estate vehicles regulated by the Luxembourg regulator, the "Commission de Surveillance du Secteur Financier" or "CSSF". The inclusion of unregulated Luxembourg real estate investment vehicles would increase these figures considerably.

There are several key factors to the success of Luxembourg, including:

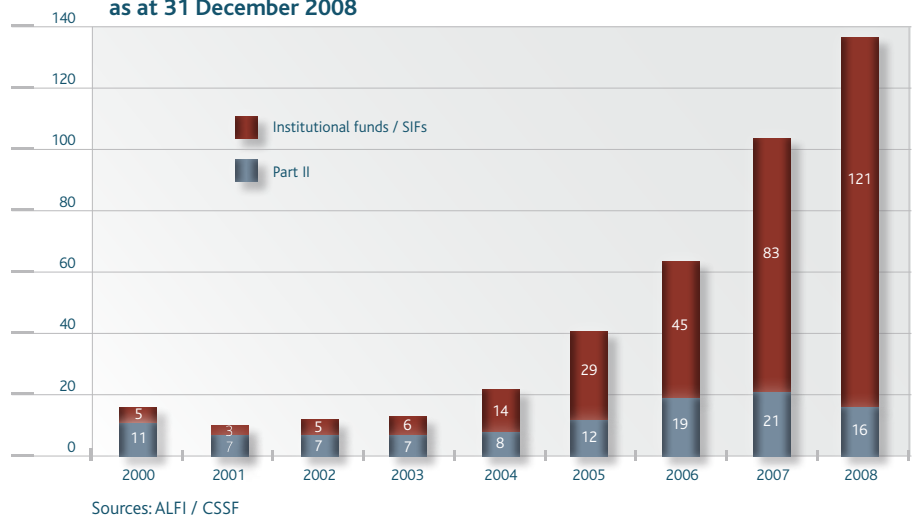
- ongoing political support for the development of the financial services industry;
- increasing investor awareness of Luxembourg funds;
- a high level of investor protection;

- a flexible onshore regime for setting up highly sophisticated and tax efficient real estate vehicles investing internationally;
- the presence of experienced service providers.

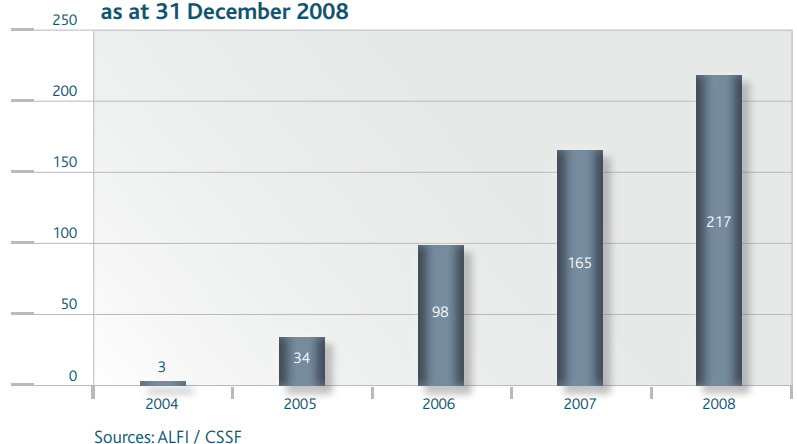
The optimal choice of a real estate investment vehicle will depend largely on the type of funding that needs to

be raised, the proposed investor base, any tax considerations and the type of investments. The current Luxembourg legal framework is diverse and flexible enough to fulfill a wide range of investor needs and the Luxembourg taxation regime is a key factor when considering whether to choose an unregulated or regulated real estate investment vehicle for international investors.

Growth in the number of Luxembourg real estate fund units as at 31 December 2008



Growth in the number of SICARs as at 31 December 2008



Unregulated real estate investment vehicles

Corporate companies

Luxembourg is often used by professional, institutional and private investors to set up companies acquiring real estate.

Legal features

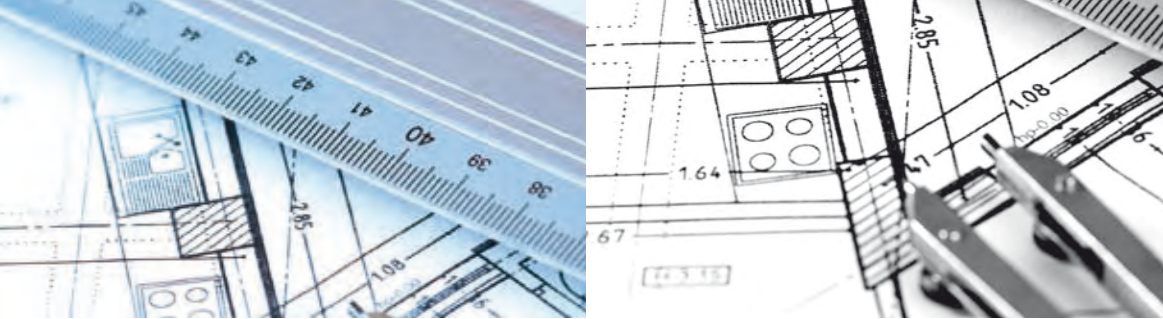
In accordance with the law of 10 August 1915 on commercial companies, as amended, companies may be incorporated in Luxembourg, as a:

- public limited company
- private limited company
- limited partnership
- partnership limited by shares
- cooperative company.

In practice, the legal form of a public limited company (*Société Anonyme* or *SA*) or a private limited company (*Société à Responsabilité Limitée* or *Sàrl*) is most commonly chosen for companies investing in real estate. One of the main features of these two forms of company is the limited liability of each shareholder to the amount of his participation in the company (this also applies to the partnership limited by shares).

The following table provides a comparison of the main features of the most popular corporate forms:

	PUBLIC LIMITED COMPANY (SA)	PRIVATE LIMITED COMPANY (Sàrl)
Incorporation	Notarial deed required	Notarial deed required
Capital	≥ € 31,000 No minimum par value as from 1/1/2007	≥ € 12,500 No minimum par value as from 1/1/2007
Shares	Registered or bearer	Registered only
Transfer of shares	Free	Subject to certain conditions being met
Shareholders	≥ 1	1 to 40
Liabilities	Shareholders' liability is limited to the amount of their participation	Shareholders' liability is limited to the amount of their participation
Assembly	1 annual general assembly required	1 annual general assembly required if the number of members/partners is ≥ 25
Management	≥ 3 directors (if there is more than one shareholder) or a <i>Conseil de Surveillance & Directoire</i>	≥ 1 manager
Statutory auditor	Required	Required only if the number of partners is ≥ 25
Accounts	Annual	Annual
Independent auditor's report	Required if certain size thresholds are exceeded	Required if certain size thresholds are exceeded



Securitisation vehicles

The Luxembourg law of 22 March 2004 on securitisation as amended contains a broad definition of securitisation and a complete legal framework for securitisation transactions, including real estate transactions. It is sufficiently flexible for promoters to develop workable and effective structures for securitisation transactions, whilst ensuring a high level of investor protection.

Legal features

Securitisation is a technique which allows to convert assets (or the risks linked to the assets), which are not marketable, into transferable securities, and then to transfer these assets (or the risks linked to the assets) to a specific entity. The entity which owns, acquires or assumes all rights in connection with a specific asset or pool of assets transfers this asset to a securitisation vehicle through the issue of transferable securities which are backed/collateralised by the underlying assets.

A wide range of assets, tangible or intangible, movable or immovable, including real estate, may be securitised as long as a value may be reasonably ascertained

Tax features

According to the "*lex rei sitae*" principle, income derived from real estate is generally taxed in the country of situation of the real estate. If the real estate is held through a company, the sale of the shares is, according to the ordinary rules of double taxation treaties, taxed in the country of residence of the seller. However, Luxembourg companies which invest directly or indirectly in real estate are subject in Luxembourg to:

- a fixed registration duty of € 75 which is due upon incorporation of a company, modification of its articles of association or transfer of registered office of a company to Luxembourg,
- net worth tax of 0.5%,
- municipal business tax and corporate income tax of 28.59% (for companies located in Luxembourg City) on all their income.

It is possible to leverage the investment through a mixture of equity and debt and the Luxembourg vehicle may benefit (via applicable double tax treaties or the EU Parent-Subsidiary Directive) from tax exemptions on income deriving from real estate situated abroad.

Dividends and gains from qualifying shareholdings in property companies are usually also exempt under the Luxembourg domestic participation exemption. In addition, there is normally no net worth tax due on directly held foreign real estate or shareholdings in foreign property companies as a result of tax treaties and domestic law exemptions.

If the income is not exempt under a tax treaty, all investment expenses (property tax, interest on loans etc.) and costs associated with real estate management are deductible from taxable income.



and there is a reasonable likelihood of current or future income or gain. Securitisation can take the form of a transfer of ownership of the assets (true sale) or of a transfer of the risks linked to the asset (synthetic).

In Luxembourg, securitisation is accessible to a wide range of investors (retail or institutional), directly or indirectly.

Securitisation vehicles are, in principle, unregulated. However, a securitisation vehicle which issues securities to the public on a continuous basis (normally interpreted as being more than three times a year) falls under the supervision and regulation of the CSSF, although offers to institutional investors and private placements do not constitute a "public offer".

There are two types of securitisation vehicle which may be set up under Luxembourg law: securitisation funds and securitisation companies.

Securitisation funds have no legal personality and, therefore, must be managed by a management company. Securitisation funds may be structured in the form of a contractual common fund (*Fonds Commun de Placement* or *FCP*) as either a co-ownership of assets (*co-propriété*)

where there is a right to the securitised assets underlying the investor's securities or as a fiduciary property (*patrimoine fiduciaire*), where the management company holds the securitised assets as fiduciary property.

Securitisation companies may take the legal form of a:

- public limited company (*Société Anonyme* or *SA*);
- private limited company (*Société à Responsabilité Limitée* or *Sàrl*);
- partnership limited by shares (*Société en Commandite par Actions* or *SCA*);
- cooperative company organised as a public limited company (*Société Coopérative organisée sous forme de Société Anonyme* or *SCoSA*).

Securitisation vehicles may:

- issue equity or debt securities;
- value, and make a return from, securities, depending on the underlying assets;
- create multiple compartments, with different assets and liabilities, which may be liquidated separately;
- issue securities to the public (if an *SA* or *SCA*).

The annual accounts must be audited by an independent auditor approved by the CSSF.

Tax features

The tax treatment of securitisation funds is similar to that of an FCP since securitisation funds are not subject to income or wealth taxes. Securitisation funds are also exempt from subscription tax (*taxe d'abonnement*).

Securitisation companies are subject to corporate income tax and municipal business tax of 28.59% (for companies located in Luxembourg City) as are other commercial companies but may deduct, without limit, dividends, interest payments and commitments towards their investors which de facto may reduce their tax basis to zero. They are exempt from net worth tax. A fixed registration duty of € 75 is due upon incorporation.

Regulated real estate investment vehicles

Undertakings for collective investment (UCIs)

Most real estate investment vehicles established in Luxembourg are undertakings for collective investment (UCIs). Real estate UCIs are those:

- which invest their funds in real estate;
- place their shares or units with the public by means of a public or private offer;
- whose exclusive object is to invest in real estate assets in accordance with the principle of risk diversification.

Legal and regulatory features

Real estate UCIs may be set up either in corporate form (i.e. *Société d'Investissement à Capital Variable* or SICAV and *Société d'Investissement à Capital Fixe* or SICAF) or in a contractual common fund form (FCP). A key determining factor in the selection of one of these structures is the tax regime applicable to investors.

FCP, SICAV and SICAF UCIs all fall within the scope of the Luxembourg law of 20 December 2002 on undertakings for collective investment as amended and Chapter I, paragraph III of CSSF Circular 91/75 of 21 January 1991 (CSSF Circular 91/75), unless they have been established as a specialised investment fund (SIF) under the Luxembourg law of 13 February 2007 as amended (see below).

Real estate UCIs may adopt a multiple sub-fund structure (umbrella fund) where, for instance, sub-funds have a different investment policy or are restricted to certain investors. The umbrella fund is legally treated as a single entity; however, in principle, each sub-fund is responsible for its own assets and liabilities.

The main types of real estate UCIs are the following:

- Real estate SICAFs, which are investment companies with a fixed capital and thus with share capital which may only vary in accordance with legal requirements. They are generally in the legal form of a public limited company (SA) or a partnership limited by shares (SCA).
- Real estate SICAVs, which are investment companies with variable share capital, i.e. the share capital is at all times equal to their net asset value. The share capital of the SICAV is automatically increased or reduced upon issue or redemption of shares.
- Real estate FCPs, which are unincorporated co-proprietorships of assets (common funds) with no legal personality and, thus, must be managed by a management company incorporated in Luxembourg. The management

company may delegate all or part of its functions to investment managers located in Luxembourg or abroad. Unitholders of the FCP, who have their liability limited to the amounts contributed by them to the FCP, are not, in principle, entitled to shareholder rights.

As for any UCI, a real estate UCI has to comply with the principle of risk diversification in the implementation of its investment policy. CSSF Circular 91/75 provides that a real estate UCI may, in principle, not invest more than 20% of its net assets in a single property. However, this rule does not apply during the start-up period which may not extend beyond 4 years after the closing date of the initial subscription period.

Distribution requirements vary according to the type of real estate UCI. As an example, an FCP or a SICAV may not make any distribution whereby the net assets of the UCI would fall below the legal minimum requirement of € 1,250,000.

Borrowing restrictions also apply to real estate UCIs since, in principle, real estate UCIs may only borrow up to 50% of the valuation of all their properties.



The net asset value of a real estate UCI is calculated at least once a year (at the end of the financial year) and on each day on which shares/units are issued or redeemed. The valuation of its assets is subject to specific requirements, such as the appointment of an independent valuer to value the underlying properties.

All real estate UCIs are subject to CSSF approval and supervision. They must appoint a custodian bank to supervise their assets and must have their central administration located in Luxembourg. Management companies of real estate UCIs also fall under CSSF supervision and need to comply with specific rules (e.g. minimum capital requirements, "fit and proper" managers). Directors and investment managers of real estate UCIs are subject to CSSF approval.

Finally, any real estate UCI may apply for a listing on the Luxembourg Stock Exchange, provided it complies with the listing requirements.

Tax features

Real estate UCIs benefit from the general tax rules applicable to UCIs and are exempt from corporate income tax and net worth tax but are subject to a fixed registration duty and an annual subscription tax (*taxe d'abonnement*).

The fixed registration duty of € 75 is payable only upon creation of the UCI, regardless of the amount invested and of any subsequent increases in capital or subscriptions.

Subscription tax is an annual tax, payable quarterly and assessed on the total net asset value on the last valuation day of each quarter. Real estate UCIs are subject to the standard rate of 0.05%. A lower rate of 0.01% may apply for those sub-funds/share classes of UCIs governed by the law of 20 December 2002 on undertakings for collective investment as amended which are reserved for institutional investors only.

Tax on income received / capital gains realised by Luxembourg real estate UCIs (e.g. real estate income such as rent) is generally taxed in the country where the asset is located. Luxembourg real estate UCIs may in addition be subject to withholding taxes on dividends and

interest levied at source, and capital gains realised by UCIs may be taxable in the country of the investment.

Some real estate UCIs in corporate form (i.e. SICAV and SICAF) are entitled to benefit from a certain number of double tax treaties signed by Luxembourg. As of 31 January 2009, 52 tax treaties had been signed by Luxembourg, with approximately half of these covering UCIs in corporate form.

UCIs formed as FCPs generally do not benefit from double tax treaties but their investors, where the tax transparency of the FCP is recognised, may be protected under the double tax treaty in place between their country of residence and the country of the source income.

Luxembourg withholding tax does not apply to distributions made by real estate UCIs to investors, irrespective of their country of residence, subject to the application of the provisions of the EU Savings Directive. The taxation of income derived from real estate UCIs will follow the rules applicable in the country of residence of the investor.

Management companies are, in principle, fully taxable companies and are therefore subject to Luxembourg taxes, such as a

Specialised investment funds (SIFs)

fixed registration duty of € 75, municipal business and income taxes of 28.59% (for companies located in Luxembourg City) and net worth tax of 0,5%. Distributions are subject to a withholding tax of 15%, unless exempted or reduced under the Luxembourg withholding tax exemption or a double tax treaty. The withholding tax on dividends distributed to a parent company that is a qualifying entity under the EC Parent-Subsidiary Directive (90/435/EEC) is reduced to 0% provided that the parent company is an entity that either holds, or commits to hold, for an uninterrupted period of 12 months, at least 10% of the shares in the Luxembourg distributing entity or alternatively, holds shares with an acquisition cost of at least 1.2 million euros. In addition, as of 1 January 2009, the withholding tax on dividends distributed to parent companies in a double tax treaty country is reduced to 0% provided the parent company is an entity that is subject to an effective tax rate of at least 10.5% and either holds, or commits to hold, for an uninterrupted period of 12 months at least 10% of the shares in the Luxembourg distributing entity or shares with an acquisition cost of at least 1.2 million euros. Liquidation distributions are not subject to withholding tax in all cases.

Under the law on specialised investment funds of 13 February 2007 as amended, which succeeds and replaces the Luxembourg law of 19 July 1991 on UCIs, the securities of which are not intended to be placed with the public, "eligible investors" are able to invest in lightly regulated, operationally flexible and fiscally efficient real estate investment funds.

Legal and regulatory features

The range of eligible assets (nature of assets or associated risks) is unlimited and consequently includes real estate.

The scope of eligible investors for SIFs is limited to well-informed investors which include institutional or professional investors or any other investor who meets the following conditions:

- a) he has confirmed in writing that he adheres to the status of well-informed investor, and

- b) (i) he invests a minimum of € 125,000 in the SIF, or
(ii) he has been the subject of an assessment made by a credit institution within the meaning of Directive 2006/48/EC, by an investment firm within the meaning of Directive 2004/39/EC or by a management company within the meaning of Directive 2001/107/EC certifying his expertise, his experience and his knowledge in adequately appraising an investment in the SIF.

Key characteristics are:

- A SIF may start activities without prior approval from the CSSF, unlike other Luxembourg regulated investment funds. However, an application for approval has to be filed with the CSSF within the month following its creation.
- The supervision of a SIF by the CSSF is lighter than for other regulated investment vehicles since neither the promoter, nor the investment manager of the SIF is subject to CSSF approval.

- In common with other Luxembourg UCIs, the SIF must appoint a custodian bank to supervise its assets. However, the custodian bank has reduced responsibilities.
- The risk diversification requirement remains in respect of the investment policy (as this is the essence of a UCI), but there are no quantitative, qualitative or geographic investment restrictions. Investment limits are determined by the SIF and agreed with the CSSF.
- Investors may invest in a SIF via equity or debt. There are no borrowing restrictions.
- In respect of disclosure and reporting requirements, a SIF is only required to produce an annual audited report covering the relevant financial year. No publication of net asset value is required.

SIFs may be structured as:

- an FCP managed by a management company;
- an investment company with variable capital (*Société d'Investissement à Capital Variable or SICAV*), opting for the corporate form of
 - a private limited company (*Sàrl*);
 - a public limited company (*Société Anonyme or SA*);
 - a partnership limited by shares (*Société en Commandite par Actions or SCA*);
 - a cooperative company organised as a public limited company (*Société Coopérative organisée sous forme de Société Anonyme or SCoSA*);
- any other legal form available under Luxembourg law.

The rules applicable to subscription, redemption and distributions, valuation of assets and the compartmentalisation of assets may also be freely determined by the SIF.

The minimum capital (share capital and share premium), however, must reach € 1,250,000 within a period of 12 months following approval by the CSSF.

Tax features

Whether organised as an FCP, SICAV or in another legal form, capital contributions will be subject to a one-off fixed capital duty of € 75. SIFs are otherwise only subject to an annual subscription tax (*taxe d'abonnement*) of 0.01% assessed on the total net assets of the SIF. Some exemptions may apply.

There is no withholding tax for distributions, except if due by application of the EU Savings Directive. Non-resident investors will usually not be subject to capital gains taxation in Luxembourg on disposal of shares in a SIF.



Sociétés d'investissement en capital à risque (SICARs)

The law of 15 June 2004 as amended created a legal framework establishing an investment vehicle tailored for qualified investors investing in venture capital and private equity, the investment company in risk capital (*Société d'Investissement en Capital à Risque* or SICAR).

Legal and regulatory features

Eligible assets under the SICAR regime are all assets representing risk capital. CSSF Circular 06/241 dated 5 April 2006 gives a general description of the concept of risk capital. Although a SICAR is not authorised to invest directly in real estate properties, CSSF Circular 06/241 specifies that a SICAR can do so indirectly via entities that hold or invest in real estate assets. The purpose of a SICAR, as a real estate investment vehicle, is to buy real estate investments with a view to selling them at a profit.

Real estate investments need to have risk capital characteristics to be classified as eligible assets. These could, for example, include a combination of:

- the objective of developing the target asset (for example value creation through investment in renovating a property or restructuring of a portfolio of properties);
- a specific element of risk associated with the property which is beyond the common level of real estate risk (for example the location of the property in a distressed area or an emerging country, or a property with significant tenant or void risk);
- the objective of acquiring the property in order to sell at a capital gain.

Typically, "opportunistic" investment strategies would qualify for the SICAR.

The securities issued by the SICAR are reserved to well-informed investors which include institutional and profes-

sional investors or any other investor who meets the following conditions:

- he has confirmed in writing that he adheres to the status of well-informed investor and
- he invests a minimum of € 125,000 in the company, or
- he has been subject to an assessment made by a credit institution within the meaning of Directive 2006/48/EC, by an investment firm within the meaning of Directive 2004/39/EC or by a management company within the meaning of Directive 2001/107/EC certifying his expertise, his experience and his knowledge in adequately appraising an investment in risk capital.

Investment rules are flexible to fit with the specific needs of the private equity and venture capital industry. The SICAR is not subject to risk diversification requirements. It may use various forms of investments and various forms of financing for its investments.

A SICAR may be incorporated in the legal form of a:

- public limited company (*Société Anonyme* or *SA*);
- private limited company (*Société à Responsabilité Limitée* or *Sàrl*);
- partnership limited by shares (*Société en Commandite par Actions* or *SCA*);
- limited partnership (*Société en Commandite Simple* or *SCS*);
- cooperative company organised as a public limited company (*Société Coopérative organisée sous forme de Société Anonyme* or *SCoSA*).

A SICAR is entitled to create multiple investment compartments with specific investment policies and potentially with securities of a different par value or no nominal value at all.

Operational flexibility is provided as there are no rules in respect of the type of capital (fixed or variable), the subscription and redemption of shares, and the

distribution policy. However, the minimum capital of € 1 million (including share premium) must be reached within 12 months of incorporation and there are requirements to calculate the net asset value semi-annually and to produce an audited annual report.

The SICAR is subject to the pre-approval and supervision of the CSSF. The managers of the SICAR, the auditor and the custodian are also subject to such pre-approval, but there is no such requirement for the promoter and the investment manager of the SICAR.

Tax features

The SICAR is subject to a registration duty of € 75 upon incorporation. It is exempt from net worth tax and subscription tax (*taxe d'abonnement*).

A SICAR formed as a transparent vehicle is exempt from corporate income tax, municipal business tax and withholding tax on distributions made by the SICAR. The income received by the investors of

a transparent SICAR is taxed according to the rules applicable in their country of residence. Non-resident investors are not taxed on gains realised upon disposal of shares in the transparent SICAR.

A SICAR formed as a non-transparent vehicle is subject to corporate income tax and municipal business tax of 28.59% (for companies located in Luxembourg City) but may benefit from tax exemptions for income and capital gains realised on transferable securities (including shares and debt securities) and on income from cash held for up to 12 months pending investment in risk capital. However, capital losses on such investments are not tax-deductible. The non-transparent SICAR is exempt from withholding tax and should be able to claim treaty benefits or qualify for the affiliation privilege under the EU Parent-Subsidiary Directive. Non-resident investors are not taxed on gains realised on the disposal of shares in a non-transparent SICAR, and there is no withholding tax on dividends or other distributions of profit.

Luxembourg for Finance

Agency for the Development of the Financial Centre

Luxembourg for Finance is a public-private partnership between the Luxembourg Government and the Luxembourg Financial Industry Federation (PROFIL). It consolidates the efforts made by the public authorities and principal actors of the financial sector to ensure the development of an innovative and professional financial centre through a coherent and structured communications policy.

Thus Luxembourg for Finance will enhance the external presentation of the financial centre, communicating the advantages of its products and services to a wider public and highlighting the numerous opportunities available to investors and clients, whether institutional or private, from around the world.

Luxembourg for Finance organises seminars in international financial centres and takes part in selected world class trade fairs and congresses.

The agency also develops its contacts with opinion leaders from international media and is the first port of call for foreign journalists.



Luxembourg for Finance

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