Building a better working world

Luxembourg fund series – Chapter Two

The new favorite of the Luxembourg Fund Toolbox – Reserved Alternative Investment Fund ("RAIF")

RAIFs are governed by the Luxembourg Law of 23 July 2016, as amended (the "RAIF Law"). Since the RAIF Law came into effect, 953 RAIFs have been launched as at 28 February 2020[1]. A RAIF can invest in all types of asset classes.

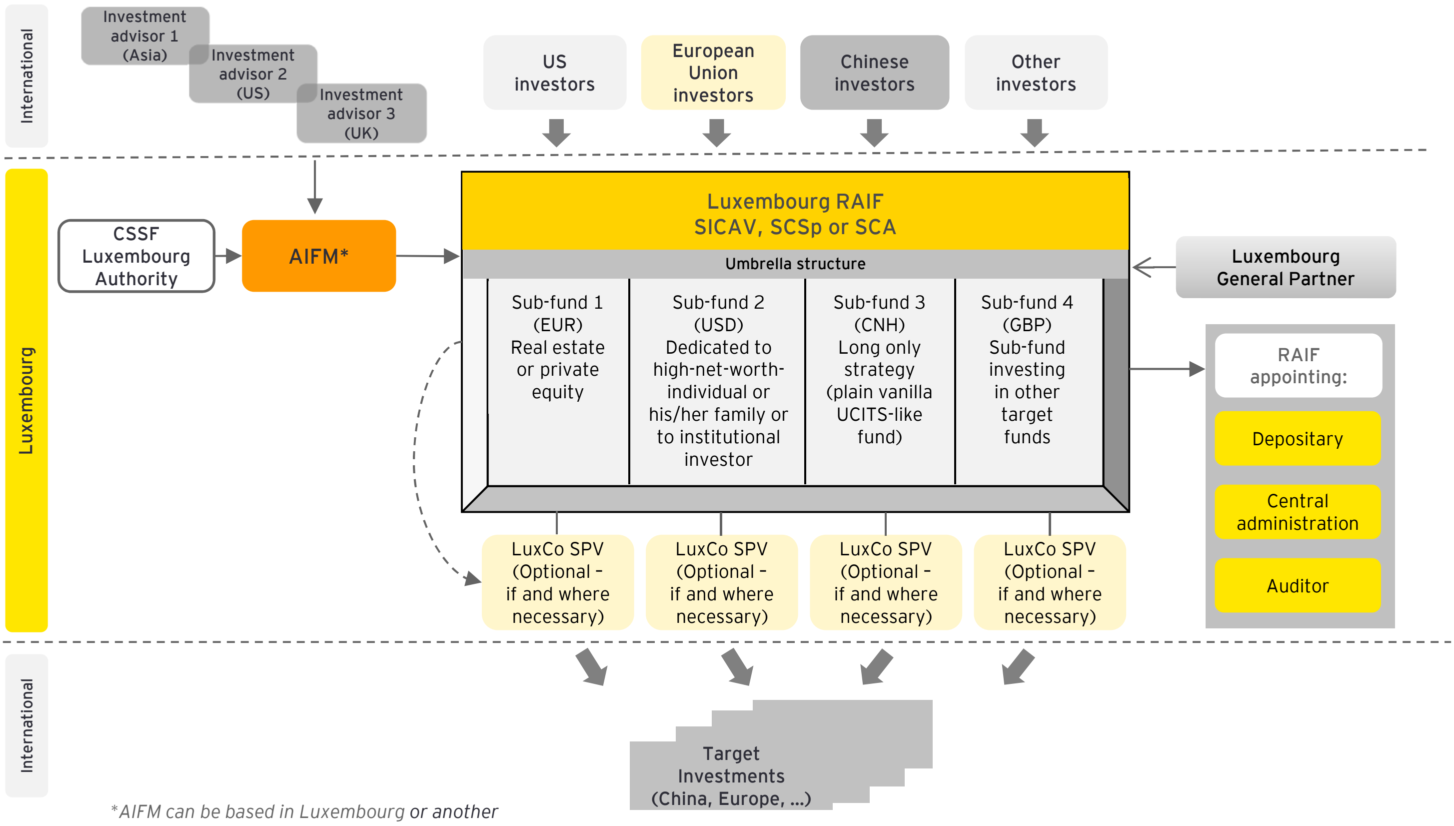
Why is the RAIF structure so popular amongst fund managers in the alternative investment fund space? It is because RAIF is not subject to the direct supervision of the *Commission de Surveillance du Secteur Financier* ("CSSF", the competent authority in Luxembourg) but is only indirectly supervised at the level of its appointed Alternative Investment Fund Manager ("AIFM"). Thus, the fund industry is confident in the RAIF structure as it provides the desired investors' protection while being more flexible compared to other regulated fund vehicles.

In the first chapter of the Luxembourg fund series[2], we have mentioned that there is an increasing interest from Chinese and Asian fund managers to raise onshore Luxembourg funds and introduced the importance and advantages of having Luxembourg fund. This is the second chapter of the Luxembourg fund series, which we aim to provide an overview of the key attractive features of the RAIF structure, a new favorite amongst fund managers in the Luxembourg fund toolbox.

[1] Source: Registre de Commerce et des Sociétés

[2] Please refer to below link for the first chapter of the Luxembourg fund series:
https://www.ey.com/Publication/vwLUAssets/ey-understanding-luxembourg-fund-in-10-minutes-en/$File/ey-understanding-luxembourg-fund-in-10-minutes-en.pdf

Below is an example of a RAIF structure.



**AIFM can be based in Luxembourg or another European Union member state*

Attractive features of the RAIF structure

1. Not subject to double-tier supervision

Luxembourg's fund regulation and supervision are structured at the level of the fund ("Product Regulation") and are applicable to regulated funds such as the Specialized Investment Fund ("SIF") and the Investment Company in Risk Capital ("SICAR"). The Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers ("AIFM Directive") introduced regulation and supervision at the level of the AIFM ("Manager Regulation"). Being managed by an authorized AIFM which is regulated under the AIFM Directive (i.e., Manager Regulation), a RAIF offers the protection desired by investors and marketability wanted by certain fund managers while, at the same time, avoiding Product Regulation being applied to regulated funds such as SIF or SICAR.

The appointed AIFM of a RAIF can be authorized in Luxembourg or any other EU Member State. If it is the latter, the AIFM should meet certain requirements as stipulated in the AIFM Directive.

2. Quicker time to market

Unlike regulated funds such as SIF and SICAR, RAIF can be set up quickly as no CSSF prior approval is required.

3. More corporate flexibility

A RAIF can be structured as a common fund, a corporate form[3] or a partnership. The choice of legal forms would be based on commercial considerations and would differ in the below key aspects:

- Whether the fund would be treated as a legal person
- Whether the fund would be treated as a tax transparent entity
- Minimum capital requirements
- Limit on the number of shareholders
- Liability of investors
- Transferability of shares
- Requirements on the part of the management
- Disclosure requirements

[3] With respect to the corporate form, it can be structured as an investment company with variable capital ("SICAV") or an investment company with fixed capital ("SICAF").

4. Passporting

As a RAIF is managed by an authorized AIFM, it enjoys the benefits of passporting in the European Union ("EU"), meaning that it can be marketed to professional investors throughout the EU.

5. Attractive tax regime

From a tax perspective, a RAIF structure enjoys the below attractive tax features:

- Tax neutrality at fund level, not increasing the tax burden of investors
- Applicable tax regime:
  1. Treated as a SIF unless it selects to be treated as a SICAR
     - Exempt from Luxembourg Corporate Income Tax
     - Subject to Subscription Tax at 0.01% (with certain exemptions available)
  2. Opting for being treated as a SICAR
     - Exempt from Luxembourg Corporate Income Tax on income derived from risk capital
     - Not subject to Subscription Tax
  3. Taking the form of a Luxembourg partnership (e.g., limited partnership (S.C.S.) or special limited partnership (S.C.Sp.))
     - Tax transparent and not subject to any Luxembourg taxes at fund level (i.e., investors would be treated as taxpayers instead)
- Only subject to minimum Net Wealth Tax
- No Withholding Tax on distributions to investors
- Potential reduction of Withholding Income Tax on investment income derived from underlying investments via the EU Parent-Subsidiary Directive or treaty relief under the relevant double taxation agreement

6. Enjoys the benefits of an umbrella fund structure

A RAIF can be established as an umbrella fund, with each sub-fund having separate assets and liabilities, as well as bearing different features from other sub-funds. Each sub-fund can display its own features in below aspects in the RAIF's issuing document, including:

- Investment policy
- Appointed investment manager or investment adviser
- Tailored rules governing the issuance and redemption of securities / interests
- Specific rules governing investment terms
- Fee structure and distribution or carried-interest structure
- Type of eligible investors
- Separate annual report

The use of an umbrella fund structure allows the sharing of initial formation cost and ongoing operating cost. It also permits investors to switch between sub-funds, subject to meeting certain conditions stated in the issuing document.

That said, a RAIF would need to appoint the same authorized AIFM, depositary, auditor and central administration agent across all sub-funds.

7. Possible to convert existing structure into a RAIF structure

Seeing the attractive features of a RAIF structure, if commercially and legally feasible, some fund managers may consider converting their existing fund structure (e.g., unregulated or regulated fund in Luxembourg or outside of Luxembourg) into a RAIF. Of course, the conversion will require compliance with the AIFM Directive as the RAIF should be managed by an authorized AIFM. We would be pleased to explore the feasibility of such a conversion and support the actual implementation if a conversion is deemed to be legally and commercially possible.

If you would consider setting up a RAIF in Luxembourg or convert your existing fund structure into a RAIF, please feel free to contact us. Our Luxembourg fund team would be happy to further discuss this topic with you.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please contact us for specific advice.

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