The impact of the draft "*Unshell Directive*" on Luxembourg-based collective investment undertakings

Dr. Julia Sinnig*

Prof. Dr. Dirk Zetzsche, LLM**

Le (projet de) directive européenne dit « Unshell » (ou ATAD3) vise à abolir la structuration fiscale par le biais de «coquilles» de sociétés, sans aucune activité économique ni substance. Cet article analyse en particulier l'impact de la proposition de directive sur les organismes de placement collectif (OPC).

Les OPC qui ne sont ni détenus par le grand public ni cotés en bourse sont potentiellement exposés aux règles de la proposition de directive sur la transparence, sur l'ignorance de l'existence d'une coquille de société à des fins fiscales entraînant le refus des avantages prévus par les directives fiscales de l'UE et les conventions sur la double imposition, ainsi que sur les contrôles fiscaux. Tandis que la proposition de directive sur les sociétés non transparentes exclut de son champ d'application toutes les sociétés d'investissement d'OPCVM et de fonds alternatifs ainsi que les sociétés de gestion d'OPCVM et les gestionnaires de fonds alternatifs ; un certain nombre d'entités supplémentaires jouent un rôle significatif dans le contexte d'un fonds dans le but de relier le fonds au gestionnaire, aux actifs et aux investisseurs.

Nous constatons que les sociétés d'investissement des fonds alternatifs, les commandités des sociétés en commandite et les véhicules de portage bénéficient tous de l'exclusion du champ d'application des fonds d'investissement alternatifs telle que prévue dans la proposition initiale de directive ATAD3 par la Commission européenne. Nous soutenons également que, conformément à l'approche de l'OCDE, les entités ad hoc (« Special Purpose

The (draft) "Unshell Directive" (or ATAD3) seeks to abolish tax-driven structuring by virtue of empty corporate 'shells' without economic activity and substance. In particular, this article analyses the Unshell Directive Proposal's impact on collective investment undertakings.

Undertakings of this kind that are neither widely held nor listed are potentially exposed to the Unshell Directive Proposal's rules on transparency, on the disregard of the existence of a corporate shell for tax purposes entailing denial of benefits under EU tax directives and double tax conventions, as well as on tax audits. While the Unshell Directive Proposal carves out all UCITS and AIF investment companies, UCITS management companies and AIFMs, a number of additional entities are employed in the context of the given fund that link it to the manager, the assets and the investors.

We find that AIF investment companies, general partners of limited partnerships and carry vehicles all benefit from the AIF carve-out as it stands under the initial Commission Proposal for the Unshell Directive. We further argue that, in line with the OECD approach, Special Purpose Vehicles (SPVs) between the fund and its assets benefit from this carve-out since EU fund regulation treats these SPVs as an

* PhD; Postdoctoral Researcher, ADA Chair in Financial Law (Inclusive Finance), University of Luxembourg.

Vehicles » – SPV) interposées entre le fonds d'investissement et ses actifs bénéficient de cette exclusion puisque la réglementation européenne sur les fonds d'investissement considère ces SPV comme faisant partie intégrante du fonds alternatif ou de l'OPCVM. Parmi les entités interposées entre le fonds et les investisseurs, seules les « institutions financières réglementées » doivent être exclues.

Pour les SPV couverts par le champ d'application de la proposition de directive « Unshell », nous voyons de solides raisons de renverser la présomption de coquille en vertu de l'article 9 (2) (a) de la proposition de directive, car les SPV interposées entre le fonds et le gestionnaire, ainsi qu'entre le fonds et les actifs, servent souvent à protéger les investisseurs, à réduire les coûts et à renforcer la sécurité juridique. Contrairement à cet objectif, la procédure de renversement de présomption de société dépourvue de substance minimale pour ces entités diminue la sécurité juridique en matière fiscale et augmente les coûts de conseil fiscal et juridique, ce qui nuit à l'efficacité du marché unique européen.

Nous identifions en outre au moins six raisons commerciales légitimes différentes de placer des entités entre les fonds et les investisseurs. Bien que les objectifs de la proposition de directive « Unshell » impliquent une dérogation dans ce cas, le législateur européen est encouragé à renforcer la sécurité juridique par le biais des raisons commerciales valables acceptées pour l'utilisation des SPV.

En résumé, la proposition de directive « Unshell » empêche les investisseurs privés d'utiliser les SPV pour une « double structuration fiscale (proche de zéro) », tant au niveau de l'entité que de l'investisseur. En outre, les entreprises qui ne sont pas des fonds alternatifs ou des OPCVM (par exemple, les structures d'investissement en dette collective et les «family offices»), ainsi que certains fonds alternatifs gérés par des gestionnaires de fonds alternatifs sous-seuil, ressentiront l'impact de la proposition de directive « Unshell ». Le choix d'un organisme financier réglementé pour la structuration de ces cas pourrait présenter une solution valable et efficace en réponse à la proposition de directive « Unshell ».

integral part of the AIF/UCITS. Among the entities between fund and investors, however, only "regulated financial institutions" are to be carved out.

For in-scope SPVs, we see robust grounds for the rebuttal of the shell presumption under Article 9 (2) (a) Unshell Directive Proposal as SPVs between fund and manager, as well as between fund and assets, often serve to protect investors, reduce costs and increase legal certainty. Contrary to this purpose, the rebuttal procedure for these entities decreases legal certainty in tax matters and enhances tax advisory and legal costs that undermine the efficiency of the European single market.

We further identify at least six different context-dependent legitimate commercial rationales for putting entities between fund and investors. While the objectives of the Unshell Directive Proposal entail a carve-out in this case, the EU legislature is encouraged to enhance legal certainty on the accepted commercial rationales for the use of SPVs.

In summary, the Unshell Directive Proposal prevents private investors' use of SPVs for "double (close-to-)zero tax structuring" at both entity and investor level. Furthermore, non-AIF and non-UCITS undertakings (e.g. collective debt investment structures and family offices), as well as some AIFs managed by sub-threshold AIFMs, will feel the impact of the Unshell Directive Proposal. Opting-in to a regulated financial institution is one plausibly effective solution in response to the Unshell Directive Proposal.

Après l'introduction, la partie I fournit une vue d'ensemble de la proposition de directive « Unshell ». Ensuite, la partie II analyse l'impact de la proposition de directive « Unshell » sur le fonds d'investissement, le gestionnaire du fonds et les entités ad hoc employées dans le contexte du fonds. La partie III expose des considérations politiques sur la manière d'améliorer la proposition de directive « Unshell ».

After the introduction in Pt. I, Pt. II provides an overview of the Unshell Directive Proposal's framework. Thereafter, Pt. III analyses the impact of the Unshell Directive Proposal on the given fund, the fund manager and the SPVs employed in the fund's context. Meanwhile, Pt. IV outlines policy considerations on how to improve the Unshell Directive Proposal, before Pt. V concludes.

Introduction

Almost 20 billion EUR in assets is managed by EU-based Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs). With net assets of 5,162 billion EUR, Luxembourg constitutes the main centre of the EU investment fund industry, ahead of Ireland (3,764 billion EUR), Germany (2,551 billion EUR), and France (2,165 billion EUR).[1] The attractiveness of Luxembourg as an investment fund hub lies in its efficient and transparent regulation and regulatory enforcement as well as the high density of financial services providers, which together offers legal certainty both for investors and intermediaries.[2] Any piece of regulation, and particularly legislation concerning the operating environment of investment fund structures and financial intermediaries such as tax legislation, is of high interest to Luxembourg and its economy.

Recently, European tax harmonisation has focused on creating a common framework for (corporate) taxation that limits possibilities for tax arbitrage to achieve a level playing field amongst EU Member States and a coherent internal market as well as greater legal certainty.[3] This endeavour follows international taxation trends observable at OECD level.[4]

In 2016, the European Commission launched its so-called "*Anti-Tax Avoidance Package*" providing the blueprint for a directive "*laying down rules against tax avoidance practices that directly affect the functioning of the internal market*" (*hereafter* "ATAD1").[5] Through ATAD1, the European Commission implemented some

[1] EFAMA, *Investment Fund Industry Fact Sheet – May 2023 Data*, available at: https://www.efama.org/sites/default/files/files/Monthly%202023%2005%20EFAMA%20Fact%20Sheet%20%28May%202023%29.pdf (last access: 17 August 2023).
[2] *Cf.* also: Dirk A. Zetzsche, *The Anatomy of European Investment Fund Law*, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2951681 (last access: 9 August 2023), p. 29.
[3] Recital (4) of Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, *OJ* L 193 of 19 July 2016, p. 1 (hereafter "ATAD1").
[4] *Cf.*, e.g., recitals (1) and (2) of ATAD1.
[5] *Cf.* full citation in note 3 *supra*.

action points[6] of the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan and takes account of the EU's initiative on a Common Consolidated Corporate Tax Base (CCCTB).[7]-[8]

Since its coming into effect on 1 January 2019, ATAD1 has addressed aggressive tax planning through the following five[9] measures: (1) the controlled foreign company (CFC) rule,[10] (2) the (initial) rule on hybrid mismatches,[11] (3) the rule on exit taxation,[12] (4) interest limitation[13] as well as (5) the general anti-abuse rule (GAAR)[14].

While Luxembourg's ATAD1 implementation[15] has prompted the European Commission to initiate an infringement procedure in front of the Court of Justice of the European Union (CJEU),[16] the EU's tax agenda did not relent. Specifically,

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[6] Notably actions 2 (hybrid mismatches), action 3 (controlled foreign company rules), action 4 (interest limitation rules), action 6 (general anti-abuse rule), action 7 (permanent establishment status) and action 13 (country by country reporting); *cf.* Council of the European Union, *Council conclusions on corporate taxation – base erosion and profit shifting*, press release 910/15 of 8 December 2015, para. 17; Luxembourg Ministry of Finance, *Tax transparency and the fight against aggressive tax planning*, last updated: 17 May 2023, available at: https://mfin.gouvernement.lu/en/dossiers.gouvernement%2Ben%2Bdossiers%2B2018%2Btransparence-fiscale.html (last access: 9 August 2023).

[7] European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), 25 October 2016, COM(2016) 683 final.

[8] European Commission, Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market, 28 January 2016, COM(2016) 26 final, pp. 4-5 of the Explanatory Memorandum (hereafter "draft ATAD1").
In the meantime, two other initiatives have been launched on corporate taxation in the European Union: European Commission, *Business in Europe: Framework for Income Taxation (BEFIT)*, information available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Business-in-Europe-Framework-for-Income-Taxation-BEFIT-_en (last access: 31 August 2023); European Commission, Proposal for a Council Directive on laying down rules on a debt-equity bias reduction allowance and on limiting the deductibility of interest for corporate income tax purposes, 11 May 2022, COM(2022) 216 final, also referred to as "DEBRA".

[9] Art. 6 of the draft ATAD1 contained also a switch-over rule, which was removed throughout the legislative proceeding.

[10] Art. 7 ATAD1.

[11] Art. 9 ATAD1.

[12] Art. 5 ATAD1.

[13] Art. 4 ATAD1.

[14] Art. 6 ATAD1.

[15] Luxembourg implemented ATAD1 by the law adopted on 21 December 2018. *Cf.* Loi du 21 décembre 2018 (1) transposant la directive (UE) 2016/1164 du Conseil du 12 juillet 2016 établissant des règles pour lutter contre les pratiques d'évasion fiscale qui ont une incidence directe sur le fonctionnement du marché intérieur; (2) modifiant la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; (3) modifiant la loi modifiée du 1er décembre 1936 concernant l'impôt commercial («*Gewerbesteuergesetz*»); (4) modifiant la loi d'adaptation fiscale modifiée du 16 octobre 1934 («*Steueranpassungsgesetz*»); (5) modifiant la loi générale des impôts modifiée du 22 mai 1931 («*Abgabenordnung*»), *Mém. A* – n° 1164 du 21 décembre 2018, p. 1 (hereafter "ATAD1 Law").

[16] The European Commission criticizes Luxembourg for granting an exception from the interest limitation rule under Art. 4 (7) ATAD1 to securitization entities not mentioned in the exhaustive list of financial undertakings provided by Art. 2 (5) ATAD1. *Cf.* European Commission, *Taxation: Commission decides to refer Luxembourg to the Court of Justice for failing to correctly transpose the Anti-Tax Avoidance Directive*, press release of 14 July 2023, available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3456 (last access: 9 August 2023). The Luxembourg government, however, already took action in spring 2022 to address the issue by modifying the implementing law in accordance with the European Commission's argument (*cf.* Projet de loi n° 7974 portant modification de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu, document de dépôt, 9 March 2022). The Luxembourg Chamber of Commerce pleads in favour of including securitization entities in the Luxembourg ATAD1 implementation, arguing that ATAD3 covers those entities as "*financial undertakings*" benefitting from certain exemptions and that it therefore makes sense to have a uniform exemption of these entities in anti-tax avoidance rules (Projet de loi n° 7974 portant modification de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu, Avis de la Chambre de commerce, 30 March 2022, p. 1). The issue is due to timing: the securitization entities in question have only be regulated by a European regulation in 2017 (Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC and 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012, *OJ* L 347 of 28 December 2017,

in May 2017, ATAD2 broadened the scope of the ATAD1 rule on hybrid mismatches, by including third-country situations[17] and additional types of hybrid arrangements.[18] Subsequently, Luxembourg implemented ATAD2 in December 2019.[19]

On 22 December 2021, the European Commission presented its proposal for the Unshell Directive, or also dubbed "ATAD3".[20-21] With ATAD3, the Commission seeks to address the abuse of legal entities with no minimal substance and engaged in no economic activity,[22] and ensure "*fair and effective taxation*" by "*combating tax avoidance and evasion practices, which directly affect the functioning of the internal market*."

p. 35), i.e. after the adoption of ATAD1. However, the Luxembourg government understood the purpose of ATAD1 as to include all financial entities regulated by an EU legislative act in the exception of the ATAD1 interest limitation rule: "*L'objectif poursuivi par la définition des entreprises financières est de couvrir toutes les entités réglementées par une directive européenne ou un règlement européen. D'autres entreprises non réglementées en vertu d'une directive ou règlement européens ne sont pas couvertes par cette définition, (…)*" (Projet de loi n° 7318 1) transposant la directive (UE) 2016/1164 du Conseil du 12 juillet 2016 établissant des règles pour lutter contre les pratiques d'évasion fiscale qui ont une incidence directe sur le fonctionnement du marché intérieur (…), document de dépôt, 19 June 2018, p. 24).

[17] Council Directive (EU) 2017/952 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries, *OJ* L 144 of 7 June 2017, p. 1 (hereafter "ATAD2").

[18] In particular, ATAD2 inserted Art. 9a, 9b ATAD2 on reverse hybrid mismatches and tax residency mismatches, respectively. *Cf.* Tomas Balco, "ATAD 2: Anti-Tax Avoidance Directive", *European Taxation* 2017, pp. 127-136; Christian Kahlenberg/Florian Oppel, "Anti-BEPS-Richtlinie: Erweiterung um Regelungen zur Neutralisierung von hybriden Gestaltungen mit Drittstaaten", *Internationales Steuerrecht* 2017, pp. 205-213; Tijmen C. Cabollet, "The Impact of ATAD 2 on Real Estate and Private Equity Funds", *Derivatives & Financial Instruments* 2019, vol. 21 no. 3, published online at IBFD; Tom Hamen/Pierre-Antoine Klethi, "The Luxembourg reverse hybrid rules: challenges and suggestions for reform", *Revue générale de fiscalité luxembourgeoise* 2022, no. 1, pp. 17-26; Aurélie Budzin-Dang/Maxime Budzin, "CIV exemption in ATAD II: Is it worth the hype?", *Revue générale de fiscalité luxembourgeoise* 2021, no. 2, pp. 41-50; Jérôme Charpentier/Charlotte Genot/Marie Germain/Julie Hecklen, "La transposition de la directive ATAD 2: une perspective franco-luxembourgeoise", *Revue générale de fiscalité luxembourgeoise* 2021, no. 3, pp. 66-78.

[19] The law modified the 1967 Income Tax Law (*Mém. A* – n° 79 du 6 décembre 1967, p. 1225) by inserting article 168*ter*. *Cf.* Loi du 20 décembre 2019 portant 1° modification de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; 2° modification de la loi modifiée du 16 octobre 1934 concernant l'impôt sur la fortune («*Vermögensteuergesetz*»); 3° modification de la loi d'adaptation fiscale modifiée du 16 octobre 1934 («*Steueranpassungsgesetz*»); 4° modification de la loi générale des impôts modifiée du 22 mai 1931 («*Abgabenordnung*»); en vue de transposer la directive (UE) 2017/952 du Conseil du 29 mai 2017 modifiant la directive (UE) 2016/1164 en ce qui concerne les dispositifs hybrides faisant intervenir des pays tiers, *Mém. A* – n° 889 du 23 décembre 2019, p. 1.

[20] Technically, the Unshell Directive Proposal is not amending ATAD1, but constitutes a stand-alone proposal for a new Directive (the spirit of which well inserts within the ATAD framework). Legally, the Unshell Directive Proposal intends to amend the Directive on Administrative Cooperation (Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, *OJ* L 64 of 11 March 2011, p. 1) and the Interest and Royalty Directive (Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies in different Member States, *OJ* L 157 of 26 June 2003, p. 49).

For the purposes of better readability, however, the Unshell Directive Proposal is hereinafter referred to as ATAD3.

[21] European Commission, Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU, 22 December 2021, COM(2021) 565 final (hereinafter referred to as "ATAD3").

[22] *Ibid.*, p. 1 of the Explanatory Memorandum.

ATAD3 goes beyond the ambitious objectives of the OECD's BEPS Action Plan.[23] The Commission meets with ATAD3 a request of the European Parliament,[24] as well as "several Member States, businesses and civil society."[25]

To prepare for ATAD3, the Commission launched a public consultation in April 2022.[26] Initially scheduled to come into force per 1 January 2024, the European Parliament did not adopt its negotiation position prior to January 2023[27] and proposed that ATAD3 enters into force per 1 January 2025.[28] At the time of writing, the trilogue procedure between the European Council, the European Commission and the European Parliament was ongoing, and the final text had not been adopted. Considering the criticism on the ATAD3 Proposal and the ongoing negotiations in the trilogue procedure, it is assumed that the final text of the Unshell Directive – if adopted – may differ significantly from the publicly available Commission Proposal dated 22 December 2021.[29]

In its budget plan for 2022-26, the Luxembourg fiscus considered ATAD3's potential negative impact on state revenues.[30] In this article, we are concerned with ATAD3's impact on the set-up of Luxembourg-based investment funds and entities we usually see in the context of collective investment undertakings.

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[23] With regard to the OECD BEPS Project, Recital (8) of ATAD3 states: "*To ensure compatibility with relevant international standards, a common minimum level should draw on the existing Union and international standards on substantial economic activity in the context of preferential tax regimes or in the absence of corporate taxation, as developed in the context of the Forum on Harmful Tax Practices*".

[24] The European Parliament emphasised the need for EU action against the misuse of shell entities at several occasions, *cf.* European Commission, *Commission Staff Working Document – Impact Assessment Report accompanying the document "Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU"*, 22 December 2021, SWD(2021) 578 final, p. 2 and references contained therein, e.g. European Parliament, *Report on financial crimes, tax evasion and tax avoidance – European Parliament resolution of 26 March 2019 on financial crimes, tax evasion and tax avoidance (2018/2121 (INI))*, P8_TA(2019)0240, para. 275.

[25] ATAD3, p. 1 of the Explanatory Memorandum.

[26] European Commission, Tax avoidance – fighting the use of shell entities and arrangements for tax purposes, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12999-Tax-avoidance-fighting-the-use-of-shell-entities-and-arrangements-for-tax-purposes_en (last access: 9 August 2023). Among others, the European Fund and Asset Management Association (EFAMA), the Association for Financial Markets in Europe (AFME), the Association of the Luxembourg Fund Industry (ALFI), Irish Funds, the Association of Real Estate Funds (United Kingdom) and the German association "*Bundesverband Investment und Asset Management e.v.*" (BVI) commented on the ATAD3 project.

[27] Cf. European Parliament, Rules to prevent the misuse of shell entities for tax purposes – European Parliament legislative resolution of 17 January 2023 on the proposal for a Council directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU (COM(2021)0565 – C9-0041/2022 – 2021/0434(CNS)), 17 January 2023, available at https://www.europarl.europa.eu/RegData/seance_pleniere/textes_adoptes/definitif/2023/01-17/0004/P9_TA(2023)0004_EN.pdf (last access: 9 August 2023).

[28] Cf. Article 18 as proposed by European Parliament, Draft report on the proposal for a Council directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU, 12 May 2022, 2021/0434(CNS), available at: https://www.europarl.europa.eu/doceo/document/ECON-PR-731794_EN.pdf (last access: 9 August 2023). The legislative position adopted in January 2023 confirmed this date (cf. ibid).

[29] The findings of this contribution, however, are based on the Proposal of the European Commission as published on 22 December 2021; and, where indicated, on the modifications proposed by the European Parliament (European Parliament, *Rules to prevent the misuse of shell entities for tax purposes – European Parliament legislative resolution of 17 January 2023 on the proposal for a Council directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU (COM(2021)0565* – C9-0041/2022 – 2021/0434(CNS)), 17 January 2023, *op. cit.*).

[30] Projet de loi n° 8080 concernant le budget des recettes et des dépenses de l'État pour l'exercice 2023 et projet de loi n° 8081 relative à la programmation financière pluriannuelle pour la période 2022-2026, Avis de la Banque centrale du Luxembourg, 6 décembre 2022, p. 79.

We provide an introduction to the ATAD3 framework in Pt. II, before Pt. III analyses ATAD's impact on the prospects of relevant parties in collective investment undertakings: the fund, the fund manager, as well as SPVs in between the fund and the manager, the assets, and its (real person) investors. We then summarise in Pt. IV our policy considerations on how to improve the ATAD3 framework, after which Pt. V concludes.

I. The ATAD3 Framework

Located, like most 21st century EU direct tax initiatives,[31] in the broader framework seeking to counter tax evasion and avoidance and create a "*robust, efficient and fair business tax system*," ATAD3 is aimed at addressing the particular situation of "*legal entities with no minimal substance and economic activity [that] continue to pose a risk of being used for improper tax purposes, such as tax evasion and avoidance*."[32] It thus stands in contrast to more global initiatives, such as ATAD1, the directives on administrative cooperation[33] or the Global Minimum Tax Directive[34]. Given that the European Commission justifies the proposed legislation by referring to "*continuous scandals on the misuse of shell entities worldwide and specifically in the single market*,"[35] ATAD3 can be seen as a direct response to increasing media coverage on tax-beneficial shell companies.[36]

A. Rationale

Detecting an entity's lack of substance by virtue of abstract legal measures is challenging, considering that substance ultimately "*is a matter of facts and circumstances*"[37] highly specific to each jurisdiction. Moreover, developing uniform

[31] ATAD3, p. 1 of the Explanatory Memorandum.
[32] ATAD3, p. 1 of the Explanatory Memorandum.
[33] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, *OJ* L 64 of 11 March 2011, p. 1; as modified by: Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, *OJ* L 359 of 16 December 2014, p. 1; Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, *OJ* L 332 of 18 December 2015, p. 1; Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, *OJ* L 146 of 3 June 2016, p. 8; Council Directive (EU) 2016/2258 of 6 December 2016 amending Directive 2011/16/EU as regards access to anti-money-laundering information by tax authorities, *OJ* L 342 of 16 December 2016, p. 1; Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, *OJ* L 139 of 5 June 2018, p. 1; Council Directive (EU) 2020/876 of 24 June 2020 amending Directive 2011/16/EU to address the urgent need to defer certain time limits for the filing and exchange of information in the field of taxation because of the COVID-19 pandemic, *OJ* L 204 of 26 June 2020, p. 46; and Council Directive (EU) 2021/514 of 22 March 2021 amending Directive 2011/16/EU on administrative cooperation in the field of taxation, *OJ* L 104 of 25 March 2021, p. 1.
[34] Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, *OJ* L 328 of 22 December 2022, p. 1.
[35] ATAD3, p. 5 of the Explanatory Memorandum.
[36] *Ibid.*, p. 1 making reference to the OpenLux investigation and the Pandora Papers in its footnote 4.
[37] As the European Commission correctly stated; *cf. ibid.*, p. 5 of the Explanatory Memorandum.

standards for 27 jurisdictions with different corporate tax systems represents a mammoth task.

The European Commission's starting point is the assumption that Member States' tax laws lack effective specific anti-abuse rules against the misuse of shell entities, while general anti-abuse rules such as ATAD1's GAAR oftentimes do not cover on a large scale the misuse of shell entities due to their case-by-case application.

To tackle the issue, the Commission decided to implement the most invasive of the options presented in its consultation preceding ATAD3: (1) enacting binding legislation (rather than soft law instruments); (2) coordinating criteria for identification of shell entities; (3) setting up an automatic exchange of information mechanism; and (4) imposing sanctions on non-compliant entities.[38] Its approach has attracted controversy, for sure. Concerns raised by stakeholders include: a) as ATAD1 and ATAD2 have just been implemented, their impact could not yet be properly assessed and any initiative should wait its turn until the results of the former two initiatives become known;[39] b) new anti-tax avoidance legislation is not timely against the background of international global minimum tax developments, as reflected in the EU by way of the Global Minimum Tax Directive; and c) ATAD3 increases legal uncertainty and costs, as defining a shell entity is anything but simple and in many respects arbitrary.[40]

In turn, the Commission seeks to fill a perceived "*gap*" under the Global Minimum Tax Directive.[41] Moreover, it lays out a set of criteria to distinguish "*at-risk*" and "*low-risk*" entities, with only the first group falling within the scope of ATAD3.[42] Here, we discuss whether these efforts have been successful with respect to collective investment undertakings *infra*, in parts III and IV.

B. Identifying Shell Entities

1. *Scope*

ATAD3 covers "*all undertakings that are considered tax resident and are eligible to receive a tax residency certificate in a Member State*" (Article 2 ATAD3), while

[38] *Ibid.*, p. 6 of the Explanatory Memorandum: the Impact Assessment Report, evaluated positively by the Regulatory Scrutiny Board, suggests four policy options to address the misuse of shell entities: (1) soft law instruments; (2) a regulatory act coordinating the criteria to identify shell entities and coordinating their treatment amongst Member States; (3) option 2 plus an automatic exchange of information mechanism and (4) options 2 and 3 plus the imposition of sanctions on non-compliant entities.

[39] *Cf.* Oliver R. Hoor/Keith O'Donnell/Samantha Schmitz, "Using a Sledgehammer to Crack a Nut: The European Commission's Draft Directive to Tackle Shell Entities", *Tax notes international*, vol. 106, no. 2, 11 April 2022, p. 225 (231, 246); Oliver R. Hoor/Keith O'Donnell, "The New EU Initiative on Fighting Shell Entities: Tackling a Nonissue?", *Tax notes international*, vol. 103, no. 4, 26 July 2021, p. 459 (462); p. 7.

[40] ATAD3, p. 5 of the Explanatory Memorandum.

[41] Ibid.

[42] *Ibid.*, p. 9 of the Explanatory Memorandum.

third-country entities are outside ATAD3's scope[43]. The notion of "*undertakings*" is to be construed broadly, covering any structure or legal arrangement irrespective of the legal form an entity might take.[44]

In light of this broad scope, the exemptions provided for in Article 6 (2) ATAD3 become important, and will be discussed, to the extent they are relevant for investment funds, *infra*, in Pt. III.

2. *Substance Test*

Once confirmed to be within its scope, ATAD3 establishes a so-called "*substance test*" comprising the following seven steps[45]: (1) criteria for identifying "*at risk*" undertakings that should report;[46] (2) additional reporting requirements;[47] (3) possible exemption from reporting "*for lack of tax motives*";[48] (4) "*lack of no minimal substance*" presumption;[49] (5) possible rebuttal of that presumption;[50] (6) tax effects[51]; and (7) automatic exchange of information and possibility to request a tax audit in another Member State[52].

Undertakings "*at risk*" are those that, in the Commission's view, lack substance and may potentially be misused for tax purposes, and thereby differ from undertakings at "*low risk*."

3. *Gateways to Shell Entities*

An undertaking is considered to be "*at risk*" if it presents a number of characteristics (or so-called "*gateways*") that are usually common to undertakings lacking substance.[53]

Article 6 (1) ATAD3 suggests the following gateways with respect to undertakings in a reference period of the preceding two tax years:

1) More than 75% of the undertaking's revenues are *relevant income* in the sense of Article 4 ATAD3; *and*
2) The undertaking has engaged in cross-border activity evidenced by

[43] *Ibid.*, p. 14 of the Explanatory Memorandum. *Cf.* also section III.4.b. *infra*.
[44] Art. 3 (1) ATAD3.
[45] ATAD3, p. 9 of the Explanatory Memorandum.
[46] Art. 6 ATAD3.
[47] Art. 7 ATAD3.
[48] Art. 10 ATAD3.
[49] Art. 8 (2) ATAD3.
[50] Art. 9 ATAD3.
[51] Arts 11 and 12 ATAD3.
[52] Art. 13 ATAD3.
[53] ATAD3, p. 9 of the Explanatory Memorandum.

(i) more than 60% of the book value of its immovable and certain movable[54] assets being located outside of its residence state, *or*

(ii) "*at least 60% of the undertaking's relevant income [in the sense of Article 4 ATAD3] [being] earned or paid out via cross-border transactions*";

and

3) The undertaking has outsourced day-to-day management and decision-making with regard to significant functions.

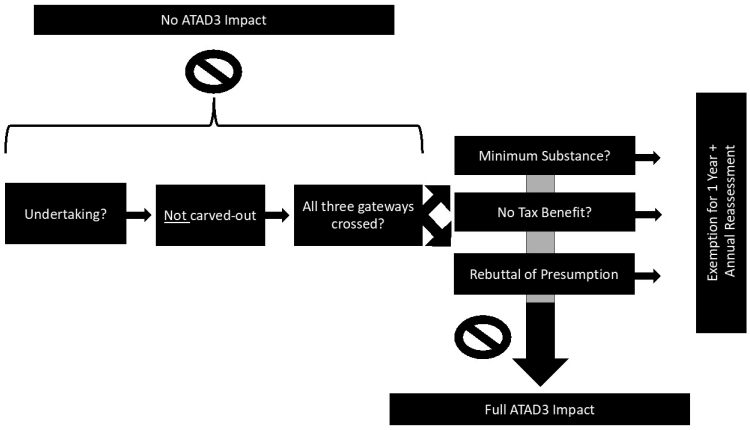
Yet, the first requirement may be replaced in two cases. The first such case is that of an undertaking with assets generating income from immovable property and/or income from movable property other than cash, shares or securities, held for private purposes and with a book value of at least 1 million EUR amounting to at least 75% of the total book value of all assets. Even if the undertaking does not generate income from these assets in the two preceding tax years, it is considered to fulfil the first condition.[55] The second such case is that of undertakings with assets which are able to generate dividends and income from the disposal of shares if, again, these assets constitute at least 75% of the total book value of the undertaking's assets. Again, the first requirement is satisfied in such circumstances even when these assets do not generate income in the preceding two years.[56]

Apparently, the European Commission sees in these cases a (perceived) greater risk of highly beneficial tax arrangements.

In turn, the term "*relevant income*" is at the heart of the Proposal's substance test. "*Relevant income*" is defined in Article 4 ATAD3 to include income from financial activity as well as passive investments in the *broadest* sense. Examples include dividends, interest and other income from financial assets, royalties and other income from intellectual property, from financial leasing, from immovable property, from movable property other than cash, shares or securities held for private purposes and with a book value of more than 1 million EUR, as well as income from insurance, banking and other financial activities. In addition, income from services which the undertaking has outsourced to other associated enterprises is also taken into account.

[54] Movable property "*other than cash, shares or securities, held for private purposes and with a book value of more than one million euro*" pursuant to art. 4 (f) ATAD3.
[55] Art. 6 (1) (c) second sub-paragraph ATAD3 Proposal.
[56] Art. 6 (1) (c) third sub-paragraph ATAD3 Proposal.

Figure 1: Gateway Test under ATAD3



4. *Carve-out of Regulated Financial Institutions (Art. 6 (2) ATAD3)*

Notwithstanding the relevance of passively generated financial or investment income, some undertakings are exempted even if, according to the above threshold, they do pass the gateway. These activity-based exemptions resulting in a carve-out from the scope of ATAD3 are laid down in Article 6 (2) ATAD3. Most notably, ATAD3 excludes certain listed companies, regulated financial undertakings, and holding companies where their beneficial owners, shareholder(s) or the ultimate parent entity reside for tax purposes in the same Member State. In addition, the gateway requirements are also not satisfied where there are five own full-time equivalent employees / staff members that exclusively carry out the undertaking's relevant income-generating activity.[57]

Given that all collective investment undertakings surpass the quantitative gateway thresholds, and thus would fall within ATAD3's scope in the absence of exemptions, the activity-based exemptions from ATAD3 come to be of the utmost importance. We will discuss them *infra*, in Pt. III.

[57] The fact that undertakings with five employees are always exempted from ATAD3 could be of interest for undertakings with a sufficient size of the assets if the carve-out for "*regulated financial undertakings*" is not sufficient. *Cf.* also section II. 4. c) *infra*.

C. ATAD3 Impact: Transparency, Disregard the Undertaking, Exchange of Information and Tax Audits

Undertakings "*at risk*" are subject to the following three measures that seek to prevent tax avoidance: increased transparency (*infra*, at a); potentially, under conditions specified in ATAD3, being disregarded for tax purposes (*infra*, at b); and, potentially, being subject to automatic exchange of information among Member States, including information generated by way of tax audits (*infra*, at c).

1. *Transparency on Shell Criteria*

Undertakings "*at risk*" need to report on certain criteria which ATAD3 sets out to indicate substance, in their annual tax return.[58] The ATAD3 shell test includes:

- Premises available for the exclusive use of the undertaking; *and*
- The ownership of at least one of its own active bank accounts in the Union; *and*
- Accommodating
  - at least one director in geographic proximity to the undertaking and dedicated to its activities, *or*
  - a number of employees "*engaged with its core income-generating activities*."[59]

Moreover, directors shall neither be employed by, nor performing directors' functions of, an enterprise that is *not* an "*associated enterprise*" under Article 5 ATAD3.[60] The idea here is, apparently, that if directors are prevented from working for undertakings other than the one "*at risk*," undertakings cannot as easily circumvent the substance criteria by hiring local directors to act as professional directors. At least, given that the number of qualified directors is limited in all financial centres, the rule limits the ability of *any* financial centre to provide substance to thousands of tax-beneficial arrangements at the same time. The impact of these rules may go beyond tax law. In practice, some Luxembourg entities are characterized by a dualism of directors: "*Class A*" directors belong to an "*associated enterprise*", while "*Class B*" directors are often suggested by administrative service providers. According to the statutes, Class A directors' consent is indispensable for certain (if not all) essential decisions. It is uncertain whether under the final

[58] ATAD3, p. 9 of the Explanatory Memorandum; art. 7 (1) ATAD3; *cf.* also section II. 3. a) *infra*.
[59] ATAD3, p. 9 of the Explanatory Memorandum; art. 7 (1) ATAD3. It is noted that these substance criteria are not tailor-made for collective investment undertakings, as we discuss also in section III. 1. *infra*. *Cf.* also: ALFI, *Draft Unshell Directive – Fighting the use of shell entities and arrangements for tax purposes*, 6 April 2022, available at: https://www.alfi.lu/pdfs/alfi-feedback-on-the-unshell-directive-proposal-06042022 (last access: 31 August 2023), p. 8.
[60] "*Associated enterprises*" are notably characterised by (legal or natural) persons that take part in the management and involve persons being able to "*exercise a significant influence over the other person*"; hold at least 25% of voting rights; participate in the capital of another person with at least 25% of the total capital; or is entitled to at least 25% of the profits of the other person (art. 5 (1) of the ATAD3).

version all of these directors count for substance, potentially prompting a change in the governance of these entities.

The disclosure of the above-mentioned substance criteria must be accompanied by documents that allow the tax administrations "*to verify directly the truth of the reported information as well as to form a general overview of the situation of the undertaking so as to consider whether to initiate a tax audit*."[61] Additional disclosures may relate to the address and type of premises, the amount and type of gross revenue and expenses, the business activities, the directors and employees, outsourced business activities and details relating to the bank account.[62]

If the undertaking at risk can prove with documentary evidence in a convincing manner that it satisfies the substance criteria of Article 7 (1) ATAD3, it is "*presumed to have minimum substance for the tax year*."[63] This presumption of substance precludes any additional measure(s) prescribed in ATAD3, such as disregarding the entity for tax purposes or tax audits. However, the Explanatory Memorandum contains a paradox that opens up the possibility of tax authorities applying an additional, and potentially different, substance or abuse test under domestic law, or finding that the undertaking "*is not the beneficial owner of any stream of income paid to it*."[64] This reference to domestic rules is not however included in the legislative draft of the ATAD3 Proposal and should therefore not be weighted too heavily. It refers to the existence of domestic anti-abuse rules other than those explicitly addressing shell entities, and is supposed to leave those rules intact.[65] However, this approach is not really coherent overall, since, for instance, the lack of beneficial ownership should apply to all shell entities so that the presumption of substance under Article 8 (1) ATAD3 would not have any value if beneficial ownership is a requirement beyond the list of indicators for substance of Article 7 (1) ATAD3.

Should the undertaking fail on one of the criteria of the ATAD3 shell test, it is presumed to lack minimum substance for the tax year in question (*cf.* Article 8 (2) ATAD3). This may trigger two types of consequences detailed *infra*, at sections b) and c).

[61] ATAD3, p. 10 of the Explanatory Memorandum.
[62] Art. 7 (2) ATAD3.
[63] Art. 8 (1) ATAD3.
[64] ATAD3, p. 10 of the Explanatory Memorandum.
[65] Dal Farra, *Luxembourg Holding Companies – Domestic and International Tax Aspects*, *op. cit.*, pp. 84-85.

2. *Disregarding the Undertaking*

First, a shell entity is deemed to be potentially misused for tax purposes,[66] and this entails consequences in the undertaking's home Member State as well as in other Member States according to Articles 11 and 12 ATAD3.[67]

a. The Shell's Home Member State

Article 12 ATAD3 grants the shell's home Member State discretion as to whether it denies the shell a certificate of tax residence for use outside of its jurisdiction, or whether it grants that certificate under the condition that the entity is not entitled to benefit from double tax conventions, the Parent-Subsidiary Directive and the Interest and Royalty Directive.[68]

b. Other Member States

Member States other than that of the shell's country of residence are obliged to deny the benefits provided by the double tax conventions, the Parent-Subsidiary Directive[69] and the Interest and Royalty Directive[70] in relation to the home Member State of the undertaking.[71]

ATAD3 distinguishes between shareholders residing for tax purposes in the EU and third countries.

For EU-resident shareholders, the relevant income of the shell entity shall be taxed in the hands of the shareholder(s) "*as if it had directly accrued to the undertaking's shareholder(s)*."[72] Taxes already paid on the shell's income at its domicile remain deductible,[73] but double tax conventions will not apply. The home Member State of the shareholder(s) shall tax the shell's income directly in the hands of the shareholder(s), yet apply double tax conventions potentially applicable between the third country of the payer and the home Member State of the shareholder(s).[74] Where the shell owns property in the sense of Article 4 (e) ATAD3 in a Member State other than its state of residence, the home Member State of the shareholder(s) shall tax the property as if it was owned directly by the shareholder(s). Again,

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[66] ATAD3, p. 10 of the Explanatory Memorandum; art. 8 (2).
[67] For criticism, *cf.* Dal Farra, *Luxembourg Holding Companies – Domestic and International Tax Aspects*, *op. cit.*, p. 88.
[68] Art. 12 ATAD3.
[69] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast), *OJ* L 345 of 29 December 2011, p. 8.
[70] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies in different Member States, *OJ* L 157 of 26 June 2003, p. 49.
[71] Art. 11 (1) ATAD3.
[72] Art. 11 (2) ATAD3.
[73] It is noted that the Proposal does not specify whether the tax already paid by the shell entity shall be deductible as a cost (i.e. deducted from the tax basis in the now taxing Member State), or by virtue of a tax credit, applied when calculating the tax to be paid in the now taxing Member State (i.e. tax to be paid in shareholder's Member State minus tax already paid by the shell entity).
[74] Art. 11 (2) ATAD3.

double tax conventions concluded between the states of the shareholder(s) and of the property shall be respected.[75]

For third-country-resident shareholders, the *payer's* Member State applies withholding taxation on outgoing payments in accordance with its national law, yet taking into account double tax conventions concluded with the third country of the shareholder(s).[76] Where the shell entity owns property in the sense of Article 4 (e) ATAD3 in a Member State other than its state of residence, the Member State in which the property is located shall tax the property as if it was directly owned by the shell's shareholder(s). Furthermore, applicable double tax conventions concluded between the Member State in which the property is situated and the state(s) of the shareholder(s) are to be taken into account.[77]

3. *Automatic Exchange of Information and Tax Audits*

Article 13 ATAD3 foresees the application of the Directive on Administrative Cooperation (DAC)[78] that enables the automatic exchange of information on shell undertakings.[79] Accordingly, Member States shall communicate the facts where a shell has been identified on the basis of its tax filing to all Member States within 30 days.[80] A central directory will facilitate the information exchange.[81]

To ensure that the information is complete, usable and correct, the home Member State's tax authority may be asked to perform a tax audit, and the information obtained in the course of the audit must be shared with the Member States' tax authorities.[82]

D. Limiting the Effects of ATAD3 for In-scope Entities

Due to the severe tax effects of ATAD3, entities potentially qualified as shells have an essential interest in avoiding being disregarded for tax purposes. Besides the exemption from ATAD3 provided for in Article 6 (2) ATAD (*supra*, at Pt. II.2.c) and *infra*, at Pt. III.), we see three avenues through which to get out of the presumption.

[75] Art. 11 (3) (b) ATAD3.
[76] Art. 11 (2) ATAD3.
[77] Art. 11 (3) (a) ATAD3.
[78] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, *OJ* L 64 of 11 March 2011, p. 1.
[79] Art. 13 ATAD3 introducing an article 8ad to Directive 2011/16/EU.
[80] Art. 13 (2) ATAD3; art. 8ad (1) that shall be added to Directive 2011/16/EU.
[81] Art. 13 (4) ATAD3; replacing art. 21 (5) of Directive 2011/16/EU.
[82] Art. 15 ATAD3.

1. *Rebuttal of the Shell Presumption (Art. 9 ATAD3)*

Since the Article 7 substance test is based on indicators, Article 9 ATAD3 enables rebuttal of the shell presumption, upon the provision of additional supporting evidence "*of the business activities*" performed to generate relevant income, as well as:

- An ascertainment of its commercial rationale, showcasing its legitimate business purpose;
- Information on employees' profiles, including on their qualifications, experience, decision-making powers, roles and contracts (duration); *and*
- Evidence that decisions were actually taken in the home Member State of the undertaking.

The ATAD3 Explanatory Memorandum also refers to the commercial reasons for maintaining the undertaking, and why it does not need its own premises and/or own bank account as well as dedicated management or employees. Further information may include relevant resources the undertaking uses to conduct its activities and information on its tax residence in the given Member State.[83] These details are not included in the legislative draft part of the ATAD3 Proposal.

The tax administration shall accept the rebuttal if the undertaking proves that it "*has performed and continuously had control over, and borne the risks of, the business activities that generated the relevant income or, in the absence of income, the undertaking's assets*."[84] Moreover, the tax administration's decision on the rebuttal is valid for one tax year, but can be prolonged for another five tax years, as long as the legal and factual circumstances regarding the undertaking do not change.[85]

Note that the ATAD3 rebuttal does not preclude the undertaking from enjoying tax benefits. That is, when an undertaking meets the control test under Article 9 ATAD3 it may well result in tax benefits for that undertaking, group entities or its shareholders. This is the key difference compared to the next alternative of receiving full recognition as an undertaking for tax purposes provided for in Article 10 ATAD3.

2. *No Tax Benefits (Article 10 ATAD3)*

If the rebuttal fails, the undertaking may demonstrate that its very existence does not result in tax benefits for itself, the corporate group entities or its shareholders.[86] The undertaking must compare the overall amount of tax due by the benefi-

[83] ATAD3, p. 11 of the Explanatory Memorandum.
[84] Art. 9 (3) ATAD3.
[85] ATAD3, p. 11 of the Explanatory Memorandum; art. 9 (4) ATAD3.
[86] ATAD3, p. 10 of the Explanatory Memorandum.

cial owners or the group as a whole, under the premise that the entity exists, to a state that assumes the undertaking to be absent.[87] This must be accompanied by information about the company's group structure and its activities.[88] Depending on the group's complexity and size, this hypothetical tax calculation may prove extremely complex and costly.

Again, the exemption is granted for one tax year, but can be extended for up to five tax years.[89]

3. *Providing Substance*

Third, an entity falling within the scope of the covered entities by virtue of its activities/revenues in line with Article 6 (1) ATAD3 could either: employ five full-time staff members and reorganize itself so that the staff members perform the relevant income-generating activities to benefit from the general carve-out stipulated in Article 6 (2) (e) ATAD3; or lease its own premises (importantly, a letter box in a building with hundreds of other firms would not suffice), actively use one of its own bank accounts in its home Member State, and employ at least one qualifying resident director to comply with the substance indicators of Article 7 (1) ATAD3.

II. Impact on Investment Funds and Related Entities

Collective investment undertakings and the entities employed in the fund context are characterized by little substance according to ATAD3's substance criteria since the fund manager organization and various services providers together constitute what is commonly referred to as "*the fund*". In turn, ATAD3's scope is of utmost importance for Luxembourg's investment fund practice.

A. Scope: Luxembourg Income Tax Residents

Pursuant to Article 2 ATAD3, the Directive applies to "*undertakings*." "*Undertaking*" means any entity engaged in an economic activity, regardless of its legal form, that is a tax resident in a Member State.[90] ATAD3 refers to tax residence *for income tax purposes*. The fact that any fund is subject to the Luxembourgish "*taxe*

[87] Art. 10 (2) ATAD3.
[88] *Ibid.*
[89] Art. 10 (2), (3) ATAD3.
[90] *Cf.* Art. 3 (1) ATAD3.

d'abonnement" (subscription tax) does not qualify it for tax residence.[91] Whether the fund itself or any Luxembourg company making investments qualifies for residence status depends on whether it is a legal entity for income tax purposes.

Luxembourgish legal entities that qualify as an "*undertaking*" under ATAD3 include UCITS and AIFs set up as investment companies with variable or fixed capital (SICAVs/SICAFs[92]) in the legal form of a:

(1) Stock corporation ("*société anonyme*");

(2) Cooperative in the form of a public limited company ("*société cooperative organisée sous forme de société anonyme*");

(3) Limited liability company ("*société à responsabilité limitée*");

(4) A partnership limited by shares ("*société en commandite par actions*"); or

(5) A limited partnership ("*société en commandite simple*" – SCS).

Some investment funds lack entity status for tax purposes, and are thus transparent from an income tax perspective and do *not* qualify as undertakings under ATAD3. Meanwhile, UCITS und AIFs set up as common funds ("*fonds commun de placement*" – FCP) and AIF-SICAVs/SICAFs set up in the form of a special limited partnership ("*société en commandite spéciale*" – SCSp) – the Luxembourgish equivalent of the Anglo-American limited partnership – cannot obtain tax residence for income tax purposes in Luxembourg, since neither an FCP nor an SCSp[93] are legal persons. Their existence is not independent from the sum of its owners (FCP) or partners (SCSp). In the absence of an company making investments being applied in between the fund and the assets, the manager, or the investors (which we will discuss *infra*, in Pt. III.3-4.), these funds are treated as non-existent for the purposes of ATAD3.

AIFs may also use legal forms not listed above, to be assessed on a case-by-case basis.[94] The one form that comes to mind here, namely the Anglo-American trust where the residence status of the trust rests on the residence of the trustee, cannot be set up under Luxembourgish private law.

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[91] For the issuance of tax residence certificates to investment funds, *cf.* Administration des contributions directes, *Circulaire du directeur des contributions L.G. – A. n° 61 du 8 décembre 2017*. Generally, to obtain a tax residence certificate, investment funds must satisfy the residence requirements of capital companies as laid down in article 159 of the Luxembourg Income Tax Law, even if they are exempt from corporate income tax.

[92] SICAVs / SICAFs are considered to be non-transparent entities and therefore considered to be tax resident. However, their access to double tax conventions may be limited in practice due to their specific exemption from income tax duties in Luxembourg. *Cf.* Alain Steichen, *Manuel de Droit fiscal*, Legitech 2023, p. 790.

[93] Société en commandite spéciale (SCSp) – Entreprises – Guichet.lu – Guide administratif – Luxembourg (public.lu).

[94] *Cf.* Arts 97 ff. Loi du 17 décembre 2010 concernant les organismes de placement collectif et portant transposition de la directive 2009/65/CE du Parlement européen et du Conseil du 13 juillet 2009 portant coordination des dispositions législatives, réglementaires et administratives concernant certains organismes de placement collectif en valeurs mobilières (OPCVM) (refonte) (…), *Mém. A* – n° 239 du 24 décembre 2010, p. 3928 (hereafter referred to as the "2010 Law"); chapter 4, Arts 31 ff. Loi du 23 juillet 2016 relative aux fonds d'investissement alternatifs réservés (…), *Mém. A* – n° 140 du 28 juillet 2016, p. 2376 (hereafter referred to as "2016 RAIF Law").

ATAD3, as a piece of entity-focused tax legislation, may impact on investment funds in four different ways. Besides the fund and the fund manager, which we will discuss in the next part, a target of ATAD3 could be entities between the fund vehicle and the fund manager (Pt. III.2.), in between the fund vehicle and the assets (Pt. III.3.) and in between the fund vehicle and the investors (Pt. III.4.).

B. Collective Investment Undertakings (AIFs and UCITS)

1. *Exemption for AIFs and UCITS*

a. Focus Point: Regulatory Status

Article 6 (2) (b) ATAD3 outlines a carve-out for regulated financial institutions. In the following subsections (i) and (j), ATAD3 stipulates that regulated financial institutions include "*AIFs managed by an AIFM*," "*an AIF supervised under the applicable national law*", as well as UCITS.

This is one rare case where status under financial regulation determines the tax treatment. In turn, all Luxembourg-based investment funds classifying as UCITS-SICAV under Part I of the 2010 Law[95] as well as all Luxembourg-based funds classifying as AIFs (i.e. other Undertakings for Collective Investments to be placed with the public under Part II of the 2010 UCI Law,[96] Part II Specialized Investment Funds (SIFs) under the 2007 SIF Law,[97] Part II SICARs under the 2004 SICAR Law,[98] and Reserved AIFs (RAIFs) under the 2016 RAIF Law[99]) are carved out by ATAD3, *if they are managed by an in-scope, fully authorised AIFM*.

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[95] Loi du 17 décembre 2010 concernant les organismes de placement collectif et portant transposition de la directive 2009/65/CE du Parlement européen et du Conseil du 13 juillet 2009 portant coordination des dispositions législatives, réglementaires et administratives concernant certains organismes de placement collectif en valeurs mobilières (OPCVM) (refonte) (…), *Mém. A* – n° 239 du 24 décembre 2010, p. 3928 (hereafter referred to as the "2010 UCI Law").

[96] These "other UCIs" can be set up as "*société d'investissement à capital variable*" (SICAV) or "*société d'investissement à capital fixe*" (SICAF) taking the legal form of a public limited company ("*société anonyme*"), a partnership limited by shares ("*société en commandite par actions*"), a limited partnership ("*société en commandite simple*"), special limited partnership ("*société en commandite spéciale*"), a limited company ("*société à responsabilité limitée*") or a cooperative in the form of a public limited company ("*société coopérative organisée sous forme de société anonyme*") (arts 93 ff. 2010 UCI Law as modified notably by Art. 46 of the Loi du 21 juillet 2023 portant modification de: 1° la loi modifiée du 15 juin 2004 relative à la société d'investissement en capital à risque (SICAR); (…), *Mém. A* – n° 442 du 24 juillet 2023, p. 1 (hereafter referred to as "*2023 Luxembourg investment fund toolbox law*") or any other legal form (arts 97 ff. 2010 UCI Law).

[97] Loi du 13 février 2007 relative aux fonds d'investissement spécialisés (…), *Mém. A* – n° 13 du 13 février 2007, p. 368. SICAV-SIFs can take the legal form of a public limited company ("*société anonyme*"), a partnership limited by shares ("*société en commandite par actions*"), a limited partnership ("*société en commandite simple*"), a special limited partnership ("*société en commandite spéciale*"), a limited company ("*société à responsabilité limitée*") or a cooperative in the form of a public limited company ("*société coopérative organisée sous forme de société anonyme*") (chapter 3, arts 25 ff.); and other forms (chapter 4, arts 38 ff.).

[98] Loi du 15 juin 2004 relative à la société d'investissement en capital à risque (SICAR) (…), *Mém. A* – n° 95 du 22 juin 2004, p. 1568. SICARs can take the legal form of a limited partnership ("*société en commandite simple*"), a special limited partnership ("*société en commandite spéciale*"), a partnership limited by shares ("*société en commandite par actions*"), a cooperative in the form of a public limited company ("*société coopérative organisée sous forme de société anonyme*"), a limited company ("*société à responsabilité limitée*") or a public limited company ("*société anonyme*") (art. 1 (1)).

[99] Loi du 23 juillet 2016 relative aux fonds d'investissement alternatifs réservés (…), *Mém. A* – n° 140 du 28 juillet 2016, p. 2376. RAIF-investment companies can take the legal form of a public limited company ("*société anonyme*"),

The carve-out occurs regardless of: a) the fund's investor base; b) the fund's number of investors; c) the fund's investment policy; d) the fund's assets; e) (as long as it is an "*undertaking*") the fund entity's legal form; f) the fund's authorisation or registration; and, finally, g) the fund's ability to be "*resident for tax purposes*."

However, only *EU entities* can benefit from the carve-out, given that the carve-out refers, in the investment fund context, to entities in scope of the UCITS Directive[100] and AIFM Directive[101]. Third country managers, such as those that may distribute AIF units under the Member States' marketing rules for investment undertakings located in third countries (so-called National Private Placement Regimes[102]) do not meet this condition.[103]

b. Investment Companies and Compartments

Given that ATAD3 carves out UCITS and AIFs, while the status as "*undertakings*" under ATAD3 is preserved for SICAVs/SICAFs/SICARs (other than SCSps), the pertinent question is whether status is to be granted to the investment company (i.e. the legal entity) or the compartments (sub-funds) attached to the investment company. ATAD3 follows an entity-based approach. Yet, it refers to the regulatory status as AIF and UCITS in Article 6 (2) (b) and subsection 2 ATAD3. From a regulatory point of view, all compartments of a fund may be treated as separate UCITS and AIFs (for instance, each UCITS compartment needs to be authorised separately[104]), while share classes of a fund do not qualify as separate funds. There may also be master and feeder funds held by the same investment company, which are from a regulatory perspective entirely different types of fund.[105]

ATAD3 leaves this question unanswered, although we observe two perspectives here. On the one hand, any substance may attach to the entity as only the entity may enter into contracts, own assets, employ staff, etc. Furthermore, the investment company will receive only one tax residence certificate for all funds attached

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a partnership limited by shares ("*société en commandite par actions*"), a limited partnership ("*société en commandite simple*"), a special limited partnership ("*société en commandite spéciale*"), a limited company ("société à responsabilité limitée") or a cooperative in the form of a public limited company ("*société coopérative organisée sous forme de société anonyme*") (chapter 3, arts 23 ff.); RAIFs can also be set up as other not specified forms (chapter 4, arts 31 ff.).

[100] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) (Text with EEA relevance) (*OJ* L 302, 17.11.2009, p. 32-96) (hereinafter referred to as "UCITSD").

[101] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (Text with EEA relevance), *OJ* L 174 of 1 July 2011, p. 1 (hereafter referred to as "AIFMD").

[102] Dirk Zetzsche/Robin Veidt, "The AIFMD's Third-Country Rules and the Equivalence Concept", in Zetzsche (ed.), *The Alternative Investment Fund Managers Directive*, 3rd ed., Kluwer Law International 2020, p. 795 (806 *et seq*.).

[103] While these third country fund managers may rarely have tax entity status within a Member State, this limitation is of relevance for the entities related to these funds and which we discuss *infra*, at III.3., III.4. and III.5.

[104] Art. 181 (7) 2010 UCI Law, Art. 3 (7) 2004 SICAR Law (as introduced by Art. 2 2° Luxembourg investment fund toolbox law).

[105] Arts 77 ff. 2010 UCI Law.

to the entity.[106] On the other hand, for each sub-fund there may be an entirely different a) group of beneficial owners, b) investment policy and assets invested, and c) pay-out and distribution policy. Moreover, the beneficial owners of the investment company may be entirely different from the beneficial owners of either the UCITS or the AIF.

We hold that SICAVs/SICAFs/SICARs (i.e. the entity) and the investment compartments treated as separate funds *together* qualify as UCITS/AIFs for the purposes of Article 6 (2) ATAD3. We draw this conclusion from a literal application of Article 4 (1) (a) AIFMD, which states "'*AIFs' means collective investment undertakings, including investment compartments thereof*." From a legal perspective, that approach is coherent since the AIF/UCITS would not exist without the entity to which it is attached. At the same time, exempting only one of the two would lead to insurmountable frictions in applying ATAD3. For the purpose of practical application, and depending on the context, in some cases the emphasis will be placed on the entity, and in others on the investment compartment and its investors, yet both are carved out from ATAD3.

c. AIFs Managed by Sub-threshold AIFMs?

As laid out in Recital (6) ATAD3, the rationale of the carve-out is that certain financial institutions are heavily regulated in the Union, directly or indirectly, and subject to increased transparency requirements and supervision, and may therefore be excluded from the scope of ATAD3.[107] It follows from this rationale that the privilege ends where the transparency and supervision end.

ATAD3 carves out an AIF "*managed by an AIFM as defined in Article 4(1), point (b) [AIFMD] or an AIF supervised under the applicable national law.*" One wonders whether the carve-out applies to AIFs managed by sub-threshold AIFMs that have not obtained a full AIFM license, given that they do not manage more than 500 million EUR in assets (or at least 100 million EUR, respectively, in case where the funds use significant leverage in their investment policy), subject to Article 3 AIFMD. From the fact that subsection 2 (c) of Article 6 (2) AIFMD lists only some sub-threshold AIFMs, it follows that AIFs managed by other sub-threshold AIFMs do not benefit from the carve-out. The rationale behind that may be that these AIFMs and the AIFs they manage could be entirely unregulated, given that the AIFMD mandates Member States to establish only a registration of these sub-threshold AIFMs and some mandatory, albeit very basic, minimum information

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[106] Administration des contributions directes, *Circulaire du directeur des contributions L.G. – Mém. A. n° 61 du 8 décembre 2017*, p. 5 *et seq.* (stating the requirements for the issuance of a tax residence certificate to SICAVs/SICAFs). This circular lacks provisions for the issuance of tax residence certificates for fund compartments/sub-funds.

[107] *Cf.* Recital (3) of ATAD3: "*It would be fair to exclude from the envisaged rules undertakings whose activities are subject to an adequate level of transparency and therefore do not present a risk of lacking substance for tax purposes. Companies having a transferable security admitted to trading or listed on a regulated market or multilateral trading facility as well as certain financial undertakings which are heavily regulated in the Union, directly or indirectly, and subject to increased transparency requirements and supervision, should equally be excluded from the scope of this Directive.*"

to the financial services authorities. Of note, Luxembourg made use of this regulatory option in Article 3 of the 2013 AIFM Law[108].

However, there are three cases where the carve-out nevertheless applies to AIFs managed by sub-threshold AIFMs, each of which is outlined below.

First, where the sub-threshold AIFM has obtained a full license, by way of opting-in pursuant to Article 3 (4) of the 2013 AIFM Law; it is then no longer a sub-threshold AIFM.

Second, where the *AIF* (i.e. the product, rather than the manager) is supervised under national law. Part II UCIs, SICARs and SIFs are authorised and subject to CSSF supervision,[109] even when managed by a sub-threshold AIFM.[110]

And, third, where the type of sub-threshold AIFM of the AIF is explicitly listed in the carve-out provided for by ATAD3.[111] This is the case for managers of European Venture Capital Funds (EuVECAs)[112] and European Social Entrepreneurship Funds (EuSEFs).[113] ATAD3's mentioning of European Long-term Investment Funds (ELTIFs) in that context is superfluous given Article 5 (2) ELTIF Regulation[114] reserves the management of ELTIFs to fully licensed AIFMs.

One may wonder whether the RAIFs under the 2016 RAIF Law are carved out from ATAD3. A RAIF is not an authorised or supervised fund product, but merely

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[108] Loi du 12 juillet 2013 relative aux gestionnaires de fonds d'investissement alternatifs (...), *Mém. A* – n° 119 du 15 juillet 2013, p. 1855 (hereafter "2013 AIFM Law").

[109] Part II AIFs pursuant to Art. 129 2010 UCI Law, SICARs pursuant to Arts 11 (3) 2004 SICAR Law and SIFs under Arts 41 (3) 2007 SIF Law.

[110] For Part II UCIs *cf.* Arts 88-2, 88-3 2010 UCI Law; for SICARs see Arts 11 *et seq.* 2004 SICAR Law; Arts 41 *et seq.* 2007 SIF Law; Part II of the 2004 SICAR Law and Part II of the 2007 SIF Law does not apply since sub-threshold AIFMs are not authorized under Chapter 2 of the 2013 AIFM Law.

[111] Art. 6 (2) (c) of the second sub-section ATAD3.

[112] Pursuant to Art. 3 (c) Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds (Text with EEA relevance), *OJ* L 115 of 25 April 2013, p. 1 (as modified notably by Regulation (EU) 2017/1991 of the European Parliament and of the Council of 25 October 2017 amending Regulation (EU) No 345/2013 on European venture capital funds and Regulation No 346/2013 on European social entrepreneurship funds (Text with EEA Relevance), *OJ* L 293 of 10 November 2017, p. 1; and Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014 (Text with EEA relevance), *OJ* L 188 of 12 July 2019, p. 55). On the EuVeCa-Regulation *cf.* Mark Fenwick & Erik P.M. Vermeulen, "How to "Fix" the Venture Capital Model? Regulation Versus Disruption", in Zetzsche (ed.), *The Alternative Investment Fund Managers Directive*, *op. cit.*, pp. 161 ff.

[113] Pursuant to Art. 3 (1) (c) Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds (Text with EEA relevance), *OJ* L 115 of 25 April 2013, p. 18 (as modified notably by Regulation (EU) 2017/1991 of the European Parliament and of the Council of 25 October 2017 amending Regulation (EU) No 345/2013 on European venture capital funds and Regulation No 346/2013 on European social entrepreneurship funds (Text with EEA Relevance), *OJ* L 293 of 10 November 2017, p. 1; and Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014 (Text with EEA relevance), *OJ* L 188 of 12 July 2019, p. 55). On the EuSEF-Regulation *cf.* Mark Fenwick & Erik P.M. Vermeulen, "How to "Fix" the Venture Capital Model? Regulation Versus Disruption", in Zetzsche (ed.), *The Alternative Investment Fund Managers Directive*, *op. cit.*, pp. 161 ff.; Sebastiaan N. Hooghiemstra & Dirk Zetzsche, "Loan-Originating (Debt) Funds", in Zetzsche (ed.), *The Alternative Investment Fund Managers Directive*, *op. cit.*, pp. 715-716.

[114] Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds (Text with EEA relevance) *OJ* L 123 of 19 May 2015, pp. 98-121.

registered with the CSSF for marketing purposes.[115] However, RAIFs *are* carved out from ATAD3 as they are managed by a fully licensed AIFM subject to Chapter 2 of the Law of 2013 (and thus indirectly supervised).

Although Article 6 (2) (b) ATAD3 does not mention European Money Market Funds (MMFs) under the MMFR[116] explicitly, they are carved out nevertheless. Indeed, MMFs must be managed by either a UCITS ManCo or a fully licensed AIFM pursuant to Articles 4 (2) and 5(2) MMFR.

2. *Denial or Removal of UCITS and AIF Status*

In this context, the crucial question to arise is whether a *potential* classification as a UCITS or AIF suffices for the carve-out from ATAD3 provided for by Article 6 (2) ATAD3. In principle, the ATAD3 carve-out is linked to the definitional features of a UCITS pursuant to Article 1 (2) UCITSD (= Article 2 (2) of the Law of 2010[117]) and an AIF pursuant to Article 4 (1) (a) AIFMD (= Article 1 (39) AIFM Law).[118] Under that definition, authorisation of the fund is a feature of a UCITS,[119] but not the AIF. Thus, the ATAD3 privilege of a UCITS begins with the authorisation.

A fund that is not authorised as a UCITS or where the UCITS authorisation has been revoked, may classify as an AIF *if it meets the AIF test* under Article 4 (1) (a) (i) AIFMD. For instance, the AIF status is available for funds (1) with more generous investment limits than those allowed for UCITS, (2) that do not seek to market to the public, and (3) where the fund manager holds both a UCITS and an AIFM license.

Some entities, however, will not pass the AIF test and, accordingly, will not benefit from the carve-out. Examples include entities with a) a complete lack of an investment policy, and b) a lack of a qualified and, in principle, authorised fund manager (an AIFM or UCITS ManCo, as required). If non-AIF entities serve, for instance, as Special Purpose Acquisition Vehicles (SPACs[120]), they are subject to ATAD3.

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115 *Cf.* Art. 50 Law of 2016 referring to Chapter 6 law of 2013 implementing the AIFMD (Directive 2011/61/EU).
116 Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds, *OJ* L 169 of 30 June 2017, p. 8.
117 See for a detailed discussion: Zetzsche, *The Anatomy of European Investment Fund Law*, *op. cit.*, at pp. 47 ff.
118 *Cf.* Dirk Zetzsche/Christina D. Preiner, "Scope of the AIFMD", in Zetzsche (ed.), *The Alternative Investment Fund Managers Directive*, 3rd ed., Kluwer Law International 2020, pp. 26 ff.
119 *Cf.* Art. 6 (1) UCITSD / Arts 4 and 129 (1) 2010 UCI Law.
120 SPACs tend to come without an investment policy as the policy would disclose information on the (potential) acquisition target(s).

3. *Liquidation of UCITS and AIFs*

The denial of UCITS/AIF status must be distinguished from the liquidation of a fund, following, for instance, the expiry of the duration of the fund, or a decision taken by shareholders in the general meeting.

If the fund manager (UCITS ManCo or AIFM) exercises the voluntary[121] or mandatory dissolution of the fund, their final report and the filing of the post-liquidation form will mark the end of the fund as an entity. The fund remains a UCITS/AIF managed by a licensed UCITS ManCo/AIFM throughout this period and is hence exempted under ATAD3. UCITS, Part II UCIs, SIFs and SICARs in non-judicial liquidation remain subject to supervision by the CSSF, while the liquidators and any changes of service providers must be approved, and a number of financial and non-financial reports are to be filed throughout the liquidation process.[122] Under these conditions, the supervision and transparency rationale of ATAD3 is met, and these funds are "*supervised under national law*" for ATAD3 purposes and hence remain carved out from ATAD3 during their liquidation.

The same applies to RAIFs under the 2016 RAIF Law: where RAIFs subject to voluntary liquidation are liquidated by the AIFM, they remain within the carve-out for the reasons laid out in the previous paragraph. Where judicial liquidation takes place according to Chapter 6 of the 2016 RAIF Law under court supervision according to Article 35 of the 2016 RAIF Law, the district court will appoint a liquidator and reporting judge, as well as a supervisory auditor inspecting the liquidator's reports. Given that, in liquidation, the RAIF is no longer operational and its shareholders have very little influence on the liquidation and cash flows (meaning the potential for tax leakage is minimal) we hold that the court-steered supervision is as good for ATAD3 carve-out purposes as the supervision provided previously by the CSSF.

4. *Non-UCITS and Non-AIF Investment Undertakings*

By reference to the UCITSD and the AIFMD, the EU-harmonised definitions of EU investment funds also limit the scope of the carve-out. A number of collective investment undertakings qualify neither as UCITS *nor* AIFs. We will now discuss the most important limitations of both UCITS and AIFs in turn.

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[121] The voluntary liquidation comprises four steps: (1) the Board/GP proposes to put the fund into liquidation, (2) the Extraordinary General Meeting (EGM) (or a written resolution of the shareholders/partners) puts the fund into liquidation and appoints a liquidator (and sometimes also an auditor). (3) The liquidator and auditor, as the case may be, liquidate and draw up their reports, and (4) the 2nd EGM is asked to approve the auditor and liquidator reports and resolve upon final formalities. Where the fund itself is regulated, the CSSF will receive draft EGM minutes for first EGM and a letter explaining the rationale of the liquidation, as well as an ID, declaration of honour, and explanation of the selection of the liquidator.

[122] *Cf.* Arts 144 *et seq.* of the 2010 UCI Law (UCITS, Part II UCIs); Arts 48 *et seq.* 2007 SIF Law (SIFs); Arts 20 *et seq.* 2004 SICAR Law (SICARs); all as modified notably by the 2023 Luxembourg investment fund toolbox law.

a. REITs

First, *some* real estate investment trusts (REITs) are not carved out from the scope of ATAD3 if they do *not* qualify as AIFs, due to the fact that they pursue a real-estate-related operating business, rather than an investment business.[123] REITs with shares listed on regulated markets, however, may rely on the exemption of listed companies pursuant to Article 6 (2) (a) ATAD3.

b. Securitisation Vehicles

Second, securitisation vehicles are exempted from the UCITSD and AIFMD[124]. The reasoning relies, on the one hand, on the UCI definition that requires investment discretion in the hand of a third-party manager: where the securitization trustee lacks investment discretion, asset securitisation vehicles lack third-party management, as defined by the UCITSD and the AIFMD. On the other hand, some Collateralized Loan Obligations set up within securitisation schemes in Luxembourg and Ireland are actively managed. In these cases, while some legal uncertainty exists, the regulator looks at the objective of the entity: if the objective is securitization, the entity qualifies as Securitisation Special Purpose Entity (SSPE).

ATAD3 exempts securitisation vehicles if they meet the prerequisites of a 'securitisation special purpose entity' (SSPE) as defined in Article 2 (2) STSR.[125] SSPEs are defined by reference to the classification of securitisations in Article 2 (1) STSR. The STSR definition of securitisation is quite narrow; it requires, in principle, the transfer of credit risk from a credit institution or investment firm to an SSPE and, in turn, the SSPE's investors, while the SSPE's trustee is not entitled to a discretionary investment decision.[126] Numerous securitisation vehicles used in the fund domain will not meet this definition. In particular, the ad-hoc 1:1 securitisation of physical assets for purposes of fund investments will not qualify for the carve-out of securitisation vehicles under ATAD3,[127] unless the shares or debt instruments issued by the securitisation vehicle are listed on a regulated market.[128] In addition, owing to a lack of third-party management, investment clubs where all participants and members participate in the investment decision do not qualify as AIFs. These clubs (regardless of their form) are therefore within the scope of ATAD3.

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[123] Note that the REIT status is a tax status rather than a financial regulatory status. Whether REITs qualify as AIF varies across jurisdictions. For instance, the German BaFin is leaning more towards an operating business, while some Belgium REITs are being qualified, as of now, as non-AIF, yet risk disclosures recognize the risk that the REIT may qualify as AIF.

[124] *Cf.* Art. 2 (3) (g) AIFMD.

[125] Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012, *OJ* L 347 of 28 December 2017, p. 35.

[126] For details, *cf.* Dirk Zetzsche/Sebastiaan N. Hooghiemstra, "Securitizations and SPVs under STSR and AIFMD", in Zetzsche (ed.), *The Alternative Investment Fund Managers Directive*, *op. cit.*, pp. 378, 380-82.

[127] UCITS interested in exposure to physical assets, commodities and precious metals (all of which are not eligible under Art. 50 UCITSD) may buy the securities issued by an company holding these assets.

[128] *Cf.* Art. 6 (2) (a) ATAD3.

c. Family Offices and Holding Companies

Also excluded from the ATAD3 carve-out for AIFs remain certain single family offices that are exempted under Recital (7) AIFMD whereby certain family offices establish a "*pre-existing group*"[129] even where some family members limit their own activity to investing, or where some family members inject capital after the family investment vehicle has been established. The ESMA guidelines[130] determine that where "*capital is invested in an undertaking by a member of a pre-existing group, for the investment of whose private wealth the undertaking has been exclusively established, this is not likely to be within the scope of raising capital*."[131]

Relatedly, Article 2 (3) (a) AIFMD exempts holding companies from the AIF definition. While the meaning of the term is subject to wide-ranging discussion,[132] there is no doubt that once an entity qualifies as a holding company, it is not subject to the AIFMD. However, Article 6 (2) (c) and (d) ATAD3 explicitly carves out certain undertakings with holding activities[133] subject to further conditions: pursuant to Article 6 (2) (c) ATAD3, the holding company must hold shares "*in operational businesses in the same Member State while beneficial owners are also resident for tax purposes in the same Member State*." Under Article 6 (2) (d) ATAD3 the holding company must be "*resident for tax purposes in the same Member State as the undertaking's shareholder(s) or the ultimate parent entity*." Only under these very limited conditions can holding companies benefit from being carved out from ATAD3.

We discuss some additional aspects of holding companies *infra*, in parts III. 4. and III. 5.

d. Collective Debt Investment Undertakings and "*Black Box*" Funds

Finally, various collective investment undertakings do not qualify under both the UCITSD and the AIFMD. These non-UCITS and non-AIF funds may include, in the view of some Member States, collective debt investment structures[134] where investors participating in the undertaking hold only debt instruments issued by an investing vehicle. These Member States construe the "*raising of capital*" in

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[129] *Cf.* ESMA, *Key concepts of the AIFMD*, ESMA/2013/611 of 13 August 2013, at p. 4: a pre-existing group is "*a group of family members, irrespective of the type of legal structure that may be put in place by them to invest in an undertaking and provided that the sole ultimate beneficiaries of such legal structure are family members, where the existence of the group predates the establishment of the undertaking. This shall not prevent family members' joining the group after the undertaking has been established. For the purpose of this definition, 'family members' means the spouse of an individual, the person who is living with an individual in a committed intimate relationship, in a joint household and on a stable and continuous basis, the relatives in direct line, the siblings, uncles, aunts, first cousins and the dependants of an individual.*"

[130] *Cf. ibid.*, at No. 15.

[131] For a detailed discussion of the treatment of family offices under AIFMD *cf.* Zetzsche/Preiner, "Scope of the AIFMD", in Zetzsche (ed.), *The Alternative Investment Fund Managers Directive*, *op. cit.*, pp. 34-37.

[132] *Cf.* Zetzsche/Preiner, "Scope of the AIFMD", in Zetzsche (ed.), *The Alternative Investment Fund Managers Directive*, *op. cit.*, pp. 48-53.

[133] Yet, an essential impact of ATAD3 on holding companies is expected, *cf.* Olivier Dal Farra, *Luxembourg Holding Companies – Domestic and International Tax Aspects*, *op. cit.*, p. 80.

[134] These collective debt investment undertakings include, for instance, vehicles under the German *Vermögensanlagengesetz*. For a detailed discussion and an argument that these undertakings are often used to circumvent the investor protection provided by the AIFMD, *cf.* Dirk Zetzsche, in Assmann/Wallach/Zetzsche (ed.), *Kapitalanlagegesetzbuch*, (Otto Schmidt Verlag, 2022), § 1 no. 26.

Article 4 (1) (a) AIFMD as the raising of *equity* capital. Moreover, such collective debt investment structures will now be subject to ATAD3.

Moreover, outside the scope of the ATAD3 carve-out in Article 6 (2) ATAD3 are "*black box funds*" that lack *any* type of written investment policy (to the extent that black box funds are permitted under the financial regulation of the given Member State and accepted by financial supervisory authorities).

If a collective investment undertaking is not classified as an AIF, advisers may consider opting-in to the AIFMD by structuring the activities in a way that it qualifies for AIF regulatory status and thereby benefits from the carve-out for regulated financial undertakings under Article 6 (2) (b) ATAD3.

C. Entities between Fund and Fund Manager

1. *AIFM and UCITS Management Company*

The first entity relating to the fund manager is the one that holds the license as a UCITS ManCo or an AIFM. In this regard, Article 6 ATAD3 provides certainty: the exemption of regulated financial institutions in Article 6 (2) (b) ATAD3 includes, as clarified in subsection 2 c) and d) of Article 6 (2) ATAD3, the managers of AIFs and UCITS. This also includes internally managed UCITS and AIFs where the legal form of the UCI permits an internal management (as is the case with regard to all investment companies), the governing body has refrained from appointing an external fund manager, and hence the fund and its management entity are the same.[135]

The carve-out of Article 6 (2) (b) ATAD3 is linked to the license issued to a UCITS ManCo or an AIFM. In turn, managers of debt structures and family offices as well as other investment entities outside of the AIF definition (*supra*, in Pt. III.2.d) do not benefit from ATAD3's privilege for regulated entities. Where the assets managed include financial instruments, some of them may qualify as a portfolio manager under MiFID and benefit from a carve-out from that perspective.[136] Such a MiFID carve-out, however, is unavailable where the assets managed do not qualify as financial instruments, as is the case where the assets held include physical assets like planes, art, commodities or certain cryptocurrencies.[137]

A number of other entities that do not hold an AIFM or UCITS ManCo license are found in the context of the fund manager. Most important among these are entities functioning as a general partner (section b) *infra*) in limited partnership structures, and carry vehicles (section c) *infra*).

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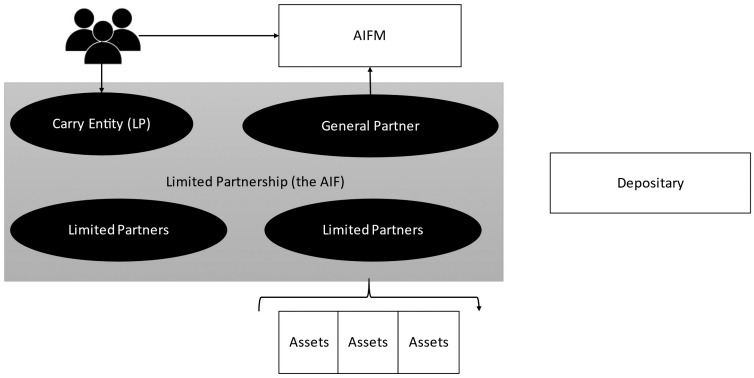
[135] *Cf.*, for instance, Art. 4 (1) b) Law of 2013; Art. 88-2 (2) b) Law of 2010; Art. 47 (2) b) Law of 2004; Art. 80 (2) b) Law of 2007.
[136] Art. 6 (2) (b) referring to lit. (b) of subsection 2 ATAD3.
[137] Crypto-asset service providers, in turn, are carved out from ATAD3 as laid down in sub-section (s) of Art. 6 (2) ATAD3.

2. *General Partner Entities*

In AIFs structured as limited partnerships frequently used for private equity and hedge funds, as well as infrastructure funds and other closed-end funds, we often see entities linking the AIFM to the fund, as depicted in Figure 2 *infra*. This is because the AIFM organisation (that often manages multiple funds) would be impaired if the general partner is held liable for obligations stemming from the fund's activity (for instance, from credit or other agreements in relation to the acquisition of assets).[138]

Figure 2: Simplified Limited Partnership with External AIFM



While the limited partner (LP) and the general partner are legally separate entities, we hold that the general partner entity is not a *separate* "*undertaking*" under Article 2 ATAD3, but part of the "AIF" and thus exempted pursuant to Article 6 (2) (b) ATAD3 under the carve-out provided for UCITS and AIFs. This is because investment fund regulation in Luxembourg[139] and, to our knowledge, in all advanced fund jurisdictions globally,[140] allows the establishment of AIFs in the form of limited partnerships. Moreover, limited partnerships require at least one

[138] Note that the tax issue described in this section does not exist where the general partner or the LP as a whole is authorized as AIFM according to the CSSF guidance: "*The AIFM of such AIF is in principle an External AIFM, who can be the managing general partner or the gérant or any other External AIFM designated by the gérant of the limited partnership. A limited partnership can also opt to qualify as an Internal AIFM in case the purpose of the gérant is limited to the gérance of the given limited partnership.*" (CSSF, *CSSF FAQ – Luxembourg Law of 12 July 2013 on alternative investment fund managers*", p. 23).

[139] Art. 25 SIF Law of 2007; art. 1 (1) SICAR Law of 2004; art. 23 RAIF Law of 2016. The law for Part II AIFs is limited to the stock corporation, yet in principle open to other legal forms. For details on the Luxembourg variants of limited partnerships *cf.* Claude Kremer & Isabelle Lebbe, *Organismes de placement collectif*, 3rd ed., Larcier 2015, p. 73 ff., 77 ff., 95 ff., 905 ff

[140] *Cf.* Dirk Zetzsche, "Fondsregulierung im Umbruch – ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie", *Zeitschrift für Bankrecht und Bankwirtschaft*, 2014, pp. 22-40; Dirk Zetzsche, *Prinzipien der kollektiven Vermögensanlage*, Mohr Siebeck, 2015, pp. 431 *et seq*.

partner with limited liability, *and* at least one general partner bearing unlimited liability. In turn, the general partner and the limited partners together form the limited partnership (i.e. "the AIF").

This has, in our view, two consequences. First, where the limited partnership is an "*undertaking*" (i.e. where it is a simple limited partnership) *and* classified as an AIF, all elements that together constitute the limited partnership benefit from the AIF carve-out. In this case, the general partner entity shares the fate of the AIF, which cannot exist without it. Second, where the limited partnership is not an "*undertaking*" (i.e. where it is an SCSp), the general partner entity that is, by way of a legal form on a stand-alone basis, an "*undertaking*" benefits now from the AIF carve-out. Note that this has particular relevance in cases of cross-border fund management where the limited partnership (including at least *one* GP) and the AIFM (that is distinct from at least *one* GP) reside in different Member States. If the general partner, possibly additional entities and the AIFM are located in the same Member State, the general partner often also benefits from the carve-out stipulated in Article 6 (2) (d) ATAD3.

3. *Carry Entities/Vehicles*

In private equity and hedge funds, members of the AIFM organisation benefit from the profits of the AIF by way of carry vehicles, which are often limited partnerships where the units are held by staff and shareholders of the AIFM or their family. Carry vehicles usually hold, from the AIF perspective, the limited partnership units in the AIF and benefit, under the limited partnership agreement, in the profits of the AIF. While details vary,[141] in all carry vehicles their share in the AIF's profits is larger than the proportion of initial investment provided by the limited partner, compared to the overall fund.

The pressing question to arise here is whether carry vehicles that are 'undertakings' residing in an EU Member State different from Luxembourg (if Luxembourg is the place of the AIF entity)[142] but do not qualify as AIFs themselves, are part of ATAD3's AIF carve-out. The first view is that the carry vehicle is a limited partner and as such forms part of the AIF; and, in turn, is carved out accordingly. Another common perspective is that carry vehicles are not carved out, which in itself begs the question of whether the carry vehicle meets the "*commercial rationale*" test under the rebuttal rule of Article 9 (1) ATAD3.

[141] We commonly see the 1:10 or 1:20 rule: 1% of investments is required as 'skin in the game', but the carry agreement grants rights to 10% or 20% of the fund's profits *after* the residual fund investors received a guaranteed 8% minimum share in the profits.

[142] The tax matter discussed in this paragraph does not exist if the carry vehicle is tax resident of a third country or Luxembourg, or if the carry vehicle is transparent for income tax purposes (which is often the case, given these are structured as LPs).

We support the first view, namely that the use of carry vehicles is a long-standing business practice in private equity and hedge funds. While some tax considerations may affect the calculations, investor protection objectives prevail with regard to the set-up of carry vehicles.

First, the AIFMD recognises carried interests as legitimate participation schemes of the fund manager that ensure alignment between the interests of the investors and the AIFM.[143] Here, the fund manager holds discretion over the investment decision, allocating a share of the profits to ensure that they will search for the best investment opportunities and take all necessary steps to avoid unnecessary risks and manage necessary risks to the best of their abilities. The disproportionate profit allocation that comes with carried interest serves as a means of protecting the investors in closed-ended private equity and hedge funds.[144]

One could now argue that for a carry arrangement with an AIFM's key personnel, the key personnel do not need a carry *vehicle*, but could instead hold the assets directly. In this case, the personal affairs of the manager's organisation create risks to be borne by fund investors. The use of a carry vehicle protects the fund investors from negative impacts stemming from this manager's organisation. For instance, if a private equity manager terminates a work contract with a key staff member, or if a key staff member is involved in divorce proceedings, their position in the limited partnership would be impacted by any legal disputes at a personal level in the manager's organisation. Using a carry vehicle thus shields the investors' legal sphere from risks developing within the AIFM's remit.

In turn, both the carry interest arrangement and the use of a carry vehicle serve to protect investors, on one hand against conflicting interests, and on the other against legal risks, created in the AIFM organisation. Even if one argues that carry vehicles are not carved out from ATAD3, the use of a carry vehicle is at least justified by way of the commercial rationale rule, given that investor protection is a legitimate business purpose which is to be recognised as a "*commercial rationale*" pursuant to Article 9 (1) ATAD3.[145]

The line between a carry vehicle and an AIF is a fine one: any investor going beyond the AIFM staff and their family members turns the carry vehicle into an AIF.[146] Where legal certainty is desired, the carry vehicle may be (1) structured as an RAIF managed by the (fully licensed) AIFM, and *then* benefit from the carve-out for AIFs, or (2) entirely avoided through an LP contract granting a "*carry share*

[143] Art. 4 (1) (d) AIFMD and annex II (2) of the AIFMD; *cf.* also Roderik Boogaard/Jérôme Mullmaier, "AIFMD and Private Equity", in Zetzsche (ed.), *The Alternative Investment Fund Managers Directive*, *op. cit.*, pp. 654-655.
[144] *Ibid*.
[145] The ATAD3 Proposal remains entirely silent about the definition of "*commercial rationale*", which leaves a huge margin of discretion to tax authorities interpreting this rule, and courts to review the authorities' decisions. It is likely that this interpretation varies amongst the 27 Member States implementing ATAD3, which creates legal uncertainty and may lead to adverse results in the finding of shell entities.
[146] *Cf.* Peter-Jan Smet/Sebastiaan Hooghiemstra, "Co-Investment Vehicles" under the AIFM Law: Is your Vehicle an AIF?", *Juris News*, vol. 7, No 1/2019, p. 125, 128.

class" to the GP instead.[147] We do not recommend using Part I SICARs or Part I SIFs as carry vehicle given they do not benefit from the ATAD3 carve-out for AIFs.

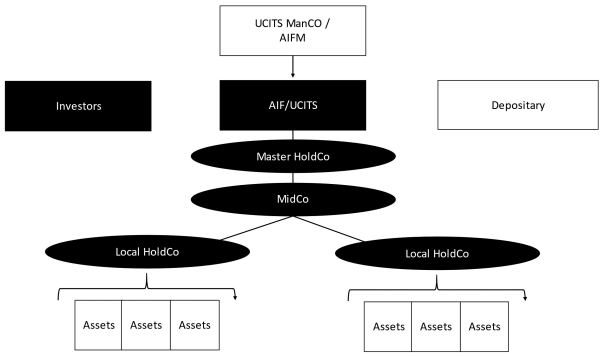
D. Entities between Fund and Assets

1. *HoldCos between Fund and Assets*

In AIF structures, we often see entities in between the fund and the assets, as shown in Figure 3.[148] In these cases, the assets are formally owned by a holding company ('HoldCo'), or in a chain of HoldCos comprising several holding companies, controlled by either the fund, the AIFM on behalf of the fund, or the depositary of the AIF. The AIF holds, as assets, the shares of the master HoldCo, which is the lead entity holding shares in other holding companies. All other assets are indirectly held. To avoid additional legal costs and risks for Luxembourg-based investment funds, the master HoldCo is often a Luxembourg-based entity, while the second- and third-layer holding companies are domiciled where the place of domicile furthers the purpose of the investment fund: holding companies for illiquid assets are usually located in the country in which the real estate is located or ship is registered as this facilitates its registration and administration.

For instance, a Luxembourg-based AIF may hold shares in a Luxembourgish *société à responsabilité limitée* (the Master HoldCo), which then holds shares in a Dutch limited liability company (the MidCo); the MidCo then holds shares in a Cypriot limited liability company and a German GmbH, both of which then hold the real estate in Cyprus and Germany directly.

Figure 3: Investment Funds with HoldCo Set-up



147 *Cf.* Ezechiel Havrenne, "Distribution waterfalls and carried interest explained", *JurisNews Investment Management* 2021, vol. 9, No 1-2, p. 167 (167-169).

148 In the context of UCITS, SPVs are rarely deployed since UCITS are required to hold liquid financial assets traded at regulated markets; to these types of assets none of the rationales for deployment of SPVs laid out in this section apply.

We identify six purposes of utilizing entities this way, all of which are beneficial for investors by reducing either risk or transaction costs.

First, the use of an entity facilitates depositary services: if the assets are individual loan contracts, commodities, physical assets like real estate, planes and ships or crypto-assets, then the depositaries would worry about the verity (i.e. existence) of, and ownership with regard to, the asset. In addition, they would fear statutory liability for being incapable of holding the very assets in custody. If an entity is used, several depositaries may be willing to provide the services, and at lower costs, due to competition among depositaries.

Second, some of these assets come with potential liabilities (such as insurance fees, or tort liability of owners in cases of unforeseen events) which may expose the fund to liabilities beyond the initial investment in that very asset. In turn, the entities are utilised as liability shields.

Third, the use of entities facilitates the acquisition and disposition of the assets. For instance, from a strict civil law perspective, an FCP is in legal terms set up as co-property. If the Luxembourgish FCP held real estate or ships in other countries than Luxembourg, it is uncertain whether the entity status granted to FCPs for regulatory purposes under Luxembourg law is recognized in that other country, given private international law for collective investment undertakings is hardly aligned in the EU, not even speaking about third countries.[149] Under the property laws of *some* countries, all fund investors would need to be registered in the register for real estate and ships in the country where the real estate or ship is registered, even where the composition of investors changes frequently. In turn, initial registration and, in the event of a sale, deregistration of the asset, but also the filing of a lawsuit in relation to the assets, would be slow and costly. Therefore, instead of the asset, the company making the investment is registered. In the same vein, if the fund would acquire a share in a partnership, under the laws of some countries, the acquisition could be subject to all partners' consent. The same share held by virtue of a company making the investment may be obtained by acquiring that company – without legal risks (eventually showing as costs to the fund, i.e. the investors).

Fourth, the use of companies making investments renders the administration of the assets more economical as all administrative steps are bundled together in a given country. For instance, a Germany-based entity holding German real estate may hire German facility managers and provide German tax declarations, even where the real estate is (indirectly) owned and controlled by a Luxembourgish fund and its investors.

[149] *Cf.* Dirk Zetzsche, "Das grenzüberschreitende Investmentdreieck – das IPR und IZPR der Investmentfonds", in Dirk Zetzsche/Matthias Lehmann (eds), *Grenzüberschreitende Finanzdienstleistungen*, 2018, Mohr Siebeck, pp. 199-264.

Fifth, the deployment of entities facilitates diversification by way of co-investments, *and* the reduction of transaction costs due to economies of scale. Imagine an AIF with a pan-EU investment focus has identified an investment opportunity in Poland but lacks the financial capacity to acquire the asset alone and still meet the AIF's diversification criteria. In this case, if it invests by way of an entity, co-investors (for instance an Eastern Europe-focused AIF run by the same fund manager) can join in the investment without creating new conflicts of interest, while reducing transaction costs borne by (both of) the fund(s).

Finally, the entity, as a result of legacy transactions, may hold rights in relation to the asset that have value for investors. Examples here include (1) the right to have preference votes or golden shares in a given company on certain subject matters, (2) the right to use certain intellectual property for commercial purposes, or (3) a right of way. Unbundling these rights on reasonable terms is often impossible. The legacy then "*lives on*" in the entity, and investors benefit therefrom.

2. *Conditions for In-scope Treatment*

ATAD3 poses the question of whether the entities in between AIF and assets are within the scope of ATAD3.[150] Given that ATAD3 relies on financial law when it comes to determining the scope of the carve-out, this question must, in our view, be answered with investment fund regulation in mind.

Investment fund regulation grants special status to entities controlled by the AIFM and the AIF, and in some cases also the depositary. In particular, the AIFMD requires that the depositary's safekeeping duties – both for financial assets to be kept in custody and ownership verification in other cases – also relate to "*the underlying assets of financial structures and, as the case may be, legal structures controlled directly or indirectly by the AIF or by the AIFM acting on behalf of the AIF*."[151] In the same vein, Article 6 (3) AIFMD L2 Regulation[152] states on the calculation of leverage for purposes of risk limits and exposures that may create financial stability risk supervision: "*Exposure contained in any financial or legal structures involving third parties controlled by the relevant AIF shall be included in the calculation of the exposure where the structures referred to are specifically set up to directly or*

[150] *Cf.* Hoor/ O'Donnell/ Schmitz, "Using a Sledgehammer to Crack a Nut: The European Commission's Draft Directive to Tackle Shell Entities", *Tax notes international* 2022, *op. cit.*, p. 225 (234, 239). The authors are aware several statements have requested a clarification that holding entities are considered to be part of AIFs for the purpose of ATAD3. *See*, e.g., ALFI, *Draft Unshell Directive - Fighting the use of shell entities and arrangements for tax purposes*, 6 April 2022, *op. cit.*; Emilien Lebas, "ATAD 3 – European Commission to end perceived misuse of so-called 'shell entities'", *Revue générale de fiscalité luxembourgeoise*, no 2022/1, p. 4 (7): "*What does not seem to be covered by this carve out though, are intermediary holding companies or special purpose vehicles (SPVs) that are held by the funds (which is not surprising as they are the focus of the proposed directive)*".

[151] *Cf.* Recital (102), Art. 89 (3), first subsection, and 90 (5) of Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (Text with EEA relevance), *OJ* L 83 of 22 March 2013, p. 1 (hereafter "AIFMD L2 Regulation").

[152] For full citation, *cf. ibid*.

indirectly increase the exposure at the level of the AIF."[153] Furthermore, the fund's balance sheet, under assets, must show any assets comprising the resources *controlled by the AIF*[154] (i.e. the assets owned by the entities show on the balance sheet as assets of the AIF!). The same is true for the purposes of calculating investment limits and risk exposures.[155]

This shows that for purposes of investment fund regulation, the holding companies are seen as an integral part of the fund; they are inherently intertwined with the fund and used to meet fund regulation objectives.

For that reason, Luxembourg's corporate tax law foresees specificities regarding the tax treatment of holding companies in the fund context. HoldCos are corporations and as such fully subject to corporate tax. However, if these holding companies are in scope156 of the Securitisation Law of 2004[157] they may qualify for tax deductibility of generated income paid out to the fund entity.[158] Alternatively, the fund may hold debt instruments issued by the HoldCos, and the interest paid on the debt instruments are deducted from the holding companies' taxable profits. In both cases, the tax burden on the HoldCos is low, following the underlying logic of any collective investment undertaking that the fund is often tax transparent, the fund's shareholders are subject to income tax and the fund is subject to the *taxe d'abonnement*.

While some commentators have taken a different view,[159] we hold that this comprehensive perspective of investment fund regulation where the fund comprises the AIF entity *including* all HoldCos controlled by the AIF entity, is the interpretation suggested by a literal understanding of the current wording of the carve-out in the Commission draft of Article 6 (2) ATAD3: after all, for its carve-out ATAD3 refers to investment fund regulation which removes any boundary between the fund and legal structures controlled by it or the AIFM. We hold, if the wording of Article 6 (2) ATAD3 (Commission draft) is not amended in the ongoing Trilogue, Member States, exercising their right to clarify uncertainties of EU legislation as part of their implementing powers, may well construe Article 6 (2) ATAD3 when

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153 *Cf.* on details: ESMA, *Questions and Answers – Application of the AIFMD*, ESMA34-32-352 of 14 June 2023, p. 41 *et seq*.

154 *Cf.* Art. 104 (1) (a) AIFMD L2 Regulation.

155 *Cf.* Recital (82), art. 17 AIFMD and art. 6 (3) L2 AIFMD Regulation.

156 Art. 1 (1) of the Law of 22 March 2004 defines securitisation as "*the transaction by which a securitisation undertaking acquires or assumes, directly or through another undertaking, risks relating to claims, other assets, or obligations assumed by third parties or inherent to all or part of the activities of third parties and issues financial instruments or contracts, for all or part of it, any type of loan, whose value or yield depends on such risks*" (translation taken from the CSSF: https://www.cssf.lu/wp-content/uploads/L_220304_securitisation.pdf). For further explanation, *cf.* also Isabelle Riassetto/Michel Storck, *Les organismes de placement collectif – Tome 2. Les fonds d'investissement alternatifs*, Joly éditions, 2022, pp. 1274 ff.

157 Loi du 22 mars 2004 relative à la titrisation et portant modification de la loi modifiée du 5 avril 1993 relative au secteur financier ; la loi modifiée du 23 décembre 1998 portant création d'une commission de surveillance du secteur financier ; la loi du 27 juillet 2003 sur le trust et les contrats fiduciaries ; la loi modifiée du 4 décembre 1967 relative à l'impôt sur le revenu ; la loi modifiée du 16 octobre 1934 concernant l'impôt sur la fortune ; la loi modifiée du 12 février 1979 concernant la taxe sur la valeur ajoutée, *Mém. A* – n° 46 du 29 mars 2004, p. 720.

158 Art. 46 (14) and 164 (1) and (2) of the Luxembourg Income Tax Law.

159 *Cf.* references cited in note 150 *supra*.

implementing ATAD3 and include into the carve-out the collective investment undertaking *and* its holding entities.

Such an interpretation reflects the perspective of the OECD under its BEPS Pillar 2 according to which the fund is defined as the sum of the fund entity plus its directly or indirectly controlled holding companies making investments.[160] Assuming other OECD countries adopt the GloBE rules as proposed by the OECD, any other definition of an investment fund than the OECD's inclusive concept of investment funds creates either frictions or gaps relating to the overall BEPS project as a multi-national coordination effort involving more than 135 countries. In turn, both the regulatory perspective and the tax perspective support construing the fund definition of the ATAD3 carve-out as the sum of the fund entity plus the related holding entities.

The consequences of the view laid out in this section are the same as laid out above for the general partner entity. First, where the fund is an "*undertaking*" *and* classified as an AIF, all elements that together constitute the fund benefit from the AIF carve-out. In this case, the holding entity shares the fate of the AIF which would not have any assets or investment policy without the entity. Second, where the fund is not an "*undertaking*" (i.e. where the fund is a common fund or an SCSp),[161] while the holding entity is, by way of its legal form, legally a standalone entity and as such an "*undertaking*," the holding entity benefits from the AIF carve-out, as it forms an integral part of the AIF. At the same time, entities controlled by collective investment undertakings domiciled in third countries, such as British Qualifying Asset Holding Companies (QAHC) which are deployed as debt funds, cannot benefit from the carve-out of regulated financial institutions since the carve-out is limited to entities subject to the EU's AIFMD.

The former matters only where the fund and one of the entities are located in different countries as ATAD3's scope is limited to set-ups where the shareholder entity and the holding entity reside in different Member States (*cf.* Article 6 (2) (d) ATAD3).

Furthermore, fund regulation also sets a limit on the interpretation we have put forward here. Specifically, if the entity is not controlled by the AIF (nor the AIFM

[160] *Cf.* OECD/G20 Base Erosion and Profit Shifting Project, Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), First Edition, 14 March 2022, Commentary on Article 1.5.2., para. 43: "*Article 1.5.2 is an extension of the definition of an Excluded Entity in Article 1.5.1 that covers Entities owned by an Excluded Entity. Article 1.5.2 recognises that Excluded Entities may be required, for regulatory or commercial reasons, to hold assets or carry out specific functions through separate controlled entities. For example, commercial or regulatory requirements may prevent an Investment Fund referred in Article 1.5.1(e) from investing directly in an asset and may require the investment to be made through a separate vehicle to limit the Investment Fund's liability. The rule in Article 1.5.2 addresses these types of situations and may permit such a holding vehicle to qualify as an Excluded Entity*." The EU implementation of the Model Rules, the Global Minimum Tax Directive, defines investment funds in its art. 3 (31) broadly without referring to financial regulation. Yet, the definition is not limited to *one* "*entity*", but inludes also "*arrangements*", which seems to favour an inclusion of SPVs/investment-making companies in the definition of "*investment fund*".

[161] *Cf.* section III. 1. *supra*.

or the depositary, on behalf of the AIF), the entity does not form an integral part of the AIF. In turn, it is not carved out from ATAD3 under Article 6 (2) ATAD3. In this case, it must either be carved out under other provisions (for instance Article 6 (2) (a) ATAD3 for listed securities, or Article 6 (2) (d) ATAD3 for intra-Member State set-ups) or be justified under the commercial rationale rebuttal reason set out in Article 9 (2) (a) ATAD3.

3. *Commercial Rationale behind the Establishment of the Undertaking*

We have laid out *supra*, in Pt. II.4.a) that if an undertaking is not carved out under Article 6 (2) (b) ATAD3 (since it is controlled by neither the fund, the fund manager, nor the fund's depositary), and if the group to which it belongs to[162] cannot pass ATAD3's quite stylized substance test in a given country (as few mere holding entities will be able to do on a stand-alone basis[163]), it may nevertheless rely on the rebuttal rule set out in Article 9 ATAD3 in order to avoid the undesired tax effects that come with classification as a shell.

Pertinent cases here include companies making investments that are controlled by:

- the fund's sponsor (often the portfolio manager or the portfolio manager's investment advisor);
- the fund's shareholders;
- a fund manager or depositary different from the manager managing the fund or functioning as a depositary of the fund; or
- by independent third parties or third-party service providers.

These companies may rely on the rebuttal rule if its existence is due to a "*commercial rationale*" (and if it meets the additional two cumulative conditions provided by Article 9 (2) ATAD3). In the event of co-investments by AIFs managed by *different* AIFMs, the carve-out of Article 6 (2) ATAD3 may not be available since the AIFM that controls the investment-making company is different from the AIFM managing the fund. Yet, the same investor protection rationale (i.e. lower transaction costs, risk sharing and diversification) that accounts for the use of companies making investments controlled by the AIFM also justifies invoking the commercial rationale justification in this case. The same applies *mutatis mutandis*

[162] According to the European Court of Justice's judicature, tax authorities must look at the substance of the respective group to which the entity belongs. *Cf.* CJEU, *Skatteministeriet v T Danmark* (C-116/16), *Y Denmark Aps* (C-117/16), 26 February 2019, Joined Cases C-116/16 and C-117/16, EU:C:2019:135, notably paras 79, 100 *et seq.*, 114; *cf.* also Opinion of AG Kokott, *Skatteministeriet v T Danmark*, 1 March 2018, Case C-116/16, EU:C:2018:144.

[163] Assuming holding entities are not carved-out and based on ATAD3's beneficial owner definition, all entities managed by the same AIFM (or equivalent investment platform, as the case may be) established in one Member State could constitute a group in that Member State. Then, the substance of the AIFM would be attributed to the holding companies. *See*, in the same direction (without referring to the ECJ), ALFI, *Draft Unshell Directive – Fighting the use of shell entities and arrangements for tax purposes*, *op. cit.*, at p. 3.

to investment-making companies controlled by other AIFs, other depositaries, and even other regulated financial institutions that pursue an investment in the asset held by the company making the investment (such as credit institutions and MiFID investment firms) and that enable co-investments by the fund.

E. Entities between Fund and Investors

1. *Use of Entities between Fund and Investors*

The third type of entity to be considered in the context of investment undertakings concerns those in between the investment fund (UCITS/AIF) and its investors. As a final reference point, ATAD3 provides for an exemption from the Directive's obligations "*if the existence of the undertaking does not reduce the tax liability of its beneficial owner(s) or of the group, as a whole, of which the undertaking is a member*."[164] This first requires an understanding of what constitutes the "*beneficial owner*." Article 3 (5) ATAD3 refers to the classification of beneficial owner "*as defined in Article 3, point (6), of Directive (EU) 2015/849 of the European Parliament and of the Council*." This is, interestingly, not a tax directive, but a directive on money-laundering (the so-called "Anti-Money Laundering Directive V" (AMLD V)[165]), and one wonders whether the objectives of the two – countering abusive shell companies on the one hand, versus money-laundering on the other hand – justifies the use of an AML/CTF definition to combat abusive shell companies. The use of beneficial owner concepts developed for tax law purposes[166] could avoid major inconsistencies from deploying criminal law concepts in that context.

Under Article 3 (6) AMLD V, "*beneficial owner*" means "*any natural person(s) who ultimately owns or controls the customer and/or the natural person(s) on whose behalf a transaction or activity is being conducted*." In the case of entities, the AMLD V outlines that this means at least "*the natural person(s) who ultimately owns or controls a legal entity through direct or indirect ownership of a sufficient percentage of the shares or voting rights or ownership interest in that entity [...] or through control via other means*."[167] Thus, ATAD3 refers to the natural person at the end of the investment chain, as depicted in Figure 4.

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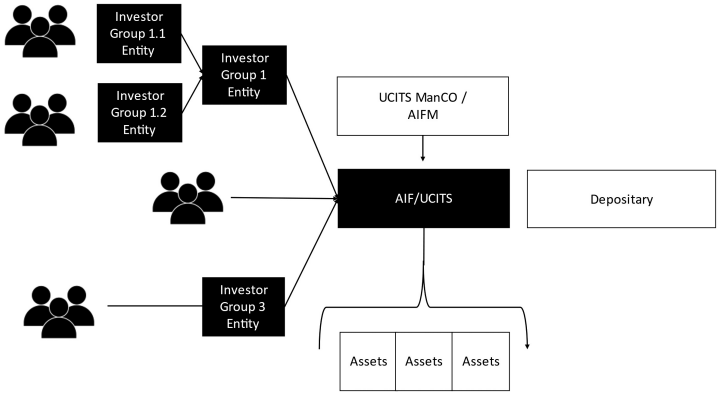
[164] Art. 10 (1) ATAD3.

[165] Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC, *OJ* L 141 of 5 June 2015, p. 73.

[166] *Cf.* e.g., Art. 1 (4) of the Interest and Royalty Directive defines a company as beneficial owner "only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, for some other person", which is in line with the beneficial ownership concept attached to Arts 10 (2), 11 (2) and 12 (1) of the OECD Model Income Tax Convention and the corresponding commentaries on these articles (*cf.*, e.g., OECD, Commentary on Art. 10 OECD MC, paras 12.1 *et seq.*). The Global Minimum Tax Directive makes reference to "*beneficial owners*" of dividend distributions in its Art. 3 (37), without however further defining the concept. However, the notion has also been discussed in the case-law of the CJEU, *cf.*, e.g., CJEU, *Skatteministeriet v T Danmark* (C-116/16), *Y Denmark Aps* (C-117/16), 26 February 2019, *op. cit.*, paras 103 *et seq.*, 118 *et seq.*; *cf.* also Opinion of AG Kokott, *Skatteministeriet v T Danmark*, 1 March 2018, *op. cit.*, paras 44 *et seq.*, 79 *et seq.*

[167] Art. 3 (6) (a) (i) AMLD V.

Figure 4: Entities between the Fund and the Beneficial Owner



2. *Conditions for In-scope Treatment*

Given that ATAD3 defines entities in the broadest possible sense, entities between the fund and natural persons functioning as beneficial owners of the fund require a careful analysis.

The use of entities between the fund and "*beneficial owners*" is frequent.

For one, any institutional asset owner, be it a pension fund, an insurance undertaking or credit institution, or even a fund of funds, qualifies as an "*entity*" and is in principle subject to ATAD3 *unless carved out or exempted*. The carve-out stipulated in Article 6 (2) (b) ATAD3 referring to the catalogue in subsection 2 of Article 6 (2) provides in this regard an extensive list of regulated financial institutions, comprising:

- CRR-compliant credit institutions;
- MiFID investment firms;
- AIFM and UCITS ManCos, including managers of sub-threshold AIFs, as well as the UCITS and AIFs themselves;
- Insurance and reinsurance undertakings, insurance holding companies, as well as authorised insurance or reinsurance SPVs in accordance with Article 211 of Directive 2009/138/EC;
- EU-harmonised pension funds (IORPs) under the IORPD[168] and pension institutions operating schemes which are considered to be social security schemes

[168] Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (recast) (Text with EEA relevance), *OJ* L 354 of 23 December 2016, p. 37.

covered by Regulation (EC) No 883/2004 of the European Parliament and of the Council and Regulation (EC) No 987/2009 of the European Parliament and of the Council as well as any legal entity set up for the purpose of investment in such schemes;

- Central counterparties, CSDs under the CSD Regulation[169], a "*securitisation special purpose entity*" as defined in Article 2, point (2), of Regulation (EU) No 2017/2402 of the European Parliament and of the Council;
- PSD2[170]-compliant payment institutions and EMD[171]-compliant e-money institutions; and
- Crowdfunding service providers and crypto-asset service providers under MiCA[172].

The complication with the list above is that each of the corresponding definitions have their own boundaries and discussion items. Under ATAD3, the limitations of EU financial law concepts become important, and we discuss the implications below, in Pt. V.1.

Second, an "*entity*" could be the result of private individuals cooperating. For instance, under the private laws of some Member States (notably Germany), the simple partnership between individuals is sufficient for entity status. For example, if two friends or two siblings invest jointly through one securities deposit, their cooperation may be classified as a simple partnership and that partnership may qualify as an "*entity*" under ATAD3.

Third, a number of entities stem from family relationships preceding the fund investment. For instance, family holdings or family wealth structures (including foundations, trusts and establishments) may invest on behalf of a family.

ATAD3 puts these three types of entity under scrutiny, and we see little discretion to limit the scope of ATAD3 to the benefit of these entities under the existing wording, unless they are regulated financial institutions. Needless to say, the scrutiny afforded here may increase the need for legal and tax advice, and thus costs, for these investor entities. In light of this insight, the SPVs' "*commercial rationale*" justification as part of the rebuttal provided for by Article 9 ATAD3 becomes important.

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[169] Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (Text with EEA relevance), *OJ* L 257 of 28 August 2014, p. 1.
[170] Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC, *OJ* L 337 of 23 December 2015, p. 35.
[171] Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC, *OJ* L 267 of 10 October 2009, p. 7.
[172] Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937, *OJ* L 150 of 9 June 2023, p. 40.

3. *Commercial Rationale of Investor Entities*

For purposes of the rebuttal of the presumption that an entity is a shell company, we see at least six valid "*commercial rationales*" pursuant to Article 9 (2) (a) ATAD3 that account for the use of undertakings in between the fund and its investors.

First, there is liability shielding.[173] In particular here, participating in alternative strategies may bring additional financial obligations. Often, AIFs are seeded by a group of anchor investors, while additional investors join in funding rounds depending on the investment opportunities and whether the target investment have reached certain milestones. These capital calls may come at an inopportune time though. For instance, some investors, whose wealth stems from an enterprise, found it difficult to meet capital calls during the COVID-19 pandemic. An undertaking may shield these investors from the unexpected negative effects of these capital calls; when push comes to shove, these investors may prefer to default on the call (and lose their initial investment in the fund) when they need their remaining funds for financing and to keep their enterprise alive.

Second, an undertaking may assist in complying with legislation protecting minors and people in care. For instance, legislation protecting minors and people in care would usually prohibit certain types of investment deemed risky by the law, or engagements that may result in long-term obligations for the protected (such as real estate that comes with tax liability). An interposed undertaking can prevent these obligations from coming about, and thus allows for investments disqualified for direct investments by minors and people in care.

Third, an undertaking may assist in complying with investment restrictions of an entity further up the investment chain, in particular where the investment restriction stems from private documents. For instance, the settlor of a trust or founder of a foundation may provide regional or substantive investment criteria, such as that investment entities must be located in a given country or that only shares of a given type are permissible. These restrictions are often made with a view to protecting the activities of the trust and foundation or its financial stability to ensure the long-term funding of family members. Pertinently, a company making investments may assist in meeting these obligations.

Fourth, an undertaking may be used to achieve regional diversification in response to, or to insure against, political developments at the Member State level which may become costly for the investors. In some Member States, elections have led to sudden changes; these may impact the currency value or impair the value of domestic firms and investments by other means, which investors seek to hedge against. For instance, where a country has elected, or is about to

[173] *Cf.* also European Commission, Commission Staff Working Document – Impact Assessment Report accompanying the document "*Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU*", 22 December 2021, SWD(2021) 578 final, p. 5.

elect, a totalitarian government whose approach to the rule of law is in doubt and whose influence on the courts may be overly strong, one way to avoid a negative impact on the investment value is to opt-out of the country's laws and courts by way of an company making the investments. In a similar vein, such a company may assist in protecting against expected or future barriers to move capital across borders in response to a country's banking or monetary crisis. From our perspective, the same perfectly legitimate commercial rationale applies in the opting-out of environmental legislation that is potentially financially harmful.

Fifth, a company making the investments may help to avoid "*double taxation*" but could also be instrumental in avoiding "*double zero taxation*." Both variants are harmful to the beneficial owner-investors as the latter comes with penalty taxation under the tax laws of some Member States and may also preclude reliance on the exemption provided under Article 10 ATAD3.

Finally, an investment-making company may ensure a greater degree of privacy for family members and relatives. In particular, in some countries the disclosure of directly held stakes could expose relatives to extortion and even endanger their lives. In other countries, family members may be exposed to negative social responses facilitated by the political climate of the day. Elsewhere, while transparency with respect to the tax authorities and for money laundering purposes to financial intelligence units is desirable, "*transparency to the public*" may have negative effects for some family members. In particular, where corporate registers require disclosure of small stakes in a given firm or entity (which may be held by minors and people in care), a company making the investments may be deployed to allow the family to live in peace. While one may argue this sixth rationale is personal rather than commercial, ATAD3 looks to determine tax through all affiliates onto the beneficial owner and treats all close family members collectively as *one* person (*cf.* Article 5 (4) ATAD3). The same must then apply, vice versa, to identifying the commercial rationales of the undertaking: under ATAD3, the motives behind beneficial owners setting up the undertaking *are* the commercial rationales.

III. Policy Considerations

A. Beneficial Impact on Collective Investment Undertakings

Despite the technical challenges ATAD3 will bring about for investors' own vehicles, the positive message is that collective investment undertakings, as defined by EU financial law, are carved out from ATAD3.[174] We argue that the Commission

[174] For a narrower approach in OECD initiatives see Dirk Zetzsche, "Non-collective Investment Funds under BEPS Action 6 Versus European Investment Fund Law", in Werner Haslehner (ed.), *Investment Fund Taxation – Domestic Law, EU Law, and Double Taxation Treaties*, Wolters Kluwer, 2018, pp. 181-196.

draft's wording further allows Member States to include the holding entities between investment funds and assets in the carve-out when implementing ATAD3, but prefer legal certainty by clarifying in the remaining Trilogue that the carve-out of Article 6 (2) ATAD3 extends to include holding entities.

Going forward, the investment fund practice is encouraged to make use of this exemption from ATAD3 in a responsible manner, and avoid overly aggressive tax strategies becoming available by way of employing investment funds.

B. Size-dependent Legal Certainty

ATAD3's formal approach to substance is not beyond doubt. One aspect of doubt which we cannot discuss here is whether ATAD3 is truly necessary, in light of many other EU and international initiatives not yet fully implemented at Member States level. Criticism further extends to the stylized substance criteria. Assuming the criteria of the Commission draft were finally adopted (which we do not expect in light of the obvious deficiencies and the ongoing Trilogue negotiations), these stylized criteria run, to the extent that they require primarily group members to function as directors, against principles of good governance that ask for the involvement of outside directors; outside directors must by definition be employed elsewhere. Further, a stylized substance test allows for strategic responses, by allocating substance where it truly matters for tax purposes.

On the other side, the strict criteria of ATAD3 may further certainty as they allow for a set-up of all-ATAD3-compliant entities even where the overall outcome is disadvantageous to the given treasury. While Member States may seek to apply their GAARs nevertheless, in practice, there may be cases where the treasury finds itself in a position that it cannot argue convincingly anymore that shell entities constitute part of a beneficial tax arrangement. Although the European Commission states in the (non-binding text of the) Explanatory Memorandum[175] that ATAD3 would not preclude domestic rules on shell companies or the lack of substantial economic activity, ATAD3 if adopted in the version of the Commission draft, could potentially have an indicative effect on these domestic rules, exercised by national courts or the European Court of Justice: it would be contradictory to

[175] *Cf.* ATAD3, p. 10 of the Explanatory Memorandum: "*An undertaking that is a risk case but whose reporting reveals that it has all relevant elements of substance, should be presumed not to be a 'shell' for the purposes of the Directive. However, this presumption does not exclude that the tax administrations still find that such undertaking: is a shell or lacks substantial economic activity under domestic rules other than this Directive, taking into account the documentary evidence produced and/or additional elements […]*" (emphasis added). Partly contradictory to that statement in unbinding accompanying materials, the European Parliament suggested to amend Recital (2) as to include the sentence "*It is therefore important to create a Union-wide legal approach to ensuring a framework for safeguarding the integrity of the internal market, fully respecting the highest standards of accessibility, simplicity and transparency*." (emphasis added) (European Parliament, *Rules to prevent the misuse of shell entities for tax purposes – European Parliament legislative resolution of 17 January 2023 on the proposal for a Council directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU*, COM(2021)0565 – C9-0041/2022 – 2021/0434(CNS), 17 January 2023, *op. cit.*). This underpins the case for a uniform EU definition of shell entities and therefore negligence of the Commission's mention at p. 10 of the Explanatory Memorandum.

find sufficient substance under one rule, but then doubt the very same when it suits the treasury. Notwithstanding the former, we believe that ATAD3 will have guiding effects on Member States' interpretation of existing, and negotiations of new, double taxation agreements. Member States will seek to deny treaty benefits to entities that do not meet the ATAD3's substance requirements.

While one may argue that the EU's efforts to ensure minimum taxation for multi-national enterprises will balance some of its effects, in truth, ATAD3's main impact in the context of collective investment undertakings is on high net worth individuals with assets of an overall size that would make 250,000 EUR per annum (the cost of substance) a discouragingly large amount in relation to the tax advantage created by the shell. For sure, these would *not* be super-high net worth individuals that have the greatest incentives to arrange their tax affairs in a manner (overly) beneficial for themselves.

C. List of "*Regulated Financial Institutions*"

While the draft's approach to exempt all regulated financial institutions is sound, we take issue with the technical execution thereof. From a financial law perspective, each of these definitions has its own boundaries and discussion items. Under ATAD3, the limitations of these concepts become relevant for tax matters.

For instance, to this day some uncertainty exists whether collectively held deposits where a third-party manager manages financial instruments on behalf of the owner, would qualify under Article 4 (1) (a) AIFMD for the purposes of the AIF definition. While the prevalent (and from our view: correct) view supports such classification (as the joint property in the deposit suffices (*cf.* the FCP), some argue that an "*undertaking*" is lacking, which is a precondition for an "*undertaking for collective investments*."

Furthermore, a CRR-credit institution is an institution pursuing the business of deposit-based lending. Article 4 (1) (1) Regulation (EU) No 575/2013 (CRR)[176] does not cover credit institutions that pursue the business of equity-based lending (i.e. lending of shareholders' funds, rather than depositors' funds).[177] Here, we wonder about the rationale behind including one type of lending activity, and excluding the other. If we follow the rationale laid down in Recital (6) ATAD3,

[176] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Text with EEA relevance), *OJ* L 176 of 27 June 2013, p. 1.

[177] Art. 4 (1) (1) CRR reads: "*'credit institution' means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account*". Member States' implementation showcases the lack of clarity of this definition. However, the European Banking Authority observed that e.g. France explicitly excluded funds deriving from equity loans (*cf.* European Banking Authority, *Report to the European Commission on the perimeter of credit institutions established in the Member States*, 27 November 2014, p. 5 footnote 9).

equity-based lending institutions are also supervised and transparent in that sense, albeit under the laws of the given Member State(s).[178]

In a similar vein, there may be institutions that do not qualify under EU law as a regulated financial institution, but which are nevertheless supervised and transparent under Member States' laws. For instance, the STS Regulation does not cover 1:1 securitisation of physical assets. Yet, these securitisation vehicles are regulated and supervised under Luxembourg's national Securitisation Law of 2004.[179] Similarly, Member States have developed a wide range of licenses for crypto-asset services, and it is uncertain at this point in time whether all of these licenses qualify under MiCA for a license as a crypto-asset service provider. For instance, custody of non-fungible tokens (NFTs) is, in most cases, precluded from the scope of MiCA,[180] yet it is covered by the financial regulation of some Member States, including Germany and France.[181]

We use these examples to show that ATAD3 leans on complex financial regulation concepts with partly unforeseen impacts for all parties involved. To reflect on the complexity of the list and address the practical implications (which differ from one Member State to the next), we propose making the list of "regulated financial institutions" non-exhaustive (i.e. by stating "*regulated financial institutions including at least …*") and grant powers to the Member States transposing ATAD3 to expand that list, taking into consideration their own financial regulation.

To avoid controversies similar to the one currently in front of the ECJ in the context of ATAD1,[182] we argue in favour of a crystal-clear provision that empowers the Member States to expand the list of carved-out entities pursuant to Article 6 (2) ATAD3. To ensure sound implementation of EU law, ATAD3 should:

a) Set the conditions for the carve-out (such as transparency on facts relevant for tax matters, conducting business regulation, and supervision by a recognised authority); *and*

b) Mandate Member States to notify the European Commission of additional entities that qualify under the law of the given Member State as "*regulated financial institutions*."

If these recommendations were to be followed, Luxembourg's legislator could consider including entities with a licence as a Professional in the Financial Sector

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[178] For instance, for Luxembourg, *cf.* Art. 24-8 Loi du 5 avril 1993 relative au secteur financier, *Mém. A* – n° 27 du 10 avril 1993, p. 462.
[179] Art. 1 (1) and (2) of the Law of 22 March 2004.
[180] Recitals (10) and (11) and Art. 2 (3) MiCA; Dirk Zetzsche/Ross Buckley/Douglas Arner/Maurits van Ek, *Remaining regulatory challenges in digital finance and crypto-assets after MiCA*, Study requested by the ECON Committee of the European Parliament, May 2023, pp. 100 ff.
[181] See § 1 (1a) nos 6 and 8 and (11) of the German *Kreditwesengesetz*; art. L. 54-10-3 of the French *Code monétaire et financier* (as modified by the "*Loi n° 2023-171 du 9 mars 2023 portant diverses dispositions d'adaptation au droit de l'Union européenne dans les domaines de l'économie, de la santé, du travail, des transports et de l'agriculture*", *JORF*, n° 0059 du 10 mars 2023) and arts 721-1-2 and 721-1-3 of the French *Règlement général de l'Autorité des marchés financiers*.
[182] *Cf.* pt. I. and note 16 *supra*.

supervised by the CSSF and regulated by the Law of 5 April 1993[183] in the scope of the exemption as well as potential other entities that function as depositaries for investment funds or assume functions (for instance as a HoldCo) in the securitisation of assets in which the fund invests.

Conclusion

While the OECD's Minimum Taxation initiative[184] regarding multi-national enterprises, and the corresponding EU implementation[185], has tackled the tax practices of large multinationals, ATAD3's impact will be felt with regard to private and institutional wealth management. While some questions remain, we find by and large that undertakings in between the fund and any fully licensed fund manager are exempted. With an interpretation of ATAD3's wording that draws on investment fund regulation *and* is in line with the OECD's work in the field, and thus certainly not tailored to encourage tax evasion, we also find that the current version allows Member States to carve-out also undertakings in between the fund and the assets; yet legal certainty should be provided on that matter in the Trilogue.

The main impact of ATAD3 will be felt by undertakings in between the fund and the beneficial owners of investing entities. For these undertakings, their recognition on the basis of its legitimate business purpose becomes a matter of high importance. In this regard, we have proposed various legitimate reasons to be considered under the "*commercial rationale*" requirement of the rebuttal rule outlined in Article 9 ATAD3.

In response to ATAD3, we expect wealthy beneficial owners to acquire or establish regulated financial institutions or "*buy substance*" by setting up group entities and allocating business function to them, to prepare for ATAD3's coming into force. While doubting the soundness of ATAD3 with regard to providing a so-called "*second way out*", we welcome the first trend in light of the increased transparency that it will bring, but ask lawmakers to provide legal certainty and enable a smooth transition into regulated financial institutions, and AIFs in particular.

Moving forward, the investment fund community is encouraged to make use of this privilege afforded by ATAD3 in a responsible manner, and avoid investment funds being used as part of overly aggressive tax strategies.

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183 *Cf.* full reference in note 178.

184 OECD/G20 Base Erosion and Profit Shifting Project, *Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)*, 20 December 2021, available at: https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_782bac33-en (last access: 31 August 2023).

185 Global Minimum Tax Directive, *cf.* note 34 *supra*.