Private equity and real estate substance in Luxembourg

2017 survey

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Snapshot of a changing world

Some may be under the impression that substance is a widely known tax concept and that there is not much to say about it.

Substance, however, is a constantly changing concept. It evolves with tax laws, jurisprudence, and doctrine, and has recently changed again with the principal purpose test (PPT) introduced by the OECD in Action 6 of their anti base erosion and profit shifting (BEPS) plan.

For this survey, we decided to put theoretical discussions aside and focus only on factual elements, providing a snapshot of the current alternative funds landscape in Luxembourg.

We are delighted to share our results with you.

Kind regards,

Christophe Diricks
Partner

Objectives of the survey

- to interpret current behaviours in alternative funds in Luxembourg, and predict where they are headed
- to provide qualitative insights based on numerical data

Gathering data

Between May and September 2017, we surveyed 40 general partners active in Luxembourg's private equity, real estate, infrastructure, and debt sectors.

We focused on the following themes:

- office organisation in Luxembourg
- office functions
- future development of the offices

The professionals surveyed were selected for their representativeness and their organisations' statistical significance (e.g. we spoke to six of the ten biggest private equity funds in Luxembourg).

Our data represents about 4,000 entities and almost 550 employees in Luxembourg.

Evolution

The majority of the general partners surveyed indicated that they need assistance with, or further guidelines for, new substance regulations.

We therefore took care to compile this survey thoroughly, building a many-sided understanding of alternative funds in Luxembourg.

First insights

A large majority of the general partners surveyed have a fund vehicle* domiciled in Luxembourg.

Half of the alternative funds surveyed have at least one AIFM in Europe, 75% of which are located in Luxembourg.

Alternative funds employ as little as one person or as many as 130. The average is 14 employees, and the median six.

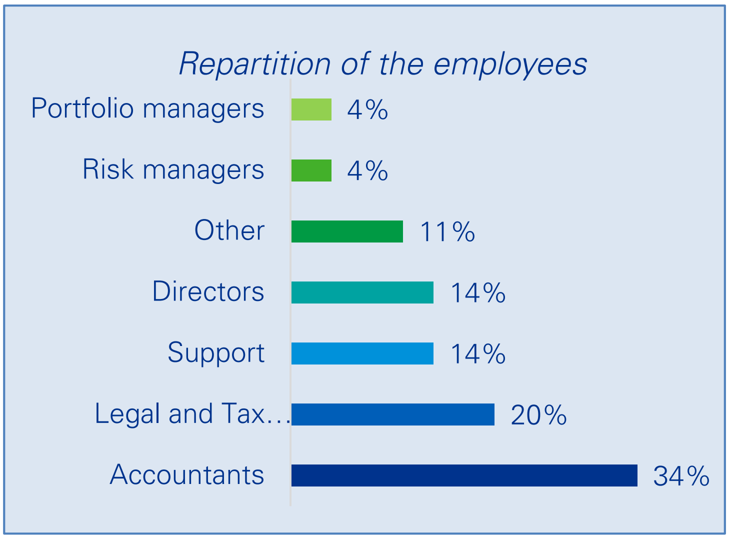
Of the alternative funds surveyed, 43% plan to hire new staff in the coming six months, and 10% are currently relocating decision-makers to Luxembourg.

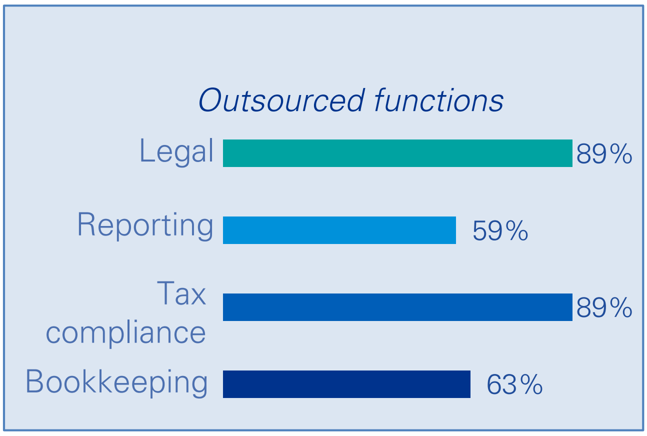
*a collective investment scheme, e.g. SICAR, SIF, RAIF

What are the staff's roles and qualifications?

Our analysis shows that alternative funds are staffed mostly by accountants and by legal and tax experts.

In this context, it is unsurprising that 85% of the alternative funds surveyed employ accountants and 70% legal and tax specialists.





Which functions are outsourced?

Most alternative funds outsource tax compliance and legal services.

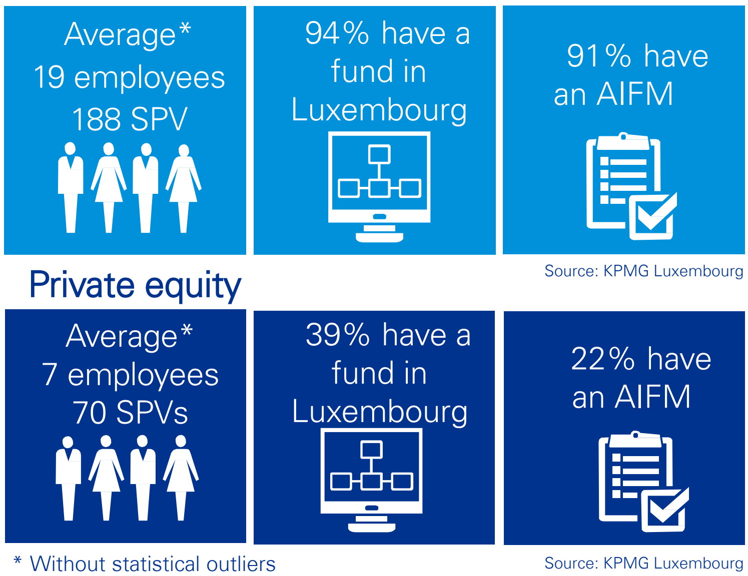
Even if most accounting functions are done internally, 63% of the alternative funds surveyed outsource at least part of their accounting work.

Ninety percent of the offices we surveyed have directors, the majority of whom give their service providers regulatory and accounting insights—it therefore is perhaps not as simple as interpreting "outsourced" to mean done completely outside the company. Additionally, 10% of the alternative funds surveyed are currently relocating decision-makers to Luxembourg, so it appears that the percentage of key functions carried out in Luxembourg will increase.

Private equity vs real estate

Is there any material difference between private equity (PE) firms and real estate (RE) funds in how they organise their affairs in Luxembourg?

Real estate

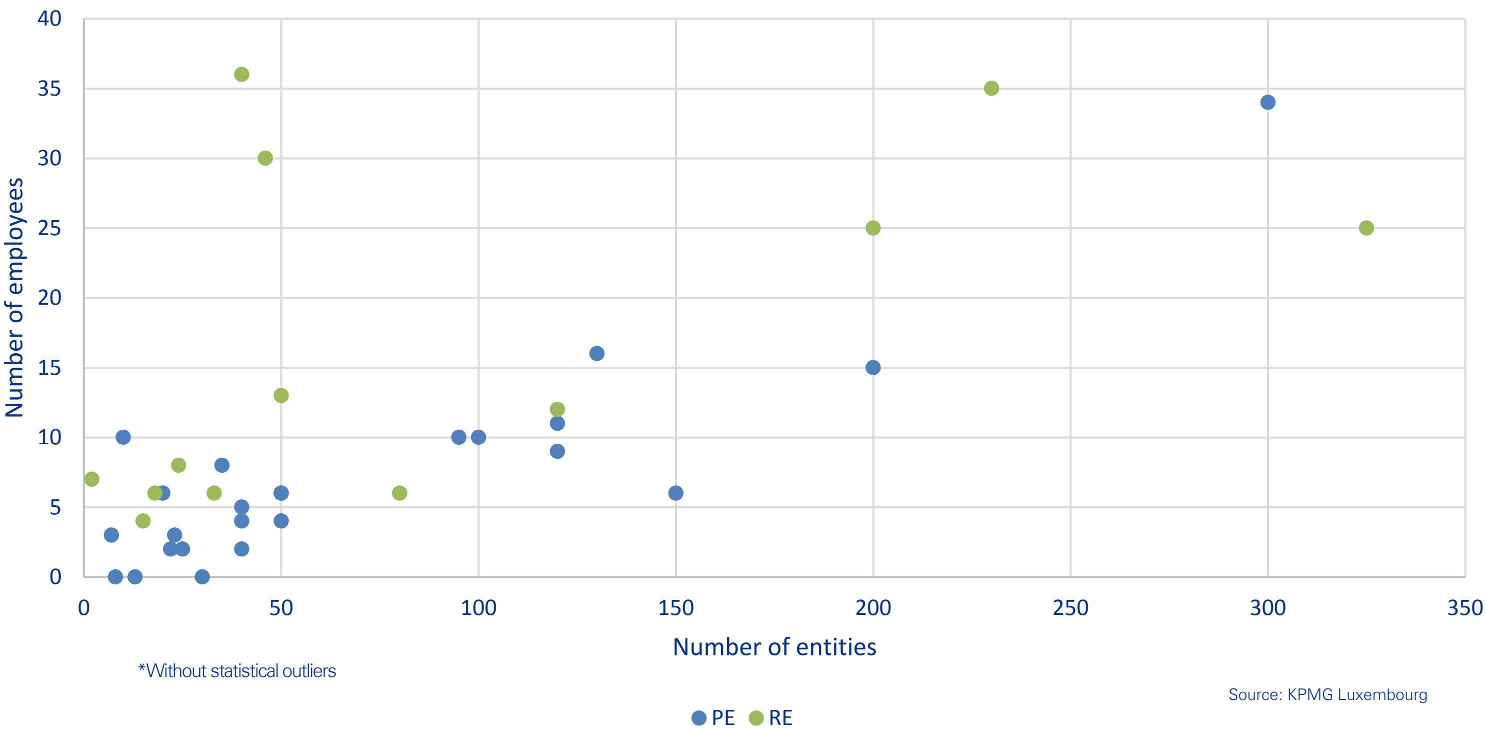


Our research found that PE companies have an average of nine employees per 83 entities, whereas RE funds average 29 employees per 168 entities.

It thus seems reasonable to conclude that the Luxembourg offices of RE funds are generally bigger, in the sense that they employ more people and manage more SPVs.

We also noticed that RE funds generally have an AIFM whereas fewer than 25% of PE funds have one.

The graph below shows where the firms lie by number of employees vs number of SPVs managed.*

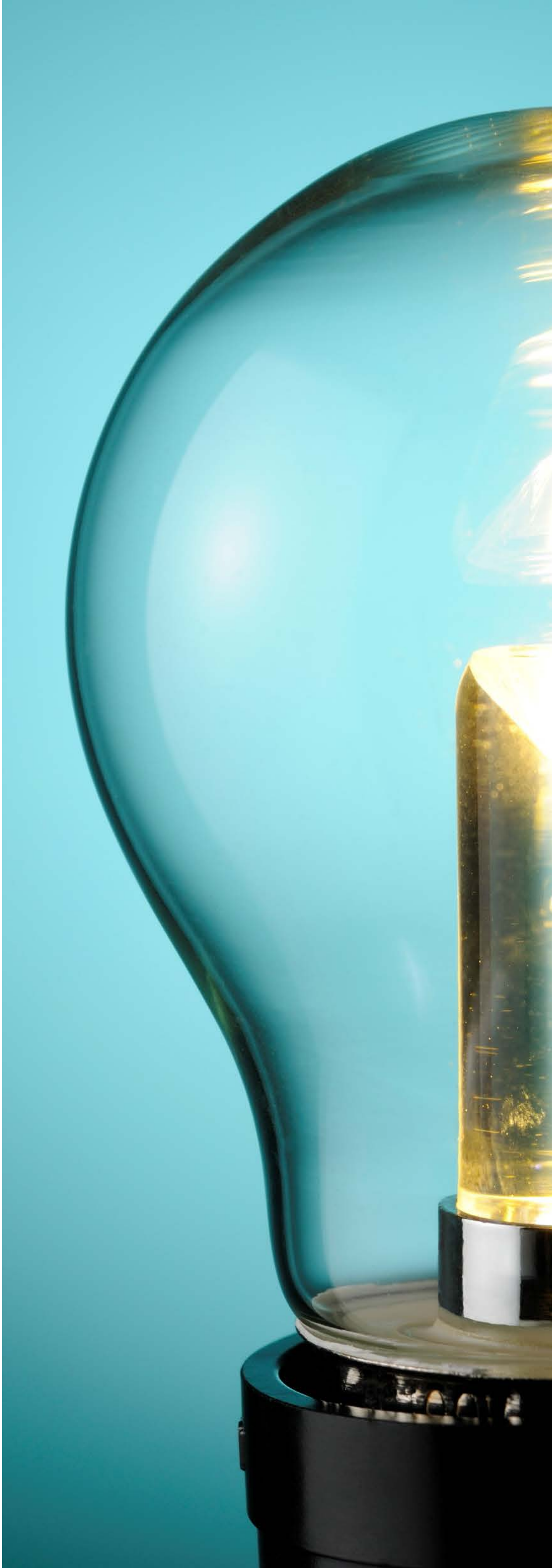


Compared to their PE counterparts, RE general partners have a longer history in Luxembourg-established regulated funds and regulated managers. These discrepancies, however, have become less significant since the Brexit announcement. We have indeed noticed an increase in agreement requests for AIFMs by PE general partners over the last six months.

Follow tax reforms, coordinate your business response

Oversight is becoming an increasingly important activity within the Luxembourg alternative investment fund industry, with regulatory and anti-BEPS requirements meaning that directors must better understand the business in which they invest.

If audited, directors must be able to demonstrate (through documentation) that all the appropriate functions are being effectively performed.



Management teams, in order to adequately and promptly document the oversight of the business, need efficient IT dashboard tools that show the compliance status of their entities.

They must also be able to perform risk management and compliance duties (according to FATCA/CRS, MiFID, AIFMD, and any other local requirements) smoothly and efficiently.

Tailor-made software solutions already exist in this area.

KPMG can assist you in transforming your business for the next decade through substance/BEPS health-checks, robotic process automation (RPA) implementation, and blockchain technology.

Anticipate tomorrow. Deliver today.

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