

Investment Funds |

UCIs: Reduction of the subscription tax rate for funds investing in sustainable investments

# Getting Started

## Here with you today

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## Agenda

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- 1 Context
- 2 Rules and Practical Considerations
- 3 How the EU taxonomy defines environmentally sustainable activities

# Context

A position of Luxembourg as a leader in the EU's transition to a more sustainable economy

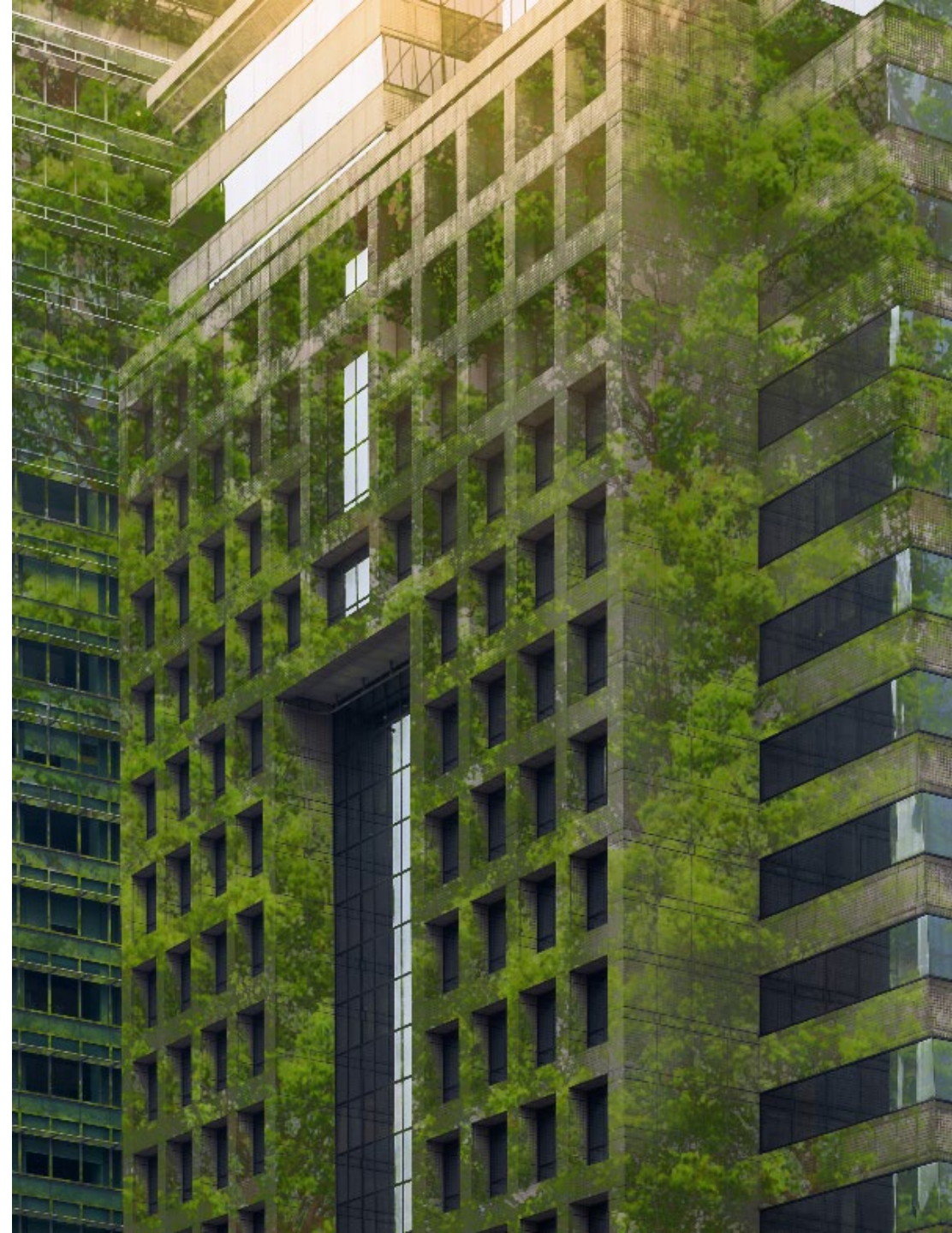
# Context

In recent years, **Luxembourg** has implemented several measures to position itself as a leader in the EU's transition to a more **sustainable economy**.

In December 2020, **the subscription tax rate reduction** was approved for undertakings for collective investments (UCIs) having investments that qualify according to **Taxonomy Regulation**.

Multiple advantages are available to Lux UCIs: not only an **immediate saving** on taxes, but it also accelerates the implementation of procedures and controls to collect, process and report data required by the **SFDR** and the **Taxonomy Regulation**.

Investment managers that perform structured analyses of their investment databases, supported by proper data enrichment, will be ready to **comply with the future regulatory deadlines** and immediately benefit from the advantages.



## **Rules and practical considerations**

A reduced rate linked to the proportion of UCI assets invested in sustainable economic activities

# Scope, principles and rates

Since 1<sup>st</sup> January 2021, article 174, paragraph 3 of the UCI Law states that, where the proportion of net assets of a UCI (or an individual compartment of a UCI with multiple compartments) **invested in sustainable economic activities** represents at least

- **5%** of the aggregated net assets => the subscription tax rate amounts to **0.04%**;
- **20%** of the aggregated net assets => the subscription tax rate amounts to **0.03%**
- **35%** of the aggregated net assets => the subscription tax rate amounts to **0.02%**
- **50%** of the aggregated net assets => the subscription tax rate amounts to **0.01%**

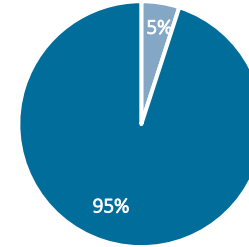
**for the proportion of net assets invested in taxonomy aligned assets.**

The article is therefore

-> applicable to UCITS and UCI part II -> more than 4,3 trillions of AUM as at June '22.

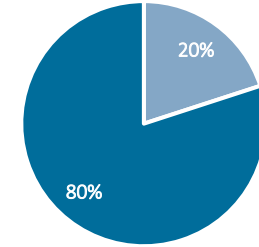
-> applicable to share classes not currently dedicated to institutional investors (those classes are already subject to the minimum rate 0,01%).

**Sustainable economic activities are defined in Article 3 of Taxonomy Regulation - Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment.**



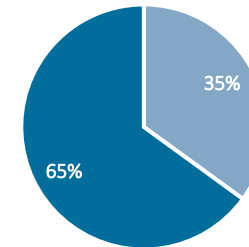
Subscription tax: **0.04%**

**Saving: 100k€** every 1bn€ invested in aligned assets



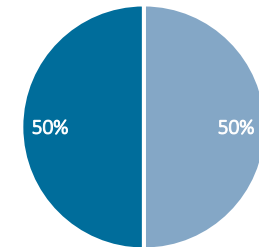
Subscription tax: **0.03%**

**Saving: 200k€** every 1bn€ invested in aligned assets



Subscription tax: **0.02%**

**Saving: 300k€** every 1bn€ invested in aligned assets



Subscription tax: **0.01%**

**Saving: 400k€** every 1bn€ invested in aligned assets

# Potential savings from the tax subscription rate reduction for UCI Funds





## Practical considerations

- Sustainable economic activities are those that comply with the criteria set forth in the EU “Taxonomy” Regulation 2020/852 **art. 3**;
- The reduced subscription tax rate is **fixed at financial year-end** based on the % of sustainable economic activities at that date;
- The reduced subscription tax rate is applicable for the **next 4 quarters** after communication to Tax Authority;
- The reduced rate has to be applied to the % of sustainable economic activities calculated at the **end of the quarter**;
- The **% of sustainable economic activities** have to be disclosed in the annual accounts or in a specific report;
- Réviseur d’entreprises agréé have to provide at least **reasonable assurance** on the % of sustainable economic activities and **issue a certificate** to the Luxembourg tax authorities including the % of sustainable economic activities.



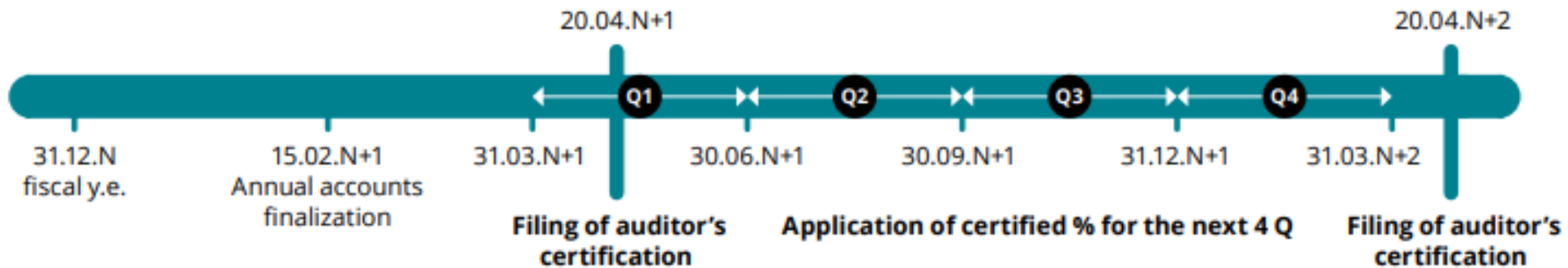
# How to calculate

The Tax Authority issued the **Circular 804bis** and issued a clarification letter to IRE on July 7, 2021, detailing the following:

- A Fund has to provide to the Tax Authority the réviseur d'entreprises agréé certified attestation on the % of sustainable economic activities at **the first tax declaration following** the finalization of the annual accounts (or reasonable assurance report) or **not later than the last day of the quarter** to which the reduction will apply for the first time. Only the attestation has to be provided while the annual accounts (or reasonable assurance report) need to be available upon request.
- The determined tax rate is fixed and **applicable for the next 4 quarters**; only for the first-year shorter application is accepted to align the covered quarters to the annual reporting cycle.
- In each of the 4 quarters, the tax liability will be calculated applying the reduced rate to the % of aligned assets calculated **at the end of each quarter**.

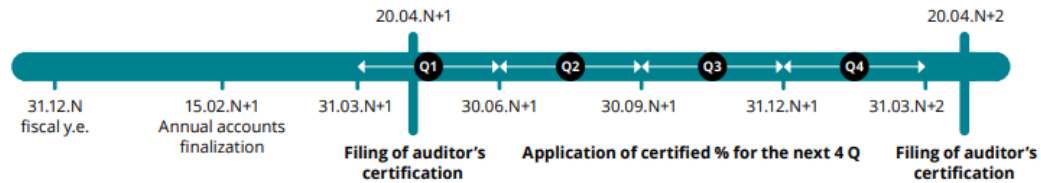
In practice: an example with financial year end on 31.12

- Auditor's annual report (or reasonable assurance report) detailing the % of aligned assets in the Fund's portfolio as at 31.12.N, ready on 15.02.N+1;
- Subscription tax declaration, under usual process, to be submitted within 20.04.N+1, with the certified attestation to fix the reduced tax rate.
- Reduced rate will be applicable as from 31.03.N+1 and for the next 4 quarters.



## Example – Determination & application of a reduced subscription tax rate

In practice: an example with financial year end on 31.12.N



### Assumptions

- TNA: 1.000€m at each quarter end
- Year-end 31.12.N
- Aligned TNA as at year-end 67%
- Therefore, the subscription tax rate applicable to the aligned assets is fixed at 0,01% for the next 4 quarters.
- This will be certified by the auditor with an attestation that needs to be provided to the Tax Authority during the first tax declaration after the certification.
- Assuming the certificate is ready when the tax declaration is filed (within 20.04), the reduced rate certified will be applicable as from 31.03.N+1

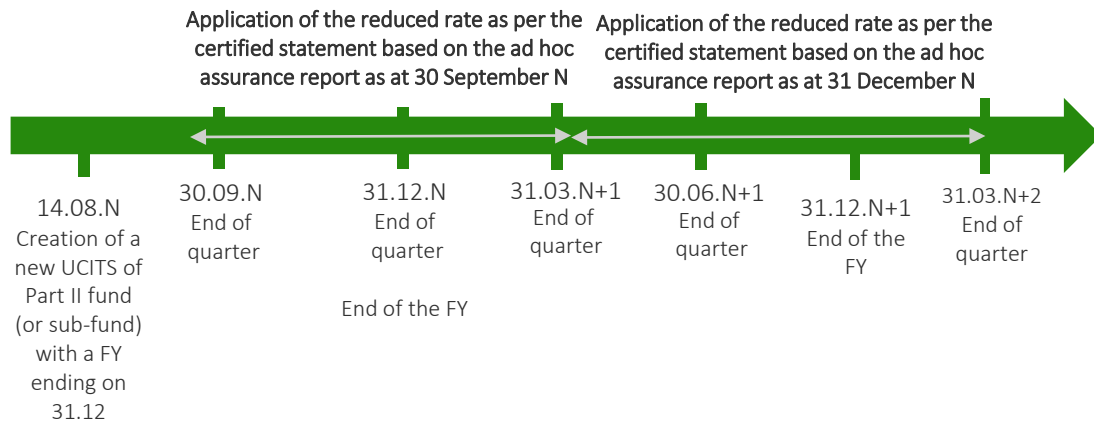
End of quarter	% alignment	Quarter of Tax liability	Tax liability value	Tax liability formula
30.06.N+1	80%	FY Q2	€45,000	$(1.000m * 20% * 0,05% + 1.000m * 80% * 0,01%) / 4$
30.09.N+1	48%	FY Q3	€77,000	$(1.000m * 52% * 0,05% + 1.000m * 48% * 0,01%) / 4$
31.12.N+1	20%	FY Q4	€105,000	$(1.000m * 80% * 0,05% + 1.000m * 20% * 0,01%) / 4$
31.03.N+2	40%	FY+1 Q1	€85,000	$(1.000m * 60% * 0,05% + 1.000m * 40% * 0,01%) / 4$

➤ On the 4 quarters the Fund paid €312.000 instead of €500.000

➤ The new audit cycle on 20.04.N+2 will fix the new reduced tax rate considering the portfolio composition as at year end and the new rate will be fixed for 4 quarters.

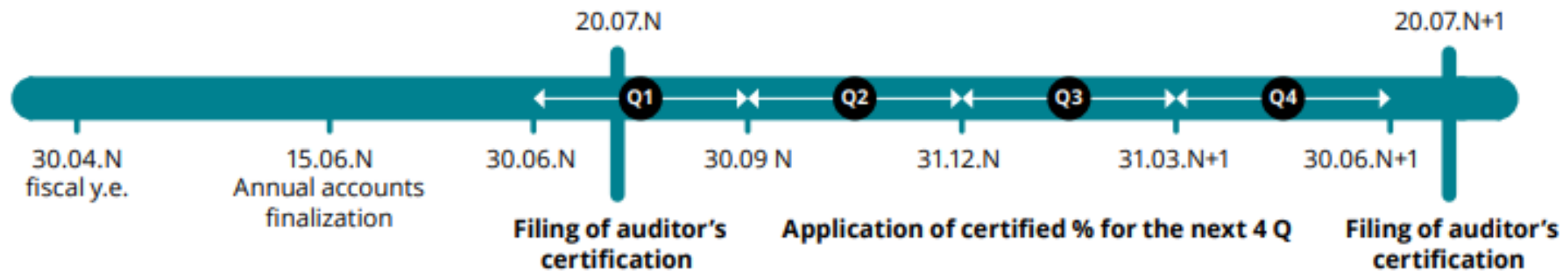
## Examples 2 and 3 – Newly created fund & financial year divergent

In practice: Late first filing / Newly created fund/sub-fund



- Filing date of the certified statement based on an ad-hoc assurance report based on figures as at 30 September N – within 31.12.2022 for the reduced rate to apply from 30 September N until new filing based on financial y.e. figures
- Filing date of the certified statement based on an annual report as at 31 December N – statement for the reduced rate to apply from 1st April N+1 until March N+2
- End of the application of the reduced rate based on the audited annual report for FY31 December N on the 31.03.N+2

In practice: Financial year divergent from the calendar year



# Assurance engagements: reasonable vs. limited assurance

Level of assurance	Reasonable	Limited
Objective	Reduce engagement risk to an <b>acceptably low level</b> in the circumstances of the engagement	Reduce engagement risk to a level that is <b>acceptable for the facts and circumstances</b> of the engagement, but <b>where that risk is greater than for a reasonable assurance engagement</b>
Conclusion	<b>Positive assurance</b> conclusion that conveys <b>opinion</b>	<b>Negative assurance</b> conclusion
Evidence-gathering procedures	<p><b>Combination of assurance procedures</b>, which can include inspection; observation; confirmation; recalculation; reperformance; analytical procedures; and inquiry</p> <p>The work effort in such engagement entails more extensive procedures than in a limited assurance engagement. They include: (i) <b>risks identification and assessment that any matters may be unfairly represented</b>; (ii) <b>testing the operating effectiveness of the company’s internal controls upon which the practitioner intends to rely on</b>; and (ii) <b>substantive procedures</b>.</p>	<p><b>Combination of assurance procedures</b>, which can include any that would be performed for a reasonable assurance engagement</p> <p><b>Nature, timing and extent of procedures performed is less</b> compared a reasonable assurance engagement</p>

# Reasonable assurance standards

## WHAT STANDARDS BEING USED

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A variety of standards exist. Nowadays, the **International Standard on Assurance Engagements (ISAE) 3000 Revised (ISAE 3000)** is the standard mostly used when dealing with sustainability information assurance as practice has evolved.

However, the IAASB is developing a new overarching standard for sustainability assurance engagements, the proposed **International Standard on Sustainability Assurance (ISSA) 5000, General Requirements for Sustainability Assurance Engagements**.

# Potential advantages vs Requirements

## Potential advantages

- Tax reduction improving performance
- Taxonomy alignment
- Taxonomy learning process
- Applicable also to SFDR art. 6
- Market differentiation
- Marketing argument



## Requirements

- Additional costs for new procedures
- Internal controls
- Reconciliations with asset managers
- Reporting
- Data availability / access
- Additional reports from auditor

# Taxonomy framework

How the EU taxonomy defines environmentally sustainable activities



# The EU Taxonomy

An EU-wide classification system or 'framework' to identify to what extent economic activities can be considered environmentally sustainable regarding the 6 environmental objectives



**Regulation (EU) 2020/852 of 18 June 2020** on the establishment of a framework to facilitate sustainable investment, and amending Regulation 2019/2088 on sustainability-related disclosures in the financial services sector



## What is the aim?

- Establish the criteria for determining **whether an economic activity is environmentally sustainable** for the purposes of establishing the degree of environmental sustainability of an investment.



## Who is in scope?

- Measures adopted by **Member States** or by the Union setting out any requirements on financial market participants or issuers in respect of financial products or corporate bonds that are made available as environmentally sustainable.
- **Financial market participants (FMPs)** making available financial products
- **Undertakings which are subject to the obligation to publish a non-financial statement** or a consolidated non-financial statement pursuant to Articles 19a or 29a of Directive 2013/34/EU.



## What are the key concepts?

For the purposes of establishing the degree of environmental sustainability of an investment, an **economic activity shall be considered environmentally sustainable** where that activity complies with all of the following criteria:

1. Substantially **contribute** to at least one of the six environmental objectives;
2. Do **not significantly harm** any other environmental objective;
3. Comply with **minimum safeguards** such as the OECD Guidelines for Multilateral Enterprises, UN Guiding Principles on Business and Human Rights, ILO,... ;
4. Comply with **technical screening criteria**.

## Key dates:

- **1<sup>st</sup> Jan 22** - Application of Climate change adaptation and mitigation (Art.5,6,7)
- **1<sup>st</sup> Jan 23** - Application of Complementary Climate Delegated Act (Specific gas and nuclear activities)
- **1<sup>st</sup> Jan 24** –Application of Delegated Act on remaining environmental objectives (to be confirmed after the JO publication)

1. **Climate change mitigation**
2. **Climate change adaptation**
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy, waste prevention and recycling
5. Pollution prevention control
6. Protection of healthy ecosystem

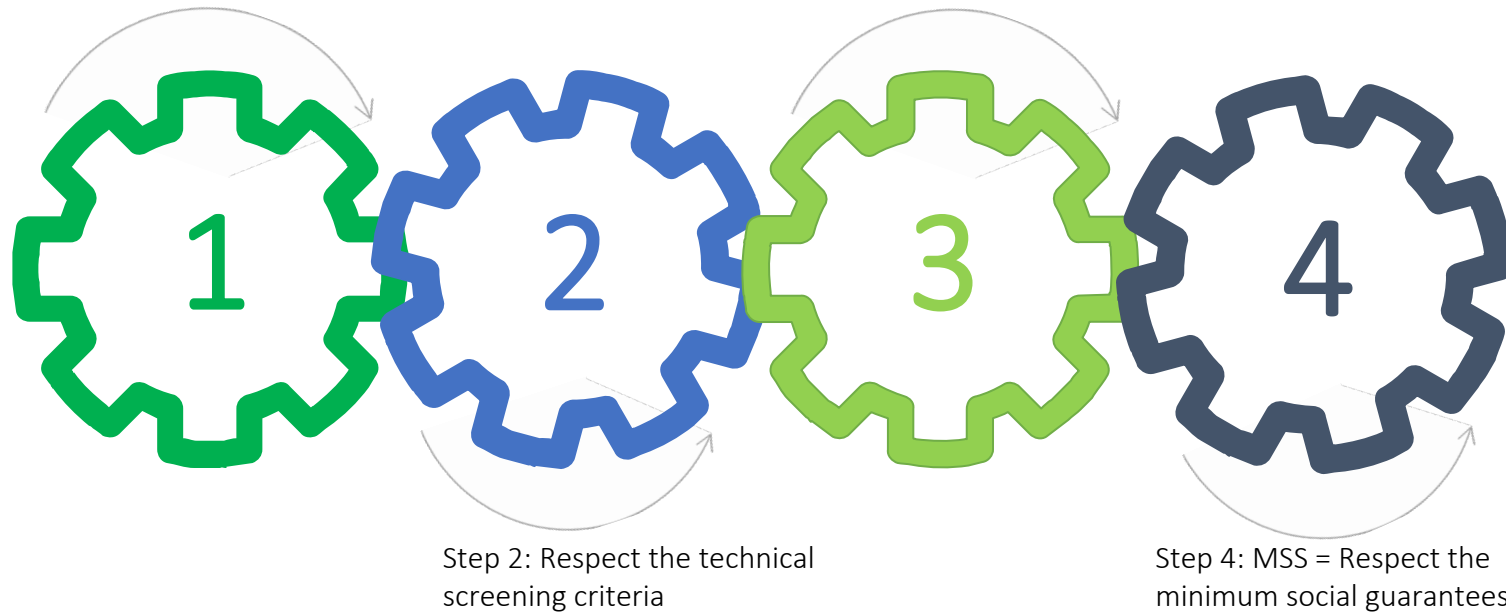
- (1) [EU Taxonomy Regulation](#)
- (2) [Disclosures Delegated Act](#)
- (3) [Climate Delegated Act](#)
- (4) [Complementary Climate Delegated Act](#)
- (5) [Amendments of Climate of Delegated Act](#)
- (6) [Taxonomy Delegated Act on the 4 remaining objectives](#)

# Taxonomy Mechanism

## Four steps to fulfill

Step 1: Eligible economic activities

Step 3: Do no significantly harm to any other environmental objective (DNSH)



**Taxonomy-aligned economic activities** (or environmentally sustainable) are those activities that fulfill all of the following criteria:

Step 1: The economic activity contributes to **one or more of the environmental objectives** of the Taxonomy Regulation as defined in the delegated acts;

Step 2: It **complies with technical screening criteria** as laid down in the delegated acts on the environmental objectives (currently, for climate change mitigation and adaptation (the “Climate Delegated Act”));

Step 3: It **does not significantly harm any of the other environmental objectives**;

Step 4: It **complies with the Minimum Social safeguards**:

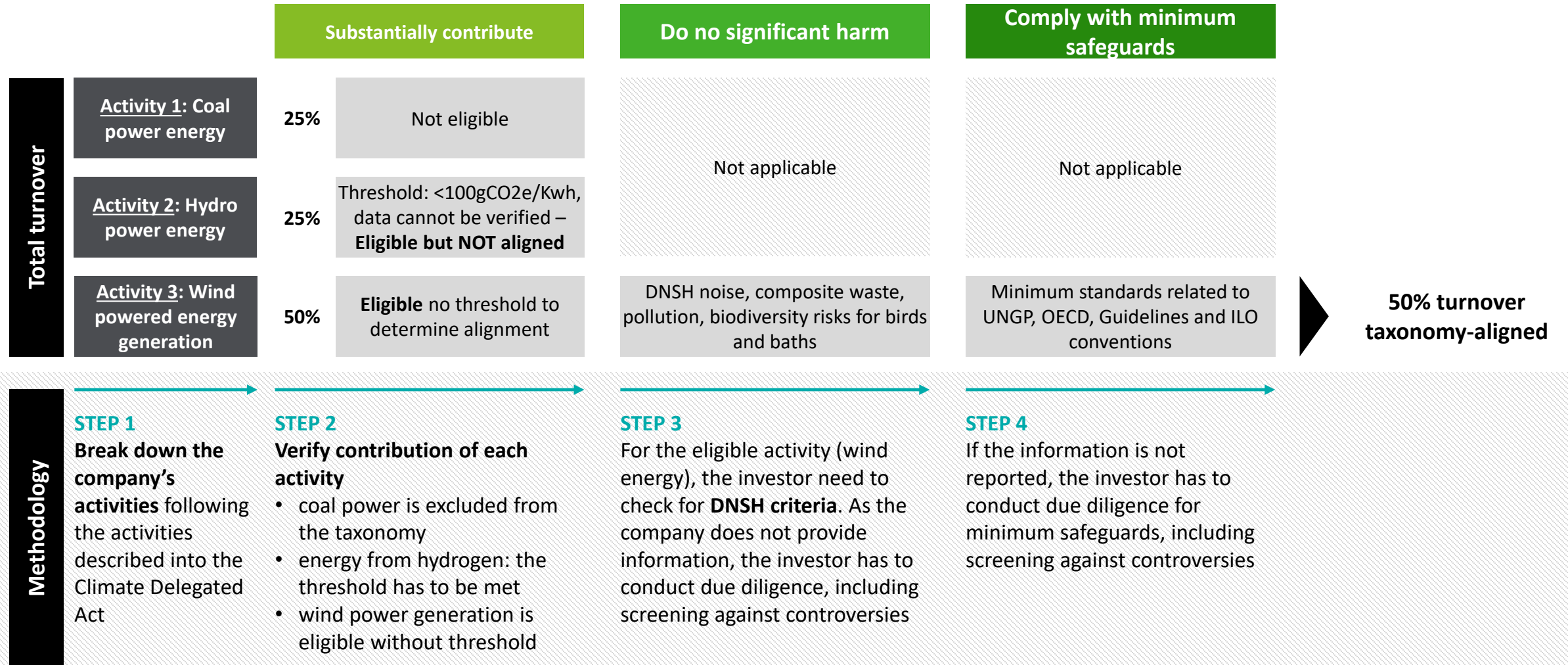
- The OECD Guidelines for Multinational Enterprises
- The UN Guiding Principles on Business and Human Rights
- The International Labor Organization (ILO) declaration on fundamental Rights and Principles at work



The 2023 budget law excluded investments in natural gas and nuclear power from the reduced subscription tax for the proportion of a fund’ net assets invested in sustainable economic activities.

# EXAMPLE

We consider power energy generation activities performed by the investee company with 3 different sources; the simulated analysis considers the four steps.



# Next Link'n Learn webinar

*Date: 11/10/2023*

**Topic: Investment Funds |  
Supervision of costs in UCITS and  
AIFs**





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