Liquidation: advanced planning as a key strategy

The end of the year often coincides with a particularly busy period for corporate entities actively managing their voluntary liquidation processes, either for opening or closing aspects, according to their strategic plans defined previously in the year. Alessandro Bertonazzi and Fanny Him from Value Partners highlight the importance of selecting an appropriate liquidation process and the necessity of advanced planning in navigating these decisions.

For companies considering voluntary liquidation, the traditional path involves a three-step process, which starts with an extraordinary general meeting of shareholders to initiate liquidation in the presence of a notary, appoint the liquidator and define its authority.

The appointed liquidator then oversees the liquidation actions, including, among others, asset realisation, supplier identification, the review of remaining payments, the review and termination of agreements and the consideration of tax and VAT situations in both Luxembourg and abroad.

The next step involves a second general meeting to submit the liquidator's report and appoint an auditor to the liquidation (*"commissaire à la liquidation"*). The process concludes with a final general meeting implying the approval of the liquidator's report, the auditor's report, and the distribution of liquidation proceeds, thus finalizing the liquidation.

Nevertheless, the Company Law reform of August 2016 confirmed a streamlined alternative (as delineated by Art 1865 bis of the Civil Code): a one-step dissolution for sole-shareholder companies. This option simplifies the process by dispensing with the need for a liquidator or auditor.

However, the consequences of choosing this alternative process include the transfer of all company assets and liabilities to its sole shareholder, along with the preliminary receipt of three certificates to be issued by some Luxembourg Administrations (*Centre d'informatique, d'affiliation et de perception des cotisations commun aux institutions de sécurité sociale, Administration des contributions directes, Administration de l'enregistrement et des domaines*).

By choosing this option, the company has to be in compliance and up-to-date from a tax, VAT, and social security contributions. The expertise of liquidators can be considered as a precious and valuable asset, providing assistance in managing any potential liabilities that may arise during the restructuring or cessation of operations, just as it can help in determining the best process to apply and defining a reasonable timetable of intervention.

Overall, even for corporate entities not considering liquidation, the year-end provides an opportune moment to review their structures and strategies. This may involve assessing operational efficiencies, tax planning, and compliance measures. Foresight in these areas can provide stakeholders a clear and comprehensive view of the company's obligations and enable them to define the objectives for the upcoming year.

As emphasized by Bertonazzi and Him: "Advanced planning is essential regardless of the company's immediate intentions. Whether facing a complete wind-down or simply looking to refine operations, the close of the year is a critical period for thorough review and strategic decision-making to ensure a company is well-positioned for the future."

Alessandro BERTONAZZI, Managing Director
Fanny HIM, Director
Value Partners S.A.

Pillar Two Perimeter: Embarking on a top-down assessment journey

By *Sophie VANESSE, Partner, Anca-Elena GRIGORE, Director and Ilaria PANZERI, Senior Manager, Deloitte*

On 4 August 2023, the Luxembourg government submitted the draft law (Draft) to the Luxembourg parliament, implementing the Pillar Two Directive which aims to establish a global minimum taxation threshold of 15% for multinational enterprise (MNE) groups and large-scale domestic groups (DG) in the EU through three new taxes (i.e., tax related to the Income Inclusion Rule, the Undertaxed Profits Rule and Qualified Domestic Minimum Top-up Tax.

The Draft is currently progressing through the legislative process, with the aim of achieving final implementation by 31 December 2023, in accordance with the EU deadline.

In light of these impeding changes, asset managers should conduct a proactive evaluation of the potential impacts of the Pillar Two rules on their investment platforms and determine which entities should be included in the Pillar Two perimeter. Such assessment requires the implementation of a systematic top-down approach, which starts with an analysis at the level of the investor(s), extends to the fund and its intermediate holding entities, and finally to the portfolio entities.

This article provides an overview of the main principles guiding the determination of the Pillar Two perimeter, with a specific focus on the identification of the MNE group or DG, its Ultimate Parent Entity (UPE), and any excluded entities, within the context of an alternative investment structure.

Scope of application of the Pillar Two rules

According to the Draft, the forthcoming Pillar Two rules are expected to apply to constituent entities that are part of either a MNE group (i.e., any group which comprises at least one entity or permanent establishment situated outside the jurisdiction of the UPE) or a domestic group (i.e., any group which comprises constituent entities all situated in the same jurisdiction), provided that the group has achieved an annual turnover of at least EUR 750 million. This financial threshold is to be determined based on the UPE's consolidated financial statements, whether actual or deemed, for at least two of the four fiscal years immediately preceding the tested fiscal year.

Building on the above, the initial step in assessing the Pillar Two perimeter is to identify the MNE group or DG and its UPE per investment structure.

Identification of the MNE group and its UPE

The UPE is defined as an entity that (i) owns, directly or indirectly, a controlling interest in any other entity and that (ii) is not owned, directly or indirectly, by another entity with a controlling interest; or as the main entity of a group that has one or more permanent establishments.

For this purpose, a controlling interest means an ownership interest (i.e., any equity interest that carries rights to the profits, capital, or reserves of an entity or a permanent establishment) in an entity where the interest holder is required or would have been required (deemed consolidation test) to consolidate the assets, liabilities, income, expenses, and cash flows of the entity on a line-by-line basis in accordance with an acceptable financial accounting standard.

The deemed consolidation test is intended to cover situations in which the UPE did not prepare consolidated financial statements either in compliance with an acceptable financial accounting standard listed in the draft, or with another financial accounting standard adjusted to prevent material distortions.

The identification of the MNE group and its UPE should be performed as a factual analysis, starting at the level of the investors, and continuing with each entity within the investment structure until one aligns with the UPE's criteria outlined in the Draft. This process entails a meticulous examination of the accounting rules at the level of each entity within the investment structure, with a particular focus on the accounting consolidation requirements. The goal is to understand whether these entities are required or would have been required to consolidate on a line-by-line basis, applying an acceptable accounting standard foreseen in the Draft.

Considering the common accounting standards typically employed by Luxembourg investment funds (such as IFRS 10 for investment entities and the specific consolidation exemptions applicable to fund products), these funds would qualify as an UPE only in rare instances.

Similarly, we anticipate that Luxembourg intermediate entities, which consolidate on a voluntary basis or do not consolidate by application of the generally acceptable accounting principles in Luxembourg and related doctrine (e.g., opinion of the Commission on Accounting Standards – CNC 09/002 known as "private equity exemption") would not qualify as UPEs and would therefore be out of scope of the Pillar Two rules. Further clarification on these matters is expected during the legislative process.

Finally, it is worth noting that, while there are certain similarities in establishing the UPE between the Pillar Two and the country-by-country (CbC) reporting rules, there are also differences. Therefore, it is crucial to perform a separate analysis and not relying entirely on the CbC reporting rules.

Once the UPE and MNE group have been identified, the turnover threshold must be assessed.

Turnover threshold assessment

To be considered in scope of the Pillar Two rules, the annual consolidated turnover (actual or deemed) of the MNE group or domestic group should be at least EUR 750 million in two or more of the four fiscal years immediately preceding the tested tax year.

A tax year is defined as a 12-month period. In this respect, whenever a tax year is shorter or longer than 12 months, the turnover threshold should be adjusted proportionally for the purpose of the turnover assessment. At this stage, neither the Draft, nor its commentaries provide any definition for the "turnover." It is still unclear which items of the consolidated accounts need to be considered while checking such threshold. Further clarification from the OECD is expected on this matter.

Once the UPE and the EUR 750 million threshold have been determined, excluded entities must be identified.

Identification of any Excluded entities

The draft foresees a list of entities that should be excluded from the Pillar Two perimeter on the basis that these would normally not have been required to consolidate on a line-by-line basis. These entities are governmental entities, international organizations, nonprofit organizations, and pension funds (including pension services entities).

Additionally, investment fund and real estate investment vehicles, as defined in the Draft, should also be considered as excluded entities to the extent they qualify as an UPE. This exclusion aims at preserving their status as tax-neutral investment vehicles.

The scope of exclusion would also extend to entities that are owned by one of the aforementioned excluded entities, to the extent such entities are held:

a) for at least 95% by such vehicles, and (i) all or almost all of the entity's activities involve holding assets or investing funds for the benefit of such investment funds, (ii) it exclusively carries out activities ancillary to those performed by the investment funds, or (iii) it carries out a combination of the previous two activities; or
b) for at least 85% by such vehicles, provided that substantially all of the entity's income consists of dividends or equity gain or loss excluded from qualifying income.

Following the top-down approach outlined earlier, in case there is another entity above the fund that is the UPE (e.g., a majority limited partner consolidating the fund on a line-by-line basis for financial statement purposes), the fund and its underlying investments could be excluded only to the extent such UPE is an excluded entity itself and the fund and its investments meet the criteria in a) or b) above.

In cases where no investor holds a controlling interest in the fund, and the fund itself does not qualify as an UPE since it does not consolidate or is not deemed to consolidate its investments on a line-by-line basis, the fund cannot be considered as an excluded entity.

Consequently, the entity or entities it owns directly or indirectly may fall within the scope of the Pillar Two rules as they could not benefit from the exclusion available for entities meeting the 95% or 85% tests mentioned above.

Uncertainties are still present in relation to the interpretation of the OECD commentary to article 1.5.2 in relation to a possible extension of the exclusion to entities held by investment vehicles not consolidating such entities on a line-by-line basis.

A broad interpretation would allow to grant the exclusion to all such entities, while a narrow one would allow it only to the extent the investment fund is at least the UPE of another group. Both interpretations would require in any case an assessment in light of the object and purpose of the Pillar Two rules.

Conclusion

Although the draft is set to be finalized by the end of 2023 and further clarifications may be expected from various public and private stakeholders, asset managers should take proactive steps to properly establish the Pillar Two application perimeter of their investment structures. This entails the implementation of a structured top-down approach.