Subscription Tax in the spotlight:

Increasing number of audits launched by the tax authorities

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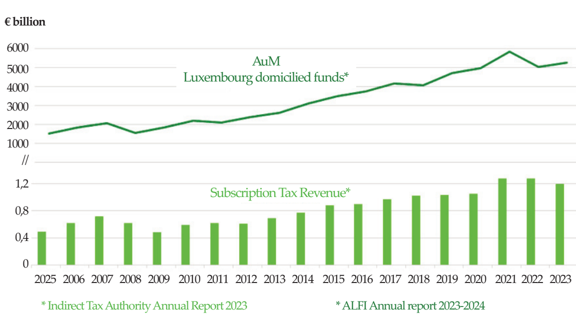
While sometimes considered a "low profile" tax, recent developments have set Subscription Tax[1] in the spotlight. In this regard, a noticeable rise in Subscription Tax audits initiated by the Luxembourg competent tax authority[2] has been observed in recent months. Compliance with the requests of information can be challenging, as the inspectors of the AED are requesting an extensive range of information within a limited timeframe.

Subscription Tax is levied on the net asset value (NAV) of Luxembourg funds, including UCIs[3], SIFs[4], and RAIFs[5]. UCIs are subject to a general rate of 0.05%, while SIFs and RAIFs are subject to a 0.01% rate. Nevertheless, the legislation provides several rate reductions and exemptions.

Even though some voices have been advocating for its removal, Subscription Tax remains an important source of revenue for the Luxembourg State[6], and its extinction does not seem likely for the foreseeable future. In contrast, the current trend seems to be the "fine tuning" of its scope, establishing specific reductions and exemptions[7], combined with a higher degree of scrutiny by means of audits. The below chart describes the consistent evolution of the assets under management (AuM) of Luxembourg domiciled funds despite the increase of revenue generated by the collection of Subscription Tax by the AED.



In addition to the potential application of interest and penalties, poor compliance with Subscription Tax obligations may also trigger a red flag with respect to AML legislation[8], which may lead to further investigations by the *Commission de surveillance du secteur financier* (CSSF). A CSSF Circular considers the lack of adequate Subscription Tax supporting documentation as one of the indicators to consider in AML tax risk assessments. During late 2022, the CSSF published a thematic review on Luxembourg IFMs (Investment Fund Managers), which highlighted weaknesses connected with Subscription Tax as one of its key findings[9].

The Subscription Tax audits currently performed by the AED's inspectors include an integral review of the supporting documentation connected with the compliance of such tax, notably covering:
- Written procedures, and formalized control framework;
- NAV calculations;
- Technical description of the IT system used for Subscription Tax compliance;
- Internal and/or external controls;
- Sample testing of filed returns and interviews with the relevant teams; and
- Other measures put in place, such as staff training and data storage.

The first item of this list is specially remarkable: When performing an audit, the AED is currently expecting to find in place an adequate Subscription Tax governance framework, including a detailed written procedure and robust internal controls to manage and monitor the relevant tax obligations. Such procedure should notably cover the methodology implemented to determine the taxable basis, addressing, when needed, the necessary steps to apply rate reductions and exemptions.

In this sense, one of the main focus of said audits is the verification of the correct application of the so-called "Lux fund of funds" (FoF) exemption[10]. When a FoF invests in another Lux fund (TF) subject to Subscription Tax, such participation should not be taxed again (i.e., there is a "FoF exemption"). The purpose of this rule is to prevent economic double taxation[11].

The FoF exemption is only applicable provided that the underlying fund (i.e., the TF) was actually subject to Subscription Tax on the relevant assets[12]. Under such conditions, the FoF is allowed to exclude from the taxable basis the portion of the NAV attributable to investments made in TFs that were subject to Subscription Tax. In contrast, if the TF was not subject to Subscription Tax, the FoF exemption shall not be applicable and the FoF shall pay the Subscription Tax on the NAV represented by the investments held in such TF.

The challenge of applying the FoF exemption relates to the need to make a detailed breakdown of the relevant portfolio of the FoF, distinguishing between investments in TFs subject to Subscription Tax and TFs that where not subject to such tax. This is not an easy task for large funds investing in multiple Luxembourg TFs. This is due to the multiple situations where a TF is exempt/excluded from Subscription Tax and, therefore, the FoF is not subject to the FoF exemption, as detailed below:
- Vehicles without regulated fund form;
- Investment companies in risk capital (SICARs);
- Reserved Alternative Investment Funds (RAIFs) that have as exclusive object the investment in assets representing risk capital;
- UCIs qualifying as listed Index Funds;
- UCITS qualifying as actively managed ETFs;
- UCIs, SIFs and RAIFs qualifying as eligible short-term Money Market Funds;
- UCIs, SIFs and RAIFs qualifying themselves for the FoF exemption;
- UCIs, SIFs and RAIFs qualifying as European Long Term Investment Funds (ELTIFs);
- UCIs, SIFs and RAIFs that have as main objective to invest in Microfinance Institutions;
- UCIs reserved to investors in the context of pan-European Personal Pension Products (PEPPs); and
- UCIs, SIFs and RAIFs reserved for institutions for occupational retirement provision and employee's retirement benefits plans.

The most prudent approach to monitor the correct application of the FoF exemption requires to implement a classification procedure that allows to check whether the relevant TF falls under the scope of any of the scenarios under which it would not be subject to Subscription Tax (which would, in turn, disallow the application of the FoF exemption). Only when it has been confirmed that the TF does not fall under neither of the exempt/out of scope categories, it would be prudent to consider that the FoF exemption should apply to a particular case. The tax authority seems to be aligned on this approach, since these elements are currently being requested and reviewed during the Subscription Tax audits.

As a final note, the AED published last year updated online forms for submitting Subscription Tax returns[13]. Notably, the new online forms now require declaring and individualizing the legal name and CSSF number of each TF giving rise to the application of the FoF exemption, which should clearly increase the extent of supervision of the AED on this matter. While the new online forms are already launched, there is a transition period that will last until August 2026, during which the old forms will remain valid. During such transition period, Luxembourg investment funds may choose to apply either the old or new versions of the online forms.

In conclusion, the monitoring of compliance with Subscription Tax matters is undoubtedly in the spotlight. The AED is conducting integral audits on this matter and the updated tax forms that will become mandatory in the near future will enhance such monitoring function. Applying Subscription Tax rules is complex in some situations, like in the case of the FoF exemption. It requires a proper governance framework, including detailed written procedures, and robust internal controls. Luxembourg asset managers should take proper action to put in place such measures and monitor their effectiveness.

1) *Taxe d'abonnement.*
2) *Administration de l'enregistrement, des domaines et de la TVA* – "AED".
3) Undertakings for Collective Investment, as per Article 173 of the Law of 17 December 2010 ("UCI Law").
4) Specialized Investment Funds, as per Article 66 of the Law of 13 February 2007 ("SIF Law").
5) Reserved Alternative Investment Funds ("RAIFs") which do not have as exclusive object the investment of their funds in assets representing risk capital, as per Article 45 and 48 of the Law of 23 July 2016 ("RAIF Law").
6) According to the AED Annual Report 2023 (*Rapport d'activité 2023 de l'Administration de l'enregistrement, des domaines et de la TVA*, page 148), the Subscription Tax revenue for FY 2023 was around EUR 1.2 billion.
7) E.g., the reduced rates established for Funds that invest in qualifying sustainable economic activities [Article 174(3) of the UCI Law] and the recently established exemption for actively managed ETFs [Article 175(g) of the UCI Law].
8) The Luxembourg AML Law (Law of 12 November 2004) establishes that certain covered professionals of the financial sector have the obligation to inform when they know, suspect or have reasonable grounds to suspect that money laundering (which definition includes "aggravated tax evasion" and "tax swindle").
9) Communication Published on 8 November 2022 in the CSSF official website (https://www.cssf.lu/en/2022/11/aml-cft-controls-applied-in-terms-of-preventing-tax-offences/).
10) Article 175(a) of the UCI Law, Article 68(2)(a) of the SIF Law and Article 46(2)(a) of the RAIF Law.
11) i.e., to prevent that the Subscription Tax is levied twice on the same asset.
12) As clarified by the AED Circular N° 818 of 26 July 2023.
13) AED Circular 821 of 15 July 2024.

Association of the Luxembourg Fund Industry (ALFI)

Unlocking Europe's Savings and Investment Potential

Europe's capital markets are at a pivotal moment. While Europeans save a significant portion of their income, they often fail to unlock the potential of these savings through investment. In contrast to other regions, where household wealth is actively invested, Europe's financial assets largely remain dormant in cash and savings accounts. This presents both a challenge and an opportunity.

Currently, EUR10 trillion of household wealth in Europe (41%) is held in cash and savings, compared to EUR13 trillion (16%) in the US. This substantial difference highlights the need to mobilise these funds into productive investments.

By activating Europe's €33.5 trillion in household financial assets we can accelerate growth in Europe, and fuel a new era of financial empowerment. Key to this transformation is unlocking the vast potential of retail savings, particularly by promoting second-pillar occupational pensions through auto-enrolment, adequately designed investment solutions and targeted tax incentives. These solutions will not only benefit individuals, but also drive economic growth and financial stability across the continent.

In order to foster a true investment culture in Europe, **ALFI recommends a set of concrete actions** designed to unlock Europe's savings potential, stimulate investment, and drive long-term economic growth, that can be implemented at both national and EU levels. While many of these levers fall within the powers of national governments, EU institutions can play a key role in guiding and encouraging fundamental reforms.

a) Mobilising younger generations

- **Financial education in schools**: Introduce mandatory lessons focusing on fundamentals of investing, including compound returns, long-term investing, and understanding market risks.
- **Investment accounts for children**: Promote investment accounts over savings accounts, fostering long-term investment habits from a young age.
- **Building an investment culture**: Launch annual events and competitions for students, rewarding the best "mock portfolio managers" with contributions to their investment accounts.
- **EU-wide investor education campaign**: Tackle adult financial literacy to support pension reforms and empower citizens to make informed investment decisions.

b) Strengthening European pension systems

As Europe faces significant demographic challenges, modernising pension systems—particularly second-pillar pension schemes—is crucial:
- **Pension tracking tool:** Introduce an EU-wide tool to track first-pillar pensions and later expand to second and third pillars, based on transparent, demographically sensitive rules that give citizens a clear view of their retirement expectations.
- **Best practices framework**: Focus on transparency, efficiency, broad eligibility of pension schemes, and simplified participation for employers and employees.
- **Encouraging competition and beneficiary choice**: Second pillar pension schemes should be accessible to multiple providers (banks, insurers, asset managers) to ensure competitive costs. Beneficiaries should have the freedom to choose their allocations and investment products, as this has proven to enhance financial literacy and market participation.
- **Investment strategies and default options**: Capital-guaranteed products should be limited to those approaching retirement due to their low yields. Default investment solutions should focus on long-term growth, with high equity exposure for younger investors and lifecycle investing strategies. Providers should offer guidance tools and model portfolios to assist employees in making informed decisions.
- **Supporting the real economy**: Pension schemes should allow allocations to private asset investments.
- **Promote auto-enrolment and portability**: Employees should be automatically enrolled, with both employers and employees required to contribute, supported by targeted tax incentives. Additionally, ensuring cross-border pension mobility and consistent tax treatment will help mobilise bank deposits into the economy.
- **Enhance IORP** (Institutions for Occupational Retirement Provisions) and **PEPP** (Pan-European Personal Pension Product)
- **Frameworks**: Eliminate regulatory barriers to foster cross-border pension solutions. Allow for a unified, scalable pension product to simplify saving for retirement.

c) Investment Savings Accounts (ISAs)

An ISA could be an additional entry point to savings products or pillar 3 pension schemes and be combined with targeted tax incentives. ISAs should:
- Cover a **broad spectrum of assets** like equities, bonds, UCITS, and ETFs. Investments into private assets via Alternative Investment Funds or ELTIFs should also be possible.
- Be easily **accessible** through banks, insurers, investment fund managers and investment firms.
- Be **available to minors**, encouraging early financial literacy.
- Operate with **uniform, simple tax treatment**—tax-deductible contributions with tax-free growth.
- **Avoid unnecessary restrictions** such as fee caps or mandatory EU investment allocations.
- ISAs offer a proven model, ready to be implemented without the complexity of new labels or agencies.

d) Supervisory convergence, not centralisation

We support regulatory convergence while maintaining national expertise by upholding a decentralised supervision model. National authorities should retain agility and adaptability in managing asset management regulations. A centralised supervisory body would add complexity and costs without solving existing barriers to fund distribution. Changes to the current supervisory framework would not result in directing any additional savings to capital markets in Europe and would be an unnecessary distraction.

Source: ALFI

More information : https://www.alfi.lu/en-gb/publications