# LUXEMBOURG: CHINESE INVESTORS' WINDOW TO EUROPE

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# INTRODUCTION

**Luxembourg offers an unrivalled combination of a stable economy, a reliable tax regime, and a sophisticated, internationally oriented infrastructure. The government strongly supports a pragmatic approach as regards its dealing with China, as a consequence of which the legal and economic environment remains attractive for multinational companies, be it for locating their European corporate headquarters in Luxembourg for Chinese outbound investments or for structuring Chinese inbound investments via Luxembourg corporate vehicles.**

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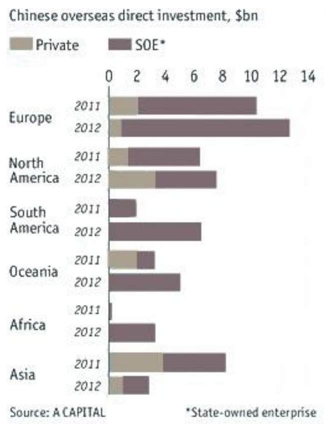
## 1. CHINESE INVESTMENTS

Over the last few years, China's strategy seems to have evolved from mainly inbound driven to outbound investments. Indeed, **China's mergers and acquisitions activity in Europe last year was up 21%.** To sell across the world, Chinese firms need brands and technologies: Europe has both. Investments in Europe firms often take the form of minority stakes in the European target companies, rather than outright takeovers, so as to tap European management expertise and to overcome local hostility at outright takeovers.




From 2011 to 2013, the number of enterprises in Europe chosen for investments by Chinese individuals and corporates rose from 4,525 to 7,148, a 66% increase. Among them, 82% are owned by individual or family investors, while 18% are owned by the state owned companies and private companies.

As a result, by the end of 2012, China's outward Foreign Direct Investment stock in Europe has reached over USD 31 billion, with the following percentage in terms of main industrial contribution: leasing and business services 30.7%, finance 21%, manufacturing 20%, mining 12% and wholesale and retail trade 4.5%.

## 2. LUXEMBOURG'S ATTRACTIVENESS

The figures on outbound FDI, being **F**oreign **D**irect **I**nvestments made cross-border via an entity that is located in Europe shows that roughly **a third of all outbound FDI into Europe** have been channeled through Luxembourg. In 2010, Luxembourg has benefited from FDI totalling € 1 451 000 million. For the same year Luxembourg has made FDI for an amount of € 1 496 000 million. The similarity in the amounts of inbound and outbound FDI shows that FDI are typically made "through" Luxembourg, rather than into Luxembourg: Luxembourg is a facilitator, gateway in the truest sense of the word for foreign investors investing in foreign countries by using an intermediary holding company located in Luxembourg. **Worldwide Luxembourg holds the 3rd place in the table of countries receiving FDI.**

### 2.1. A favorable tax regime

The **participation exemption** is a key element of the Luxembourg corporate tax system and aims at avoiding double taxation of profits. This facility allows under certain circumstances the receipt of dividends and capital gains from subsidiaries that carry out business activities to be exempt from (additional) tax Luxembourg. As a result, inserting a Luxembourg acquisition structure between an (Chinese) acquirer and a European target can result in **tax savings or tax deferrals** compared to a direct investment in the target.

The **broad tax treaty network** (70 tax treaties in force, 32 additional tax treaties pending), also makes Luxembourg very attractive as many double tax treaties reduce withholding tax rates on dividends, interest payments and royalties. Under domestic tax law there is **no withholding tax** on outbound interest or royalty payments. Dividend withholding tax in case of China gets avoided as well, irrespective of whether the holding of the Luxembourg entity by the Chinese investor is done out of Mainland China or via Hong-Kong.

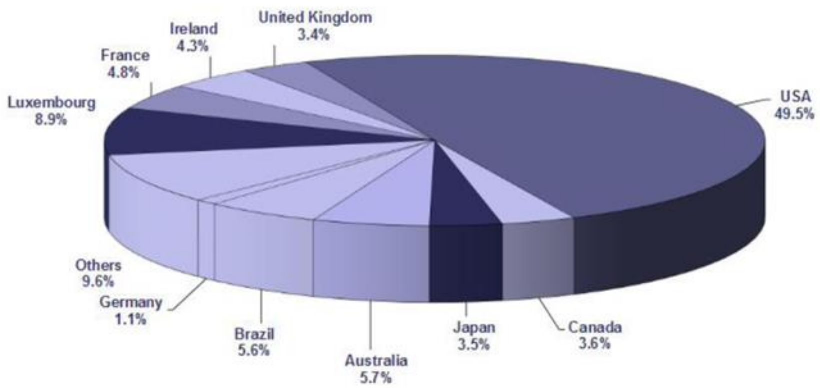
As a result of the above, **Luxembourg has become increasingly interesting for investments into China as well as for outbound investments by Chinese companies.**

## 2.2. What else does Luxembourg offer?

A key feature of Luxembourg is that the decision-makers of the country understand that economic growth may only be achieved by offering a business-friendly climate to foreign investors, and by anticipating their needs.

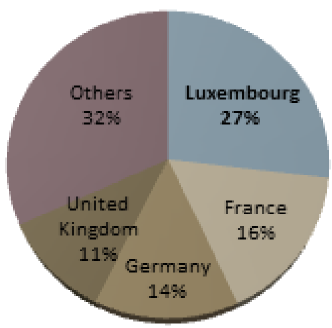
### 2.2.1. Investment fund business

UCITS (Undertakings for Collective Investment In Transferable Securities) are the investment funds of choice for retail investors. They operate under an harmonized European Union regulatory regime and offer a high degree of investor protection. **Owing to a quick implementation of a European Directive on the cross-border distribution of regulated funds, Luxembourg has become over the last 20 years the second-largest place in the World for domiciling investment funds,** after the United States.




In Europe, Luxembourg is the clear leader for investment funds. It harbors 27% of investment funds in Europe, more than any other European countries.

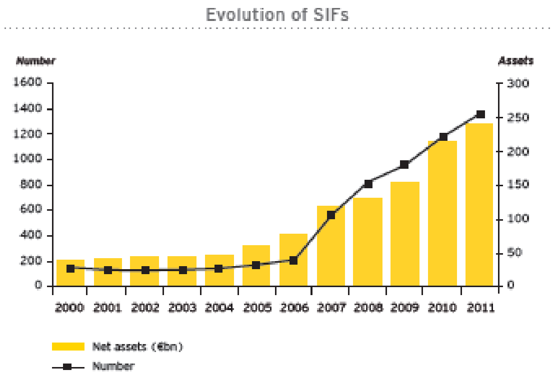
European Fund Industry



Today almost 75% of the UCITS funds distributed internationally are based in Luxembourg.

Building on its success with UCITS, Luxembourg has developed over the last 5 – 10 years a strong track record in alternative investment products and bespoke investment structures such as hedge funds and funds of funds, private equity vehicles and real estate funds. In 2004 and 2007 respectively Luxembourg created the Investment Company in Risk Capital (the "SICAR") and the Specialised Investment Fund (the "SIF") in anticipation of a changing regulatory environment for alternative investment funds.

The *SIF* as a regulated and tax efficient multipurpose investment fund vehicle is worth specific mentioning. The scope of the SIF is characterized by its variety: a SIF may indeed be dedicated to all types of investments including plain vanilla, alternative, real estate and private equity investment strategies as well as innovative strategies in infrastructure, renewable energy, collectible assets, etc. A SIF is destined for well-informed investors only.



*Source: Commission for the Supervision of the Financial Sector – CSSF*

Whilst continuing to increase the investment options through the creation of different types of vehicles, the Luxembourg government has in parallel put great efforts in making Luxembourg more attractive for Chinese investors. Indeed, in 2008, a Memorandum of Understanding (the "2008 MoU") has been signed between Luxembourg's *Commission de Surveillance du Secteur Financier* ("*CSSF*") and the China Banking Regulatory Commission *("CBRC")*. It allows Chinse Qualified Domestic Institutional Investors ("*QDII*") to invest on behalf of their clients in financial products regulated by the Luxembourg Supervisory Authority. Luxembourg is one of only a few countries that have such an agreement with China.

### 2.2.2. Private Equity

Capitalising on the infrastructure, expertise and knowledge that Luxembourg has developed in the retail fund industry over the past 30 years, combined with a favourable environment for private equity, for many years now Luxembourg has been used for the structuring of international acquisitions via unregulated vehicles such as SOPARFIs. Today, **Luxembourg is the domicile of over 50,000 registered holding companies,** of which a considerable number is used to structure private equity acquisitions.

### 2.2.3. Banking sector

Luxembourg's banking sector started developing in the 1960s. Today there are in excess of 100 banks in the country with a total balance-sheet totalling in excess of € 700bn. Three major Chinese banks are currently present in Luxembourg. Industrial and Commercial Bank of China ("ICBC") and Bank of China ("BoC") have their European headquarters in Luxembourg whilst China Construction Bank ("CCB") has recently been granted a full banking license. Most recently, two more Chinese banks, China Merchants Bank and Agricultural Bank of China will set up their European headquarters in Luxembourg in the next few months.

#### 2.2.4. Private wealth management

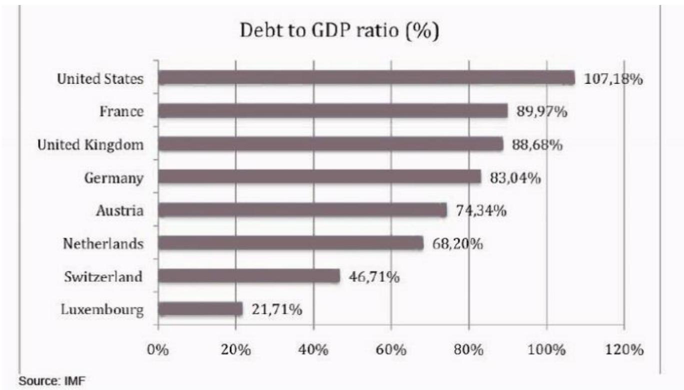
Starting in mid-2000, Luxembourg has been adding an additional business line to the banking sector. Indeed, Luxembourg now also offers a **privileged framework for private wealth management** by abolishing the net wealth tax for individuals, levying a withholding tax of 10% on interest income, maintaining the exemption of inheritance tax in direct line and - under certain conditions - the exoneration of capital gains realised on stocks and capitalization products and the exemption on gifts made by hand under conditions as well. Luxembourg offers financially independent persons the opportunity of becoming a resident. Sufficient funds, a sustainable monthly income, permanent housing, and full health insurance, in accordance with the local standards and laws, are the main prerequisites. Visas where required are obtained swiftly and most documents may be processed in English.

In order to offer high net worth individuals (“*HNWI*”) a flexible vehicle for the management of their private wealth, Luxembourg introduced in 2007 the Family Wealth Management Company, commonly known as the "*SPF*" (i.e. *Société de gestion de Patrimoine Familial*). The exclusive purpose of the SPF, always incorporated as a separate legal body, is the acquisition, holding, management and sale of financial assets (shares, bonds, bank assets, SICAVs, collective investment funds, etc.). The SPF is exempt from corporate income tax, municipal business tax and net wealth tax on corporations. It is only subject to an annual subscription tax of 0.25% on the paid capital plus share premium with a maximum taxation of € 125,000 per year. As for income distributed by the SPF, in principle no withholding tax applies on dividends and liquidation proceeds. This type of income will be taxed at the progressive tax rates. In the event of payment of interest to Luxembourg resident individuals by the SPF, a withholding tax at the final tax rate of 10% will only be levied.

### 2.3. Exceptional political stability and soundness in public finances

Luxembourg is AAA rated with a stable outlook.

The Luxembourg public debt currently stands at 21% of GDP. This is far below the 60% imposed by the euro convergence criteria of the Maastricht Treaty.



### 2.4. Luxembourg v. the Cayman Islands and the British Virgin Islands

In recent years, Luxembourg has increasingly become the preferred platform to structure Chinese outbound investments in the light of government clampdowns on offshore tax heavens such as the British Virgin Islands ("BVI") and the Cayman Islands ("CI"). For example, the well-known acquisition of the Portugal's largest power producer by China Three Gorges Corporation, one of China's largest outbound M&A deals to date, used a Luxembourg company structure. The joint takeover of Putzmeister Holding by Sany Heavy Industry Co. and CITIC PE Advisors (Hong Kong) was also structured through a Luxembourg holding company.

A major reason for using a Luxembourg company structure is the tax advantage, especially true in case of investments in assets that suffer withholding tax (dividends, interest). A CI/BVI fund is not the right option in this case, since one would suffer withholding tax in the source country. On the contrary, when a Luxembourg entity is used, the withholding tax gets eliminated either under the Parent-Subsidiary Directive, the Interest-Royalty Directive or the relevant Luxembourg tax treaty.

## 3. RECENT DEVELOPMENTS TO IMPROVE THE LUXEMBOURG INVESTMENT CLIMATE

Luxembourg's government has undertaken several legislative changes in the recent past aiming at remaining attractive for foreign investors, in particular from China.

### 3.1. Targeting Chinese investments

#### 3.1.1. Becoming the main Renminbi clearing centre

The latest move for Luxembourg in the banking sector Luxembourg's ambitions is China-focused: on 29 June 2014 China and Luxembourg signed a new MoU designating a renminbi clearing bank in Luxembourg, evidencing a significant step towards the internationalisation of the Chinese currency in a fast-growing offshore RMB market.

According to figures of 2013, **Luxembourg has 40 billion in RMB deposits, the largest amount in the Eurozone,** 60 billion in RMB loans and 220 billion in RMB assets managed by fund companies in Luxembourg. It is anticipated that the RMB business in Luxembourg will continue to grow after the establishment of a RMB clearing bank in Luxembourg.

#### 3.1.2. The Dim Sum Bonds market

Known as a premier market of international bond listing, the Luxembourg Stock Exchange was the first European stock exchange to issue a "Dim Sum Bond" (i.e., bonds denominated RMB) in May 2011. Currently, 46 Dim Sum Bonds from 29 international issuers with a volume of over 26bn RMB are listed on the Luxembourg Stock Exchange. With a global market share of 20% for the listing of dim sum bonds, Luxembourg ranks third in the world after Hong Kong and Singapore.

In May, the Luxembourg Stock Exchange received the first Dim Sum Bond in Eurozone from Bank of China. Thus it is also referred to as "Schengen bond" which has strengthened the Luxembourg Stock Exchange's position for the listing of offshore RMB bonds.

To further develop a strategic corporation between the China and Luxembourg in the fund industries, two more MoUs were signed, namely, an MoU between the Luxembourg Stock Exchange and Bank of China on 19 June and an MoU between the Asset Management Association of China ("AMAC") and Association of the Luxembourg Fund Industry ("ALFI") on 30 June.

#### 3.1.3. A logistics hub for China

The Luxembourg government is actively promoting the country as a logistics hub for China. It has been so successful that now about 40% of all goods sent from China to the European Union now pass through Luxembourg.

In order to further stimulate the logistics hub ambitions of Luxembourg, particularly as regards China exportations into Europe, Luxembourg recently enacted legislation enabling import of EU and particularly non EU goods into licensed free zones in a tax free environment, **the Freeport**.

### 3.2. Offering more tools to the high net worth individuals

#### 3.2.1. Private foundation

In summer 2013 a draft bill on **the Luxembourg private foundation regime ("*fondation patrimoniale*"),** has been presented to Parliament. Once voted into law, the Bill should allow entrepreneurs and high net wealth individuals to benefit from new innovative, flexible and modern tools in the management and the transmission of their assets and businesses. It will introduce a new wealth management tool expected to be a suitable solution to secure private or business assets, to separate economic ownership from decision-making authority, or to protect private sphere, etc.

The private foundation will offer a considerable degree of flexibility both in terms of management and governance. It actually may own movable and immovable properties, tangible and intangible assets or enter into insurance contracts as a subscriber or a beneficiary. It may also create other public or private foundations or trusts or be the beneficiary of such vehicles.

The tax treatment applicable to private foundation appears to be particularly attractive, all the more in the current environment:

- although the private foundation is subject to corporation income tax at the standard corporate income tax rate, it should not pay any tax in fact, since it will benefit from an exemption regarding its investment income : dividends; profit sharing and interest payment derived from securities; capital gains realized on the sale of assets;
- income distributions made by the private foundation to non-resident beneficiaries are not subject to withholding taxes.

#### 3.2.2. Step-up in basis for individuals relocating their tax residence to Luxembourg

The government has seized the opportunity presented by the draft Bill on Private Foundations to additionally introduce a tax rule aiming at increasing the attractiveness for non-resident HNWI to relocate their tax residence to Luxembourg. Indeed, the draft Bill includes a step-up in basis for individuals who become Luxembourg residents.

In the context of the new step-up in basis scheme, the individual's qualifying assets are valued at their fair market value at the date of the relocation of his tax residence in Luxembourg. This value will be considered as the acquisition price of the assets considered for the calculation of any future capital gain.

This new mechanism is therefore expected to be a competitive advantage to attract to Luxembourg entrepreneurs and high net wealth individuals carrying unrealized capital gains even though the tax treatment applicable in the former country of residence shall also be considered.

## 4. Bonn Steichen & Partners, a leading independent local firm

### 4.1. History of the firm

Following in the footsteps of his father, Benjamin Bonn, a lawyer and chairman of the Luxembourg Bar Association, Alex Bonn proceeded to become one of Luxembourg's most respected lawyers of his time. In his long and distinguished career that spanned from 1932 to 2007, he headed the Luxembourg Bar Association, like his father before him, and served as president of the Luxembourg *Conseil d'Etat*, which was both the highest administrative court in the country and the public body entrusted with the control of the constitutionality of the draft bills. Alex Bonn's professional achievements were manifold. All along, he demonstrated competence, integrity and perseverance at the highest level.

To this day, it is still these very qualities that define Bonn Steichen & Partners ("BSP") even as the world has changed, raising new challenges for the legal profession: a more globalised economy in which complex transactions affect multiple legal orders, an increasingly opaque regulatory environment, the impact of technology on the delivery of legal services and expectations of clients, to name a few. Building on this history and mindful of the legacy of Alex Bonn while at the same time adapting to a quickly changing legal landscape, BSP is fully committed to providing value to their clients and meeting their needs in the 21st century.

### 4.2. BSP today

With more than 60 professionals, BSP is an independent full-service law firm committed to providing the highest quality legal services to domestic and international clients in Luxembourg.

As leaders in each of the areas in which we practice, we offer our clients a wealth of knowledge and experience in all aspects of Luxembourg law. These include financial and tax services, corporate law, investment, capital markets, real estate finance, employment, dispute resolution, private wealth and IP/IT. The firm's strong experience in a number of buoyant sectors – healthcare, energy and infrastructure - adds further to its reputation as a dynamic leading law firm in Luxembourg.

Developing long-term and trusting relationships with clients, BSP takes advantage of the proven synergy between departments to ensure a reliable and consistent high-standard service. Thanks to a wide variety of resources and expertise which are continuously adapting to new laws and regulations, situations and challenges, we provide legal support for our clients in dynamic business environments. Besides delivering tailor-made advice, the broad range of concrete skills enables our lawyers to be proactive and to provide answers not just options.

At BSP, we have created an environment where collegiality, trust and respect are the guiding principles under which we work today. Over time, we have successfully attracted and retained talented professionals allowing us to achieve legal excellence. Focused on achievements, our professionals at all levels of seniority bring together their expertise around a common objective: creating value for the client.

A sample of transactions we have been involved with in the recent past includes:

1. *Advent*: BSP advised Advent, a leading private equity fund, in diverse acquisition transactions from the last quarter 2009 to date for an aggregate amount of approximately € 1,5bn and lately in relation to the acquisition of DFS, the UK's number one sofa retailer for approximately GBP 400,000,000.

2. *Apax*: BSP represented Apax Partners in connection with the acquisition of Orange communications SA by funds advised by Apax for a purchase price of approximately CHF 2bn, which closed on February 29, 2012. Orange Communications SA is a leading mobile operator in Switzerland, and was previously controlled by France Telecom SA.

3. *Arcelor Mittal*: BSP advised Mittal on the merger & acquisition of Arcelor by Mittal worth € 10bn +.

4. *BNP Paribas*: BSP advised on the acquisition of Fortis group by BNP Paribas, making BNP Paribas the largest bank in the Eurozone by deposits. In the transaction, we acted for BNP Paribas in its acquisitions of approximately 75% of Fortis Bank and a majority stake in *Banque Générale du Luxembourg*, and on the acquisition of 25% of Fortis Insurance Belgium by Fortis Bank, as well as the simultaneous defeasance of a portfolio of structured products from Fortis Bank worth about € 11.5bn.

5. *Citigroup*: BSP advised Citigroup on the establishing and refinancing of a securitisation vehicle issuing structured notes in the framework of a € 20,000,000,000 programme.

6. *General Motors*: BSP advised General Motors on the incorporation and refinancing of securitisation companies that are used by Gmac, a subsidiary of General Motors, for the securitisation of car loans worth € 500m + originated by them.

7. *Goldman Sachs*: BSP advised a Luxembourg holding company Alchemy Holding S.à r.l. ("Alchemy") in connection with the sale by Goldman Sachs of Alchemy's major stake in Ahlsell AB (publ) worth € 1,8bn to CVC Capital Partners.

8. *Nordea*: BSP advised the Nordea group in the context of a restructuration of their management companies of regulated investment funds holding in excess of € 18bn under management.

9. *Pfizer*: BSP advised Pfizer on the sale of its Nutrition business to Nestle for $ 11.85bn in cash.

10. *Thomson Reuters:* BSP advised Thomson on a $ 24bn (£ 15bn) market merger & acquisition transaction with Reuters in order to create the dominating screen-based financial information group for banks and investment institutions around the world.

### 4.3. BSP' China Desk

As a one-stop and totally independent Luxembourg law firm, BSP has generated great interest of a growing Chinese clientele. Our law firm therefore decided to dedicate time and resources to best meet their specific needs and give them even better support in their legal local procedures.

With this in mind, we recruited Helen Liu Haijing, a Chinese professional who focuses on the flow of business between China and Luxembourg. Headed by Laurent Lazard, Partner, BSP's China Desk brings together lawyers specialising in tax, capital markets, corporate and banking & finance matters to provide clients a multi-disciplinary and comprehensive approach. Furthermore, our excellent relationships with many influential government bodies and our large and reliable networks enable us to act promptly and efficiently on behalf of Chinese clients.

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