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A legal update from Dechert's Financial Services Group

The New Luxembourg Limited Partnership Regime

At the time of the transposition of the AIFMD into Luxembourg law,¹ the Luxembourg government took the opportunity to reform the limited partnership regime, from both a corporate and fiscal perspective. The reform aims to make the Luxembourg limited partnership a more attractive structure for fund managers – in particular, private equity managers. To date, the vast majority of Luxembourg investment companies have been organized as joint-stock companies.

Background

The typical “limited partnership” has one or more general partners (each of whom bears unlimited personal liability, is responsible for management and is authorized to represent the partnership vis-a-vis third parties) and one or more limited partners (whose liability is limited to their respective contributions and who may not participate in the conduct of management or represent the partnership vis-a-vis third parties). The Luxembourg law on commercial companies of 10 August 1915, as amended (the “Companies Law”) until recently recognized only two forms of limited partnership, each of these having a separate legal personality:

- The corporate partnership limited by shares (*société en commandite par actions* or “SCA”), which is a joint-stock company whose capital is represented by shares in principle freely transferable; and
- The common limited partnership (*société en commandite simple* or “SCS”), which is an “*intuitu personae*” company issuing limited partnership interests that in general are not freely transferable.

As in other civil law countries, Luxembourg law traditionally classifies companies into joint-stock companies, where creditors’ claims in principle are limited to the company’s capital, and *intuitu personae* companies, where creditors may extend their claims to all or some of the partners/shareholders personally.

The Luxembourg law of 12 July 2013 on alternative investment fund managers (the “AIFM Law”) transposing the AIFMD into Luxembourg law amends the SCS regime and introduces a third form of limited partnership – namely, the special limited partnership (*société en commandite spéciale* or “SCSp”) – into the Companies Law. The SCA regime, which has been rather popular among private equity managers, will be subject to only a few technical amendments.

¹ Directive 2011/61/EC of the European Parliament and of the Council on Alternative Investment Fund Managers has been transposed into Luxembourg law by the law of 12 July 2013 on Alternative Investment Fund Managers. For further information, please refer to July 2013 *OnPoint* “[Luxembourg Law Transposing the AIFMD Passed by Luxembourg Parliament](#)”.

This *OnPoint* describes the main characteristics of the SCS and the SCSp and includes in the Appendix a side-by-side comparison of key characteristics of the SCA, SCS and SCSp structures.

Legal Personality and Transparency

SCS and SCSp are *intuitu personae* entities. However, unlike the SCS which has its own legal personality, the SCSp is a partnership which does not constitute a legal person distinct from its partners. Alongside the limited-life partnership (*société momentanée*) and the joint undertaking (*société en participation*), the SCSp is the sole form of commercial company without legal personality under the Companies Law.²

The SCSp is transparent both from a corporate and fiscal perspective, while the SCS is transparent only from a fiscal perspective.

Assets contributed to the SCS are owned by the SCS. Assets contributed to the SCSp are owned by its partners, but the Companies Law explicitly provides that assets can be recorded in the name of the SCSp. The Companies Law also clarifies that those assets can only satisfy claims in relation to the creation, conduct or dissolution of the SCSp. As a result, a creditor with a personal claim against one of the partners of the SCSp cannot make a claim against the portion of the assets owned by that partner in the SCSp. The SCSp will have its own creditors and may be entitled under the partnership agreement to borrow for its own account. Despite the absence of a legal personality, the SCSp benefits from other features generally attached to the legal personality – for example, it has its own registered office and it can sue and be sued.

Establishment

The SCS and the SCSp are each established by a partnership agreement (either through notary deed or by private instrument), entered into between one or more general partners (*associés commandités*) with joint and several liability for all the obligations of the partnership (each, a “General Partner”) and one or more limited partners (*associés commanditaires*) having their liability limited to their respective contributions (each, a “Limited Partner”). The current approach of the CSSF³ is to require that a SIF,⁴ a SICAR⁵ or a Part II UCI⁶ adopting the form of an SCS or SCSp must be established by notary deed.

Unless otherwise provided for in the partnership agreement, a General Partner may also be a Limited Partner, provided there is at all times at least one General Partner and one Limited Partner distinct from

² Luxembourg case law recognizes the de facto partnership (*société de fait*), which is a company that either no longer has a legal personality (but continues to operate) or did not comply with formalities required for the acquisition of the legal personality.

³ *Commission de surveillance du secteur financier*, the supervisory authority for financial services in the Grand Duchy of Luxembourg.

⁴ Specialized investment fund (“SIF”) under the law of 13 February 2007 on specialized investment funds, as amended (the “SIF Law”).

⁵ Investment company in risk capital (“SICAR”) under the law of 15 June 2004 on investment companies in risk capital, as amended (the “SICAR Law”).

⁶ An undertaking for collective investment (“Part II UCI”) under part II of the law of 17 December 2010 on UCI, as amended (the “UCI Law”) can be organized in either the SCS or the SCSp form. However, an undertaking for collective investment in transferable securities (“UCITS”) under part I of the UCI Law cannot be formed as SCS or SCSp. Contrary to SIF and SICAR, Part II UCI can be sold to any type of investors including retail investors.

each other. The partnership can be declared null if it does not have at least one General Partner and one Limited Partner.

The partnership agreement concluded under private deed can be drafted in English or any other language agreed by the partners. In case of a notarial deed, the partnership agreement must be drafted in French or German or, if drafted in English, accompanied by a French or German translation. If a SIF, a SICAR or a Part II UCI, adopts the form of an SCS or SCSp, no French or German translation of the deed is required.

There is a high degree of contractual freedom when setting up the partnership agreement. However, the agreement must include the name of the partnership and its objective (that cannot be contrary to law or public policy in order to be valid).

In addition, the partnership agreement may include provisions to determine:

- Form of the partners' contributions, which may be cash contributions and non-cash contributions including contributions of tangible and non-tangible assets (e.g., intellectual property, patent);
- Valuation of the contributions;
- Issuance of partnership interests, if any, and determination of rights attached to those interests;
- Terms and conditions regarding the admission of new partners and the removal or withdrawal of partners;
- Allocation of profits, provided that no partner may be entirely excluded from any allocation of profit;
- Allocation to reserves – contrary to other Luxembourg companies, neither the SCS nor the SCSp is required to establish a legal reserve;
- Distribution of profit – unless otherwise provided in the partnership agreement, partners participate in profits and losses proportionally to their respective partnership interests;
- Voting rights of the partners;
- Categories of decisions to be submitted to the partners, provided that decisions regarding changing the objective, legal regime or domicile, as well as dissolution, must always be submitted to the partners; and
- Rules to amend the partnership agreement.

When the SCS or SCSp is organized in the form of a SIF, a SICAR or a Part II UCI, it must fulfil the respective conditions set under the SIF Law, the SICAR Law or the UCI Law. For instance, the objective of a SIF must be the collective investment of funds with the aim of spreading the investment risks and providing the partners with the benefit of the results of the management of their assets. The objective of a SICAR must be the investment in securities representing risk capital to provide the partners with the benefit of this investment.

Both SCS and SCSp will enter into existence from the execution of the partnership agreement.

Limited Publication Requirements

SCS and SCSp must be registered with the Luxembourg companies' and trade register⁷ and an extract of the partnership agreement must be published with the Luxembourg official gazette.

This extract must designate:

- Name(s) of the General Partner(s);
- Name(s) of the Manager(s);
- Name of the SCS/SCSp – it is no longer necessary to include the name of the General Partner(s);
- Objective of the SCS/SCSp;
- Location of the registered office; and
- Duration of the SCS/SCSp.

The identities of Limited Partners who have not yet fully paid in their contributions is no longer required, thus ensuring a higher level of confidentiality.

Domicile

The Companies Law provides that the domicile of the SCS and the SCSp (irrespective of the fact that the SCSp is not a legal person) is located at the seat of its central administration. Unless evidence is provided to the contrary, the head office is deemed to be the registered office indicated in the partnership agreement.

Partners (including the General Partner) do not need to be located in or resident of Luxembourg.

Maintenance of Register

SCS and SCSp must maintain a register containing:

- The complete and up-to-date version of the partnership agreement;
- A list of all partners (name, surname, profession and private or professional address or, in case of legal persons: name, legal form, address and registration number), as well as the number of partnership interests held by each partner; and
- Information as to any transfer of partnership interests, including the date of the notification or acceptance of such transfer.

Each partner may inspect the register, subject to any limiting provisions set forth in the partnership agreement.

⁷ *Registre de Commerce et des Sociétés* ("RCS").

Annual Accounts

Under the Companies Law, the SCS is required to prepare annual accounts. The annual accounts must be made available to the partners at the registered office of the SCS at least 15 days prior to the partnership meeting to approve the annual accounts. The date of this meeting is set in the partnership agreement and cannot be later than six months after the end of the relevant accounting year. Annual accounts must be filed with the Luxembourg companies' and trade register.

The Companies Law does not impose any similar obligations for the SCSp. The partnership agreement establishes the provisions in relation to the annual accounts. Annual accounts are not required to be filed with the Luxembourg companies' and trade register.

The Companies Law does not require that the annual accounts of either the SCS or the SCSp be subject to an internal or external audit.

A SIF, SICAR or Part II UCI in the form of an SCS or SCSp must submit an annual report reviewed by a certified auditor to the partnership meeting for approval within six months after the end of the accounting year. The audited annual report must be filed with the Luxembourg companies' and trade register.

Contributions, Partnership Interests and Capital Accounts

As an *intuitu personae* company, neither the SCS nor the SCSp has the concept of capital. Therefore, contrary to joint-stock companies, there is no minimum capital requirement for an SCS or SCSp. The aggregate value of the contributions made to a SIF or a Part II UCI in the form of an SCS or SCSp must however reach €1.25 million within twelve months following authorization of the entity by the CSSF. This minimum amount is set at €1 million for a SICAR.

The partnership agreement determines whether or not partnership interests (*parts d'intérêts*) take the form of securities (*titres*). Contributions, withdrawals, loans, allocations to profits, losses and expenses can also be directly booked for each partner in a capital (and loan) account. This makes it easier for investors – through the use of contractual investor excuse provisions – to not take an exposure to certain of the investments of the SCS or SCSp. It is currently unclear if the exposure to a single investment by a relevant partner of a SIF might be acceptable for the CSSF, as this could enable circumventing the risk spreading required under the SIF Law.

In addition to partnership interests, SCS and SCSp may issue debt instruments (*titres de créance*). While an SCS or SCSp may be funded by a combination of equity and loans, it is not necessary that this funding be comprised of a small amount of equity (e.g., 0.001%) and a large amount of debt (e.g., 99.999%). The statutory provision⁸ enabling a creditor of an SCS to reclaim from partners distributions that have been paid from a source other than profits has been removed from the Companies Law.

Conditions with respect to the redemption, transfer, splitting or pledge of a partnership interest are set forth in the partnership agreement. Unless otherwise provided in the partnership agreement, the transfer of a limited partnership interest (other than due to death of the relevant partner) requires the consent of the General Partner(s). The transfer of a general partnership interest requires the approval of all partners, in accordance with the provisions to amend the partnership agreement. To be effective vis-à-vis the SCS or SCSp, a notice of transfer of a limited partnership interest must be provided to or

⁸ Article 17 of the Companies Law, which had been repealed for SICARs in 2008, has been removed from the Companies Law.

accepted by the SCS or SCSp. Further, the transfer of the general partnership interest must be published to be effective vis-a-vis third parties.

The Companies Law provides that partnership interests may be listed on a stock exchange or a regulated market. However, restrictions on making a public offer and on the transferability of partnership interests will in practice limit such a listing to a purely technical one.

Management and Liability

Both the SCS and the SCSp are managed by one or more managers (each, a “Manager”) designated in the partnership agreement.

A General Partner may, but is not required to, be a Manager – the partnership agreement may designate one or more other persons as Managers. The indefinite, joint and several liability of the General Partners, however, will not be affected by the fact that a General Partner is not managing the entity.

In the capacity solely as a Limited Partner of an SCS or SCSp, a Limited Partner is prohibited from carrying out any act of external management (*i.e.*, any act of management that relates to third parties). However, a Limited Partner may be designated in the partnership agreement as a Manager – in such a case, the Limited Partner will not forfeit its limited liability, provided that there is a clear separation between being a Limited Partner and acting as a Manager. If a Limited Partner carries out as a Limited Partner an act of external management, the Limited Partner may be held indefinitely, jointly and severally liable with the General Partner(s) vis-a-vis third parties for the obligations related to that act. The Limited Partner may even be liable for all obligations of the SCS or SCSp, if the Limited Partner repeatedly participates as a Limited Partner in the external management of the entity.

A list of actions that are not deemed participation in external management has been introduced in the Companies Law. These include:

- Exercising partnership rights;
- Advising the SCS or SCSp, or its affiliates or Manager;
- Controlling and supervising the affairs of the SCS or SCSp;
- Granting loans, guarantees or securities or any other form of assistance to the SCS or SCSp; and
- Authorizing the Manager for acts that, under the partnership agreement, extend beyond the powers of the Manager.

If the Manager is a corporate entity, the Limited Partner may also be a member of the Manager’s governing body. The Limited Partner can furthermore be a representative of the Manager and can sign on behalf of the Manager without incurring unlimited, joint and several liability with the General Partner(s), provided that the capacity in which the Limited Partner acts is always clearly indicated.

The Manager will be liable in accordance with general principles of agency. Limitation of the powers of the Manager under the partnership agreement is not effective vis-a-vis third parties, even if such limitation has been published.

Nothing precludes the Manager from delegating management to a third party, provided that any conditions on delegation set forth in the partnership agreement are fulfilled. SIFs, SICARs or Part II UCIs adopting the form of an SCS or SCSp must additionally comply with requirements regarding delegation set in their respective laws. For instance, delegation of portfolio management may in principle only be given to a person authorized or registered for that purpose and subject to prudential supervision of an authority recognized by the CSSF.

Impact of the AIFMD

An alternative investment fund (“AIF”) refers to any collective investment undertaking that raises capital from investors with a view to investing the capital in accordance with a defined investment policy for the benefit of such investors.⁹ The alternative investment fund manager (“AIFM”) is the person entrusted with portfolio and risk management of the AIF. The AIFM will be designated in the partnership agreement, and replacing the AIFM will require amending the partnership agreement.

If the SCS is an AIF that cannot or does not want to benefit from the lighter regime under the AIFM Law,¹⁰ the SCS must either be internally managed (*i.e.*, the SCS itself will be authorized as the AIFM under chapter 2 of the AIFM Law) or appoint an external AIFM.

The lack of legal personality does not enable the SCSp to be authorized as an internally managed AIF (*i.e.*, as an AIFM). The AIFM of the SCSp will either be one of its General Partners or any other party nominated in the partnership agreement.

Fiscal Regime

Both SCS and SCSp are fiscally transparent for the purposes of income tax and wealth tax.

A SCS with a Luxembourg-based General Partner in the form of a joint-stock company carrying out a commercial activity was previously deemed to realize a taxable commercial benefit even though the SCS itself did not carry out a commercial activity.¹¹ The Income Tax Law¹² now states that no Luxembourg municipal business tax can be levied when such a General Partner owns less than 5% of the partnership interests.

No withholding tax is levied on payments made by an SCS or SCSp, whether the partners are located in Luxembourg or elsewhere. No capital gains tax will be levied from a Luxembourg perspective when disposing of or redeeming partnership interests.

The adoption of the AIFM Law provided the opportunity to clarify the fiscal treatment with respect to the carried interest¹³ distributed by an AIF (including an AIF in the form of an SCS or SCSp). Carried interest as an incentive right not attached to a partnership interest is considered as miscellaneous

⁹ Article 1(39) of the AIFM Law.

¹⁰ Article 3(2) of the AIFM Law.

¹¹ The General Partner carrying out a commercial activity making the SCS to be deemed to realize a taxable commercial profit is based on German case law known as “*Gepragerechtsprechung*”.

¹² Article 14 of Luxembourg law of 4 December 1967 on income tax, as amended.

¹³ Article 99bis of the Luxembourg law of 4 December 1967 on income tax, as amended.

income to be taxed in principle at the marginal income tax rate of the beneficiary, subject to what is set out below. Carried interest attached to a partnership interest qualifies as capital gain for tax purposes.

A favourable tax regime regarding the carried interest has been introduced for employees of a Luxembourg management company or an AIFM (which may include employees of the Manager of an internally managed AIF in the form of an SCS) who were not Luxembourg tax residents during five years preceding the effective date¹⁴ of the AIFM Law but who become Luxembourg tax residents before 31 December 2018. The favourable tax regime applies for a maximum period of 10 years following the year when the relevant employee became a Luxembourg tax resident. Under certain conditions, including that investors have recovered their contributions, the carried interest received by an employee will be taxed only as extraordinary income, at a lower rate equal to a quarter of the normally applicable personal income tax rate of that employee.¹⁵

The introduction of the SCSp enables structuring Luxembourg funds in a very similar way to the limited partnership under English common law, which is often considered to be the industry standard in private equity. Alongside this introduction, the regime of the SCS (and, to a lesser extent, that of the SCA) has been overhauled to strengthen legal and fiscal certainty and to remove outdated statutory provisions, thus making the SCS and the SCSp probably the most flexible legal form a company can adopt under Luxembourg law.

¹⁴ 15 July 2013.

¹⁵ Leading to a maximum tax rate of 10.9%.

Appendix – Comparison of SCA, SCS and SCSp Structures

	SCA <i>Société en commandite par actions</i> (corporate partnership by shares)	SCS <i>Société en commandite simple</i> (common limited partnership)	SCSp <i>Société en commandite spéciale</i> (special limited partnership)
Legal nature	Joint-stock company	Intuitu personae company	Intuitu personae company
Legal person	Yes	Yes	No
Fiscal transparency	In principle, no	Yes	Yes
Participants	At least one unlimited shareholder and at least one limited shareholder	At least one general partner and one limited partner	At least one general partner and one limited partner
Establishment	Articles of association; Notarial deed required	Partnership agreement; Notarial deed optional (when non regulated)	Partnership agreement; Notarial deed optional (when non regulated)
Publication	Full publication of articles of association; No disclosure of limited shareholders	Publication of excerpt of partnership agreement; No disclosure of limited partners	Publication of excerpt of partnership agreement; No disclosure of limited partners
Ownership of assets	SCA	SCS	Partners of SCSp
Shares/partnership interests	Shares	Partnership interests (securitized or not)	Partnership interests (securitized or not)
Transferability	Freely transferable (except management shares) if not otherwise stated in articles of association	Transferability determined in partnership agreement	Transferability determined in partnership agreement
Voting rights	Overall principle: one share, one vote – issuance of non-voting shares subject to specific conditions	Voting power determined in partnership agreement	Voting power determined in partnership agreement



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