

LUXEMBOURG IMPLEMENTS KEY TAX UPDATES IMPACTING INVESTMENT FUND SECTOR

Luxembourg has recently reinforced its status as a premier hub for alternative investment funds ("AIFs") through two significant tax developments. The first is a reform of the carried interest tax regime, introducing greater clarity and competitiveness for fund managers and sponsors. The second is a welcome clarification of the reverse hybrid rule, providing essential guidance for fund structuring and compliance.

These positive developments not only enhance legal certainty but also further solidify Luxembourg's position as a leading jurisdiction for attracting private capital.

Key issues

- Alternative investment fund industry
- New carried interest tax regime
- Clarification on reverse hybrid rule

CARRIED INTEREST TAX REFORM

On 24 July 2025, the Luxembourg Government submitted bill n°8590 (the "Bill") to the Parliament, proposing a significant and positive reform of the existing carried interest tax regime.

The Bill amends the current carried interest tax regime by:

- **Expanding the scope of beneficiaries** of the carried interest regime beyond AIFs' employees (e.g. consultants, independent board members, shareholders, etc. are now eligible).
- **Expanding the type of AIFs** that could grant a carried interest to transparent entities, i.e. limited partnerships (*société en commandite simple*), special limited partnerships (*société en commandite spéciale*) or FCP (*Fonds Commun de Placement*).

Two types of regime would be available:

- **Carried interest linked to a participation:** for Luxembourg tax resident carry holders holding a direct or an indirect participation in the AIF, the carried interest will be fully exempt if they hold no more than 10% in the AIF and receive the carried interest after a six-month holding period.
- **Contractual carried interest:** for contractual carried interest (i.e. under a legal arrangement between the AIF and the manager, with no

participation of the latter in the AIF), it will be taxed at a quarter of the global income tax rate (i.e. +/- 12%).

The Bill has now undergone the legislative process, including potential amendments, and is expected to enter into force for the 2026 tax year.

REVERSE HYBRID RULE: GUIDANCE ISSUED BY THE LUXEMBOURG TAX ADMINISTRATION

On 22 August 2025, the Luxembourg tax administration released circular L.I.R. n° 168quater/2 (the "**Circular**" – dated 12 August 2025) completing the previous circular L.I.R. n° 168quater/1 and providing some guidance on the application of the reverse hybrid rule, in particular on the conditions to benefit from the collective investment vehicle exemption.

Under Luxembourg's reverse hybrid rules, and in broad terms, a Luxembourg tax transparent entity may become liable to corporate income tax if it is considered as tax opaque from an investor perspective. However, this rule does not apply to entities that are (i) widely held, (ii) hold a diversified portfolio of securities and (iii) are subject to investor-protection regulation – commonly referred to as the "CIV exemption".

The Circular provides helpful and welcome guidance on the interpretation of the CIV exemption, clarifying that:

- The scope of the CIV exemption would automatically apply to UCITs, UCI Part II, SIFs and RAIFs.
- Other AIFs that do not fall within the above categories may also benefit from the CIV exemption, provided they meet the three above-mentioned conditions (which have been further specified):
 - **Widely held:** a limited number of investors does not necessarily prevent the widely held requirement from being satisfied.
 - **Diversified portfolio of securities:** the term "securities" should be interpreted broadly.
 - **Investor-protection regulation:** this condition is deemed to be met for all AIFs.

HOW CAN WE HELP?

We are at your disposal to provide tailored advice on how these legislative changes may affect your current and planned operations.

Our teams are ready to guide you through the complexities of these new regulations, ensuring that you remain compliant and well-positioned in your day-to-day activities.

Please do not hesitate to contact us for further assistance or specific guidance.

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