Tax news – implementation of the AIFM Directive

Besides the implementation of the directive 2011/61/EC on Alternative Investment Fund Managers (AIFMD), the bill n°6471 includes tax provisions aiming at (i) improving the tax regime applicable to Luxembourg partnerships and to AIF and (ii) attracting alternative investment fund managers to Luxembourg.

This bill (n°6471) has been submitted to the Luxembourg Parliament on 24 August 2012 and its provisions are likely to enter into force on 1 January 2013. Our legal update of October 2012 details the investment fund and corporate aspects of the bill.

Key information

- Special limited partnership is tax transparent
- Limitation of the application of the *Geprägerechtsprechung*
- Introduction of new regime for carried interest (reduced tax rate)
- VAT exemption on management services rendered to AIFs
- Exclusion from any direct taxation in Luxembourg of a foreign AIF

New tax transparent vehicle: the Special Limited Partnership

The bill creates a new type of partnership: the Special Limited Partnership (*Société en Commandite Spéciale* - SCP). SCPs will have no legal personality and will be as flexible as Anglo-Saxon trusts from an organisational standpoint. The bill also allows SIFs and SICARs to be set up as SCPs.

From a Luxembourg tax perspective, an SCP will be treated as a transparent partnership. An SCP will thus not be subject to Luxembourg taxes, i.e. it is not subject to Corporate Income Tax (tax normally assessed on the profit of Luxembourg companies) and Net Wealth Tax (tax normally assessed on the net equity of Luxembourg companies).

SCPs may however be subject to Municipal Business Tax (this tax is also assessed on the profit and its rate is 6.32% for Luxembourg city). Municipal Business Tax may however only apply if either (a) the SCP performs a commercial activity or (b) its general partner is a capital company further to the so-called *Geprägerechtsprechung* theory according to which a partnership is deemed to make business profit (and is therefore liable to Municipal Business Tax on its profits) because its general partner is a capital company.

This theory also applies to the other types of Luxembourg partnership, such as common limited partnerships.

Change in Partnership Taxation

The bill relaxes the application of the *Geprägerechtsprechung* so that such theory should practically not have any adverse impact anymore. Following the entry into force of the bill, any Luxembourg partnership will only be subject to Municipal Business Tax if its general partner is a capital company owning an interest of at least 5% in the partnership. In other words, the bill guarantees a full tax exemption in Luxembourg for the partnership if its general partner is not a capital company with an interest representing more than 5% (provided that the SCP does not perform any commercial activity).

Carried interest may benefit from a 10.335% tax rate

Employees of AIF managers and employees of management companies of AIFs can benefit from:

- a full tax exemption on the capital gain realised upon the sale/redemption of their interest in the AIF, if:
  - the holding period exceeds 6 months;
  - the interest does not exceed 10% of the AIF.
- A reduced tax rate of 10.335% on the carried interest if the following conditions are met
  - the employee transfers his residence to Luxembourg during the year the law enters into force or during the following 5 years;
  - the employee was neither a Luxembourg tax resident nor taxable in Luxembourg on professional income during the five year period preceding the year of the law enforcement;
  - the carried interest is an incentive based on the net asset of the AIF or its profit;
  - the other investors in the AIF have fully recovered their investment.

The employees can benefit from this reduced tax rate only for a maximum period of 10 years following the year they applied for the regime.

The VAT exemption for management services

The VAT exemption for management services under article 44-1d of the VAT Law will also apply to management services granted to an AIF (either established in Luxembourg or in the EU).

This adaption of the VAT laws intends to ensure a uniform application of the VAT exemption between AIF and the other types of investment funds.

Foreign AIFs managed from Luxembourg are not subject to Luxembourg tax

The bill explicitly excludes from the scope of the Luxembourg tax, the AIFs established in a country other than Luxembourg even if such AIFs are only managed and controlled in Luxembourg i.e. by local managers/management company.

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