Taxation of carried interest

Draft law

Context

Within the scope of the Draft Law of 24 August 2012 transposing the Alternative Investment Fund Manager Directive into Luxembourg Law ('Draft Law'), the government decided to modernise the Luxembourg legal framework and introduce related tax provisions–specifically relating to the tax regime of carried interest–to enhance the position of Luxembourg as a centre of excellence.

Key Issues

The lack of explicit provisions in the current Luxembourg tax legislation regarding the treatment applicable to income or gains arising from a carried interest scheme was causing difficulties for the Luxembourg fund industry as well as giving rise to uncertainties.

While the Draft Law clarifies these tax uncertainties, the requirements set under the AIFM Directive in terms of remuneration policies will have to be respected when implementing a carried interest scheme.

Impacts

The Draft Law aside, clarifying the Luxembourg tax regime applicable to carried interest paid to employees of Alternative Investment Funds Managers (AIFMs) and of management companies of an Alternative Investment Fund (AIF), introduces a temporary beneficial regime.

Under the beneficial regime, the income that the employees derive from their right to profit participation in the AIF ('carried interest') will be subject to a reduced rate, i.e. a maximum of 10.335%. This beneficial regime will apply to employees who:

- Transfer their residence to Luxembourg during the year the Draft Law enters into force or during one of the five following years
- Have neither been a Luxembourg tax resident nor subject to taxation on their professional income in Luxembourg during the five-year period preceding the year the Draft Law enters into force
- Did not receive any advance payment relating to their carried interest
- Can demonstrate that prior to payment of their carried interest, committed capital has been fully repaid to investors

Eligible employees will be able to benefit from this regime for 11 years from the year they take on the position in Luxembourg that entitles them to the carried interest.

The Draft Law also confirms that the capital gains that may be derived by employees from the sale of their shares/units in an AIF are taxable according to the usual regime applicable to capital gains, except if:

- The shareholding did not exceed 10% at any point in time during the five-year period prior to the sale or redemption
- The holding period exceeds six months

Combined with the advantages granted by the tax regime for highly skilled workers (the two regimes have conditions in common), Luxembourg–which has long been a home for investment funds–becomes a location of choice for investment managers as well.

Our Services

Our multi-disciplinary competencies and experience in implementing CRD provisions on remuneration policies (provisions having largely inspired the AIFMD requirements), combined with our experience in the fund industry, enable us to offer our clients tailor-made solutions for implementing the forthcoming AIFMD guidelines with regard to governance, risk management, human resources and tax optimisation.

Our services can be articulated through four dimensions:

- Aligning the AIFM’s remuneration policy with its business objectives and risk culture
- Reviewing and adapting , respectively, designing the AIFM’s remuneration governance and process
- Reviewing and adapting, respectively, defining the AIFM’s remuneration policy (including HR and tax optimisation aspects)
- Supporting the overall implementation/execution of the remuneration governance process

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