

Tax certainty for Luxembourg limited partnerships

Luxembourg Tax Alert

On 9 January 2015, the Luxembourg authorities published guidelines to address mainly the question of the commerciality of limited partnerships (SCS / SCSp) from a tax perspective.

Luxembourg seized the opportunity created by the implementation of the AIFMD¹ in July 2013 to modernise the legal regime of the “common limited partnership” (SCS) and to introduce a new form of limited partnership, the “special limited partnership” (SCSp)².

Since then, the SCS and more particularly the SCSp have emerged as an efficient fund structure or carried interest structures well-fitted to the business model of alternative asset managers and comparable to the Anglo-American partnership model.

Facing the increasing use of the SCS and SCSp, the tax authorities published on 9 January 2015 a circular (L.I.R. n°14/4) to address mainly the question of the commerciality of those entities from a tax perspective (“**the Circular**”). Briefly, when a SCS or SCSp is not viewed as carrying out a commercial activity for tax purposes, nor “commercially tainted” by its general partner, then it is not subject to Luxembourg municipal business tax (e.g., 6.75% for Luxembourg city).

The tax authorities confirm through the Circular that by reason of their corporate object (i.e., asset management) and investment policy, the Alternative Investment Funds (within the meaning of the law dated 12 July 2013), set up as SCS or SCSp, are deemed NOT to carry out a commercial activity when their general partner own less than 5% of their interests.

The tax authorities also restate that, in virtue of specific provisions in various Luxembourg laws, the following entities are also deemed NOT to carry out a commercial activity for tax purposes regardless of whether the general partner owns less than 5%:

- the Investment Company with Variable Capital (SICAV); and
- the Specialised Investment Fund (SIF); and
- the Investment Company in Risk Capital (SICAR), and
- the Alternative Investment Funds established outside Luxembourg when they have their effective center of management or central administration in Luxembourg.

For other SCS/SCSp, the Luxembourg tax authorities provide, via references to certain case laws, clarifications regarding the distinction between commercial activity (*“an independent activity carried out on a permanent basis with the aim of being profit making and participating to the general economic activity”*³) and private wealth management:

- The tax authorities put particular emphasis on the condition of “permanence”.
- The tax authorities indicate that although the case law referred to in the Circular deal with real estate assets, the conclusions can be transposed to movable securities.
- It is mentioned that the commercial activity would not stem only from the fact the SCS/SCSp holds significant assets or the fact that certain assets are sold within a relatively short period of time after acquisition.

The Circular also indicates that the commerciality of a SCS/SCSp is to be determined based on the specific circumstances of each case, specifically based on the investment policy of each vehicle.

The clarifications brought by this new Circular provide more certainty about the interpretation to be given to the concept of commercial activity vs. private wealth management for tax purposes. In the context of the alternative fund industry this Circular confirms the so-called principle of “tax neutrality”⁴ and makes the Luxembourg limited partnerships SCS / SCSp a prime choice for fund or carried interest structuring.

¹Directive 2011/61/EU dated 8 June 2011 on Alternative Investment Fund Managers (AIFMD)

²Most of the provisions applicable to these entities are similar, the main difference between the SCS and the SCSp is that the SCSp does not have a legal personality

³Article 14(2) and 14(1) Income Tax Law dated 4 December 1967 as amended

⁴i.e. parity of tax treatment between investors investing directly and investors investing through an investment fund in equivalent assets.

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