

New guidance on taxation of Luxembourg limited partnerships

January 14, 2015

In brief

The Luxembourg tax authorities have released circular LIR n 14/4, which includes more detailed guidance on the tax treatment of income derived by Luxembourg limited partnerships (*Société en Commandite Simple* - SCS) and Luxembourg special limited partnerships (*Société en Commandite Simple Spéciale* - SCSp).

The new circular, published January 9, 2015, clarifies the Luxembourg tax authorities' views on the tax treatment of these partnerships. While the new guidance applies to all SCS and SCSp entities, the circular also includes more specific comments about SCS and SCSp entities used in the alternative investments industry.

In detail

Background

SCS and SCSp entities are tax-transparent, and thus not subject to Luxembourg corporate income tax at the entity level. Instead, their partners are treated as carrying out, individually, the activities of the SCS or SCSp.

Foreign partners therefore are taxed in Luxembourg on business profits of the SCS/SCSp only if both (i) the foreign partners derive profits from a 'commercial activity' as defined in article 14 of the Luxembourg Income Tax law (LITL) and (ii) that commercial activity is carried out through a permanent establishment. The second condition, however, is not

specifically addressed by the circular.

The profits derived by an SCS or SCSp may, however, be subject to the municipal business tax (which is separate from, but similar to, the corporate income tax), in either of the following cases:

- When there is **no** general partner (GP) that is a capital company owning five percent or more of the interest in the SCS or SCSp, the activity of the SCS or SCSp may be subject to municipal business tax when the SCS or SCSp is carrying on a 'commercial activity' as generally defined in article 14 (1) of the LITL, and

- When the GP of an SCS or SCSp is a capital company owning more than five percent of the SCS or SCSp interest, the activities of the SCS or SCSp are de facto deemed to be commercial activities (Geprägetheorie). This triggers potential liability for municipal business tax on the profits of the SCS or SCSp.

The circular confirms that SCS or SCSp entities set up as investment companies in risk capital (*Sociétés d'Investissement en Capital à Risque* - SICARs) are, by law, not considered to be carrying on a commercial activity. Similarly, SCS or SCSp entities set up as Specialized

Investment Funds (SIFs) or Part II Funds are, by law, outside the scope of income taxes and are subject only to subscription tax. Guidance for other alternative investment funds vehicle is included below.

Clarification provided by the circular

Definition of commercial activity

The circular confirms that, where required, to determine whether an entity carries out a commercial activity, it must meet all four of the criteria defined in article 14 of the LITL (i.e., permanency, independence, intention to realize profits, participation in the general economic environment).

The circular interprets the four criteria through examples of published court precedent or parliamentary briefing documents.

The circular expressly states that an SCS or SCSp's activity should be analyzed in light of all facts of the specific case at hand. However, the circular confirms that neither the significance of assets held nor the frequency of asset sales is in itself sufficient to cause the characterization of the SCS or SCSp's activities as commercial activities.

Alternative Investments Funds (AIFs)

The circular clarifies the nature of the activity performed by an SCS or SCSp that falls within the definition of an AIF under the Luxembourg law dated July 12, 2013 (the Alternative Investment Fund Manager (AIFM) law – which incorporates the EU Alternative Investment Fund Managers Directive into Luxembourg law).

AIFs established in Luxembourg in the form of an SCS or SCSp – to the

extent that there is no GP set-up in the form of capital companies and owning five percent or more of the SCS/SCSp's interest (and excluding SICARs, SIFs or Part II Funds mentioned previously) are deemed not to carry out any commercial activity and thus should not be subject to municipal business tax.

AIFs established outside Luxembourg but having an AIFM in Luxembourg should be fully exempt pursuant to the AIFM law (i.e., exempt from corporate income tax, municipal business tax, and net wealth tax).

The takeaway

Although the circular doesn't introduce new concepts, it clarifies the tax treatment of Luxembourg SCS and SCSp entities, most importantly in the context of non-regulated fund vehicles used by AIFMs.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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