

Legislative Clarification on the Luxembourg Reverse Hybrid Entity Tax Rule with Retroactive Effect

On 23 December 2022, the Luxembourg reverse hybrid rule provided by Article 168^{quarter} of the modified Luxembourg Income Tax Law ("Article 168^{quarter} LITL") was officially amended with the passing of the Luxembourg Budget Law for 2023¹.

The new Article 168^{quarter} of the LITL clarifies the scope of the reverse hybrid entity rule with an additional condition for a Luxembourg tax transparent entity to be considered as a reverse hybrid entity.

The rule now requires that the double non-taxation outcome resulting from the reverse entity must only be due to the mismatch classification of such entity. In other words, the absence of taxation on the profits of the Luxembourg tax transparent entity must be due to its tax opaque classification under the laws of the jurisdiction of its investors. Consequently, tax-exempt recipient investors (benefiting from a local tax exemption), as well as recipient investors located in tax neutral jurisdictions should not be taken into consideration for the rule to be triggered.

The amendment applies with retroactive effect as of 1 January 2022, i.e. as from the original date of the reverse hybrid entity's rule entering into force in Luxembourg.

Under the Luxembourg reverse hybrid entity rule as amended, a Luxembourg tax transparent entity (such as a Luxembourg partnership) is treated as a resident taxpayer

and the portion of its profits which is not otherwise taxed (in Luxembourg or elsewhere) is subject to Luxembourg corporate income tax, when one or several of its investors (qualifying as non-resident associated enterprises) holding directly or indirectly an aggregate interest in this entity representing at least 50% of its capital, voting rights or profit entitlement, are located in jurisdictions that (i) treat the Luxembourg entity as tax opaque and (ii) do not tax the profits of the entity because of the mismatch tax classification thereof.

Even if such interpretation of the rule was widely anticipated, a legislative clarification is especially welcome in the current context and given the absence of related administrative tax circular.

In addition, such clarification may ease the first filing of the Luxembourg partnerships' annual tax returns since the implementation of the rule as new tax forms for Luxembourg partnerships² (form 200 or 300) should include a specific section where the partnership that is filing would have to mention whether or not it is a reverse hybrid entity under Article 168^{quarter} LITL. While it would not be required to evidence a negative answer in the form (e.g. by attaching a document), the basis for any negative answer to a question on meeting the definition of a reverse hybrid entity should be documented internally by taxpayers and service providers.

¹ Luxembourg budget law off 23 December 2022, parliamentary document n°8080.
<https://legilux.public.lu/eli/etat/leg/loi/2022/12/23/a649/jo>

² Only non-regulated SCSp/SCS (with AIF status or not) are concerned by this filing obligation. Regulated SCSp/SCSp (SIF, SICAR, RAIF) are not required to file such form even if they remain subject to Article 168^{quarter} LITL.

Our tax team can assist for this purpose by assessing the tax impact of the Luxembourg reverse rule.

For further information, please reach out to your usual Maples Group contact or any of the contacts below.

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