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Luxembourg Reverse Hybrid Rule and the New Form 205

Article 168quater of the Luxembourg Income Tax Act (“LITA”) deals with so-called “reverse hybrids”. This involves Luxembourg partnerships such as société en commandite simple ou SCS which, unlike in Luxembourg, are treated as opaque in the country of residence of one or more partners. If, as a result of such unequal treatment, one or more partners are not taxed on their profit share in the partnership in their respective country of residence, Luxembourg must subject the respective profit share to Luxembourg corporate income tax. Article 168quater of the LITA transposed the provisions of the European ATAD II Directive¹ into Luxembourg tax law.

On 9 June 2023, the Luxembourg tax authorities issued a tax circular² (the “Circular”) aiming to clarify how to determine the income of Luxembourg reverse hybrid partnerships. In addition, the tax authorities informed about the introduction of the new tax Form 205 applicable to Luxembourg partnerships (“Déclaration pour l’établissement en commun des revenus d’entreprises collectives et Déclaration pour l’impôt sur le revenu des collectivités”).

Furthermore, the tax authorities published Frequently Asked Questions (“FAQs”) to clarify tax filing obligations for Luxembourg partnerships and the use of the new Form 205 as well as the existing tax forms for partnerships.

1. Background

Article 168quater (1) of the LITA applies to Luxembourg partnerships with foreign partners where the Luxembourg partnership is not treated as tax transparent in one or more countries of residence of the foreign partners but as an opaque company subject to corporate income tax. The reason for the non-taxation and thus the application of Article 168quater of the LITA must have its cause in a different tax

¹ Please refer to our updated newsletter “Luxembourg Partnerships with Foreign Partners”: <https://aiqunited.com/en/ueberblick-ueber-die-steuerlichen-massnahmen-des-luxemburgischen-gesetzesentwurf-zum-haushalt-2023/>.

² Circular of the Director of the Luxembourg tax authorities L.I.R. No. 168quater/1 of 9 June 2023 (in French only): <https://impotsdirects.public.lu/dam-assets/fr/legislation/legi23/lir-168quater-1-du-09062023.pdf>.



treatment of the Luxembourg partnership. Hence, a scenario where one or more of the foreign partners are not taxed because they benefit from a tax exemption in their country of residence does not qualify under this provision. In case of a hybrid mismatch, the Luxembourg partnership will only be subject to Luxembourg corporate income tax and not to Luxembourg municipal or net worth tax. The corporate income tax is levied on the part of the income which is not taxed in the foreign partner's country of residence. Article 168quater of the LITA does not apply to Luxembourg investment funds in the legal form of partnerships³ such as Reserved Alternative Investment Funds or "RAIFs" as defined in the Law of 23 July 2016, Specialized Investment Funds or "SIFs" as defined in the Law of 13 February 2004, and other alternative investment funds as defined in the Law of 12 July 2013 on alternative investment fund managers.

The Luxembourg "reverse hybrid" provision applies in cases where one or more associated enterprises which are not resident and which in aggregate hold a direct or indirect participation of 50 per cent or more of the voting rights, capital interests or profit participation rights of the Luxembourg partnership. Article 168quater of the LITA applies retroactively as of the financial year 2022. The determination of income subject to corporate income tax is set out in the Circular supplemented by the FAQs.

2. Consequences of the Status of Luxembourg Reverse Hybrid Partnerships

According to the Circular, Luxembourg reverse hybrid partnerships subject to Article 168quater of the LITA are not considered as corporate entities for Luxembourg tax purposes even though they could be (partly) subject to Luxembourg corporate income tax. Therefore, the Luxembourg participation regime on dividends, Luxembourg CFCs, the interest barrier, and the anti-hybrid rules should not be applicable to the partnership if Article 168quater of the LITA applies.

3. Determination of Total Net Income of Reverse Hybrid Partnerships

According to the Circular, a reverse hybrid partnership may only generate three types of income: investment income, rental income and other income as defined by Article 99 of the LITA. Income under Article 99 of the LITA includes, in particular, capital gains income from the sale of assets and income from the liquidation of participations of more than 10% in corporations. Such income may only be taxed in Luxembourg if it is not taxed abroad.

³ According to Article 168quater (2) of the L.I.R., a collective investment vehicle is an investment fund or a vehicle that is widely held, holds a diversified portfolio of securities and is subject to investor protection regulations in the country in which it is established.

The income of the Luxembourg reverse hybrid partnership should be determined for the calendar year regardless of the financial year. It should be determined on a “cash-in and cash-out basis.” Distributions of income made to foreign partners should not be subject to Luxembourg withholding tax on dividends. However, dividends derived from the Luxembourg reverse hybrid partnership may take advantage of the Luxembourg 50% tax exemption on dividend income. Furthermore, Luxembourg and foreign withholding tax may be credited against the Luxembourg corporate income tax levied on such income.

4. Tax Filing Obligations for Partnerships – FAQs

First, it is necessary to clarify that, except for reverse hybrid partnerships, no corporate income tax is levied at partnership level. Corporate income tax is levied at partner level. However, in certain cases, Luxembourg partnerships have to file a tax return assessing the type of income generated by the partnership (commercial, rental, investment income, etc.) and the share of the income attributable to the partners (“separate and joint assessment”). In the FAQs, the tax authorities aim to clarify when a return must be filed by a partnership and which forms are to be used.

4.1. The New Form 205

The Luxembourg tax authorities introduced the new tax form 205 to be filed electronically by Luxembourg partnerships if the conditions are met. Form 205 consists of two parts: The first part of Form 205, entitled “Tax return for uniform determination of income,” refers to the income for which the partnership must file a separate and joint assessment according to paragraph 215 of the General Tax Code (“Abgabenordnung”). The second part, entitled “Declaration for corporate income tax,” pertains to the declaration of income by Luxembourg reverse hybrid partnerships within the meaning of Article 168quater of the LITA.

As for the filing of the first part of the new Form 205, the FAQs reference paragraph 215 of the General Tax Code. A partnership must file a tax return for the *financial year 2022* (Form 205, first part) if it generates investment income and other income pursuant to Article 99 of the LITA and that income is attributable to more than one partner. It is not clear whether a Luxembourg investment fund vehicle such as a RAIF or a SIF in the form of a partnership must file Form 205. Pending clarification from the tax authorities, we advise to complete Form 205 if the conditions are met.

The second part of Form 205 must be filed by reverse hybrid partnerships. The return is to be filed if the legal requirements are met regardless of whether or not the tax office has issued a request.

Form 205 must be submitted for the first time for the 2022 tax assessment year by 31 December 2023.

4.2. Form 200

According to the FAQs, Form 200, entitled “Declaration for the joint assessment of income from joint ventures and co-ownerships,” (“Déclaration pour l’établissement en commun des revenus d’entreprises collectives et de copropriétés”) must be filed by partnerships generating commercial income where such income would however not be subject to Luxembourg trade tax. Form 200 must also be filed by partnerships generating income from agriculture and forestry or freelance income, income from the rental of properties, speculation gains from the sale of real estate or other assets or, where the income is incidental, investment income according to article 97 of the LITA,

The tax authorities emphasize that Form 200 is not intended for partnerships primarily generating investment income from movable assets specified in Article 97 of the LITA or speculation income from assets other than real estate. Forms 200 and 205 should therefore be mutually exclusive.

4.3. Form 300

According to the FAQs, Form 300 “Declaration for the joint assessment of business profits and declaration for business tax” (“Déclaration pour l’établissement en commun du bénéfice commercial et déclaration pour l’impôt commercial”) must be filed by partnerships generating commercial income and being subject to trade tax in Luxembourg. The Form applies when Luxembourg residents and non-residents derive commercial income in Luxembourg through a partnership that constitutes a permanent establishment in Luxembourg for tax purposes. Form 300 and Form 205 model should be mutually exclusive.

5. AIQUNITED Takeaway

Although both the Circular and the FAQs are intended to provide clarity regarding the new Form 205, it is currently not clear whether Luxembourg RAI Fs and SIFs in form of a partnership are required to file Form 205 (first part) if the legal requirements pursuant to paragraph 214 of the Luxembourg General Tax Code are met. Given that such investment vehicles are not registered with the Luxembourg direct tax authorities, it is not possible to contact the competent tax office. Unless the vehicles receive a request from the tax authorities to file Form 205, we advise to verify whether the legal conditions for filing a return are met. We recommend the same procedure for all other Luxembourg partnerships.