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The New Luxembourg Carried Interest Regime at a Glance

Luxembourg is well known for its strong expertise in middle- and back-office functions for alternative investment funds (“AIFs”). One of the historically perceived weaknesses, however, concerned the taxation of remuneration paid to front-office professionals of AIFs working in Luxembourg (i.e. professionals involved in core investment activities such as capital raising, portfolio management and marketing). As set out in the Government’s coalition agreement for the period 2023–2028, the Luxembourg legislator therefore decided to redesign the tax regime applicable to carried interest. The objective of the legislative amendment is to attract and retain highly qualified asset management professionals in Luxembourg.

In alternative investment fund structures, management teams are generally not remunerated solely by fixed compensation. Where an AIF exceeds a predefined profitability threshold (the “hurdle rate”, often set at 8%), a portion of the capital gains is allocated to the management team. This portion is referred to as “carried interest”. Carried interest plays a central role in the remuneration of AIF management, as it rewards value creation and aligns the interests of managers with those of investors. Luxembourg has now enhanced its carried interest tax regime by amending Article 99bis of the Luxembourg Income Tax Code through draft law No. 8590 dated 24 July 2025. The bill was adopted on 22 January 2026 and published in the Official Gazette on 4 February 2026 (the “Law”).

Tax Benefits for Individuals

The tax advantages introduced by the Law for individuals may be twofold:

- taxation of carried interest at an effective rate of approximately 11.45% (i.e. one quarter of the standard progressive individual income tax rate) where the carried interest is earned on a contractual basis; and
- a full exemption from Luxembourg income tax where the carried interest is derived from a participation in an AIF that is held for more than six months and represents less than 10% of the AIF’s capital.



Taxation of the Two Concepts of Carried Interest in Luxembourg

The Law amends Article 99bis (1a) of the Luxembourg Income Tax Code (“L.I.R.”) by extending its personal scope to individuals involved in the management of an AIF. Under the former regime, only employees of AIF managers or AIF management companies could benefit from the carried interest regime. Under the new regime, the scope is extended to individuals performing management functions for an AIF (in particular portfolio management and risk management), irrespective of whether they act as employees, partners, managers or directors, or as service providers involved in the management of the AIF under a consulting services agreement. This applies whether such services are rendered directly by the individual or indirectly through one or more entities.

The new Article 99bis (1a) L.I.R. distinguishes between two types of carried interest:

- a) carried interest earned exclusively on a contractual basis; and
- b) carried interest that is inseparably linked to the acquisition of a direct or indirect participation in the AIF or that is represented by such participation.

The Law further refines the terminology of carried interest in order to accurately reflect its economic mechanism, which is based on the concept of “outperformance” above the hurdle rate. The hurdle rate constitutes a minimum return on the AIF, above which carried interest becomes payable to the beneficiaries. The hurdle rate must be determined on arm’s-length terms in order to avoid a qualification as an abuse of law. Moreover, under the Law, the carried interest must not be predictable.

a) Carried Interest Earned on a Contractual Basis

Pursuant to Article 99bis (1a), point 1 L.I.R., carried interest granted exclusively on a contractual basis is, for Luxembourg tax purposes, classified as extraordinary income and subject to taxation at one quarter of the standard individual income tax rate (i.e. approximately 11.45%). To benefit from this preferential tax treatment, the beneficiary is not required to hold a participation in the AIF. However, where such a participation is held, income derived therefrom is subject to a different tax treatment. In contrast to the former carried interest regime, the application of the new regime is not limited in time and applies both to individuals already resident in Luxembourg and to newly arriving individuals.

b) Carried Interest Inseparably Linked to a Participation in an AIF

Under Article 99bis (1a), point 2 L.I.R., this category of carried interest is characterised by two scenarios:

Scenario 1: The individual receives carried interest on a contractual basis but is also required to hold a direct or indirect participation in the AIF. Such participation must be acquired against



consideration. The hurdle rate and the conditions governing the payment of the carried interest must comply with market conditions.

Scenario 2: The individual acquires carried interest through a participation in a carry vehicle (e.g. a Luxembourg special limited partnership – société en commandite spéciale or “SCSp”) in exchange for consideration. In addition, the individual may also acquire a participation in the AIF itself. In such a case, the tax treatment of the two investments may differ.

For purposes of simplification, the legal form of the AIF in which the individual holds its participation is irrelevant. Consequently, the regime applies irrespective of whether the AIF is structured as a partnership or as a contractual mutual fund.

In both cases, the carried interest is treated as a speculative gain for Luxembourg tax purposes and is exempt from income tax provided that the participation has been held for more than six months and represents less than 10% of the AIF’s capital.

Entry into Force

The Law applies as from the 2026 tax year.

Takeaways

The revised carried interest regime constitutes a substantial simplification compared to the former rules and represents a highly attractive tax policy measure aimed at strengthening Luxembourg’s position as a fund domicile. It forms part of a broader policy of targeted tax measures designed to enhance the competitiveness of the Luxembourg asset management industry. Asset managers should review their existing remuneration structures and, where appropriate, adapt them in order to benefit from the new regime. We would be pleased to assist in this respect.