

Taxation of Luxembourg Reverse Hybrid Entities: Initial Administrative Circular and Compliance Guideline (Form 205)

On June 9 2023, the Luxembourg tax authorities released an initial administrative Circular¹ regarding the taxation of Luxembourg reverse hybrid entities, which includes tax transparent entities and arrangements that meet the conditions specified in Article 168quater of the Luxembourg Income Tax Law ("LITL"), along with a Q&A document² concerning the corresponding annual return (Form 205) that was published earlier this year. Additional administrative guidelines are anticipated, particularly regarding the collective investment vehicle exemption and the hybrid mismatch rules.

This update summarises the key points.

Tax Status and Regime of the Reverse Hybrid Entity

The Luxembourg tax authorities have confirmed that a Luxembourg reverse hybrid entity will be subject to Luxembourg corporate income tax as a resident taxpayer, rather than as a resident corporation (resident collective entity within the meaning of Article 159 LITL). This will impact the determination of its taxable profit and limit the applicable tax provisions thereof.

The income of a reverse hybrid entity is therefore not classified as commercial income and can only fall into three categories: (i)

income from movable capital (Article 97 LITL); (ii) rental income (Article 98 LITL); and (iii) miscellaneous income (Article 99 LITL).

The tax base of a reverse hybrid will be determined by considering the total net income earned during the calendar year, using a cash accounting method (income received minus expenses paid), regardless of the reverse hybrid's financial year.

A reverse hybrid entity will be subject to a maximum tax rate of 18.19% (including the 7% contribution to the employment fund) for taxable income exceeding EUR 200,000.

Distributions of income by a reverse hybrid entity to its partners are not subject to Luxembourg withholding tax.

The following tax rules will not apply to a reverse hybrid entity: CFC rules (Article 164ter LITL), participation exemption regime (Article 166 LITL for dividends and liquidation proceeds, and the Grand Ducal Decree implementing Article 166(9) LITL for capital gains), interest limitation rules (Article 168bis LITL) and anti-hybrid rules (Article 168ter LITL).

The 50% exemption for dividends provided by Article 115(15a) LITL is applicable under certain conditions and certain capital gains on

¹ Tax Circular L.I.R. n° 168quater/1: <https://impotsdirects.public.lu/dam-assets/fr/legislation/legi23/lir-168quater-1-du-09062023.pdf>

² <https://impotsdirects.public.lu/dam-assets/fr/echanges-electroniques/decl-coll/faq-modele-205.pdf>

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movable assets may not be taxable under certain conditions.

The historical acquisition value of the assets held by a reverse hybrid entity will be maintained, even if those assets were acquired prior to the entity becoming a reverse hybrid. This means that the step-up in value rule for shares, as outlined in Article 102(4a), will not be applicable. Furthermore, when a reverse hybrid entity is no longer subject to corporate income tax, there will be no deemed realisation of its assets and liabilities.

Foreign taxes, as well as domestic withholding tax, may be credited against the Luxembourg corporate income tax of the reverse hybrid entity in proportion to the percentage of income subject to corporate taxes at the reverse hybrid level.

Finally, the conversion of foreign currency income or expenses of the reverse hybrid into Euro is generally made at the exchange rate applicable on the day the income is received or the expense is incurred. However, the conversion of these amounts will be permitted at the year-end exchange rate or at the average exchange rate for the year.

Annual Tax Return of the Reverse Hybrid Entity (Form 205)

Form 205 will replace Form 200 for transparent entities that primarily generate income from movable capital (Article 97 of the LITL) or miscellaneous net income (Article 99, numbers 1 and 2 of the LITL), as well as for other tax transparent entities or arrangements that qualify as reverse hybrids. The Form 200 and 300 will continue to exist for certain transparent entities³.

Form 205 must be submitted by any transparent entity (or arrangement) under the following circumstances: (i) when requested by

mail to do so; (ii) upon formal request from the Luxembourg tax authorities, or (iii) if identified as a reverse hybrid entity according to the conditions outlined in Article 168quater (1) LITL.

Form 205 is divided into two parts. The first part aims to report the net income of the transparent entity that is subject to taxation in Luxembourg, considering both resident and non-resident investors. The second part of Form 205 is dedicated to the reporting of the net taxable income of the reverse hybrid entity, categorised by income types and (non-resident) investors. This taxable income will be subject to Luxembourg corporate income tax at the level of the reverse hybrid.

Finally, a list of all direct and / or indirect investors, i.e. those invested through another tax transparent entity, in the transparent entity must be attached to Form 205. This list should indicate the percentage of ownership and corresponding allocated amount of profits. By examining this list, the Luxembourg tax authorities can verify the accuracy of the application of Article 168quater.

Further Information

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

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³ The Form 200 has to be filed by tax transparent entities which mainly realise rental income or miscellaneous income related to real estate or business profits not subject to municipal business tax. The Form 300 will continue to be filed

by tax transparent entities that realise business profits subject to municipal business tax.

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