

## NEWSFLASH – LUXEMBOURG CLARIFIES THE CIV EXEMPTION FROM THE REVERSE HYBRID RULES.

On 22 August 2025, the Luxembourg Tax Authorities (LTA) issued Circular L.I.R. n°168quater/2, providing long-awaited guidance on the exemption for collective investment vehicles (“CIVs”) from the reverse hybrid rules.

### Background

Since 2022, Article 168quater of the Luxembourg Income Tax Law (LITL) has introduced reverse hybrid entity rules. Under these rules, a tax-transparent Luxembourg entity – such as a partnership or a mutual fund (FCP) – may become subject to corporate income tax if one or more associated non-resident investors hold more than 50% of its rights and treat the entity as tax opaque in their jurisdiction, without being taxed on their share of income due to this classification mismatch.

By way of derogation, CIVs are excluded from the application of these rules, provided they meet three cumulative conditions:

1. they are **widely held**,
2. they hold a **diversified portfolio of securities**, and
3. they are **subject to investor-protection regulation** in their jurisdiction of establishment.

Neither ATAD 2, which introduced the rule, nor Luxembourg law defined these conditions in detail. The new Circular fills this gap and offers clarity and legal certainty for fund managers, advisers, and investors.

### Which funds qualify?

The Circular confirms that certain vehicles automatically fall within the CIV exemption:

- Undertakings for Collective Investment (UCIs, law of 17 December 2010),
- Specialised Investment Funds (SIFs, law of 13 February 2007),
- Reserved Alternative Investment Funds (RAIFs, law of 23 July 2016).

These funds are presumed to meet the three conditions due to their regulatory framework, though this presumption remains **rebuttable**. For other fund types, a case-by-case assessment will be required.

### Clarifications on the three conditions

#### 1. Widely held

The Circular explains that funds should be designed to attract multiple unrelated investors. Key points include:

- A fund may still qualify with a limited investor base during its start-up phase (36 months) or liquidation, provided the situation is temporary or inherent to winding up.
- In master-feeder structures, the test is applied at the level of the feeder investors.
- Investors are considered related if one holds more than 50% of another, they are under common control, or they are family members.
- A presumption applies: a fund is deemed widely held if no single investor owns or controls more than 25% of capital or voting rights. The LTA may verify this using data from the register of beneficial owners.

## **2. Diversified portfolio of securities**

“Securities” is interpreted broadly, including shares, equity-like instruments, beneficiary units, bonds, receivables, units in other funds, deposits with credit institutions, and derivatives with securities as the underlying asset.

Diversification must be assessed against the fund’s investment policy and risk exposure. For example, a fund is not considered diversified if it invests more than 30% of its assets in a single issuer, unless there is adequate justification.

## **3. Investor protection regulation**

This condition is deemed satisfied if the fund is:

- regulated and supervised by the CSSF, or
- an AIF managed by an authorised AIFM under Directive 2011/61/EU (AIFMD).

## **Conclusion**

The Circular significantly enhances legal certainty by aligning the Luxembourg approach with OECD guidance and EU standards. In practice, most Luxembourg funds – particularly RAIFs and AIFs – will remain outside the scope of the reverse hybrid rules, provided they meet the diversification test.

Fund managers and advisers are encouraged to review their structures and offering documents to ensure that all three conditions of the CIV exemption are satisfied.