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## No municipal business tax for AIFs, says Lux authority

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Despite the fact that Luxembourg limited partnerships – either the *société en commandite simple* (SCS) or the newer *société en commandite spéciale* (SCSp) – are tax transparent, they are still technically subject to municipal business tax if they carry out a commercial activity.

However, the long-running issue has been whether unregulated AIFs under the AIFMD carry out commercial activities and are, therefore, obligated to pay municipal business tax. This has finally been clarified in a new tax circular issued by the Luxembourg tax authority, which states that AIFs under the AIFMD are not considered to be carrying out a commercial activity, unless the GP owns an interest of 5% or more in the partnership.

"The tax administrator has made clear that as long as an SCS or SCSp is an AIF, the purpose of which is to raise capital from investors with a view to investing it, it is considered to not be carrying out commercial activity, which would trigger municipal business tax," says Dechert partner Patrick Goebel. "The idea beyond overhauling Luxembourg limited partnerships was primarily to make the Luxembourg limited partnerships convenient to be used as a non-regulated investment fund, because joint-stock companies do not give fiscal transparency and are less flexible than partnerships when it comes to structuring and operating the fund."

Johan Terblanche, also a partner at Dechert, adds: "Any Luxembourg limited partnership that qualifies as an AIF under the AIFMD and Luxembourg law now has certainty in terms of its tax position.

"Any kind of doubt when it comes to tax treatment is, of course, a significant risk for investors and fund managers, alike. Certainty is crucial in the context of private equity, and this circular by the tax authority achieves that certainty. It basically confirms the tax treatment of both AIFs and non-AIF limited partnerships, by setting out useful guidance as to when an activity is deemed a business activity."

### Class becomes irrelevant

Furthermore, whether a private equity firm is classed as an AIF under the lighter or full version of the AIFMD regime is now irrelevant to the issue of municipality tax – the deciding factor is the nature and activities of the entity. "The AIFMD regulates managers and, although it indirectly imposes conditions on the vehicles, it does not require that the vehicle is itself a regulated entity," says Goebel.

This tax issue stemmed from the creation of the new type of limited partnership in Luxembourg – the SCSp – in the wake of the AIFMD. The intention of the SCSp was to make a vehicle that was convenient to use as a non-regulated investment fund and to attract private equity by doing away with the negatives that had plagued the older common limited partnership (SCS).

"The SCS, which we've had for many years, wasn't very attractive as a private equity vehicle for three primary reasons. First, a lack of privacy, due to the fact the names of limited partners that had not yet made all their contributions to the fund had to be published in the official gazette," says Terblanche. "Second, there was an LP clawback, so you never had full certainty that the distributions you received from the private equity fund were yours to do with as you wanted, as there was always a theoretical risk that a clawback might occur. Third, there were some uncertainties about the tax situation, which this circular has now cleared up. The other two items were dealt with as part of the legislative changes – both types of limited partnership are now very attractive."

What this circular by the tax authority may also achieve is an increase in requests to set up AIFs that are not subject to Luxembourg product regulation, according to Goebel. "So far, a certain number of managers did not opt for the SCS or SCSp outside the product regulation because of tax uncertainties. I think that now, with this clarification from the tax authority, we can reasonably expect there to be more SCSs or SCSPs."

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