

UPDATE

New Luxembourg Circular clarifies the definition of exempt UCIs under anti-hybrid tax rules

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On 12 August 2025, the Luxembourg tax administration, Administration des Contributions Directes, (ACD) issued a circular providing clarification on the meaning of undertaking for collective investment (UCI) under article 168 quater of the Luxembourg Income Tax Law (LITL) setting out anti-hybrid rules. The Circular brings clarity to a crucial carve-out for certain types of investment funds.

Context

The first paragraph of Article 168 quater LITL sets out an anti-hybrid rule subjecting non-taxed income of tax transparent undertakings established in Luxembourg to Luxembourg income tax if one or more of the undertaking's associated enterprise(s) holding 50 per cent or more of its voting rights, is located in a jurisdiction that considers the undertaking as taxable and as such does not tax undertaking's associated enterprise(s) income.

However, paragraph two of the article sets out an exemption for UCIs, emphasising the importance of the below described circular which aims to define and clarify its meaning.

An automatic UCI qualification for UCITS, Part II UCIs, SIFs and RAIFs

The Circular states that a UCI is an undertaking which, by definition, must have an investment purpose and cannot exercise any commercial activity. The concept of UCI covers the following:

- Undertakings for collective investment as defined in the law of 17 December 2010 relating to undertakings for collective investment, i.e. undertaking for collective investment in transferable securities (UCITS) and Part II UCIs;
- Specialised investment funds as defined in the law of 13 February 2007 relating to specialised investment funds (SIF); and
- Reserved alternative investment fund as defined in the law of 23 July 2016 on reserved alternative investment funds (RAIF).

For other undertakings or funds not falling within this scope, the LITL sets out three cumulative conditions to qualify as a UCI: it must be widely held, hold a diversified portfolio of securities, and be subject to investor-protection regulation in the country in which it is established.

A widely held undertaking

The 'widely held' condition means that the undertaking must market shares or units for distribution to several unrelated investors. The interpretation of this condition varies depending on the specific situation of the undertaking. For example, the ACD recognises that an undertaking in its launch or liquidation phase with only a few investors can be considered widely held, provided certain conditions are met.

The investors must be unrelated. According to the ACD, two investors are considered as related in the following cases:

- If one directly or indirectly holds 50 per cent of the other's share capital;

- If an individual or entity directly or indirectly holds 50 per cent of each two investors' share capital;
- If the two investors are members of the same family; or
- If, based on all the relevant facts, one investor controls the other or both are under the control of the same individual or entity.

The ACD emphasises that the large participation condition is presumed to be met when no individual investor holds or controls more than 25 per cent of the undertaking's share capital or voting rights directly or indirectly. To verify the unrelated character of the investors, the ACD may use the information disclosed to the Luxembourg Register of Beneficial Owners.

An undertaking holding a diversified portfolio of securities

The ACD understands the term 'securities' to be very broad, including shares and other similar securities giving access to the capital of a juridical entity, preferred shares, bonds or other receivables, interests in undertakings or in undertakings for collective investment, bank deposits and derivatives as long as their underlying assets are securities. Two criteria are used to determine the diversity of the portfolio: the placement policy, and the exposure to market risk in relation to the investment policy pursued.

Consequently, a securities portfolio is not considered diversified if it does not comply with the SIF diversification rules, i.e. the undertaking must not invest more than 30 per cent of its assets in the same issuer, and the use of derivatives must be subject to comparable risk diversification rules, meaning that the underlying assets shall be appropriately diversified.

An undertaking subject to investor-protection regulation

This condition is considered to be met either when the undertaking is supervised by the Commission de Surveillance du Secteur Financier (CSSF), or when the alternative investment fund is managed by an alternative investment fund manager (AIFM).

Conclusion

The clarification provided by the ACD is particularly welcome, as it brings much-needed legal certainty and transparency to the fund industry. Clear guidance on the definition of undertakings for collective investment under Article 168 quater LITL helps market participants better structure their vehicles and anticipate potential tax implications.

Do you need guidance in assessing whether your Luxembourg vehicle would qualify as an undertaking for collective investment under article 168quater of the LITL? Our team of tax experts is available to discuss with you whether you could benefit from such exemption.

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