

UPDATE

Reforming the Carried Interest Tax Regime: Another landmark advancement in Luxembourg's modernisation and competitiveness

Update prepared by Lara Forte, Eléonore Galleron and Romain Bordage (Luxembourg)

Luxembourg confirms its position as a cutting-edge financial hub.

Following last year's initiative aimed at attracting talent and highly skilled professionals through a favourable tax regime for qualified inpatriates, the focus has now shifted to asset managers and individuals in executive roles. Following Minister of Finance Gilles Roth's announcement at Nexus 2025 conference last June, a draft bill n°8590 was submitted on 24 July 2025 to the Luxembourg Parliament regarding the modernisation of the carried interest regime. The stated objective is to attract not only fund domiciliation and administration business, but also the 'front office' segment of the value chain.

This reform reinforces Luxembourg's alignment with other leading financial hubs in modernising the current carried interest regime and introducing tax-related changes aimed at attracting asset managers, executives and high-net-worth individuals. The proposal seeks to ensure neutral taxation of carried interest income distributed by AIFs to Luxembourg residents.

Counsel Eléonore Galleron (Tax), Partner Lara Forte and Counsel Romain Bordage (Funds) assess the proposed reform and its potential effect on the fund sector, noting that the bill may change during the legislative process.

Current regime

The current carried interest taxation regime was introduced by the Law of 12 July 2013. It is structured as a twofold system which applies to alternative investment fund managers (AIFMs). Under the standard regime, carried interest received in the form of profit-sharing rights is treated as ordinary income, subject to progressive income tax rates. Whereas for carried interest linked to a participation in a corporate entity, a more favourable tax treatment may apply as capital gains may be exempt from taxation, provided the holding period exceeds six months.

In parallel, a temporary preferential regime was available exclusively to individuals who relocated to Luxembourg before 2018. Pursuant to applicable rules, eligible individuals could benefit from a reduced tax rate, with carried interest taxed at one-quarter of the global income tax rate for a period of ten years.

The reform: an enhanced definition of carried interest and two different regimes

The draft bill comprehensively addresses the various forms of carried interest, extending beyond capital gains to include any rights to participate in the outperformance of the AIF where a certain threshold of return is exceeded (hurdle rate).

The new regime establishes a distinction between two categories of carried interest: primarily, that which arises from an interest in the AIF itself; and secondarily, a residual category corresponding to entitlements granted under contractual arrangements.

1. Carried interest received on the basis of a participation in the AIF

This type of carried interest is linked to the holding of a capital interest in the AIF. It generally takes the form of carry shares / interests or is allocated through a separate carry vehicle. This structure, based on

actual participation in the capital, represents the traditional model. Accordingly, carried interest falling within this category is subject to a unified tax treatment applicable to capital gains.

In such instance, a Luxembourg resident may benefit from a full exemption from tax on capital gains when they hold less than a 10 per cent participation in the AIF and receive carried interest linked to their participation more than six months after the participation's acquisition.¹

2. Contractual carried interest

The bill also foresees carried interest to be characterised as participation in the AIF's 'outperformance' through a contractual arrangement. Receipt of such carried interest does not require a direct or indirect participation in the AIF. Under the new regime, this category of contractual carried interest is subject to a reduced tax rate amounting to one quarter of the standard rate, approximately 12 per cent.

Uniform treatment across fund structures and carried interest models

The fund's legal form is no longer a determining factor in the application of the carried interest regime described above. The issuer's tax-transparent status is disregarded—even in cases where the fund is structured as a special limited partnership (*société en commandite spéciale*, SCSp) or a mutual investment fund (*Fonds commun de placement*, FCP), both of which are traditionally considered tax-transparent. Such clarification has been made with respect to participation based carried interest only. We understand that the intention of the legislator here is not to make a distinction between the two regimes but rather that it takes the assumption that such clarification is not required for contractual carried interest as it should not qualify as a distribution made by the fund in the first place.

Moreover, the future regime encompasses both whole fund carry—where carried interest distributions occur once investors have recovered their initial investment amid positive performance—and deal-by-deal carry. The previous requirement mandating the full reimbursement of investors' contributions prior to carry distributions is removed, opening new perspectives.

Extended range of eligible beneficiaries

The bill aims to extend this new favourable carried interest tax regime to all entitled individuals who are either managers themselves or, directly or indirectly, serve AIF managers or their management companies, regardless of their employment status.

The legislative text refers to a Luxembourg resident individual who is either (i) a manager or (ii) works for managers or management companies of alternative investment funds.

As indicated in the notes to the articles of the bill of law, it has become apparent that other stakeholders may also be entitled to such remuneration. Accordingly, the holder of carried interest may be employed by an entity other than the AIF manager or its management company (e.g., an investment advisory firm), or may not be an employee at all (e.g., an independent member of the AIF's board of directors or a partner in the management company).

Concrete application of the proposed regime

- Carried interest received by a fund manager (resident in Luxembourg) who receives 10 per cent carry based on a contractual arrangement, amounting to €5 million: that manager benefits from a reduced tax rate of 12 per cent on such revenue without time limitation.
- Carried interest received by the board member (also resident in Luxembourg) who receives 10 per cent carry amounting to €5 million further to a seven per cent shareholding in the fund: if that manager has held the participation for at least six months and the stake is below 10 per cent, the manager will become eligible for full exemption on such revenue.

¹ The rationale behind the 10 per cent threshold and the six-month holding period follows the existing tax treatment applicable to participations in commercial companies. Adopting an analogous rationale, the exemption should apply to each AIF participation to which a carried interest entitlement is linked. Accordingly, an individual could hold up to 10 per cent in multiple funds and still benefit from the tax exemption.

Effectivity

If enacted, the new regime will apply from the 1 January 2026 onwards and will repeal the temporary taxation regime stated at Article 213 of the AIFM Law and article 99bis (a)LIR.

Will this have an impact on the fund industry and on structuration?

The reform sends a clear and favourable signal from the legislator. It reflects a willingness to accommodate diverse carried interest structuring approach with a very attractive tax rate and represents a deliberate effort to provide asset managers with maximum flexibility - allowing them to structure carried interest as they see fit, without triggering distinctions in tax treatment.

As mentioned above, the proposed reform extends the scope of the tax benefits to contractual carried interest. This change is expected to simplify fund structuring and potentially reduce associated costs, including those related to the setup and ongoing management of carry vehicles.

As it aims to establish a favourable tax treatment of carried interest, we could logically expect an increase of the re domiciliation of alternative investment fund managers to Luxembourg.

Legislative process and next steps

The draft bill was approved by the Government Council on 24 July 2025 and formally submitted to the *Chambre des Députés*. It remains subject to the legislative process and potential amendments before entering into force. It is expected to enter into force as of the 2026 tax year.

Contacts



Lara Forte
Partner
Mourant Ozannes (Luxembourg) S.a r.l.
+352 260 082 5074
lara.forte@mourant.com



Eléonore Galleron
Counsel
Mourant Ozannes (Luxembourg) S.a r.l.
+352 260 082 5035
eleonore.galleron@mourant.com



Romain Bordage
Counsel
Mourant Ozannes (Luxembourg) S.a r.l.
+352 260 082 5047
romain.bordage@mourant.com

This update is only intended to give a summary and general overview of the subject matter. It is not intended to be comprehensive and does not constitute, and should not be taken to be, legal advice. If you would like legal advice or further information on any issue raised by this update, please get in touch with one of your usual contacts. You can find out more about us and access our legal and regulatory notices at mourant.com. © 2025 MOURANT ALL RIGHTS RESERVED