

# Reverse Hybrid rule – Clarification of the “CIV” carve-out

The reverse hybrid rule could lead, under certain conditions, to the submission of Luxembourg transparent vehicles (such as a Luxembourg SCS – *Société en commandite simple* - or SCSp – *Société en commandite spéciale*) to Luxembourg corporate income tax (at the rate of 17.12% in aggregate for tax year 2025).

On 12 August 2025, the Luxembourg direct tax authorities issued circular 168<sup>quater</sup>/2 providing useful guidance on the concept of collective investment vehicles (“CIV”) excluded from the application of this rule, offering greater certainty to fund managers and investors.

For transparent vehicles not qualifying as CIV, the impact of the reverse hybrid rule however remains limited in practice.

## Reverse Hybrid Rule – General concept

A Luxembourg reverse hybrid is an entity which (i) is treated as tax transparent in Luxembourg (such as a Luxembourg SCS / SCSp) but (ii) is treated as opaque at the level of the investors.

In the situation of a reverse hybrid, income realized by the entity would (i) not be taxable in Luxembourg at the level of the transparent entity (such as a Luxembourg SCS / SCSp) and (ii) not be taxable at the level of the investors as their jurisdictions consider that the income of the entity is subject to tax at the level of such entity considered as opaque (i.e. that the entity is taxable in Luxembourg).

To tackle these situations, Luxembourg has introduced article 168<sup>quater</sup> of the Luxembourg income tax law (“LITL”) applicable as of tax year 2022 (derived from ATAD 2 – *Anti-Tax Avoidance Directive*). According to this reverse hybrid mismatch rule, income of a Luxembourg transparent entity such as a Luxembourg SCS / SCSp could, under certain circumstances and conditions, be subject to corporate income tax in Luxembourg in case of reverse hybrid mismatch situations.

## Exclusion of CIVs per the law and parliamentary commentaries

Point 2 of article 168<sup>quater</sup> LITL provides however that the hybrid mismatch rule does not apply to “collective investment vehicles” (“CIV”).

According to this article, the terms “collective investment vehicle” means an ***investment fund or vehicle that is widely held, which holds a diversified portfolio of securities and which is subject to investor protection regulations*** in the country in which it is established.

According to the parliamentary commentaries, the concept of “collective investment vehicle” covers (i) undertakings for collective investment as defined under Luxembourg law of 17 December 2010 (e.g. UCITs and Part II UCIs), (ii) Specialized Investment Funds (SIFs) as defined under Luxembourg law of 13 February 2007, (iii) Reserved Alternative Investment Funds (RAIFs) as defined under Luxembourg law of 23 July 2016 and (iv) alternative investment funds as defined under the AIFM Law provided that they are widely held, hold a diversified portfolio of securities and are subject to investor protection requirements.

The last concept was however not defined and no further guidance was available, leading to potential uncertainties. Circular 168<sup>quarter</sup>/2 fills this gap.

### **Circular 168<sup>quarter</sup> 2 – confirmation of investment funds considered as CIVs**

In line with the parliamentary commentaries, circular 168<sup>quarter</sup>/2 confirms that the reverse hybrid rule does not apply to the following vehicles:

- UCIs ;
- SIFs ;
- RAIFs.

### **Circular 168<sup>quarter</sup> 2 – precisions regarding other vehicles qualifying as CIV**

As indicated above, point 2 of article 168<sup>quarter</sup> LITL indicates that a CIV could also be a vehicle (i) that is widely held, (ii) which holds a diversified portfolio of securities and (iii) which is subject to investor protection regulations.

The three cumulative criteria have been detailed by circular 168<sup>quarter</sup>/2.

#### **(i) A vehicle that is widely held (investors condition)**

- The principle is that the “widely held” condition is met when the vehicle’s shares or units are commercialised with the aim at becoming held by **several unrelated investors**.
- Presumption : the “widely held” condition is deemed to be met if no individual ultimately holds or controls the vehicle through a direct or indirect holding of more than 25% of its shares / units or voting rights or by any other mean. The tax authorities can refer to the UBO register to verify if such a control exists.

- Flexibility: the circular indicates that a range of circumstantial elements, factual or intentional, shall be considered when assessing if the “widely held” condition is met. A limited number of unrelated investors can be accepted under certain circumstances such as:
  - During the launch phase of the vehicle: a vehicle could have a limited number of investors if one can reasonably consider that it will be widely held within 36 months as of the date of its incorporation or authorisation;
  - During the liquidation phase: a vehicle can have a limited number of investors if the default is due to the liquidation situation.
- Master / feeder structures: in case of master / feeder structures, the “widely held” condition of the master vehicle (investment vehicle) is assessed at the level of the feeder vehicle (gathering the investors).
- Concept of related parties: the circular indicates that two investors shall be considered as related persons if:
  - One controls more than 50% of the voting rights or capital of the other;
  - Both are controlled by the same person, for more than 50% of their voting rights or capital;
  - They are family members;
  - If circumstances show that one controls the other or both are under the control of the same person.

### **(ii) Diversified portfolio of securities (assets and management condition)**

- Key criteria: the vehicle must comply with the diversification rules applicable to a Luxembourg SIF, (which represents a major restriction to the application of the CIV exemption). Such condition is **not** met if:
  - The vehicle invests more than 30% of its assets or commitments to subscribe in a single issuer (unless adequately justified), and
  - The use of derivative instruments does not lead to an appropriate diversification of the underlying assets.
- Diversification: the assessment is made on the basis of documentation but also actual risk exposure i.e. based on:
  - The investment policy as defined in the management regulations or the incorporation documents of the vehicle; and
  - The actual exposure to market risks in light of the investment policy referred to above.
- Securities: the concept shall be shall be widely construed (shares, units, beneficiary units, bonds, notes, other receivables, deposits, derivative instruments, ...).

### **(iii) Investors protection regulations (supervision from authorities condition)**

- Principle: in order to be characterised as a CIV, a vehicle which is widely held and holds a diversified portfolio of securities, must also be subject to investors protection rules in Luxembourg.

- Presumptions: the criteria is deemed to be met if:
  - The vehicle is supervised by the CSSF (*Commission de Surveillance du Secteur Financier*); or
  - The vehicle qualifies as an AIF (Alternative Investment Fund) and is managed by an authorised AIFM (Alternative Investment Fund Manager) , i.e. an AIFM subject to the authorisation and supervision of the CSSF.

### **Situation of non-CIV vehicles with respect to the reverse hybrid rule**

There are many situations where a Luxembourg transparent vehicle would not qualify for the CIV exemption based on the cumulative criteria set out under circular 168<sup>quarter</sup>/2, e.g. because it does not comply with the risk-spreading policy of a SIF or because it is not subject to the investors protection regulations. For instance:

- A SCS/SCSp managed by a self-declared AIFM (below thresholds) ; or
- A SCS / SCSp investing in a single underlying asset (e.g. a property, a company etc).

Would such a vehicle automatically fall under the reverse hybrid rule and be subject to CIT in Luxembourg ?

In reality the scope of the reverse hybrid rule is restricted by the “related party test”

According to point 1 of article 168<sup>quarter</sup> LITL, the reverse hybrid mismatch rule is applicable only if one or several non-resident associated investors situated in jurisdictions which consider the transparent entity (such as a Luxembourg SCS / SCSp) as opaque, hold in aggregate a direct or indirect 50% (or more) interests in the transparent entity in terms of voting rights, capital ownership or rights to the profits.

As a result, the reverse hybrid mismatch rule is only applicable if:

- (i) A non-resident investor (entity or individual) situated in jurisdictions which consider the non-CIV transparent entity (such as a Luxembourg SCS / SCSp) as opaque holds directly or indirectly, 50% (or more) interests in the non-CIV transparent entity in terms of voting rights, capital ownership or rights to the profits, or
- (ii) Several non-resident investors reach this threshold by “acting together”. A precise concept of what kind of actions or behaviors can be understood as acting together is not defined in the LITL or in the ATAD 2 directive. A definition can be found in Action 2 OCDE BEPS (Base Erosion and Profit Shifting) report, to which the ATAD 2 directive makes reference as a source of illustration or interpretation. Accordingly, several persons will be treated as acting together if a) they are members of the same family; b) one person regularly acts in accordance with the wishes of the other person, i.e. the case of a proxy/agent, someone that is legally bound to act in accordance with someone’s instructions; c) they have entered into an arrangement that has material impact on the value or control of a voting right or capital interest; d) the same person or group of persons manages the ownership or control of such rights or interests.

### CONCLUSION

- Circular 168<sup>quarter/2</sup> confirms that UCIs, SIFs and RAIFs qualify as CIV under the reverse hybrid rule.
- Circular 168<sup>quarter/2</sup> provides useful clarification on the concept of CIVs with respect to vehicles which are not UCIs, SIFs or RAIFs;
- Based on circular 168<sup>quarter/2</sup>, a transparent vehicle which does not comply with the risk-spreading criteria of a SIF or which is not subject to the direct or indirect regulation of the CSSF can not qualify as a CIV.
- Non CIV transparent vehicles are not automatically subject to corporate income tax in Luxembourg based on the hybrid mismatch rule:
  - There must be an hybrid mismatch (i.e. investors jurisdiction must consider the vehicle as taxable in Luxembourg and not tax income at the level of the investors);
  - The non-resident investor shall meet the “related party test” through a 50% ownership alone or via the “acting together” concept.

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