Luxembourg’s new carried interest regime compared with Belgium

Introduction

The taxation of carried interest continues to be one of the most closely watched issues in the European alternative investment space. As tax authorities increasingly scrutinise performance-based remuneration, fund managers and key executives are seeking jurisdictions that combine fiscal competitiveness with legal certainty and alignment with international standards.

In this context, Luxembourg has taken a decisive step forward. With the adoption of a comprehensive statutory carried interest regime, applicable as from 1 January 2026, Luxembourg has moved away from reliance on administrative practice and advance tax confirmations alone. The new framework introduces a clear legal definition of carried interest, identifies the eligible structures and beneficiaries, and confirms a favourable tax treatment subject to well-defined conditions.

Rather than fundamentally reshaping the existing approach, the reform codifies and refines Luxembourg’s long-standing position, offering increased predictability for fund managers while safeguarding against the recharacterisation of carried interest as disguised employment income. This development further strengthens Luxembourg’s position as a leading European hub for private equity, venture capital and alternative investment funds.

1 The New Luxembourg Carried Interest Regime - (Effective as of 2026)

1.1 From Administrative Practice to Statutory Framework

Until now, the Luxembourg tax treatment of carried interest was largely shaped by administrative guidance and case-by-case analysis, often confirmed through advance tax rulings. While this approach allowed flexibility, it also resulted in uncertainty, particularly in cross-border situations or where fund structures deviated from market standards.

The newly adopted regime replaces this fragmented approach with a clear statutory framework. Its primary objective is to provide legal certainty while maintaining Luxembourg’s attractiveness in a competitive international environment. At the same time, the legislator sought to draw a clear line between genuine carried interest, reflecting entrepreneurial risk and long-term value creation, and remuneration that should properly be taxed as employment income.

The regime applies to carried interest realised as from 1 January 2026, irrespective of when the entitlement was granted, provided the statutory conditions are met at the time of realisation.

1.2 Qualifying Carried Interest and Eligible Structures

The new framework applies to carried interest granted in connection with alternative investment funds, including private equity, venture capital, real estate and private debt strategies. The legislator deliberately adopted a functional rather than formalistic definition, focusing on the economic substance of the remuneration.

Carried interest must be directly linked to the overall performance of the fund and must be structurally subordinated to the returns of investors. In practice, this means that carried interest only becomes payable once investors have received their agreed preferred return and, where applicable, the return of their invested capital. The absence of any form of capital protection or guaranteed return is a core element of this analysis.

By anchoring the definition in economic reality, the regime accommodates a wide range of market-standard carried interest arrangements while excluding mechanisms that lack genuine risk exposure.

1.3 Eligible Beneficiaries and Substance Requirements

The regime is reserved for individuals who play an active role in the management or advisory activities of the fund. This typically includes fund managers, managing partners and senior executives, but may also extend to other key persons whose remuneration is meaningfully linked to fund performance.

A crucial aspect of the regime is the required nexus with Luxembourg. Beneficiaries must be Luxembourg tax residents at the time the carried interest is realised and must carry out their professional activities in Luxembourg. While some flexibility exists for cross-border activities, the clear policy objective is to ensure that both decision-making and value creation are anchored in Luxembourg.

This focus on substance aligns the regime with broader international trends and reduces the risk of challenges based on artificial relocation or purely tax-driven structures.

1.4 Tax Treatment: Partial Exemption and Social Security

Where the conditions of the regime are satisfied, qualifying carried interest is treated as investment income rather than employment income. As a result, it benefits from a 50% exemption from Luxembourg personal income tax, effectively halving the applicable progressive tax rate.

In addition, qualifying carried interest is excluded from Luxembourg social security contributions. This element is particularly significant in practice, as it confirms that carried interest is not assimilated to salary for social security purposes, provided that genuine risk and subordination are present.

The favourable tax treatment applies regardless of the legal form through which the carried interest is realised, whether via profit allocations, capital gains on carried interest units or comparable performance-linked instruments.

1.5 Safeguards and Recharacterisation Risk

The regime includes a series of cumulative conditions designed to prevent abuse. These relate, among other things, to minimum holding periods, the degree of subordination to investor returns and the absence of capital protection. If these conditions are not met, the Luxembourg tax authorities retain the ability to recharacterise the income as employment income, subject to full progressive taxation and potentially social security contributions.

This recharacterisation risk underscores the importance of carefully structuring carried interest arrangements and ensuring consistency between legal documentation, economic reality and operational practice.

1.6 Practical Implications for Fund Managers

With the entry into force of the new regime in 2026, fund managers and sponsors should already be assessing whether their existing carried interest arrangements will fall within the statutory framework. This review should cover fund documentation, carried interest plans and the actual allocation of roles and decision-making functions.

While advance tax confirmations will remain available, their role is expected to evolve. Rather than establishing the basic tax qualification of carried interest, rulings are likely to focus on confirming that a specific arrangement satisfies the conditions laid down by law.

2 Belgium : Carried Interest Tax Regime – (effective as of 29 July 2025)

2.1 From Legal Uncertainty to Legislative Intervention

For many years, Belgium lacked a dedicated tax framework for carried interest. The tax treatment depended on a case-by-case qualification, often oscillating between employment income, miscellaneous income, investment income or, in certain circumstances, even exempt capital gains under the concept of normal management of private assets. This uncertainty resulted in frequent disputes with the tax authorities and inconsistent outcomes across otherwise comparable fund structures.

Against this background, the Belgian legislator introduced a specific statutory regime for carried interest, applicable as from 29 July 2025. The stated objective of the reform is to enhance legal certainty and uniformity, while acknowledging the particular economic features of carried interest as a form of performance-based remuneration that is both uncertain and highly back-loaded.

Unlike Luxembourg, Belgium's approach does not primarily rely on substance requirements or partial exemptions, but instead on a fixed and final tax qualification**.**

2.2 A Statutory Definition of Carried Interest

The new regime introduces, for the first time, a legal definition of "carried interest" into Belgian tax law. In essence, carried interest is defined as the disproportionate share in profits granted to fund managers or other key persons, exceeding the "normal return" that would accrue to an ordinary investor.

The definition explicitly covers:

- profit distributions (including dividends),

- capital gains on carried interest instruments, and
- liquidation or redemption proceeds,

to the extent they exceed the normal investor return. By contrast, income derived from shares acquired through employee stock option plans remains excluded and continues to be governed by the specific tax regime applicable to stock options.

This approach reflects a deliberate attempt to isolate the economic "uplift" linked to performance, rather than taxing the entire return indiscriminately.

2.3 Automatic Qualification as Investment Income

A key feature of the Belgian reform is the absolute qualification of qualifying carried interest as investment income ("*roerend inkomen*"). Where the statutory definition is met, the income is no longer open to recharacterisation as professional income, even if it is clearly linked to the beneficiary's professional activity as a fund manager.

As a result:

- carried interest is taxed at a flat rate of 25%, which is lower than the standard 30% rate applicable to most investment income;
- the tax is generally levied via withholding tax, which is in principle final; and
- the income is exempt from municipal surcharges**.**

Importantly, the legislator explicitly excludes the application of the general anti-recharacterisation provision that would otherwise allow the tax authorities to treat investment income as professional income. This represents a significant shift in favour of legal certainty for fund managers.

2.4 Scope and Beneficiaries

The regime applies where carried interest is received directly by individuals subject to Belgian personal income tax or Belgian non-resident income tax. Where carried interest is received through a management company, the income remains subject to the ordinary rules of corporate income tax, without access to the 25% regime.

The beneficiary must perform activities, directly or indirectly, for the carried interest vehicle or its manager. The notion of "carried interest vehicle" is broadly defined and covers Belgian and foreign alternative investment funds that raise capital from multiple investors and do not qualify as UCITS-type vehicles.

In contrast to the Luxembourg regime, the Belgian framework does not impose explicit holding periods, substance requirements or risk tests as standalone conditions. The focus is instead placed on the legal and economic qualification of the income itself.

2.5 Entry into Force and Transitional Aspects

The new Belgian regime applies to carried interest paid or attributed as from 29 July 2025**,** irrespective of when the underlying entitlement was granted. However, income paid by vehicles that were already in liquidation by that date is excluded.

This timing element means that existing carried interest arrangements may fall within the new regime without requiring structural amendments, provided that the income is realised after the entry into force.

2.6 Practical Observations

From a practical perspective, the Belgian regime offers a high degree of predictability. Once income qualifies as carried interest within the meaning of the law, the applicable tax treatment is fixed and largely immune from recharacterisation risk.

At the same time, the regime is deliberately less generous than some competing European frameworks. There is no partial exemption mechanism, no link to capital gains treatment, and no explicit policy objective to anchor substance or decision-making in Belgium. The reform is best understood as a compromise between competitiveness and the traditional Belgian emphasis on legal classification and tax neutrality.

3 Belgium and Luxembourg Compared: Two Different Policy Choices

While both Belgium and Luxembourg have recently introduced statutory carried interest regimes, the underlying philosophy and practical implications of the two frameworks differ significantly.

Luxembourg's regime is built around economic substance and entrepreneurial risk. Carried interest is treated as investment income benefiting from a partial exemption, but only where strict conditions are met. These conditions focus on long-term alignment with investor performance, genuine subordination, and a clear nexus with Luxembourg in terms of residence and activity. In return for meeting these requirements, beneficiaries benefit from a materially reduced effective tax burden and the exclusion of social security contributions. The Luxembourg framework therefore rewards structures that combine risk-taking, long-term value creation and local substance.

Belgium, by contrast, has opted for legal certainty through fixed qualification. Once income falls within the statutory definition of carried interest, it is automatically taxed as investment income at a flat rate of 25%, without the possibility of recharacterisation as professional income. The regime does not rely on holding periods, substance tests or risk analyses, nor does it aim to influence where fund management activities are performed. This approach significantly reduces controversy and audit risk, but it also results in a less flexible and, in some cases, less favourable effective tax outcome.

From a comparative perspective, Luxembourg offers a more nuanced and potentially more attractive regime, particularly for internationally mobile fund managers willing to anchor substance and decision-making locally. Belgium's regime, on the other hand, prioritises simplicity and predictability, making it well suited for managers already operating in Belgium who value certainty over optimisation.

These differences underline that, despite superficial similarities, the two regimes are not interchangeable. The choice between Belgium and Luxembourg will largely depend on the fund's operational reality, the location of key decision-makers and the relative importance of tax efficiency versus legal certainty.

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