

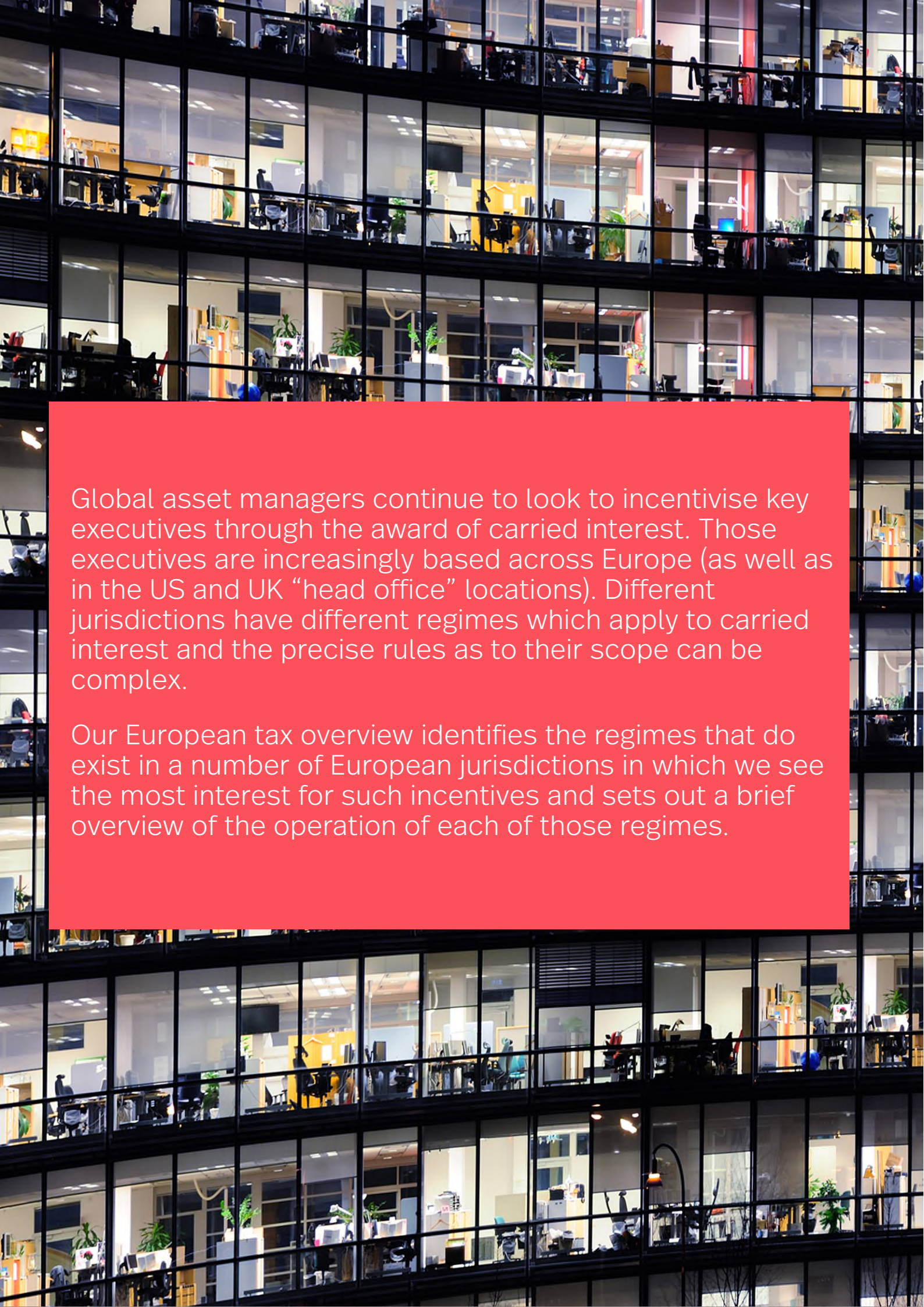
# Carried interest regimes

## A European tax overview

SPRING 2024







Global asset managers continue to look to incentivise key executives through the award of carried interest. Those executives are increasingly based across Europe (as well as in the US and UK “head office” locations). Different jurisdictions have different regimes which apply to carried interest and the precise rules as to their scope can be complex.

Our European tax overview identifies the regimes that do exist in a number of European jurisdictions in which we see the most interest for such incentives and sets out a brief overview of the operation of each of those regimes.

# 1. France

## Special carried interest regime?

Yes

## Applicable rate(s)

Income and capital gains received by French resident individuals are subject to a 30% flat tax, potentially increased to 34%, including an exceptional contribution on high income of a maximum of 4%.

## Regime features

The so-called **Arthuis Regime** is only applicable when certain conditions regarding the Fund issuing the carried interest, the carried interest holders and the carried interest shares are met.

The failure to comply with those requirements triggers the recharacterisation of the income/gains received from the carried interest shares as employment income. This is subject to the progressive income tax rate (up to 45%) as well as application of a potential 30% penalty at the level of the carry holder.

In brief, the issuing vehicle must be a French eligible fund (FPCI, FCPR or a SCR) or other investment entity meeting certain conditions as to their location (European Union, Norway and Lichtenstein) and their investment strategy.

The carried interest holders must be - at the time of acquisition of carried interest shares - employees (or executives subject to the employment tax regime) of the relevant funds, of the management companies or companies providing services to the management companies and receive arm's length compensation for his/her employment contract or corporate mandate.

The carried interest shares must represent a single class of shares and must be subscribed or acquired at a price corresponding to the value of such shares at that time. The total amount of such subscriptions must represent at all-times at least 1% of the total paid-in commitments in the Fund.

Finally, any proceeds derived from the carried interest shares may only be paid to French carried interest holders no earlier than five years after the date of the setting-up of the fund (FPCI) and in the case of other investment entities, at least five years after the date the carried interest shares were issued.

## Treatment of "phantom" carried interest alternative

If the conditions for the Arthuis Regime are not met, any income or gain payable out of the carried interest shares would be taxed as employment income (subject to progressive income tax at the maximum rate of 45% plus an exceptional contribution on high revenue at the rate of 4% maximum).

Moreover, in this case, a specific social contribution of 30% will apply and be due from the individuals only, leading to a maximum effective rate of 79%.

## 2. Germany

### Special carried interest regime?

Yes

### Applicable rate(s)

If the requirements of the special carried interest regime are met, the carried interest will be treated as income from self-employment such that the individual personal tax rate (up to 45% plus solidarity surcharge and church tax, if applicable) of the respective (private individual) executive will be applied only on 60% of the carried interest (i.e. 40% of the carried interest is tax exempt (partial income system)).

If the requirements of the special carried interest regime are not met, carried interest will, according to the view of the tax administration, generally be fully taxed as employment income.

However, according to recent case law involving funds in the form of commercial partnerships, carried interest may be subject to the so called partial income system under which such income may be 40% tax exempt to the extent it is allocable to dividends or capital gains realised upon the disposal of equity of the fund.

### Regime features

The special carried interest regime applies if:

- The executive has a participation in a vehicle that qualifies as an asset managing partnership; (*vermögensverwaltende Personengesellschaft*) and not as a commercial or a commercially tainted partnership.
- The purpose of the partnership must be the acquisition, holding and disposal of equities in companies.
- The executive must be remunerated for promoting the purpose of the partnership.
- Payment of the carried interest must be conditional on the other investors (limited partners) in the fund first fully having their capital contributions repaid.

### Treatment of “phantom” carried interest alternative

Taxed as income (employment income if paid by employer to employee), usually at time of payment rather than award.

Based on our understanding that in the case of “phantom” carried interest the executive will not hold an interest in any partnership but simply has a contractual claim for remuneration (i.e. the carried interest arrangement in a partnership is just replicated), the special carried interest regime should not be applicable (as no participation in an asset managing partnership is held by the executive).

Therefore, “phantom” carried interest should generally be treated as employment income (if paid by the employer) and should be taxed fully at the individual tax rate of the (private individual) executive.



### 3. Italy

#### Special carried interest regime?

Yes

#### Applicable rate(s)

Carried interest paid to executives and managers is taxed as financial income, as follows:

- 26% final withholding tax applies to carried interest paid in the form dividends.
- 26% capital gain tax applies to carried interest arising upon a disposal of shares.

If carried interest is indirectly received by executives and/or managers through a non-commercial partnership, the tax consequences referred to above still apply.

#### Regime features

Carried interest payments are taxed as financial income by presumption of law rather than as employment income (subject to IRPEF at progressive rates ranging from 23% to 43% plus surtaxes), if all the following three conditions are met:

1. The aggregate investment made by the carried interest holder is at least equal to 1% of the total invested capital ("Minimum Investment Condition").
2. The carried interest accrues after the ordinary investors have received an amount at least equal to their invested capital plus a minimum rate of return (hurdle rate) ("Deferment Condition").
3. The carried interest rights are held for at least a five years period or, if earlier, until the occurrence of a change of control ("Minimum Holding Period Condition").

However, if one or more of the above conditions is not met, this does not automatically result in the carried interest being treated as employment income for the recipient. Rather, it requires an in-depth case-by-case analysis of the terms and conditions governing the carried interest arrangements in order to assess whether the purpose of the Italian carried interest legislation is respected (i.e. to align the interests and objectives of investors and managers).

#### Treatment of "phantom" carried interest alternative

Phantom plans are not envisaged in the special carried interest regime. In that case, the remuneration derived from that plan would likely be taxed as general employment income (subject to progressive rates ranging from 23% to 43% plus surtaxes).

## 4. Ireland

### Special carried interest regime?

Yes

### Applicable rate(s)

- 12.5% capital gains tax rate for companies.
- 15% capital gain tax rate for individuals or partnerships.

### Regime features

There is a statutory definition of “carried interest”, and there are a number of conditions that must be met for the 12.5%/15% rates to apply.

The regime applies only for “qualifying venture capital funds” (“QVC Funds”). QVC Funds must meet the following qualifying conditions:

1. They must be structured as a partnership.
2. They must be established for the purposes of making long term (3+ years) investments in “Relevant Investments”, which is statutorily defined as “unquoted shares and securities of private trading companies that carry on research and development activities” or “the development of new technological, telecommunication, scientific or business processes”.
3. The partners (including the general partner) must be obliged under a legally binding agreement to provide capital sums for investment purposes over a period of time.

The regime only applies to the proportion of carried interest that derives from Relevant Investments in EEA states (including Ireland) and the United Kingdom. The carried interest also must not exceed 20% of the total profits of the QVC Fund.

## 4. Ireland

### Treatment of “phantom” carried interest alternative

“Phantom” carried interest alternative is taxed as income, with the rate of charge depending on the entity receiving the income and the circumstances in which the income is received. Accordingly, “phantom” carried interest alternative may be considered:

- Employment income if paid by an employer to an employee.
- Trading income if arising in the course of a trade.
- Passive income in all other cases.

The corporation tax rate that applies to passive income received by companies is currently 25%. A reduced rate of 12.5% applies to company trading income.

Ireland has a progressive taxation system for individuals. The highest marginal rate of income tax, USC and PRSI is:

- 52% for PAYE income and non-PAYE income that is less than €100,000 per annum.
- 55% for non-PAYE income greater than €100,000 per annum.



## 5. Luxembourg

### Special carried interest regime?

Yes

### Applicable rate(s)

- Luxembourg tax law provides for the special treatment of remuneration structured as a return on the units in the carry-vehicle provided that any gains are realised at least 6 months after acquisition of the units. Where the unitholder holds less than a 10% stake in the carry vehicle, the gains are not subject to tax. Otherwise, the gains are subject to tax at 22.89% (half the progressive rate). Any other performance-based remuneration will be treated as speculative income in the hands of the individual and subject to tax at the progressive rates (up to 45.78%). This includes cases where gains are made on units in a carry vehicle within 6 months of acquisition of the units.
- Carried interest holders that elected to be domiciled in Luxembourg before the end 2018 may benefit from a preferential regime for a period of 11 years and be subject to a reduced tax rate of roughly 10%. This regime was temporary.

### Regime features

- In order to fall within the carried interest regime, the carried interest rights, which the entity grants in recognition of the competencies and qualities of the individual as well as the performance of the investments, must be subject to the express condition that the shareholders or other interest holders have already recovered the funds they invested in the AIF or in the underlying assets.
- If the remuneration is derived from units in opaque Luxembourg funds, then the regime applicable to capital gains taxation should apply.

### Treatment of “phantom” carried interest alternative

Phantom plans are not covered by the special carried interest regime. Therefore, remuneration derived from phantom plans would likely be taxed as general employment income (subject to standard tax rates up to 45% and 54% depending on the Spanish region), with no tax reduction.



## 6. Netherlands

### Special carried interest regime?

Yes

### Applicable rate(s)

(Progressive rates up to) 49.5% on distributions and capital gains derived directly from carried interest (box 1 taxation; rates for 2024).

(Upon election of the taxpayer) 24.5% for taxable income up to EUR 67,000 and 33% for taxable income exceeding EUR 67,000 if the carried interest is structured properly through a management company and that company distributes at least 95% of all income derived from the carried interest during a tax year as a dividend to the manager within that same tax year (box 2 taxation; rates for 2024).

### Regime features

Statutory rules embedded in the Dutch Personal Income Tax Act. Where a management holding company is used, each manager needs to hold an interest of at least 5% of (a class of) shares in order to be able to elect for box 2 taxation. In addition, in order to ensure no corporate income tax leakage at the level of the management holding company, such company needs to hold an interest of at least 5% of the nominal paid-up capital of the portfolio company (to apply the participation exemption).

### Treatment of “phantom” carried interest alternative

Treated as regular income from employment. Upon receipt subject to personal income tax at progressive tax rates up to 49.5% (box 1 taxation; rates for 2024).

## 7. Spain

### Special carried interest regime?

Yes

### Applicable rate(s)

Taxed as employment income, either at:

- Reduced effective rates between 22.5% and 27% for “Qualifying Schemes” (aligned with capital gains tax rates and derived from applying a 50% reduction to the taxable income from carried interest); or at
- Standard highest marginal rates between 45% and 54% for non-qualifying schemes.

In both cases the actual tax rates depend on the Spanish region (Autonomous Community) where the individual resides.

### Regime features

Qualifying Schemes require that the following conditions are met:

1. The carried interest must be derived directly or indirectly from (a) closed-ended Alternative Investment Funds as defined in Directive 2011/61/EU, including the following categories: i) entities regulated under article 3 of Act 22/2014 (i.e. venture capital funds and companies), ii) European venture capital funds, iii) European social entrepreneurship funds, iv) European long-term investment funds; or (b) investment entities similar to these funds.
2. The recipient must be a director, manager or employee of the relevant fund, of the management company, or companies in its group.
3. The special rights of the carry shares must be conditional on the investors obtaining a minimum guaranteed return defined in the regulations or articles of the fund and they must be held for at least five years (subject to certain exceptions, such as an early liquidation). It should be noted that advance payments of carried interest are also eligible for the regime to the extent that the five-year holding period for the carry shares is met in due course.
4. These rights must not derive directly or indirectly from an entity resident in a blacklisted jurisdiction.

### Treatment of “phantom” carried interest alternative

The regime has only been in force since 1 January 2023 and there is, as yet very limited guidance. However, the Spanish Tax Authorities have accepted that bonuses linked to an eligible carried interest scheme may also benefit from the special regime. Hence, remuneration schemes, including potentially phantom plans, that are designed in a way such that the payment event is linked to the payment of eligible carried interest, may be able to access the special regime. Individual tax advice based on the specific circumstances would be required.

## 8. United Kingdom

### Special carried interest regime?

Yes

### Applicable rate(s)

- 28% capital gains tax rate (with remittance basis potentially available for non-doms).
- 45% rate if carried interest is “income-based” carried interest.

These rates overlay “normal” tax rules (so if carried interest is paid in the form of a dividend, it will effectively be taxed at 39.35% dividend rate as this is higher than 28% carried interest rate).

### Regime features

- Based on memorandum of understanding with UK tax authorities.
- Statutory definition of “carried interest”.
- Income-based carried interest rules apply in different ways to different types of strategies.
- Relies on tax transparent fund structure.

### Treatment of “phantom” carried interest alternative

Taxed as income (employment income if paid by employer to employee, trading income if paid by LLP to member), usually at time of payment rather than award.



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