



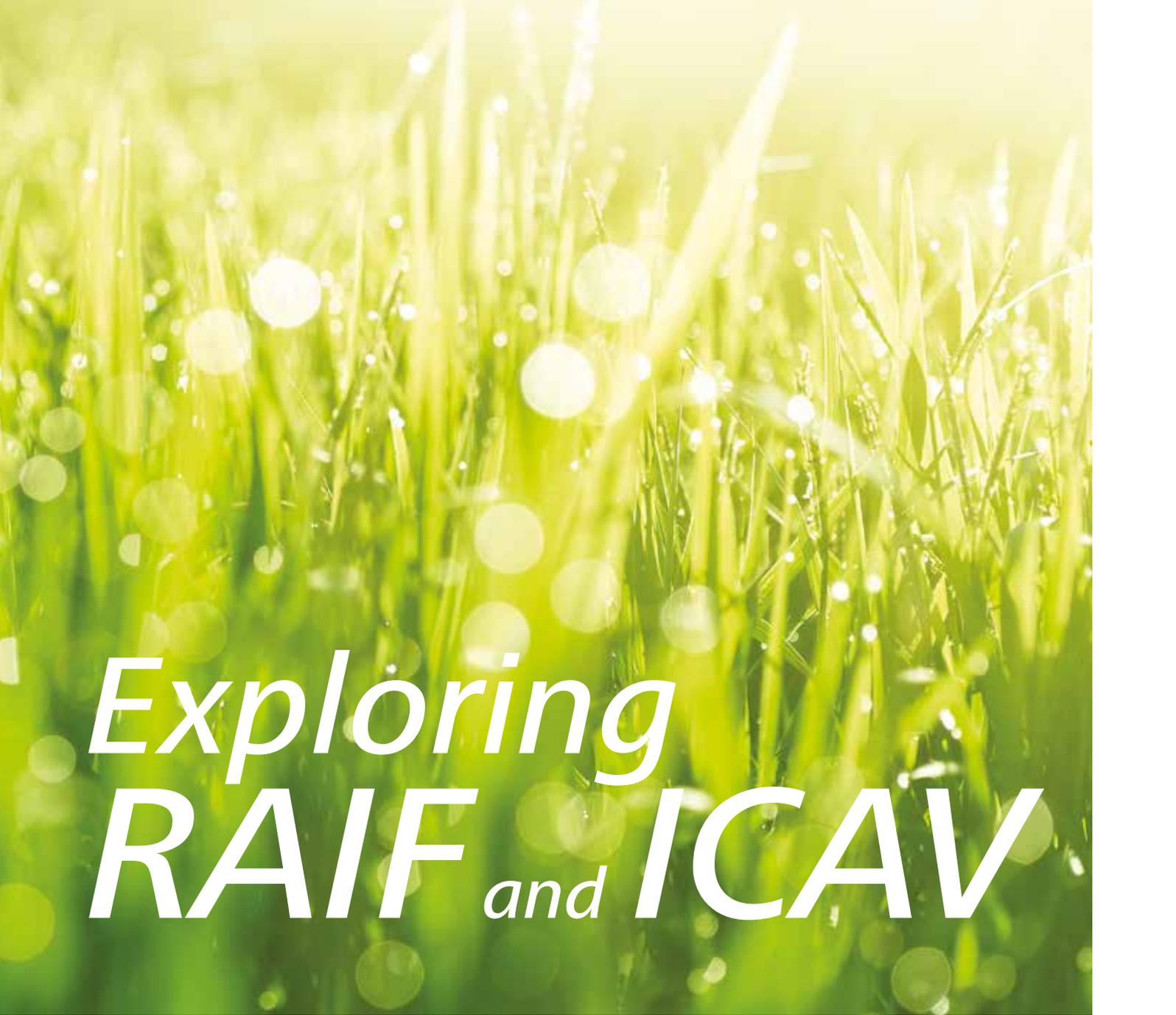
# NEW ALTERNATIVE INVESTMENT VEHICLES RISING

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The alternative investment fund industry has had to face several changes over the last few years in terms of regulation (e.g. the EU Alternative Investment Fund Directive) and tax (e.g. the OECD Base Erosion Profit Shifting reports and recent EU developments). Luxembourg and Ireland have been actively trying to provide alternative asset managers with answers to some of these challenges.



# Exploring RAIF *and* ICAV

## The upcoming Luxembourg Reserve Alternative Investment Fund

The Luxembourg Reserved Alternative Investment Fund (RAIF) is the newest type of vehicle proposed by the Luxembourg government at the end of last year. This new draft law is expected to be adopted by the parliament (subject to amendments) before the end of the second quarter 2016.

### Why a new regime?

Luxembourg already offers several opportunities and investment fund regimes to asset managers. However, current regulations in the EU and Luxembourg require both the Alternative Investment Fund Manager (AIFM)

and the fund vehicle (a Luxembourg Specialized Investment Fund<sup>1</sup> or a Luxembourg venture capital fund<sup>2</sup>) to be authorized and supervised by a regulatory body—namely the CSSF in Luxembourg.

Such an overlapping of a regulatory framework at the product and manager levels has previously weakened the position of Luxembourg compared to offshore fund regimes notably due to time-to-market issues.

The new RAIF regime proposes to extend all the existing benefits associated with the SIF or SICAR regimes without the corresponding constraints. The RAIF will not be approved and supervised by the CSSF; the supervision will only be indirect since the RAIF must appoint an authorized AIFM as manager.

<sup>1</sup> Law dated 13 February 2007 on Specialized Investment Funds (SIF).

<sup>2</sup> Law dated 15 June 2004 on Société d'Investissement à Capital Risque (SICAR).

AIFMs will now have the ability to choose to set up their Luxembourg Alternative Investment Fund (AIF) vehicle as either a regulated fund<sup>3</sup> or an unregulated fund under the RAIF regime. It will mainly depend on whether the potential investors need the AIF vehicle to be regulated.

### Main features

The industry will benefit from the following (main) features:

- There will not be any CSSF supervision of the vehicle and hence only a few days will be sufficient for setup. As indicated above, the RAIF should appoint an AIFM as manager
- The eligible investors are institutional, professional, and well-informed investors<sup>4</sup> similar to the SIF or SICAR regime
- The RAIF could be set up as a mutual fund,<sup>5</sup> a SICAV,<sup>6</sup> or under a legal regime that is neither an FCP nor a SICAV, thus offering a wide range of possibilities. In all cases, it will be possible to implement compartments to segregate investors or investment policies
- A fixed or variable capital will be permissible
- There should not be any limitations in eligible assets and the diversification ratios should apply in principle. If a RAIF restricts its investment policy in its constitutive documents to investment in risk capital, it should not be required to operate under the principles of risk spreading

It should also be noted that the central administration and the depositary function should be established in Luxembourg. In addition, the RAIF will need to appoint an independent auditor emphasizing the key role this stakeholder has in monitoring the fund structure.

### Tax regime

The main objective of the Luxembourg government was to propose a tax neutral vehicle which would allow fund managers to accommodate investments and/or investors' tax needs or constraints.

*1. By default, the full SIF tax regime would be applicable.*

The RAIF will be fully exempt from Corporate Income Tax (CIT), Municipal Business Tax (MBT), and Net Wealth Tax (NWT). Being exempt, the access to double tax treaties should be confirmed on a case-by-case basis. Tax transparency will also apply to RAIF setup as mutual funds or as limited partnerships.<sup>7</sup> In both cases, a 0.01 percent subscription tax will apply to the vehicle with certain exemptions available. Furthermore, there will not be any withholding tax on distributions and the Luxembourg non-resident speculative gain taxation rules will not apply.

*2. Alternatively, the RAIF would be subject to the SICAR tax regime in case it is investing in risk capital assets.*

The RAIF will then be subject to CIT and MBT but any income from transferable securities and temporary investments would be eligible for an exemption (i.e. in practice, no tax pick-up on dividends, liquidation proceeds, and capital gains). Being subject to tax, the RAIF should in principle have access to double tax treaties, although this is subject to confirmation on a case-by-case basis. Net Wealth Tax will not apply.<sup>8</sup> Tax transparency will also apply to RAIF setup as limited partnerships.<sup>9</sup> Furthermore, there will not be any withholding tax on distributions and the Luxembourg non-resident speculative gain taxation rules will not apply.

<sup>3</sup> Undertaking for Collective Investments governed by Part II of the Law dated 17 December 2010, SIFs or SICARs.

<sup>4</sup> Investors who confirm in writing that they adhere to the status of "well-informed" investors and who either (i) invest a minimum of €125,000 or (ii) have been assessed by a credit institution, an investment firm, or a management company which certifies the investors' ability to understand the risks associated with investing in the SIF.

<sup>5</sup> Fond Commun de Placement.

<sup>6</sup> Société d'Investissement à Capital Variable, also known as société anonyme, société en commandite simple, société en commandite spéciale, société en commandite par actions, société à responsabilité limitée or société coopérative organisée sous forme de société anonyme.

<sup>7</sup> Société en commandite simple or société en commandite spéciale.

<sup>8</sup> Saved for the minimum NWT.

<sup>9</sup> Société en commandite simple or société en commandite spéciale.



It will accordingly be possible to set up the RAIF as a tax transparent vehicle to accommodate source country tax considerations or be able to rely on the tax profile of the ultimate investors. It should also be eligible to the US's "check-the-box" election which would allow the vehicle to be disregarded for US federal income tax purposes. This would provide certain tax benefits to US investors and increase the efficiency of the structure from their standpoint.

VAT is generally a key factor when deciding on the location of the fund, especially in comparison to offshore funds. It has been confirmed that the fees paid in consideration of the management of the fund vehicle would be eligible for the Luxembourg VAT exemption, both if the RAIF opts for the SIF tax regime or opts for the SICAR tax regime.

#### Creating your RAIF

There will be various ways to set up a RAIF, including from scratch (in case this is a new fund structure), through the conversion of an existing foreign or Luxembourg vehicle, or through the migration of an offshore fund to Luxembourg. In the two latter cases,

potential foreign tax implications should be analyzed on a case-by-case basis (e.g. a migration could be a taxable event for a given foreign investor or for capital gain tax purposes in one source country) although this would probably be fully tax neutral from a Luxembourg tax standpoint.

We expect this vehicle to be widely used by AIFMs, given the regulatory and tax benefits offered but also considering the current global tax environment post-BEPS.

The model whereby the AIF vehicle (as a RAIF), the various special purposes vehicles, and possibly the AIFM are located in the same jurisdiction should reduce risks and make the structure more robust from a BEPS and a foreign tax perspective. There is indeed a clear convergence between tax and regulation which favors the single investment fund platform strategy.

Alternatively, AIFMs would use tax transparent AIFs, which the RAIF regime allows, in order to be able to rely on the tax profile of the ultimate investors and directly apply double tax treaties with source countries.

## The Irish Collective Asset-management Vehicle

The Irish Collective Asset-management Vehicle (ICAV) is the newest type of regulated Irish fund vehicle, introduced into Irish legislation in March 2015. The ICAV offers many benefits to investors and promoters including enhanced distribution and a simplified compliance model. The indications are that there has already been significant activity in the ICAV market; with expectations that this will continue, ICAVs are set to become the corporate vehicle of choice for new fund setups in Ireland.

Ireland already offers several vehicles for fund structuring purposes which have been the bedrock of Ireland's hugely successful fund industry to date. The ICAV is Ireland's first tailor-made corporate fund vehicle, designed specifically to offer the most attractive features of each of the existing structures into one. The new ICAV structure runs parallel to, rather than replaces, existing fund structures. Some of the key benefits of an ICAV include:

- The ICAV is eligible for the US "check-the-box" election
- Financial statements can be prepared on a sub-fund basis
- The requirement for an AGM can be dispensed
- Risk spreading is not required
- Amendments to the ICAV's constitutional documents are possible without shareholder approval
- The ICAV has a streamlined incorporation and authorization process, with both steps carried out simultaneously by the Central Bank of Ireland (CBI)

The ICAV may be established as a UCITS or an AIF and will have the standard features of existing Irish fund structure, such as the ability to establish an umbrella, sub-funds, and share classes, and the benefit of segregated liability between sub-funds. There is also significant flexibility concerning the type of assets in which an ICAV can invest, meaning it is quickly becoming the Irish investment vehicle of choice for new product launches.

The ICAV benefits from standalone fund legislation (Irish Collective Asset-management Vehicles Act 2015) outside the scope of European and Irish company legislation. This protects it from future company law changes, making it immune to amendments that these regimes intended for trading companies, which could have caused unintended consequences for investment funds. However, like other corporate entities, the ICAV has a board of directors and company secretary and can be listed on the stock exchange.

Existing Variable Capital Companies (VCCs) have the option of converting to an ICAV, where existing unit trusts, Common Contractual Funds, and Investment Limited Partnerships can merge with the newly created ICAV. There is also a simplified, one-step re-domiciliation and migration process available for foreign funds looking to convert their fund to an ICAV. However, before a conversion or re-domiciliation is undertaken, a cost-benefit analysis is advisable to determine whether the potential savings would justify the costs of conversion.

### Tax Considerations of the ICAV

From an Irish tax perspective, the ICAV is treated as an investment undertaking under Part 27 of the Taxes Consolidation Act 1997. The ICAV will be treated exactly the same as a VCC from an Irish tax perspective (i.e. it is effectively not subject to tax in Ireland on its income or gains, and Irish tax only arises for the fund in the occurrence of certain chargeable events where the investors are resident in Ireland or the appropriate investor declarations are not in place). However, there are a number of tax considerations, both in setting up an ICAV and in converting an existing fund structure to an ICAV.

As with setting up any Irish fund, consideration should be given to matters such as:

- The appropriate tax registrations (e.g. IUT, VAT, payroll, FATCA)
- The appropriate non-residency declarations/exempt Irish investor declarations
- Investment considerations around withholding tax and capital gains tax
- Reporting requirements, such as FATCA, returns under S891C TCA 1997, and the Common Reporting Standard (CRS)
- Availability of treaty access for the ICAV
- Foreign withholding tax reclaims
- Foreign tax reporting requirements

#### **Check-the-box election**

One of the key benefits of the ICAV is the eligibility of the ICAV for the US “check-the-box” election. This election allows a fund to be treated as a transparent entity for US federal income tax purposes. This means that any US investor is placed in the same tax position as if they had invested directly in the underlying investments of the ICAV. This status makes the ICAV particularly attractive for US investors seeking tax efficient returns from a regulated corporate fund vehicle.

It is worth noting that this election applies for US investors only and the ICAV would continue to be treated as opaque for investors resident in other jurisdictions. Where an ICAV intends to “check the box” for US tax purposes, US tax advisers will need to review the proposed ICAV structure to ensure that any sub-funds are suitable for the “check-the-box” election and meet the US tax objectives of the fund. One should also consider if there are any adverse US tax consequences of exercising the right to “check the box,” especially for non-US investors in the fund. Finally, “checking the box” may give rise to reporting requirements and the ICAV should ensure that they have a service provider able to provide such reporting.

#### **Converting to an ICAV**

Existing VCCs have the option to convert to an ICAV, and overseas investment companies have the option of redomiciling to Ireland as an ICAV. Conversion is also available for corporate AIFs and corporate UCITS. The conversion or migration by continuation enables a fund to maintain its track record by changing the seat of incorporation rather than starting anew.

With regard to other jurisdictions, a fund considering converting to an ICAV needs to consider the implications in all jurisdictions where investors are resident and also where its investments are held. For example, while there would be no adverse Irish tax implications from converting an existing fund to an ICAV, the fund would need to consider if there is any risk that the tax authorities in the other jurisdiction would regard it as a disposal and re-acquisition of the units in the fund or the investments held by the fund, perhaps giving rise to capital gains tax risks or reporting/tax return requirements.

#### **Uptake of the ICAV**

As of 31 December 2015, there were 129 ICAVs registered with the CBI, including at least eight funds converted from existing Irish PLC funds to ICAVs. It is expected that this activity in the ICAV market will continue and that the ICAV will become the corporate vehicle of choice for new fund setups.

#### **Conclusion**

The alternative investment fund industry has had to adapt its business model and structures to the various tax and regulatory changes over the last couple of months or years. Luxembourg and Ireland have proven to remain highly attractive compared to offshore fund regimes by making flexible fund regimes available to fund managers, which could also accommodate foreign tax considerations.