PANORAMIC

PRIVATE EQUITY (FUND FORMATION) 2024

Contributing Editor

Atif Azher

Simpson Thacher & Bartlett LLP

LEXOLOGY

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Quick reference guide enabling side-by-side comparison of local insights, including into choice of vehicle and formation process; regulation, licensing and registration; taxation; selling and investor restrictions; money laundering rules; listing considerations; participation in private equity transactions; compensation and profit-sharing issues; and recent trends.

Generated on: March 12, 2024

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USA

Peter H Gilman, **Jessica A O'Connell**, **Russell Reed**, **Henry Litwhiler**
Simpson Thacher & Bartlett LLP

Austria

Clemens Philipp Schindler , **Martin Abram**
Schindler Attorneys

Summary

FORMATION

Forms of vehicle

1 What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The main vehicles used for private equity funds in Austria are limited partnerships (LPs), typically with a corporation (limited liability company (LLC) or joint-stock company (JSC)) as the general partner. Each of the aforementioned types of entity has a separate legal personality, but partnerships are transparent for tax purposes.

Limited partnerships

Typically, investors become limited partners in an LP. The general partner is usually a limited liability company that receives a fee for assuming unlimited liability. In some structures, the general partner manages the partnership; in other structures, the partnership is managed by a separate management company, which is usually an LLC. As private equity funds in most cases fall under the Alternative Investment Manager Act (AIFMG), the entity managing the fund must be a legal person who is licensed or registered as an alternative investment fund manager (AIFM) under the AIFMG.

Corporations

Investors become shareholders in an LLC or a JSC. An LLC is managed by a managing director, a JSC by a managing board. JSCs (as opposed to LLCs) are required by law to also have a supervisory board. Managing directors, as well as members of the managing board, have to be natural persons. However, as with LPs, corporations can outsource management functions to a management company, which in most cases needs to be licensed or registered as an AIFM under the AIFMG.

In the past, sponsors also structured vehicles in the form of LLCs or JSCs as a medium-sized business financing company (MFG) under the Corporate Income Tax Act (KStG), as this gave rise to several tax benefits. MFGs had to fulfil certain requirements, such as higher capitalisation, participation of public bodies and certain investment restrictions. As those tax benefits no longer apply for vehicles founded after 2012, and ceased to apply in respect of participations held by existing MFGs (founded before 2012) by the end of 2015 (in special circumstances, by the end of 2018), the importance of the MFG has decreased significantly. The tax benefits for MFGs were reintroduced in 2017; however, only to a limited extent. In particular, the tax benefits only apply for minority investments in early-stage enterprises.

Law stated - 13 February 2024

Forming a private equity fund vehicle

2 | What is the process for forming a private equity fund vehicle in your jurisdiction?

All of the aforementioned private equity fund vehicles need to be incorporated in compliance with Austrian corporate law. This requires the adoption of the articles of association or the conclusion of a partnership agreement, the appointment of management and the submission by the founders of an application for registration of the vehicle with the Companies Register. Austrian law has minimum share capital requirements for LLCs (€35,000 or €10,000 in the case of a privileged incorporation) and JSCs (€70,000). There are generally no minimum capital requirements for newly incorporated partnerships. The incorporation process generally takes between two and four weeks.

Most private equity funds qualify as alternative investment funds (AIFs) under the AIFMG, which implemented Directive 2011/61/EU on alternative investment fund managers. An AIF is defined as a collective investment undertaking that raises capital from a number of investors to invest it in accordance with a defined investment policy for the benefit of those investors and which does not use the capital for a direct operational purpose. In addition to the corporate law requirements, the formation of an AIF requires the prior approval of the Austrian Financial Market Authority (FMA) if the fund is managed by a licensed AIFM, or the registration of the fund with the FMA if the fund is managed by a registered AIFM.

Regulation 345/2013/EU on European venture capital funds (as amended) (the EuVECA Regulation) was introduced to create a new pan-European designation for small AIFMs, the European Venture Capital Fund (EuVECA). Austrian-based AIFMs may register an AIF as a EuVECA provided that they comply with the EuVECA Regulation and have supplied certain information with regard to themselves and the relevant AIF to the FMA. The main advantage the AIFM gains by doing so is the option to market the relevant AIF throughout the European Union under the EuVECA designation to certain categories of investors defined in the EuVECA Regulation under an EU-wide passporting regime. Passporting allows a firm authorised under an EU single market directive to market the designated fund to certain qualified investors in another EU member state, on the basis of its home-state authorisation.

Regulation 760/2015/EU on European long-term investment funds (the ELTIF Regulation) was introduced in November 2015 to channel capital raised through AIFs towards European long-term investments (ELTIFs) in the real economy. An Austrian-based AIFM that received approval to manage ELTIFs may register an EU-based AIF (or a compartment thereof) as an ELTIF provided they comply with the authorisation requirements set forth in the ELTIF Regulation and submit an application to the FMA. The main advantage of such registration is the option to market the relevant AIF throughout the European Union under an EU-wide passporting regime similar to the regime under the EuVECA Regulation. Additionally, the designation of an AIF as an ELTIF allows its marketing to high net-worth individuals throughout the European Union.

Both the EuVECA Regulation and the ELTIF Regulation are not compulsory; if an AIFM does not want to use the EuVECA or the ELTIF designation, then it does not have to comply with the EuVECA Regulation or, as the case may be, the ELTIF Regulation for a particular fund (or at all). If the AIFM chooses not to use the EuVECA or the ELTIF designation, national laws and EU regulations apply, such as national private placement regimes.

Law stated - 13 February 2024

Requirements

3 Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

Austrian private equity fund vehicles have to be registered in the Companies Register and have to maintain a registered office in Austria. They are required by law to keep books and records. There is no requirement under Austrian law for a private equity fund vehicle to have a corporate secretary.

Most private equity funds fall under the AIFMG, which requires the AIFM to appoint a custodian for each AIF it manages. Either a bank or a securities services provider with its seat in the European Union can serve as the custodian. AIFs with the investment objective of acquiring control of non-listed companies can also utilise escrow agents (usually, public notaries or attorneys-at-law) as custodians.

Law stated - 13 February 2024

Access to information

4 What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

As a private equity fund vehicle is typically registered with the Companies Register, certain information about the vehicle is a matter of public record. Besides general information available for all types of vehicles (eg, registered office and authorised signatories), the level of information varies depending on the legal form. For LPs and LLCs (but not JSCs), the names of the investors and their shares are published in the Companies Register (note that in relation to LPs only a fixed liability amount (ie, the liability contribution) must be disclosed, which is usually entirely unrelated to the actual investment and can be as low as, eg, €1). LLCs and JSCs (but not LPs) also have to file their articles of association with the Companies Register, which can therefore be accessed by the public. As a consequence, vehicles structured as JSCs or LLCs typically have shareholder agreements (which need not be filed and thus are not public) besides the articles of association, to avoid public access to sensitive topics. Also, the annual financial statements (with varying levels of detail depending on the company type and size) have to be filed with, and can be inspected at, the Companies Register. Finally, each Austrian corporation or partnership is required to disclose its ultimate beneficial owners (eg, individuals holding 25 per cent or more in the entity) to the Beneficial Owners' Register, which can be publicly accessed (albeit with limited information disclosed).

In addition, if the vehicle qualifies as an AIF, the AIFM is subject to the publication requirements of the AIFMG. The AIFMG requires the submission of reports by the AIFM to investors (primarily, an annual report) and regulators (primarily, an annual report and monthly list of the AIFs under management). The AIFMG also contains specific reporting obligations for (private equity) AIFs (ie, AIFs aimed at acquiring control over non-listed companies other than SMEs and real estate special purpose vehicles). For such AIFs, the manager has to report any transaction, pursuant to which the stake of the AIF in a target company reaches, exceeds or falls below 10, 20, 30, 50 or 75 per cent, to the target company, any known shareholders of the target company and the FMA.

Law stated - 13 February 2024

Limited liability for third-party investors

5 In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Investors in vehicles structured as LLCs and JSCs will only be liable for the portion of the share capital attributable to their respective shares (plus any additional predetermined contributions) as provided for in the articles of association). Austrian law does allow for the 'corporate veil' to be pierced only under specific circumstances (eg, the actual management of the fund by an investor).

For LPs, the liability of the limited partners is limited by the 'liability contribution', as published in the Companies Register, which usually is a nominal amount and thus substantially lower than the contributed equity. Similar to a corporation, investors in LPs will be fully liable, however, if they actually manage the LP.

Law stated - 13 February 2024

Fund manager's fiduciary duties

6 What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Managers of Austrian private equity funds are typically general partners of an LP or fulfil their function based on management agreements with the fund vehicle. Thus, the scope of the managers' duties and the extent of their liability as regards the private equity fund are based on the provisions of the partnership agreement or, as the case may be, the management agreement.

As most private equity funds qualify as AIFs, the fiduciary duties as set forth in the AIFMG also apply, which require the manager, inter alia, to:

- act in the best interests of the AIF, the investors in such AIF and the integrity of the market;
- introduce appropriate procedures to deal with conflicts of interest;
- treat the investors in an AIF fairly; and
- use the required diligence in the performance of his or her duties.

Unless the private equity fund is an AIF, it is possible to limit the liability of the fund manager as regards the investors or, respectively, the fund vehicle by contractual provisions (eg, excluding the liability for ordinary negligence). However, such contractual provision would still be subject to judicial review.

Law stated - 13 February 2024

Gross negligence

7 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Austrian law differentiates between gross negligence and ordinary negligence. It is principally possible to exclude the liability of the manager for ordinary negligence in the partnership agreement (if the fund vehicle is an LP) or the services agreement (if the manager acts on the basis of a services agreement), unless the fund is an AIF.

Law stated - 13 February 2024

Other special issues or requirements

8 Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

There are various restrictions or issues of that type depending on the legal form of the vehicle and on whether it was set up as an AIF. By way of example, an Austrian AIF – unless qualified as a EuVECA or ELTIF – is only open to qualified investors. For Austrian fund vehicles, the articles of association or partnership agreement can contain restrictions on the transferability of shares or partnership interests or the expulsion of shareholders or limited partners. Also, the partnership agreement typically provides for a set procedure to remove the general partner.

Limited partnerships formed in other jurisdictions can, in principle, be converted into Austrian limited partnerships. Foreign private equity funds incorporated as corporations within the European Union can be transferred to Austria through either a cross-border merger or a migration. While the prior statements related to relocating the vehicles as such, sometimes only the place of effective management is transferred to Austria.

Law stated - 13 February 2024

Fund sponsor bankruptcy or change of control

9 With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Austrian law does not require private equity funds to have an institutional sponsor. Provided that an institutional sponsor does not fulfil any function related to the operation of the private equity funds (eg, custodian for an AIF), the bankruptcy of, or change of control in, the sponsor does not have any legal or regulatory consequences for the private equity fund. Any Austrian private equity fund associated with a certain institutional sponsor (which can be observed frequently) would face a reputational impact if such sponsor had to file for bankruptcy.

Law stated - 13 February 2024

REGULATION, LICENSING AND REGISTRATION

Principal regulatory bodies

10 What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

Private equity funds established as alternative investment funds (AIFs) and their managers are subject to ongoing supervision by the Austrian Financial Market Authority (FMA). The FMA has a wide range of inspection and audit rights both with respect to the alternative investment fund manager (AIFM) and the respective AIF.

Private equity funds that are not AIFs are not subject to designated ongoing regulatory supervision (except by the competent tax office). For such private equity funds, investors only benefit from the information rights set forth in the articles of association or partnership agreement of the fund vehicle and the reporting obligations under accounting and corporate law (mainly, the disclosure of the annual financial statements).

Law stated - 13 February 2024

Governmental requirements

11 What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Private equity funds established as AIFs and managed by a registered AIFM need to be registered with the FMA. Private equity funds established as AIFs and managed by a licensed AIFM need to be approved by the FMA. Special registration requirements apply to AIFs designated as European Venture Capital Funds or European long-term investment funds.

Private equity funds not established as AIFs require no special registration, except for the registration with the Companies Register upon incorporation. Additionally, the ultimate beneficial owners (if any) have to be notified to the Beneficial Owners' Register.

Law stated - 13 February 2024

Registration of investment adviser

12 Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Private equity funds established as AIFs need to be managed by an AIFM. Austrian law distinguishes between AIFMs, which require licensing by the FMA, and AIFMs, which only have to register with the FMA. Licensed AIFMs do not need any additional licences for their management activities for the fund. Registered AIFMs may require a trade permit for asset managers. Special registration requirements apply for managers of European long-term investment funds (ELTIFs).

Different licensing requirements apply for the promotion of interests in the funds.

Investment advisers typically require a MiFID (Markets in Financial Instruments Directive) licence, unless they are solely providing 'corporate finance advice' as further defined in the (still applicable) Committee of European Securities Regulators guidelines, in which case they would still require a trade licence, if they are providing those services in Austria.

Law stated - 13 February 2024

Fund manager requirements

13 Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

Austria-based AIFMs generally require a licence from the FMA. There is a de minimis exception for managers of small AIFs with assets of less than €100 million (where leverage is used) or less than €500 million (where no leverage is used). Managers of such small AIFs are only subject to a few regulations of the Alternative Investment Manager Act. They do not require a licence and only need to register with the FMA.

A licensed AIFM needs to have a minimum capital of €125,000 if it is an external manager of AIFs. If the AIFM is the internal manager of an AIF, the minimum capital requirement is €300,000.

In addition, the AIFM needs to have sufficient equity to cover 25 per cent of its annual running costs.

Increased equity requirements apply for licensed AIFMs if the assets under management exceed €250 million. In any case, the minimum capital is capped at €10 million.

The persons tasked with the management of the AIFM need to be sufficiently experienced and have to pass a fit-and-proper test by the FMA, if so requested. At least two persons must be appointed by the AIFM as its managers.

In the application, the AIFM needs to provide information on shareholders holding qualified participations in the AIFM (eg, shareholdings exceeding 10 per cent), on any closely related entities (ie, a third party that holds a stake of more than 20 per cent of the AIFM or that controls the AIFM, or is controlled by the AIFM or in which the AIFM holds a stake of more than 20 per cent), its business plan, its remuneration policy, its investment strategies, a description of any competencies delegated to third parties and information on the contractual basis pursuant to which it manages its AIFs.

The decision of the FMA regarding the licensing of an AIFM has to be passed within three months upon submission of the required documentation. If the AIFM intends to register an AIF as an ELTIF, he or she must apply to the FMA for prior approval.

Law stated - 13 February 2024

Political contributions

14 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

No such rules apply to managers or investment advisers (or their respective employees) in Austria. However, political parties are required to report any donation exceeding €50,000 to the Court of Audit, which will publish this information on its website. Additionally, Austrian political parties are barred from accepting donations over €2,500 from foreign entities or nationals. Anti-bribery laws apply as well.

Law stated - 13 February 2024

Use of intermediaries and lobbyist registration

15 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

Austria introduced special legislation concerning the registration of lobbyists in 2012, which also requires companies utilising the services of lobbyists to register in a publicly accessible register maintained by the Federal Ministry of Justice. However, this legislation does not cover activities such as the marketing of a private equity fund.

Law stated - 13 February 2024

Bank participation

16 Describe any key legal or regulatory developments (including those emerging from the 2008 global financial crisis) that specifically affect banks with respect to investing in or sponsoring private equity funds.

There are no such rules in Austria.

Law stated - 13 February 2024

TAXATION

Tax obligations

17 Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

For the purposes of this question, it is assumed that the fund vehicle is structured as a partnership, rather than as a corporation. Austrian partnerships are typically viewed as transparent for tax purposes, provided that the following is true:

- the partnership's sole activity qualifies as asset management for tax purposes; and
- it is not deemed to conduct a business or commercial operation.

Any income derived by the partnership is instead allocated to its investors and taxed at their level in accordance with the rules of the tax regime applicable to the respective investor.

Domestic individual investors are taxed as follows:

- capital gains are subject to a preferred tax rate of 27.5 per cent; and
- dividends are subject to withholding tax at a rate of 27.5 per cent.

Domestic corporate investors are taxed as follows:

- capital gains are taxed at a rate of 25 per cent if they relate to an Austrian-resident portfolio company and may be tax-exempt if they relate to a foreign-resident portfolio company in which a minimum shareholding of 10 per cent is (indirectly) held for an uninterrupted period of at least one year (section 10 of the Corporate Income Tax Act (KStG)); and
- dividends are tax-exempt if they are related to an Austrian-resident portfolio company or an EU-resident portfolio company and may be tax-exempt if they relate to another foreign portfolio company (section 10 of the KStG).

Foreign individual investors are taxed as follows:

- Capital gains are only taxable (at a rate of 27.5 per cent as of 1 January 2016) if the percentage of the investor's (weighted) shareholding in the Austrian portfolio company (through the partnership) has been at least 1 per cent during the previous five years. Double tax treaties usually restrict Austria's right to tax such capital gains (article 13, paragraph 5 of the Organisation for Economic Co-operation and Development's Model Tax Convention on Income and on Capital (MTC)).
- Dividends are subject to withholding tax at a rate of 27.5 per cent as of 1 January 2016 (subject to reduction under applicable double tax treaties).

Foreign corporate investors are taxed as follows:

- Capital gains are only taxable (at a rate of 25 per cent) if the percentage of the investor's (weighted) shareholding in the Austrian portfolio company (through the partnership) has been at least 1 per cent during the previous five years. Double tax treaties usually restrict Austria's right to tax such capital gains (article 13, paragraph 5 of the MTC).
- Dividends are subject to withholding tax at a rate of 25 per cent in the case where the exemption for foreign investors who are corporations resident in an EU member state is not applicable (but will usually be subject to reduction under applicable double tax treaties).

Law stated - 13 February 2024

Local taxation of non-resident investors

18 Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

If the fund is structured as a limited partnership not deemed to conduct a business, non-resident investors are generally not required to file tax returns in Austria, subject to the following rules. If a capital gain is subject to taxation in Austria, the investor will be obliged to file a tax return, whereas in the case of dividends no reporting obligation is triggered. A refund, an exemption or a reduction concerning withholding taxes will also require filings with the tax authorities. Special forms provided by the Austrian tax authorities are used for the proof of residence outside Austria (and further substance requirements), which have to be submitted along with the filing with the tax authorities.

Law stated - 13 February 2024

Local tax authority ruling

19 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

While it is certainly desirable to obtain a ruling from the Austrian tax authorities with respect to the tax treatment of the fund vehicle, the tax authorities are, however, rather reluctant to grant such tax rulings. Such rulings are generally not binding, unless governed by the ruling regime (which covers reorganisation, tax groups and transfer pricing, aspects of international law (beginning 1 January 2019), value added tax (VAT) law (beginning 1 January 2020) and a potential application of the abuse of law provisions (beginning 1 January 2019)). The taxpayer may, however, be protected by the principle of equity and good faith. Based thereon, an assessed tax shall be waived if the party has made dispositions or transactions in reliance on the tax ruling and the following is true:

- the ruling has been rendered by the competent tax authority;
- the ruling is not evidently incorrect; and
- the incorrectness of the ruling was not easily noticeable for the party.

There are no special tax rules relating to investors that are tax residents in Austria.

Law stated - 13 February 2024

Organisational taxes

20 Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

Since 1 January 2016, no tax is levied on equity contributions. Another area to consider is stamp duties, in particular in relation to guarantees that the formation documentation may entail. In this context, surety agreements (including any form of assumption of a debt as joint debtor) are subject to stamp duty of 1 per cent of the secured amount provided that the surety is of an accessory nature, which means that the guarantor may avail itself not only of all defences that it personally has against the creditor, but also of all defences that the debtors of the secured debt have against the creditors. If the guarantee, however, is of an abstract nature, which means that the guarantor has to pay upon first demand and has recourse only to those defences that arise from the guarantee itself, then such transaction is not subject to stamp duty. Therefore, guarantee wordings explicitly stating that a specific guarantee is meant to be abstract are commonly used.

Law stated - 13 February 2024

Special tax considerations

21 Describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

'Carried interest', which is defined as a compensation of a partner of an asset management partnership received because of outstanding contributions to a successful management of the investments, is included in the investment income according to the Department of International Taxation of the Austrian Ministry of Finance (EAS 3280 as of 14 May 2012; EAS 2698 as of 6 February 2006 and BMF 15 December 2008 [BMF 010221/3364-IV/4/2008]). Income qualifying as investment income received by an individual who is subject to unlimited taxation in Austria is taxable at the special tax rate of 27.5 per cent (as of 1 January 2016). Despite this administrative guideline, a case-by-case analysis is recommended, as the line between (self-) employed income and investment income is a rather unclear one.

The management fees received by a partner of an asset management partnership are not subject to VAT. According to the Austrian tax authorities, the general partner of a partnership is not an entrepreneur; his or her services are supplied in the exercise of a corporate function and not as a result of an exchange of services. If the fund vehicle is a corporation, however, the fees of a managing shareholder will usually be subject to VAT, unless the manager is employed by the corporation.

Law stated - 13 February 2024

Tax treaties

22 List any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Austria has entered into 90 tax treaties (as of 1 January 2023). According to the established practice of the Austrian tax authorities, a fund vehicle structured as a tax-transparent partnership is generally not entitled to treaty benefits. Rather, the investors themselves may rely on the tax treaty directly. If the fund vehicle is structured as a corporation, tax treaties will generally apply to the corporate fund vehicle itself.

Law stated - 13 February 2024

Other significant tax issues

23 Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

There are no other significant tax issues relating to private equity funds. However, there is a special tax regime for investment funds in Austria. A private equity fund should normally not be subject to this regime.

Law stated - 13 February 2024

SELLING RESTRICTIONS AND INVESTORS GENERALLY

Legal and regulatory restrictions

24 Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions)

> may be offered without registration under applicable securities laws in your jurisdiction.

Offers and sales of interests in private equity funds formed in Austria are subject to the following selling restrictions, which depend on the category of the private equity fund:

- alternative investment funds (AIFs) managed by a licensed alternative investment fund manager (AIFM):
    - interests in the fund may only be offered or sold after the AIF is approved by the Austrian Financial Market Authority (FMA); and
    - interests in the fund may be offered or sold to private investors, if the prerequisites of sections 48 and 49 of the Alternative Investment Manager Act (AIFMG) are met, except if the fund is registered as follows:
        - as a European Venture Capital Fund (EuVECA): in this case, it may be offered to private investors subject to certain restrictions (in particular, a minimum investment commitment of €100,000 and a written acknowledgement of the risks associated with the investment by the private investor); or
        - as a European long-term investment fund (ELTIF): in this case, it may be offered to private investors subject to certain restrictions (in particular, an offer is only possible to private investors having an investment portfolio of at least €100,000 after such investor has received appropriate investment advice);
- AIFs managed by a registered AIFM:
    - interests in the fund may only be offered after the AIF is notified to the FMA; and
    - interests in the fund may not be offered or sold to private investors, except if the fund is registered as a EuVECA; in this case, it may be offered to private investors subject to certain restrictions (in particular, a minimum investment commitment of €100,000 and a written acknowledgement of the risks associ ated with the investment by the private investor); and
- private equity funds outside of the AIFMG:
    - any public offer of interests in private equity funds outside of the AIFMG requires the publication or approval of a prospectus by the FMA, or both, unless a private placement exemption applies;
    - the private placement exemption applies, in particular, for the following:
        - offers to qualified investors only;
        - offers with a minimum investment amount of €100,000; and
        - offers to less than 150 investors; and
    - even if the private placement exemption applies, the intended offer has to be notified to the issue register, maintained by the Austrian Control Bank.

Since the implementation of the Cross Border Distribution of Funds package in Austria on 11 December 2021, additional requirements regarding pre-marketing measures also apply.

Law stated - 13 February 2024

Types of investor

25 Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

There are no additional restrictions on the types of investors that may participate in private equity funds.

Law stated - 13 February 2024

Identity of investors

26 Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

For fund vehicles established as limited partnerships or limited liability companies, any change in the shareholders has to be notified to the Companies Register. No such requirement exists with respect to joint-stock companies, provided that there is more than one shareholder. Should this change result in a change of one or more ultimate beneficial owners, such change has to be notified to the Beneficial Owners' Register; this applies for all types of fund vehicles.

Licensed AIFMs are required to report any changes to their legal status of the time when their licence was granted, in particular any changes in the management or any change in qualified owners (eg, owners holding more than 10 per cent of the capital or voting rights in the AIFM).

Otherwise, there are no special requirements only applicable to private equity funds as regards the notification of the identity of investors or the composition of ownership.

Law stated - 13 February 2024

Licences and registrations

27 Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

There are licence requirements for persons offering interests in an Austrian private equity fund. The actual licence required depends on the legal category of the private equity fund. Different licences are required depending on whether the private equity fund is an open-ended AIF, a closed-ended AIF or a non-AIF private equity fund.

Open-ended AIFs can be offered by banks, securities firms or securities services firms.

Closed-ended AIFs (as well as non-AIF private equity funds) can be offered by banks, securities firms or persons or entities with a trade permit for asset managers.

Law stated - 13 February 2024

Money laundering

28 Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The provisions of the Financial Market Anti-Money Laundering Act, recently amended to implement the provisions of the fifth EU Anti-Money Laundering Directive, also apply to AIFMs. Consequently, AIFMs have to comply with enhanced customer due diligence requirements (on a risk-based approach) to identify the investors (and their beneficial owners) in the fund.

For managers of private equity funds that are not AIFs, no specific money laundering rules exist, unless the managers themselves are registered as, for example, securities services providers, in which case they also are subject to the Financial Market Anti-Money Laundering Act.

Law stated - 13 February 2024

EXCHANGE LISTING

Listing

29 Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Only shares of a joint-stock company (JSC) (but not equity interests in a limited liability company and limited partnership) can be listed on a regulated market of the Vienna Stock Exchange. In our experience, it is not customary to list private equity funds in Austria.

Law stated - 13 February 2024

Restriction on transfers of interest

30 To what extent can a listed fund restrict transfers of its interests?

A listing of a private equity fund is not common in Austria. Transfer restrictions of shares of a listed JSC fund vehicle are also uncommon, except for typical lock-up obligations in connection with rights offerings.

Law stated - 13 February 2024

PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS

Legal and regulatory restrictions

31 Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

Restrictions primarily apply to private equity funds established as medium-sized business financing companies. Also, private-equity funds established as an alternative investment fund (AIF) will typically be subject to the post-investment restrictions of section 28 of the Alternative Investment Manager Act for a period of 24 months following the acquisition of control of a (listed or unlisted) target. Also, certain investment restrictions apply to AIFs designated as European long-term investment funds.

There are no other restrictions specific to private equity funds.

Law stated - 13 February 2024

Compensation and profit-sharing

32 Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

If the sponsor has an equity interest in the fund, any compensation or profit-sharing arrangement would have to be on an arm's-length basis. Otherwise, such compensation or profit-sharing arrangement would be deemed to violate the prohibition of the return of equity, and is at risk of being declared null and void.

Law stated - 13 February 2024

UPDATE AND TRENDS

Key developments of the past year

33 What are the most significant recent trends and developments relating to private equity funds in your jurisdiction? What impact do you expect such trends and developments will have on global private equity fundraising and on private equity funds generally?

Even though the corporate tax rate was reduced from 25 to 24 per cent in 2023, and will be reduced to 23 per cent in 2024 alleviated funds, fundraising by Austria-based private equity remains low by European standards for a number of reasons, such as the ongoing inflation and a more cautious approach by investors due to overall uncertainties about the general economic climate.

In July 2023, the Austrian government enacted the Venture Capital Fund Act, with the aim of establishing SICAV-like Austrian venture capital funds (WKFs). A WKF is set up in the form of a stock corporation, but is considered an alternative investment fund (AIF) for regulatory purposes. This means that it will need to be managed by a licensed or registered external AIF manager. A WKF will be able to form sub-funds, which will be considered separate for corporate and insolvency purposes. Interests in a WKF (which can only be in the form of shares) cannot be marketed to retail investors. While WKFs are under the same leverage restrictions as 'normal' AIFs, they have a wider range of permitted investments, including all forms of participations in companies and partnerships. From a tax perspective, a WKF is a transparent investment fund. It remains to be seen whether this new initiative will lead to a rise in fundraising.

Law stated - 13 February 2024

SCHINDLER ATTORNEYS

Clemens Philipp Schindler clemens.schindler@schindlerattorneys.com
Martin Abram martin.abram@schindlerattorneys.com

Schindler Attorneys

Cayman Islands

Chris Humphries, Jonathan McLean, Megan Wright, Joseph Bates
Stuarts Humphries

Summary

FORMATION

Forms of vehicle

1 What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

An exempted limited partnership (ELP) established under the Cayman Islands Exempted Limited Partnership Act (as revised) (the ELP Act) is the most commonly used structure in the Cayman Islands for forming private equity funds (PE funds). An ELP does not have a separate legal personality. An ELP must consist of the following:

- one or more persons called general partners who shall, in the event that the assets of the ELP are inadequate, be liable for all debts and obligations of the ELP; and
- one or more persons called limited partners who shall not be liable for the debts and obligations of the ELP except as provided in the partnership agreement and to the extent specified in the ELP Act.

Investors in an ELP are issued partnership interests and join the ELP as limited partners. Generally speaking, a limited partner's liability in an ELP is limited to the extent of the limited partner's partnership interests (but this limited liability status can be lost in instances where the limited partner takes part in the conduct of the business of the ELP). The general partner of the ELP is responsible for the management and conduct of the business of the ELP.

The general partner of a PE fund is usually a company or another ELP established specifically as part of the overall PE fund structure. At least one general partner of the ELP must, if a company, be registered (either as a foreign company or a Cayman Islands incorporated company) under the Companies Act (as revised) of the Cayman Islands (the Companies Act) or, if a partnership, be registered (either as a foreign partnership or an ELP) under the ELP Act.

A PE fund can also be established as a company using a Cayman Islands exempted company incorporated with limited liability, which has a separate legal personality distinct from its shareholders. The exempted company is established with share capital and shares are issued to investors in consideration of investment proceeds. Each investor's or shareholder's liability is limited to the amounts unpaid on its shares, if any, or to such amount as the shareholders may respectively undertake by the memorandum of association to contribute to the assets of the company in the event of it being wound up.

A PE fund can also be established as a limited liability company using a Cayman Islands limited liability company (LLC). The LLC is designed to be substantially similar to the form of a Delaware limited liability company and has a separate legal personality, distinct from its members. The LLC is established without a share capital and otherwise resembles an ELP in having its members' liability limited by reference to the amounts of capital they have agreed to contribute or as otherwise stated in the operating agreement of the LLC (the LLC agreement).

Law stated - 3 January 2024

Forming a private equity fund vehicle

2 | What is the process for forming a private equity fund vehicle in your jurisdiction?

Being a partnership, the ELP is established first by both the general partner and an initial limited partner (eg, a principal of the PE fund manager) entering into an initial limited partnership agreement. Second, by a section 9 registration statement (section 9 statement) being filed with the Cayman Islands Registrar of Exempted Limited Partnerships (the Registrar) signed by the general partner of the ELP and containing the following details:

- the name of the ELP;
- the general nature of the business of the ELP;
- the address of the ELP's registered office in the Cayman Islands (legally required to be in the Cayman Islands);
- the term, if any, for which the ELP is entered into or, if for unlimited duration, a statement to that effect and the date of its commencement;
- the name and address of each general partner; and
- a declaration that the ELP will not undertake business with the public in the Cayman Islands other than so far as may be necessary for the carrying on of the business of that ELP exterior to the Cayman Islands.

There are certain supporting documents that must also be filed in respect of the general partner (eg, in the case of a corporate general partner, a certificate of incorporation and a certificate of good standing).

Upon paying the requisite fee and filing the completed registration documents, the Registrar will issue a certificate of registration, which is conclusive evidence that compliance has been made with all the requirements of the ELP Act in respect of the formation and registration of the ELP.

A Cayman Islands exempted company is established by completing the following:

- filing an affidavit of the subscriber to its memorandum of association;
- filing its memorandum of association and articles of association with the Cayman Islands Registrar of Companies; and
- payment of the requisite filing fees.

An LLC is established by filing a registration statement with the Cayman Islands Registrar of Limited Liability Companies (the LLC Registrar) signed by or on behalf of any person forming the limited liability company and including the following details:

- the name of the LLC;
- the address of the LLC's registered office in the Cayman Islands (legally required to be in the Cayman Islands);

- the term, if any, for which the LLC is formed or, if for unlimited duration, a statement to that effect; and
- a declaration that the LLC will not undertake business with the public in the Cayman Islands other than so far as may be necessary for the carrying on of the business of that LLC exterior to the Cayman Islands.

The timescale and costs depend on the nature and complexity of the transaction. However, the registration of an ELP or LLC or the incorporation of an exempted company can be done on an express basis within 24 hours. Cayman Islands legal counsel will be able to provide an estimate of legal fees and disbursement costs once they have conducted an overview of the overall PE fund structure. The registration fee payable to the Registrar for an ELP is currently approximately US$1,220. An ELP will be required to file with the Registrar a return on or before 31 January of every year and pay the Registrar a fee, currently approximately US$2,500.

For an exempted company the registration fee will depend on the level of the authorised share capital of the company. An exempted company that falls within the lowest possible band of authorised share capital will have to pay a current incorporation fee of approximately US$732. Similarly, an exempted company must file an annual return in January of each year and pay a fee to the Registrar of Companies, currently approximately US$854 for the lowest band of authorised share capital.

For an LLC, the registration fee payable to the Registrar is currently approximately US$976. An LLC will be required to file with the Registrar a return on or before 31 January in every year and pay the LLC Registrar a fee, currently approximately US$976. At the formation stage for a PE fund, the only service providers that it is necessary to engage are a Cayman Islands legal counsel and a registered office service provider. Most law firms have an affiliated management company that can provide registered office services.

There are no material minimum capital requirements prescribed by Cayman Islands law.

A PE fund may be required to be registered as a 'mutual fund' pursuant to the Mutual Funds Act (as revised) of the Cayman Islands, or as a 'private fund' as set out in the Private Funds Act (as revised) of the Cayman Islands.

Law stated - 3 January 2024

Requirements

3 Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

There is no requirement under Cayman Islands law for a PE fund (whether structured as an ELP, an exempted company or an LLC) to have a Cayman Islands-based custodian or administrator.

The ELP is required to maintain a registered office in the Cayman Islands.

The general partner of the ELP is responsible for maintaining (or causing to be maintained) a register of security interests granted with respect to a partnership interest or part thereof indicating, among other things, the identity of the grantor and grantee, the partnership interest subject to the security interest and the date notice of the interest was served on the ELP.

The general partner is responsible for maintaining (or causing to be maintained) in the country or territory that the general partner may determine (including outside the Cayman Islands) a register of limited partners which shall contain the name and address of each person who is a limited partner of the ELP, the date on which a person became a limited partner and the date on which a person ceased to be a limited partner, and the register shall be updated within 21 days of the date of any change in the particulars therein. The general partner shall also be responsible for maintaining (or causing to be maintained) at the registered office of the ELP a record of the address at which the register of limited partners is kept.

The general partner is also required to maintain (or cause to be maintained) in any country or territory that the general partner may determine, a record of the amount and date of the capital contributions of each limited partner and the amount and date of any payment representing a return of the whole or any part of the capital contribution of any limited partner; such record shall also be updated within 21 days of the date of any change in the particulars therein.

An exempted company is also required to maintain a registered office in the Cayman Islands, a register of mortgages and charges, a register of directors and officers and a register of members. The latter need not be maintained locally in the Cayman Islands.

An LLC is also required to maintain a registered office in the Cayman Islands, a register of mortgages and charges, a register of security interests, a register of managers and a register of members (together with a record of contributions and distributions). The register of members and record of contributions need not be maintained locally in the Cayman Islands.

Law stated - 3 January 2024

Access to information

4 What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The register of limited partners (and address of where it is maintained) of an ELP is not open to public inspection, but instead is required to be open for inspection during all usual business hours by all partners or by any other person with the consent of the general partner. The record of contributions is only open to inspection by a person with the consent of the general partner. A copy of the section 9 statement and any amendments made to it is publicly available for inspection upon payment of a fee to the Registrar.

Under the Companies Act, the register of members of an exempted company is not open to public inspection and is a private document. The names of directors and alternate directors contained on the register of directors of an exempted company is open to public inspection upon payment of a fee to the Registrar of Companies in the Cayman Islands. Shareholders of the exempted company are entitled to see their own details in the register of members. An exempted company is required to keep at its registered office a register of mortgages and charges specifically affecting property of the exempted company. The register of mortgages and charges is required to be open to inspection by any creditor or member of the exempted company at all reasonable times. The only publicly available information in respect of an exempted company (other than information relating to its directors and alternate directors' names) is its name, company number, date of incorporation, registered office, the type of company (eg, exempted, special economic zone, segregated portfolio company) and whether the company is active or has been dissolved or is inactive, which can be accessed via the website of the General Registry of the Cayman Islands.

Under the Limited Liability Companies Act (as revised) (the LLC Act), the register of members of an LLC is not open to public inspection and is a private document. The names of managers contained on the register of managers is open to public inspection upon payment of a fee to the Registrar of Companies in the Cayman Islands. Those persons expressly given a right to inspect the LLC agreement, or otherwise as permitted by the manager of the LLC, will have the ability to inspect the register of members. Unless otherwise provided in the LLC agreement, each member has the right to inspect from time to time true and full information regarding the state of the business and financial condition of the LLC. An LLC is required to keep at its registered office a register of mortgages and charges specifically affecting property of the LLC. The register of mortgages and charges is required to be open to inspection by any creditor or member of the LLC at all reasonable times. The only publicly available information in respect of an LLC (other than information relating to its managers' names) is its name, registration number, date of registration, registered office and whether the LLC is active or has been struck off. This information can be accessed via the website of the General Registry of the Cayman Islands.

Law stated - 3 January 2024

Limited liability for third-party investors

5 In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

The limited liability of the limited partners of an ELP (who would be the third-party investors in a PE fund) may be lost if the relevant limited partner takes part in the management or operation of the ELP. The following is a non-exhaustive list of activities that a limited partner can undertake without risking loss of its limited liability status:

- holding an office or interest in, or having a contractual relationship with, a general partner of the ELP, or being a contractor for or an agent or employee of the ELP or of a general partner of the ELP or acting as a director, officer or shareholder of a corporate general partner;
- consulting with and advising a general partner or consenting or withholding consent to any action proposed, in the manner contemplated by the partnership agreement, with respect to the business of the ELP;

- investigating, reviewing, approving or being advised as to the accounts or business affairs of the ELP or exercising any right conferred by the ELP Act;
- acting as surety or guarantor for the ELP either generally or in respect of specific obligations;
- approving or disapproving an amendment to the partnership agreement;
- calling, requesting, attending or participating in any meeting of the partners of the ELP;
- taking any action that results in the winding up or the dissolution of the ELP;
- taking any action required or permitted in the partnership agreement or by law to bring, pursue, settle or terminate any action or proceedings brought in circumstances where the general partner has authority to do so but refuse, without good cause, to institute such proceedings;
- appointing a person to serve on a board or committee of the ELP, a general partner or a limited partner or removing such person;
- serving on any board or committee of the exempted limited partnership, a general partner, the limited partners or the partners, or by appointing, electing or otherwise participating in the choice of a representative or any other person to serve on any board or committee, or by acting as a member of any board or committee either directly or by or through any representative or other person, including giving advice or consenting, or refusing to consent, to any action proposed by the general partner on behalf of the ELP and exercising any powers or authorities or performing any obligations as a member of that board or committee in the manner contemplated by the partnership agreement;
- serving on the board of directors or a committee of, consulting with or advising or being an officer, director, shareholder, partner, member, manager, trustee, agent or employee of, or by being a fiduciary or contractor for, any person in which the ELP has an interest or any person providing management, consultation, custody or other services or other products for, to or on behalf of, or otherwise having a business or other relationship with, the ELP or a general partner of the ELP; and
- voting as a limited partner on certain matters in relation to the ELP, for example:

- its dissolution and winding up;
- the purchase, sale or transfer of assets;
- the incurrence or renewal of indebtedness;
- a change in the nature of business;
- the admission, removal or withdrawal of a general or limited partner; or
- transactions in which one or more general partners have an actual or potential conflict of interest with one or more limited partners.

If a limited partner loses its limited liability status, it will be liable in the event of the insolvency of the ELP for all debts and obligations of the ELP incurred during the period that the limited partner participated in the conduct of the business of the ELP as though the limited partner was, for such period, a general partner of the ELP, provided that the limited partner shall be rendered liable only to a person who transacts business with the ELP during such period with actual knowledge of such participation and who then reasonably believed the relevant limited partner to be a general partner of the ELP.

In addition, if a limited partner receives a payment representing a return of any part of his or her contribution or is released from any outstanding obligation in respect of his or her commitment and at the time that the payment was made or the release effected the ELP is insolvent including where the payment or release causes the insolvency or the limited partner has actual knowledge of the insolvency of the exempted limited partnership, then for a period of six months commencing on the date of that payment or release but not thereafter, the limited partner shall be liable to the ELP for the amount of the payment or the due performance of the released obligation in respect of his or her commitment in each case to the extent that the repayment or performance of the released obligation is necessary to discharge a debt or obligation of the ELP incurred during the period that the contribution or commitment represented an asset of the ELP.

Unlike the ELP, the exempted company is regarded as having a separate legal personality and being an entity distinct from its shareholders. The limited liability status of shareholders of an exempted company will generally be respected. In similarity to a number of other jurisdictions, including under English law, there may be certain circumstances where a Cayman Islands court might disregard the fundamental principle that a company is a separate legal person from its shareholders and that their respective assets and liabilities are distinct. Such unusual circumstances may include where the company is considered by the courts to be used as a tool for fraud or other criminality or when a person is under an existing legal obligation or liability or subject to an existing legal restriction that he or she deliberately evades or whose enforcement he or she deliberately frustrates by interposing a company under his or her control.

An LLC is also regarded as having a separate legal personality and being an entity distinct from its members. The limited liability status of members of an LLC will generally be respected. In similarity to a number of other jurisdictions, including under English law, there may be certain circumstances where a Cayman Islands court might disregard the fundamental principle that an LLC is a separate legal person from its members and that their respective assets and liabilities are distinct, although this has never been tested in relation to an LLC. Such unusual circumstances may include where the LLC is considered by the courts to be used as a tool for fraud or other criminality or when a person is under an existing legal obligation or liability or subject to an existing legal restriction that he or she deliberately evades or whose enforcement he or she deliberately frustrates by interposing an LLC under his or her control.

Law stated - 3 January 2024

Fund manager's fiduciary duties

6 What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

The general partner of the ELP is responsible under the ELP Act for the management of an ELP. In the context of a PE fund, a substantial part of this responsibility is delegated pursuant to the terms of an investment management agreement to the PE fund's investment manager. It is usually the general partner (unless otherwise delegated) that enters into contracts, deeds, instruments or other documents on behalf of the ELP. In conducting the business of the ELP, the general partner has a fiduciary duty under section 19(1) of the ELP Act to act at all times in good faith and, subject to the express terms of the partnership agreement to the contrary, in the interests of the ELP. The duty to act in the interests of the ELP can therefore be modified by the terms of the partnership agreement provided always that the general partner acts in good faith. Even where the general partner has delegated certain of its responsibilities to the PE fund's investment manager, it remains subject to this duty and therefore must retain supervisory oversight of the responsibilities delegated to the PE fund's investment manager.

The duties owed by the PE fund's investment manager will be set out in the investment management agreement between the investment manager and the ELP and may be modified in the manner set forth in the investment management agreement.

In the context of a PE fund that is structured as an exempted company, the management of the entity is vested in the directors. The duties and liabilities of directors of such company will be governed by the Companies Act as supplemented by Cayman Islands case law and English common law insofar as English common law has not been amended by statutory provisions in the Cayman Islands. English case law is considered persuasive in the courts of the Cayman Islands to the extent that there is no Cayman Islands case law to the contrary. A substantial proportion of the duties and responsibilities of directors of the PE fund (structured as an exempted company) are normally delegated to the investment manager of the PE fund under the terms of the investment management agreement.

Directors of an exempted company owe a number of fiduciary duties to the company. The fiduciary duties include the following:

- the duty to act in accordance with the constitution of the company (that is, the memorandum of association and articles of association);
- the duty to act in good faith in the best interests of the company; and
- the duty to act for a proper purpose.

The directors of an exempted company are also subject to the common law duty to undertake their functions as directors with due care, diligence and skill.

The constitutional documents of a Cayman Islands PE fund will usually contain indemnification provisions in favour of the general partner in the context of an ELP, or directors in the context of an exempted company and their respective affiliates for all liabilities, loss, damage, cost or expense, in the absence or fraud, wilful neglect or negligence (or other behaviour, such as dishonesty or gross negligence).

In the context of an exempted company, under the Companies Act, directors could also face criminal sanctions for criminal offences, including the following:

- fraud committed in the 12-month period prior to a winding up of the PE fund;
- misconduct in the course of a winding up of the PE fund; and

- making material omissions in statements relating to the company's affairs in the course of a winding up.

Subject to any express provision of the LLC agreement to the contrary, a manager of an LLC owes no duty (fiduciary or otherwise) other than a duty to act in good faith in respect of the rights, authorities or obligations of the manager. The good faith duty can be expanded or restricted, but not eliminated, by the express provisions of the LLC agreement. A member does not owe any duty (fiduciary or otherwise) to the LLC or to a member in exercising any rights or authorities, or performing any obligations, in respect of the LLC. In particular, the LLC Act provides that where a member is exercising any vote, consent or approval right, it may do so in its own best interests even though it may not be in the best interests of the LLC or any other member. The LLC Act also expressly provides that any person serving on any board or committee of the LLC may, if expressly permitted to do so by the LLC agreement, act in a manner that the person believes to be in the best interests of a particular member (even though it may not be in the best interests of all the members or the LLC).

The Cayman Islands Monetary Authority (CIMA) has issued the Statement of Guidance for Regulated Mutual Funds (the Statement), in which it sets out CIMA's expectations regarding the corporate governance regime of regulated mutual funds. In essence, CIMA expects the oversight, direction and management of a regulated mutual fund to be conducted in a fit and proper manner. Accordingly, the purpose of the Statement is to provide the governing body of a regulated mutual fund (Governing Body) and its operators (Operators) with guidance on the minimum expectations for the sound and prudent governance of the regulated mutual fund.

The Statement provides guidance for the Governing Body on matters such as:

- monitoring of a fund's compliance with applicable laws, regulations and rules;
- oversight and supervision of the service providers to the funds;
- frequency of Governing Body meetings and service provider representation at such meetings;
- reporting by the investment manager and service providers; and
- identification and recording of conflicts of interest.

The Statement also provides a non-exhaustive list of duties that CIMA considers applicable to an Operator, for example:

- ensuring it has the capacity to apply its mind to oversee and supervise each regulated fund of which it is an operator; and
- ensuring the roles and responsibilities of all service providers are clearly defined, understood and are being adequately performed.

Law stated - 3 January 2024

Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Gross negligence (as opposed to 'negligence') is not a fully recognised legal term under Cayman Islands law. However, gross negligence is often referred to in the constitutional document or agreements of a PE fund, but is usually defined either by reference to the laws of a jurisdiction that recognises gross negligence (eg, the state of Delaware in the United States) or is specifically defined in the relevant document.

Law stated - 3 January 2024

Other special issues or requirements

8 Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Most of the special issues or requirements particular to PE funds structured as limited partnerships are governed by the terms of the partnership agreement. Typically, the partnership agreement will contain provisions stating the following:

- A limited partner may only transfer its partnership interests subject to the express terms of such agreement.
- The general partner may appoint or remove the investment manager of the PE fund.
- Advisory committees may be created (which are internal bodies that consent to, or approve of, certain actions by the general partner), the members of which can include limited partners. Limited partners who are members of these committees should read the terms of these advisory committees carefully to ensure that actions taken via an advisory committee are not deemed to be managing the affairs of the ELP and thereby risk losing their limited liability status.

Any limited partnership established under the laws of a jurisdiction other than the Cayman Islands may (provided that the laws of the foreign jurisdiction where it is organised permit or do not prohibit such a transfer), at any time upon effecting such amendments to the partnership agreement as shall be necessary to comply with the ELP Act and upon filing the required documents, be registered under the ELP Act, transfer by continuation to the Cayman Islands and, with effect from the date of the certificate of registration issued by the Registrar, would then be governed as an ELP in accordance with the ELP Act.

Where a limited partnership migrates to the Cayman Islands, the ELP and the partnership interests of its partners and their rights and liabilities, as against any person who is not a partner, shall cease to be governed by the laws of the jurisdiction from which it has migrated, with effect from the date indicated on the certificate of registration issued by the Registrar. However, any act or omission occurring before such date shall continue to be governed by such law or the laws of such other jurisdiction, provided always that such registration of the migrated limited partnership in the Cayman Islands as an ELP shall not operate to do any of the following:

- create a new legal entity;
- affect the property previously acquired by or on behalf of the ELP;
- affect any act or thing done prior to such registration or the rights, powers, authorities, functions or obligations of the ELP, any partner or any other person prior thereto; or
- render defective any legal proceedings by or against the ELP or any partner or any other person, and any legal proceedings that could have been continued or commenced by or against the ELP or any partner or any other person before its registration hereunder may, notwithstanding such registration, be continued or commenced after such registration and in respect of which such law or the laws of such other jurisdiction shall be of application.

The partnership agreement is typically modified to reflect the requirements of the ELP Act.

A qualified transferring foreign company incorporated under the laws of a jurisdiction outside the Cayman Islands may continue by way of transfer into the Cayman Islands, provided that the laws of the foreign jurisdiction where it is incorporated permit or do not prohibit such a transfer. Such transfer by way of continuation does not create a new company or other new legal entity. The transferring foreign company is effectively taken from the foreign jurisdiction and redomiciled in the Cayman Islands as the same legal entity, but now governed by Cayman Islands law rather than the law of the foreign jurisdiction.

A qualified transferring foreign entity formed, registered, incorporated or existing under the laws of a jurisdiction outside the Cayman Islands may continue as an LLC by way of transfer into the Cayman Islands, provided that the laws of the foreign jurisdiction where it is incorporated permit or do not prohibit such a transfer. Such transfer by way of continuation does not create a new company or other new legal entity. The transferring foreign company is effectively taken from the foreign jurisdiction and redomiciled in the Cayman Islands as the same legal entity, but now governed by Cayman Islands law as an LLC rather than the law of the foreign jurisdiction.

Law stated - 3 January 2024

Fund sponsor bankruptcy or change of control

9 With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Under Cayman Islands law, there are no statutory or regulatory consequences in this regard except that, to the extent that such bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor necessitates, in the case of an ELP, a change of general partner of the ELP, a successor general partner should be appointed and the Registrar should be notified of the change in general partner. In the unlikely event that the PE fund is registered with CIMA, CIMA should be notified of the change in sponsor or a change of the PE fund's investment manager. The terms of the limited partnership agreement of the PE fund, the LLC agreement of the PE fund (where it is structured as an LLC) and the memorandum and articles of association of the PE fund (where it is structured as an exempted company) will typically assist in determining the consequences of the sponsor of the PE fund being faced with bankruptcy, insolvency, change of control or restructuring.

Law stated - 3 January 2024

REGULATION, LICENSING AND REGISTRATION

Principal regulatory bodies

10 What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The principal regulatory body in the Cayman Islands for investment funds and investment managers is the Cayman Islands Monetary Authority (CIMA). The Mutual Funds Act and the Private Funds Act bring into the scope of registration with CIMA many private equity funds (PE funds) that had previously been exempt. A PE fund that has interests redeemable at the option of the investor and has no more than 15 investors may need to register as a limited investor fund. The Private Funds Act introduced a new class of private fund that likewise will mean that any PE funds are required to register with CIMA.

A CIMA-registered PE fund, whether registered and regulated under the Mutual Funds Act or the Private Funds Act, is required to prepare and submit annual audited financial statements to CIMA. CIMA may require such information or such explanation in respect of the PE fund as it may wish to carry out its duties under the Mutual Funds Act. A CIMA-registered PE fund must give CIMA access to or provide at any reasonable time all records relating to the PE fund. Both the Mutual Funds Act and the Private Funds Act provide for substantial fines for failure to comply with any such requests by CIMA, and CIMA may apply to the court to have the PE fund wound up.

Unless exemptions apply, an investment manager of a PE fund may be required to obtain a licence under the Securities Investment Business Act (as revised) (SIBA) if it is incorporated or registered, or has an established place of business, in the Cayman Islands.

Law stated - 3 January 2024

Governmental requirements

11 What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

A PE fund may be required to register with CIMA. A PE fund is prohibited from doing business with the public of the Cayman Islands (other than so far as may be necessary for the carrying on of its business outside of the Cayman Islands).

The Cayman Islands' Director Registration and Licensing Act 2014 (as amended) requires all directors, whether resident in the Cayman Islands or non-resident, of regulated mutual funds, certain private funds and companies that maintain a registration as an excluded person pursuant to the SIBA to register with CIMA. Persons who hold more than 20 of such directorships will need to be licensed by CIMA and will be subject to enhanced regulatory requirements. Corporate directors, irrespective of directorship numbers held, will also need to be licensed by CIMA. Therefore, all directors of PE funds registered under the Mutual Funds Act and their Cayman Islands management companies (holding a SIBA exemption) will have to be registered with CIMA. A fee is payable upon application for registration or licensing. In addition, each such director will be required to make an annual filing each year with CIMA together with the payment of a fee, and if there are any changes to the information supplied to CIMA on registration or in any subsequent annual filing, the director concerned will be required to inform CIMA within 21 days of the change.

Law stated - 3 January 2024

Registration of investment adviser

12 Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Investment managers that are vehicles incorporated or registered in the Cayman Islands, or any person or entity incorporated anywhere else in the world but with an established place of business in the Cayman Islands through which securities investment business is carried on, will be governed by the provisions of the SIBA and its licensing requirements.

Law stated - 3 January 2024

Fund manager requirements

13 Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

If the PE fund's investment manager is registered under the SIBA, the directors of an investment manager that is a company must be registered with CIMA or where the director holds 20 or more directorships of mutual funds or excluded persons, licensed by CIMA. Where the SIBA does not apply to an investment manager, there will be no qualifications or licensing requirements required under Cayman Islands law for the PE fund manager and its principals or directors.

Law stated - 3 January 2024

Political contributions

14 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are currently no such Cayman Islands rules or policies applicable to PE funds.

Law stated - 3 January 2024

Use of intermediaries and lobbyist registration

15 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There are currently no such Cayman Islands rules or policies applicable to PE funds.

Law stated - 3 January 2024

Bank participation

16 Describe any key legal or regulatory developments (including those emerging from the 2008 global financial crisis) that specifically affect banks with respect to investing in or sponsoring private equity funds.

There are currently no such legal or regulatory developments in the Cayman Islands applicable to PE funds.

Law stated - 3 January 2024

TAXATION

Tax obligations

17 Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Under current Cayman Islands law, there are no Cayman Islands taxes on income or gains of the private equity fund (PE fund) or on gains on dispositions of shares or partnership interests, and distributions made by a PE fund will not be subject to withholding tax in the Cayman Islands.

As an exempted limited partnership, a PE fund has the ability to apply for, and could expect to obtain, an undertaking from the financial secretary of the Cayman Islands pursuant to the provisions of the Tax Concessions Act that for a period of 50 years from the date of exemption no law enacted in the Cayman Islands imposing any tax to be levied on profits or income or gains shall apply to it or its operations, and that any such tax or any tax in the nature of estate, duty or inheritance tax shall not be payable on the partnership interests, debentures or other obligations of the PE fund or by way of the withholding in whole or in part of any payment of divided or other distribution of income or capital by the PE fund to its partners or payments of principal or interest or other sums due under a debenture or other obligation of the PE fund. If the PE fund is structured as an exempted company, it can also apply to the financial secretary for an exemption for a period of 20 years and, if the PE fund is a limited liability company (LLC), it can also apply for an exemption for a period of 50 years.

Law stated - 3 January 2024

Local taxation of non-resident investors

18 | Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

No.

Law stated - 3 January 2024

Local tax authority ruling

19 | Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

No.

Law stated - 3 January 2024

Organisational taxes

20 | Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There are currently no significant organisational taxes in the Cayman Islands. However, there are registration and annual maintenance fees payable to the government of the

Cayman Islands in connection with the registration or incorporation of a PE fund in the Cayman Islands, as described previously.

Law stated - 3 January 2024

Special tax considerations

21 Describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Currently, none.

Law stated - 3 January 2024

Tax treaties

22 List any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

The Cayman Islands has signed 36 Tax Information Exchange Agreements (TIEAs) with other countries, of which 29 were in force as at July 2023, including most EU member states, and most other leading financial jurisdictions – and as a result, is on the Organisation for Economic Co-operation and Development (OECD) list of jurisdictions that have committed to improving transparency and establishing effective exchange of information in tax matters. Essentially, TIEAs are bilateral agreements under which jurisdictions agree to cooperate in tax matters through the exchange of information. The Cayman Islands has also joined the Convention on Mutual Administrative Assistance in Tax Matters, which was developed by the OECD and the Council of Europe to combat tax evasion and aggressive tax avoidance. It provides for all possible forms of administrative cooperation between states in the assessment and the collection of taxes.

The Foreign Account Tax Compliance Act (FATCA) was introduced by the United States in 2010 as part of the Hiring Incentives to Restore Employment Act with the purpose of reducing tax evasion by its citizens. The Cayman Islands has entered into a Model 1B Intergovernmental Agreement with the United States relating to FATCA. The Cayman Islands has also introduced legislation that implements FATCA under which Cayman Islands financial institutions (which would include most funds) are required to, inter alia, conduct due diligence on their account holders (ie, investors) to determine whether they are US persons; and report on an annual basis certain information to the Cayman Islands Tax Information Authority (TIA). The legislation permits the Cayman Islands government to exchange tax information automatically with the United States without violating Cayman Islands law.

On 16 October 2015, the Cayman Islands issued regulations relating to the Common Reporting Standard (CRS) – the OECD initiative for the global automatic exchange of information for tax purposes. As with FATCA, the CRS regulations require Cayman Islands reporting financial institutions to, inter alia, establish policies and maintain procedures designed to identify reportable accounts from 1 January 2016 (which include the identification of each jurisdiction in which an account holder or controlling person is resident for tax purposes, application of certain due diligence and retention of information obtained or a record of the steps taken to comply with the CRS Regulations for six years) and file an annual report with the TIA setting out certain information on reportable accounts.

Many of the sponsors of PE funds will outsource the reporting requirements imposed on them by the increased regulation to administrators or other service providers and will rely on the administrators or service providers to ensure full due diligence is conducted with respect to the investors in their funds (including the receipt of the appropriate self-certification forms from each such investor). In any event, managers should remain vigilant in their compliance with the FATCA and CRS legislation.

Law stated - 3 January 2024

Other significant tax issues

23 Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

Currently, none.

Law stated - 3 January 2024

SELLING RESTRICTIONS AND INVESTORS GENERALLY

Legal and regulatory restrictions

24 Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

A Cayman Islands private equity fund (PE fund) is not allowed to carry on business with the public of the Cayman Islands other than so far as may be necessary for the carrying on of the business of the PE fund outside of the Cayman Islands. As such, Cayman Islands PE funds are prohibited from offering shares to the public in the Cayman Islands (in the case of an exempted company) unless such shares are listed on the Cayman Islands Stock Exchange.

'Public', for these purposes, does not include a sophisticated person, a high-net-worth person, a company, partnership or trust of which the shareholders, unitholders or limited partners are each a sophisticated person, a high-net-worth person any exempted or ordinary non-resident company registered under the Companies Act (as revised) of the Cayman Islands (the Companies Act) or a foreign company registered pursuant to Part IX of the Companies Act or any such company acting as general partner of a partnership registered pursuant to the provisions of the Exempted Limited Partnership Act or any director or officer of the same acting in such capacity or the trustee of any trust registered or capable of registering pursuant to the provisions of the Trusts Act (as revised).

Law stated - 3 January 2024

Types of investor

25 Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

There are currently no other Cayman Islands restrictions to describe aside from restrictions on certain investors from Russia. On 22 February 2022, the Foreign, Commonwealth and Development Office, which is responsible for the UK's international sanctions policy, updated the UK Sanctions list on GOV.UK. The Russia (Sanction) (EU Exit) Regulations made pursuant to the Sanctions and Anti-Money Laundering Act 2018 (UK), also known as SAMLA, was extended to the Cayman Islands through an Order in Council. Thereafter, all designations made under the UK sanctions regulations and extended to the Cayman Islands, have immediate effect in the Cayman Islands once the relevant Order in Council comes into force.

Additionally, on 21 March 2023, the Governor of the Cayman Islands issued General Licence 2023/0001 under the Russia (Sanctions) (EU Exit) Regulations 2019, as extended to the Cayman Islands with modifications. This licence relates to the termination of trust services provided to designated persons.

Law stated - 3 January 2024

Identity of investors

26 Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

Save where the PE fund constitutes a financial institution for the purposes of the Foreign Account Tax Compliance Act (FATCA) or the Common Reporting Standard (CRS) and is thereby obliged to make annual notification filings to the Tax Information Authority (TIA) in respect of relevant investors, there are no filings or notifications required as regards investors in an exempted company, limited liability company or an exempted limited partnership (ELP). However, the general partner must maintain a register of limited partners that is open to inspection by all partners of an ELP or by any other person with the consent of the general partner of the relevant ELP. In addition, the general partner must file a statement with the registrar of exempted limited partnerships where there has been a change in any of the information provided under the section 9 registration statement filing.

Where a PE fund is to be registered with the Cayman Islands Monetary Authority (CIMA), in order to effect the required registration, the PE fund is required to provide CIMA with a summary of the terms of the offering for each class of equity interests and to provide details of the various service providers of the PE fund along with a copy of its offering document.

The PE fund must notify CIMA of any changes in the details of the summary of the terms of the offering and any change in the PE fund's service providers as filed on initial registration with CIMA and supply copies of any supplements to, or revision of, the offering document.

Directors of a CIMA-registered PE fund, or managers holding a Securities Investment Business Act (as revised) exemption, will be required to make an annual filing together with the payment of a fee, and if there is any change to the information previously provided, they must inform CIMA of the change within 21 days of said change.

The PE fund usually will require evidence identifying the branch or office of the bank from which subscription monies are being remitted or have been transferred, to verify that the account is in the name of the subscriber and retain a written record of such details. Normally, the PE fund and its general partner (or directors if it is an exempted company) reserve the right to request such information as is necessary to verify the identity of a subscriber. Any failure or delay by a subscriber to produce any information required for verification purposes could result in the PE fund refusing to accept the subscription application and the subscription monies relating thereto.

If any person who is resident in the Cayman Islands (including the general partner or a director) has a suspicion that a payment to the PE fund (by way of subscription or otherwise) contains the proceeds of criminal conduct, that person is required to report such suspicion pursuant to the Proceeds of Crime Act (as revised).

Pursuant to the Companies Act and the Limited Liability Companies Act (as revised), certain Cayman Islands companies and limited liability companies are required to maintain beneficial ownership registers at their registered offices. The information contained in such registers is required to be stored in encrypted form on a secure standalone search platform operated by the Cayman Islands government (the Search Platform). The principal purpose of the legislation is to make beneficial ownership information normally held by corporate service providers readily accessible in response to proper and lawful requests from specified law enforcement agencies (currently only those located in the Cayman Islands or the United Kingdom). The Search Platform is not currently publicly accessible and may only be searched by the Cayman Islands authorities following a request by one of the specified law enforcement agencies.

There are various exclusions to the requirement to maintain beneficial ownership registers. The most obvious of these is that the beneficial ownership regime does not apply to exempted limited partnerships. In addition, companies or limited liability companies that are registered under the Mutual Funds Act or managed or operated by an approved person (ie, someone regulated in the Cayman Islands or another approved jurisdiction, such as the United States) as an investment fund or private equity fund (or is a general partner of such an entity). This should exclude most, if not all, private equity funds from needing to maintain beneficial ownership registers. In any event, as the threshold for registration of a beneficial owner is 25 per cent or more of the shares or interests, or voting rights, it is unlikely that a private equity fund would need to include anyone in its beneficial owners even if it were not excluded.

Law stated - 3 January 2024

Licences and registrations

27 Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Usually, the person offering interests in a PE fund will be the investment manager or sponsor of the fund and, unless such person is domiciled in the Cayman Islands or carries on business in the Cayman Islands, there will be no requirement for that person to obtain licences or registration in the Cayman Islands provided that such PE fund is not offering interests redeemable at the option of investors and no registration with CIMA is required.

Law stated - 3 January 2024

Money laundering

28 Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The PE fund will be subject to the provisions of the Anti-Money Laundering Regulations (as revised) and Proceeds of Crime Act (as revised) of the Cayman Islands. To comply with these regulations and laws aimed at the prevention of money laundering and terrorist financing, the PE fund typically requires prospective investors to provide evidence to verify their identity and other information. The general partner of the PE fund, where it is structured as an ELP or the board of directors where it is structured as an exempted company, usually reserves the right to request such information as it considers necessary to verify the identity of a prospective investor. In addition, the PE fund would also be required to appoint a money laundering reporting officer, a deputy money laundering reporting officer and an anti-money laundering compliance officer.

As Cayman Islands-based PE funds will typically be considered financial institutions, they will be required to undertake due diligence on their investors to identify whether they are US specified persons (for FATCA purposes) and where they are tax resident (for CRS purposes) and disclose certain information to the TIA.

Law stated - 3 January 2024

EXCHANGE LISTING

Listing

29 Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

It is possible for a private equity fund (PE fund) established as either an exempted limited partnership or an exempted company to apply for a listing on the Cayman Islands Stock Exchange (CSX), but it would be unusual for a PE fund to do so. The principal advantage of obtaining a listing is that the PE fund's securities would be listed on a recognised exchange, which some institutional investors may require. However, the main disadvantage would be that it would add another layer of expense and formation procedures, which may not be necessary in order to facilitate a private equity transaction. The principal initial and ongoing requirements for listing are set out in Chapter 9 of the CSX Listing Rules.

Law stated - 3 January 2024

Restriction on transfers of interest

30 | To what extent can a listed fund restrict transfers of its interests?

Chapter 9 of the CSX Listing Rules provides that securities must be freely transferable, but certain transfer restrictions are allowed if they are adequately disclosed and approved by the CSX, such as where transfer restrictions are required in order to avoid breaching the securities laws of any relevant jurisdictions.

Law stated - 3 January 2024

PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS

Legal and regulatory restrictions

31 | Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

There are currently no such restrictions under Cayman Islands law.

Law stated - 3 January 2024

Compensation and profit-sharing

32 | Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

Other than the fiduciary duty of the general partner of an exempted limited partnership (ELP) to act in good faith and, subject to the express terms of the partnership agreement to the contrary, in the interests of the ELP, the duty of a manager of a limited liability company (LLC) to act in good faith (subject to the provisions of the operating agreement of the LLC) and the fiduciary duties of the directors of an exempted company, there are currently no specific legal or regulatory issues under Cayman Islands law that affect compensation and profit-sharing arrangements of a private equity fund. The structuring of such arrangements in a Cayman Islands PE fund is usually driven by the legal or regulatory requirements of certain onshore jurisdictions.

Law stated - 3 January 2024

UPDATE AND TRENDS

Key developments of the past year

33 What are the most significant recent trends and developments relating to private equity funds in your jurisdiction? What impact do you expect such trends and developments will have on global private equity fundraising and on private equity funds generally?

Statistics

As at Q3 2023, there were 16,530 private funds registered with the Cayman Islands Monetary Authority (CIMA) in the Cayman Islands. This is an increase from the 15,622 private funds registered with CIMA in 2022, representing the continual growth of the private equity fund market in the Cayman Islands. Registered private funds continued to exceed the number of registered mutual funds – which stood at 13,008 in Q3 2022 – for the second year in a row.

Corporate governance

On 14 April 2023, CIMA released a series of regulatory measures (the New Guidance), which includes the following:

- Rule and Statement of Guidance – Internal Controls for Regulated Entities;
- Rule – Corporate Governance for Regulated Entities; and
- an updated Statement of Guidance on Corporate Governance – Mutual Funds and Private Funds.

‘Regulated entities’ refers to all entities regulated by CIMA under the 'regulatory acts' as defined within the Monetary Authority Act (as revised), and includes mutual funds and private funds.

The New Guidance came into effect fully on 14 October 2023, bringing about enhanced internal control, corporate governance and board support requirements for all types of regulated entities, and introducing elevated guidance for mutual funds and private funds.

The New Guidance includes several reporting and documentation requirements, including the minuting of governing body meetings and a requirement for the governing body of a regulated entity to meet at least once annually. Additionally, the New Guidance includes a rule and statement of guidance that provide that the governing body of a regulated entity is ultimately responsible for ensuring that an adequate and effective system of internal control is established, documented and maintained.

Entities subject to the Cayman Islands anti-money laundering laws and regulations (the Cayman AML Regulations), including regulated investment funds, often delegate their compliance obligations. This includes the necessity to designate an AML compliance officer, a money laundering reporting officer (MLRO), and a deputy MLRO. Under the New Guidance, each of these roles is identified as a significant outsourced function. Consequently, the governing body of a regulated entity must thoughtfully assess its outsourcing arrangements and conduct thorough due diligence before enlisting the services of an outsourced provider. Individuals selected for AML officer positions must possess appropriate qualifications, relevant experience, and comprehensive knowledge of both the Cayman AML Regulations and the broader financial services sector.

Administrative Fines – AML

CIMA had its powers extended in 2023, with a new collection of bills enabling it to impose administrative fines. CIMA may now:

- impose administrative fines of up to US$120,000 for serious breaches and up to US$1.2 million for very serious breaches upon:
- individual directors;
- partnerships, exempted liability partnerships, limited liability partnerships, partners of such partnerships and unincorporated associations; and
- persons concerned in the management or control of those mentioned above;
- pro-actively share non-public information concerning criminal conduct in its possession with other overseas regulators.
- apply the disgorgement principle, intended to prevent any person who has breached the Monetary Authority Act or a regulatory law from avoiding loss or gaining financially, to all regulated entities and not just licensed entities; and
- use a simplified procedure for the exchange of information with the Minister for Financial Services.

FATF Grey List

On 27 October 2023, the Cayman Islands was removed from the Financial Action Task Force's (FATF) 'grey list' of countries that are under increased monitoring in relation to their anti-money laundering (AML), combating financing of terrorism (CFT) and counter-proliferation financing (CPF) regimes. This list relates to jurisdictions that are actively working with the FATF to address strategic deficiencies in their AML-CFT-CPF regimes, and should not be confused with the FATF 'black list' of non-cooperative jurisdictions or the EU list of non-cooperative jurisdictions for tax purposes.

With this significant milestone achieved, there is an expectation that the removal from the FATF's Grey List will soon lead to the Cayman Islands' delisting from the EU's AML/CFT List. The Ministry of Financial Services & Commerce of the Cayman Islands remains actively engaged in direct discussions with EU officials. Their objective is to further enhance the jurisdiction's regulatory framework to facilitate its removal from the EU's AML/CFT List.

Beneficial Ownership

On 30 August 2023, the Beneficial Ownership Transparency Bill, 2023 (the BOT Bill) was introduced to Parliament. The BOT Bill, which is expected to enter into force in 2024, is intended to consolidate several pieces of legislation into one beneficial ownership act and enhance the jurisdiction's current beneficial ownership regime to ensure compliance with the FATF's recommendations.

The noteworthy changes affecting Cayman Islands investment fund vehicles and fund managers/advisors are outlined as follows:

- All partnerships, including exempted limited partnerships commonly employed in investment fund structures, will now fall within the scope of the beneficial ownership regime.
- Existing exemptions in the current beneficial ownership regime, such as the one for funds registered under the Mutual Funds Act (as revised) or the Private Funds Act (as revised), will be eliminated. Instead, these funds can opt for an 'alternative route to compliance'. This entails providing their corporate services provider with contact details of a licensed fund administrator or other individual licensed or registered under a regulatory law to furnish beneficial ownership information promptly upon request by the competent authority –within 24 hours or a timeframe specified by the competent authority. This alternative compliance route does not extend to unregistered funds or other unregistered vehicles within a registered fund's structure; these entities will likely be subject to the requirement for mandatory provision of necessary particulars.
- The definition of 'beneficial owner' will undergo modification to align more closely with the definition employed in Cayman's Anti-Money Laundering Regulations. It is important to note that the ownership and control percentage thresholds will remain at 25 per cent.
- Entities registered with CIMA, or under the Securities Investment Business Act (as revised) or the Virtual Asset (Service Providers) Act, will lose their exemption status. Consequently, they will be obligated to establish and maintain a beneficial ownership register.

Law stated - 3 January 2024

Chris Humphries	chris.humphries@stuartslaw.com
Jonathan McLean	jon.mclean@stuartslaw.com
Megan Wright	megan.wright@stuartslaw.com
Joseph Bates	joseph.bates@stuartslaw.com

Stuarts Humphries

Read more from this firm on Lexology

Germany

Tarek Mardini, Enzo Biagi, Antonia Puglisi
POELLATH

Summary

FORMATION

Forms of vehicle

1 | What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The most common legal form is a closed-ended fund organised as a German limited partnership (KG) as it is tax-transparent, allows flexible structuring and provides limited liability to investors. KGs have separate legal personality. The general partner (GP) of the KG is personally liable for the debts of the KG. To reduce liability risks, typically a company with limited liability (GmbH) serves as GP (GmbH & Co KG). The investors join as limited partners. The fund manager is typically acting as managing limited partner of the KG. Besides the KG, several other legal forms are available for German private equity funds (eg, investment KG, investment AG, UBG). However, the KG is the market standard (in particular for registered, ie, 'sub-threshold', fund managers).

Law stated - 20 February 2024

Forming a private equity fund vehicle

2 | What is the process for forming a private equity fund vehicle in your jurisdiction?

The formation of a KG is simple. The KG comes into legal existence with the signing of the limited partnership agreement (LPA) by the GP and the limited partners. To ensure limited liability for investors, the KG and its partners will be registered in the German commercial register. Also, the beneficial owners must be reported to the transparency register. Notarisation of the LPA is not required, but the filing with the commercial register must be effected by a notary. Signatures of investors must be notarised by a notary public (if taking place outside Germany, generally an apostille in accordance with the Hague Convention has to be provided by the notary public). Limited partners in the form of an entity must provide proof of their valid existence and due representation by the signatories. The fees and expenses for the notarisation of filing with the commercial register and the registration fees are fairly small and generally do not exceed €2,000. Filings can usually be effected within two to four weeks. The KG itself has no minimum capital requirements. A minimum registered capital of €25,000 applies to a GmbH serving as GP.

Law stated - 20 February 2024

Requirements

3 | Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

A separate custodian is necessary if the fund is managed by a fully licensed manager under the KAGB (the German implementation of the Alternative Investment Fund Managers Directive (AIFMD)). A custodian is not necessary in the case of a registered (sub-threshold) manager. A fund in the form of a KG requires a domicile in Germany and must comply with the commercial law requirements regarding book-keeping. The fund manager typically serves as managing limited partner of the fund and also performs corporate secretarial and administrative tasks. A separate administrator is rather uncommon (as opposed to other jurisdictions).

Law stated - 20 February 2024

Access to information

4 What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The records maintained at the commercial registry are public via the internet. This includes the identity of the investors as limited partners and their liability amounts (typically expressed as a small percentage of the capital commitment). Such disclosure can be avoided by interposing a nominee as direct limited partner, to hold and manage its limited partner interest for and on behalf of the investors as beneficiaries. Filing of the partnership agreement is not required, thus the fund terms remain confidential. The partnership is required to file its annual financial statements with the commercial register and to publish them in the electronic Federal Gazette. The articles of association of the GP are filed with the commercial register and are available to the general public. Fines and other enforcement measures can be imposed for failure to make required filings. In 2018, Germany introduced the transparency register under the EU anti-money laundering law. The transparency register must include all beneficial owners unless the beneficial owners are already shown in public documents in the commercial register.

Law stated - 20 February 2024

Limited liability for third-party investors

5 In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

The investor's liability as limited partner in relation to the partnership is limited to such investor's capital commitment. Liability in relation to third-party creditors of the fund is limited to the liability amount registered with the commercial registry, typically a very small percentage of the actual capital commitment. If this amount has been paid into the partnership (and has not been repaid), then there is no additional liability of such limited partner to third parties. Potentially, there is a risk that a limited partner is treated as GP (ie, fully liable to third parties) for the period of time between its admittance to the partnership and registration of such limited partner with the commercial register (whether when subscribing to a fund in the fundraising process or in the case of a transfer). However, technical solutions are available and common to avoid such risk (eg, making the registration with commercial register a condition precedent for the formal admission to the partnership). Otherwise, there are generally no circumstances in which the limited liability of limited partners would not be respected as a matter of German law.

Law stated - 20 February 2024

Fund manager's fiduciary duties

6 What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

A fund manager's fiduciary duties are mainly based on the rules of conduct imposed by the AIFMD. This means a fund manager must act honestly, fairly and with due skill, act in the best interests of the fund and its investors and treat all investors fairly. Further, the fund manager must take all reasonable steps to avoid conflicts of interest where possible. These fiduciary duties cannot be altered by agreement. However, the fund manager and the investor can agree on higher threshold for the fund manager's liability.

Law stated - 20 February 2024

Gross negligence

7 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

The management of the fund (ie, the GP, the managing limited partner, or both) must by law apply the standard of care of a prudent business person. In particular, the management must follow the legal requirements for book-keeping, preparing of statutory accounts and filing of tax returns of the fund. In practice, however, partnership agreements typically restrict the liability of the GP and the managing limited partner to gross negligence and wilful misconduct. Some commentators in legal publications dispute, however, whether such a restricted standard of liability can be enforced in court as between the partners of a partnership.

Law stated - 20 February 2024

Other special issues or requirements

8 Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Fund sponsors need to be aware of the special rules on the taxation of a private equity fund. German regulated investors, such as insurance companies, require a free transferability of their interest in the fund. If the sponsor uses the limited partnership (GmbH & Co KG) as the most common private equity fund vehicle in Germany, investors need to be registered with the commercial register of the KG in order to be shielded from unlimited liability.

There are no specific rules for a conversion of a non-domestic vehicle into a domestic vehicle. Possible from a legal perspective is redomiciling of a non-domestic vehicle to Germany. This would result in the case of a limited partnership to a conversion of the vehicle into a German limited partnership (GmbH & Co KG). The most material change of such redomiciling will be the fact that the KG and its investors need to be registered with the local commercial register in order to benefit from limited liability. Potential negative tax effects of such conversion or redomiciling have to be analysed in advance on a case-by-case basis.

Law stated - 20 February 2024

Fund sponsor bankruptcy or change of control

9 With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

There are no legal or regulatory rules directly connecting an event at the fund sponsor level with the private equity fund and its GP and investment adviser. It is possible, though – depending on the group structure – that events such as bankruptcy, insolvency, change of control or restructuring at the sponsor level will lead to regulatory consequences at the manager level or at the level of the investment adviser. For instance, change of control events in the top holding company of a group will require a notification process to the regulator. Further, a bankruptcy or insolvency of the GP leads to an automatic removal of the GP from the fund and the fund being switched into 'run-down mode'.

In practice, it is common that the fund LPA contains at least change of control provisions with regard to the GP and the fund manager. It is then left to the negotiations with the investors how extensive these provisions are with regard to other events and other entities of the manager group.

Law stated - 20 February 2024

REGULATION, LICENSING AND REGISTRATION

Principal regulatory bodies

10 What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The regulatory body in Germany is the Federal Financial Supervisory Authority (BaFin). The regulation of private equity funds in Germany is based on the Alternative Investment Fund Managers Directive (AIFMD). The regulatory regime is therefore foremost a regulation of the manager and only indirectly a regulation of the fund itself. BaFin has inspection rights towards managers as well as the right to perform an audit. In addition, each fully licensed manager and registered manager must itself have an auditor perform an audit on the manager's regulatory compliance. The registered manager is obliged to have the annual financial statements and management report prepared by an auditor. The auditor also examines, whether the registered manager has fulfilled its obligations under the German Money Laundry Act (GwG) and complied with the provisions of the Capital Investment Code (KAGB). The auditor is obliged to send the report on the audit to BaFin without undue delay after completion of the audit.

Since August 2021, sub-threshold alternative investment fund managers (AIFM) have also been required to instruct a qualified independent third party (eg, an auditor) to audit how funds are being managed and whether the sub-threshold AIFM adheres to applicable notification obligations and anti-money laundering laws. The AIFM must notify the BaFin of the appointed auditor.

The regulatory reporting requirements are as follows:

Registered managers (AIFMD sub-threshold managers)

Reporting obligations to BaFin:

- annual report of information pursuant Annex IV of delegated regulation (EU) 231/2013 (AIFMD Annex IV Reporting).

Reporting obligations to the German federal bank (Bundesbank):

- monthly report regarding the composition of the fund's assets and the adjustment of the fund's assets as a result of revaluation; and
- quarterly reporting of granted loans of each amount over €1 million.

Fully licensed managers

Reporting obligations to BaFin:

- ad-hoc notifications in the case of material changes (eg, dismissal of a managing director or reduction of own funds);
- annual financial statement of the manager; and
- AIFMD Annex IV Reporting.

Reporting to Bundesbank:

- same as registered managers (see above).

As for the regulatory reporting to investors, half-yearly and yearly reports are mandatory for fully licensed managers. For registered managers, there is no regulatory investor reporting requirement; however, annual reports are required by German commercial law.

In respect of special funds, ie, non-retail funds, article 23 AIFMD disclosures must be provided if the fund is marketed in Germany or in the EU. In any case, a private placement memorandum (PPM) is commonly produced for all special funds to protect fund sponsors from civil litigation liability.

If a fund is marketed to semi-professional or retail investors, a key information document (PRIIPS KID) must be produced.

With regard to ESG reporting, the SFDR and Taxonomy Regulation require the disclosure of information regarding the ESG status of a fund. The level of disclosure under the SFDR depends on the relevant level of impact the fund intends to pursue. In general, funds are required to disclose pre-contractual information about the fund in the annex of the offering memorandum and on the website of the fund manager, as well as make ongoing disclosures of information about the fund as an annex to the annual report. The fund manager is also required to disclose information about itself on its website. Many details of these disclosures are still subject to additional rule-making and ongoing changes.

Law stated - 20 February 2024

Governmental requirements

11 What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Registered managers (AIFMD sub-threshold managers): registration process

Availability

The registration process is only available to certain small or medium-sized managers. The most important category of these small to medium-sized managers are known as sub-threshold managers under the AIFMD/KAGB. In practice, most German private equity fund managers fall within this category.

Sub-threshold managers under the KAGB are managers with assets under management of not more than €100 million (in the case of leverage) or not more than €500 million (no leverage) and who only manage special alternative investment funds (special AIFs). Special AIFs are AIFs whose interests or shares may only be acquired according to the fund documents by professional investors or semi-professional investors (ie, non-retail funds). Besides the requirements mentioned above, special private equity AIFs managed by sub-threshold managers are in principle not regulated.

An interesting option for a sub-threshold manager in the small to mid-cap market segment is to get additionally registered under the EU venture capital funds (EuVECA) regime to benefit from an EU marketing passport.

Registration procedure

The registration procedure for sub-threshold managers is comparatively simple. It requires the submission of an informal registration request together with certain 'corporate' documents on the manager and the managed funds (eg, the fund's limited partnership agreement and the manager's articles of association). In addition to being a special AIF, the fund may not require the investors to additionally pay in capital beyond the investor's original commitment.

The possible EuVECA registration is in line with the EuVECA requirements on the manager and the fund.

Ongoing issues

An advantage of the registration is that only few provisions of the KAGB apply to a registered-only manager; mainly the provisions on the registration requirements, ongoing reporting requirements and the general supervisory powers of BaFin. However, fund-specific requirements do not apply to registered-only managers and their funds. In particular, the depositary requirements and marketing requirements as well as the additional requirements of the KAGB for fully licensed managers do not apply.

On the downside, the registration restricts the manager to the type of funds and investors for which the registration was obtained (ie, only special AIFs and professional or semi-professional investors). Further, a registered manager does not benefit from the EU marketing passport under the AIFMD. A registered manager can, however, opt in to become a fully licensed manager.

Also, the special regulations according to which sub-threshold AIFM were allowed to manage retail funds have been abolished. Thus, all AIFM must be fully licensed to manage retail funds.

Fully licensed manager: licensing process

Availability

Fund managers who do not qualify for a registration or who opt out of a registration must apply for a full fund-management licence with BaFin under the KAGB. A full fund-management licence opens the door for a manager to market funds to retail investors as well as to the EU marketing passport under the AIFMD.

Licensing procedure

The licensing procedure is a fully fledged authorisation process with requirements equivalent to the requirements for granting permission under article 8 AIFMD. The licensing procedure checks requirements, such as sufficient initial capital or own funds, sufficiently good repute of the directors and shareholders, and organisational structure of the manager.

Ongoing issues

The licensing of the manager results in the manager being subject to the entirety of the KAGB. This means, in particular, the following:

- the required appointment of a depositary for the funds;
- access to setting up contractual funds;
- adherence to the corporate governance rules for funds set up as investment corporations or investment limited partnerships (investment KGs);
- adherence to the fund-related requirements of the KAGB;
- adherence to the marketing rules of the KAGB;
- access to the marketing passport under the AIFMD;
- access to the managing passport under the AIFMD; and
- adherence to the reporting requirements of the KAGB.

Law stated - 20 February 2024

Registration of investment adviser

12 Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

The German regime requires the entity that is conducting the portfolio and risk management of a fund to have a licence as a fund manager under the KAGB/AIFMD. There is no separate registration as an investment adviser. If a separate entity is advising the fund manager, such entity might need a Markets in Financial Instruments (MiFID) licence for investment advice.

Law stated - 20 February 2024

Fund manager requirements

13 Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

The regulatory requirements differ depending on whether the manager is fully licensed or a registered manager.

A registered manager does not have to meet any regulatory capital requirements or suitability requirements. It is sufficient for the manager to meet the capital requirements under company law (eg, €25,000 for a German company with limited liability (GmbH)). In practice, though, BaFin prefers to see that a registered manager has sufficient substance to be able to manage the fund.

The possible EuVECA registration requirements are in line with the EuVECA requirements on the manager and the fund.

A fully licensed manager must hold at least €125,000 initial capital. In addition, the manager must have additional own funds if the value of the assets under management exceeds €250 million. The additional own funds amount to 0.02 per cent of the value of the investment assets under management that exceeds €250 million. This corresponds to €20,000 per €100 million. Regardless of these calculations, the manager must have own funds amounting to at least 25 per cent of the fixed overhead costs.

A fully licensed manager needs at least two managing directors. The managing directors must be reliable and professionally suitable. The professional suitability is regularly given if the managing director has held a managerial position with a fund manager for at least three years. BaFin assesses the professional suitability individually, however, so the suitability can also be proven with less relevant professional experience.

Law stated - 20 February 2024

Political contributions

14 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are no such detailed rules or restrictions in Germany (other than the general criminal laws on bribery). This probably reflects the fact that investments of public pension plans and other governmental activities in private equity funds are still rather limited in Germany.

Law stated - 20 February 2024

Use of intermediaries and lobbyist registration

15 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

Where applicable, the disclosure requirements under MiFID II apply if intermediaries are used in the marketing of the fund interests. German law treats potential investors as the regulatory client of the MiFID intermediary. This results in the application of the MiFID rules of good conduct and cost-disclosures rules to the relationship between the intermediary and the potential investor.

In January 2022, the German Lobbying Register for the Representation of Special Interests vis-à vis the German Bundestag and the Federal Government entered into force. Individuals and legal entities involved in lobbying activities face extensive registration and (financial) disclosure obligations.

Law stated - 20 February 2024

Bank participation

16 Describe any key legal or regulatory developments (including those emerging from the 2008 global financial crisis) that specifically affect banks with respect to investing in or sponsoring private equity funds.

As a consequence of the global financial crisis, credit institutions within the meaning in the Capital Requirements Regulation are prohibited from conducting guarantee and credit business with private equity funds. However, this prohibition only applies if the balance sheet total of the credit institution exceeds a certain threshold. Under the same conditions, credit institutions are also prohibited from conducting proprietary business.

Law stated - 20 February 2024

TAXATION

Tax obligations

17 Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Partnerships

For funds in the form of a partnership (eg, a limited partnership (KG)), the general rules of taxation are applicable (ie, the special tax regime for corporate funds under the German Investment Tax Act, see below, is not applicable). Therefore, if the fund is structured as a partnership that is not engaged in trade or business, it is neither subject to German income tax nor German trade tax (ie, the partnership is treated as ‘transparent’ for tax purposes). Any income derived by the partnership is immediately allocated to its partners and taxed at the level of the partners in accordance with the rules of the tax regime applicable to the respective partner. On the other hand, if the fund vehicle qualifies as engaged in a trade or business, the fund itself is still not subject to German income tax, but it is subject to German trade tax.

There are no withholding tax implications at the level of the partnership itself. Withholding tax implications can arise from the underlying investments made by the fund.

Investment funds

Funds in the form of a corporation or of a contractual type are covered by the Investment Tax Act (investment funds). Under the opaque regime, the fund is subject to taxation with respect to certain domestic German income (in particular, dividends and real estate income, but not capital gains from the sale of securities unrelated to real estate and unrelated to a permanent establishment in Germany) at fund level (15 per cent tax rate (ie, German corporate tax)). The exemption for dividends (section 8b of the German Corporation Tax Act) is not applicable at fund level even if the relevant threshold (ie, 10 per cent) is exceeded. In addition, German trade tax may be triggered at fund level if it is engaged in trade or business in Germany (subject to a potential exemption if the fund does not engage in 'active entrepreneurial management' in relation to its assets).

Investment funds are required to withhold tax for the taxable income of their (domestic) investors, but not for the income from the sale of fund units.

In general, there are no tax exemptions at the level of the investment fund. In return, at the level of the investor investment fund proceeds are subject to partial exemptions depending on the respective fund type (equity fund, mixed fund or real estate fund).

At the investor level, there is a lump-sum taxation for investment fund proceeds (ie, distributions, predetermined tax bases and capital gains from dispositions or redemptions). For individual investors, the actual rate of investor level taxation depends on whether the investor holds the fund interests as part of their non-business or business assets. For individuals that hold their investment fund interests as part of their non-business assets, such items are subject to flat income tax. For individuals that hold their investment fund interests as part of their business assets, principally, the full amount of such items is subject to income tax at their personal rate. For corporate investors, the full amount of such items is subject to corporation tax. In addition, German trade tax may be triggered. The partial income taxation and the exemption pursuant to section 8b of the German Corporation Tax Act do not apply. In return, investment fund proceeds are subject to partial exemptions depending on the respective fund type. With respect to equity funds, the partial exemption is:

- 30 per cent of such proceeds for individuals that hold their investment fund interests as part of their non-business assets;
- 60 per cent for individuals that hold their investment fund interests as part of their business assets; and
- 80 per cent for corporate investors.

With respect to mixed funds, half of the applicable partial exemption rate applicable to equity funds is available. With respect to real estate funds, the partial exemption is 60 or 80 per cent of the proceeds, depending on whether the fund invests at least 51 per cent of its value in German or non-German real estate and real estate companies. In return, income-related expenses and operating expenses may not be deducted to the extent of the available partial exemption percentage. With regard to trade tax, half of the applicable partial exemption rate applies.

In addition, if the investment fund qualifies as a specialised investment fund, the fund may opt to be treated transparently for tax purposes. As a result, the fund itself would not be subject to taxation.

Law stated - 20 February 2024

Local taxation of non-resident investors

18 Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

In general, non-resident investors of a private equity fund structured as a partnership will be subject to taxes in Germany pursuant to the German general tax rules for non-residents. If the fund is structured as a partnership having asset management status (ie, is not deemed to be in business and not engaged in business activities for German tax purposes), non-resident investors are generally (if holding less than 1 per cent indirect share in such portfolio company) not taxed on capital gains realised by the fund from the sale of a portfolio company and they are not required to file tax returns in Germany. However, income of non-resident investors might be subject to the German withholding tax (eg, with regard to dividend distributions from a portfolio corporation held by the private equity fund). A refund, an exemption or a reduction of withholding tax may depend on certain filing procedures. This may also apply with regard to certain double taxation treaties.

The distributions to a non-resident investor of an investment fund will not be taxable in Germany and will not be subject to withholding tax. As a result, non-resident investors who make German investments via (domestic or foreign) investment funds only have to bear a German tax burden, as far as there is a taxation at fund level (fund input side). The German non-taxation of distributions to non-resident investors (fund output side) is completely independent of which assets the fund holds, in which country the investor is domiciled and whether there a double taxation agreement is applicable.

Law stated - 20 February 2024

Local tax authority ruling

19 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

It is desirable to obtain a binding ruling from the local tax authorities on the tax classification of the fund to increase the level of comfort of both investors (including foreign investors) and fund managers as the tax status may not be clear (also depending on the investment strategy). If the fund is structured as a partnership, an advanced tax ruling should ideally ensure that the asset management criteria are met from the point of view of the tax administration. For investment funds under the German Investment Tax Act that want to be taxed transparently, it may be desirable to obtain a binding ruling to ensure that the criteria for a specialised investment fund are fulfilled.

There is no special treatment of income from a fund in the form of a partnership. The income is taxed at the level of German-resident investors in accordance with the general rules applicable to the respective investor and the respective type of income. Domestic and foreign investors of investment funds are formally treated equally. However, the partial exemption rates provided in the German Investment Tax Act only benefit German investors, because foreign investors are generally not subject to any tax obligation in Germany at the level of the investment fund investor.

Law stated - 20 February 2024

Organisational taxes

20 Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There are no significant organisational taxes (including no stamp duties) required to be paid with respect to private equity funds organised in Germany.

Law stated - 20 February 2024

Special tax considerations

21 Describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Carried interest

The carried interest of a sponsor of an asset managing (ie, non-trading) private equity fund is not subject to German trade tax. In addition, there is a 40 per cent income tax exemption, resulting in an effective rate of income tax of around 28.5 per cent, if certain cumulative criteria are fulfilled (in particular, the fund must qualify for asset management status and the carried interest must be paid only after the investors have had all their invested capital paid back).

Otherwise, such income is potentially generally fully taxable at normal German income tax rates. However, a decision of the Federal Fiscal Court of Germany, issued in late 2018 and published in mid-2019, clarified the tax treatment of carried interest from business-type fund structures. The court ruled that carried interest received from a business-type private equity fund should be qualified as a (disproportionate) share of income. In other words, the decision rejected the view from the German tax authorities that, in the absence of the applicability of the special legislative rules for carried interest received from 'asset managing' funds, carried interest should be taxed as a (hidden) service fee at normal tax rates. As a consequence of this case law, the partial income applies insofar as the carried interest is comprised of capital gains or dividends. This also applies to private equity funds that are deemed-business or business-tainted only. From the sponsor perspective, this is good news, and results in a more or less uniform tax treatment of carried interest (irrespective of whether the fund is seen as a business-type fund or an asset management-type fund). It remains to be seen whether the tax authorities will accept this position (or initiate a legislative change).

Management fee

In general, the management fee payable to the managing partner of a fund was subject to the German VAT until the end of 2017 (regardless of whether such management fee was structured as a priority profit share). As part of revisions to the German VAT Act in 2018, the management of undertakings for the collective investment in transferable securities (UCITS), and of certain alternative investment funds (AIFs) that are comparable to UCITS, were exempted from VAT. The 2021 Act to Strengthen Germany as a Fund Jurisdiction amended the VAT Act again to include a tax exemption of the management fees of certain venture capital funds. Since the Act on Financing of the Future came into force in January 2024, the management of all AIFs is now exempted from VAT under German tax law. The former criteria of comparability of AIFs to UCITS or qualification as venture capital funds are therefore no longer relevant. This new law does not apply retroactively to the years prior to 2024.

Law stated - 20 February 2024

Tax treaties

22 List any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Germany has signed tax treaties with most OECD states and with many other states. Because of tax transparency, such treaties generally do not apply to a fund structured as a partnership, but apply directly to its partners. For the specific taxation under a tax treaty, it may be relevant whether the fund qualifies as a commercial or asset-managing partnership and if there is any permanent establishment. If the fund vehicle is structured as a corporation, such tax treaties generally apply to the corporate fund itself. However, each case must be carefully assessed for tax consequences arising from the applicable treaty and the relevant rules in each jurisdiction (eg, whether there is an applicable treaty override).

Law stated - 20 February 2024

Other significant tax issues

23 Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

Depending on the structure of the fund and its assets, different German tax regimes apply. The structure of the specific investment may have far-reaching tax consequences at the fund level, but also at the investor level (eg, the structure may be relevant for the question whether the income of a foreign investor in a German fund is taxable (and subject to German tax filings), subject to withholding tax or whether double taxation treaties apply). The German tax landscape is complex and subject to constant change. Thus consulting experienced tax counsel regarding the establishment and investment activities of the fund as well as fund investments by investors is highly recommended.

Law stated - 20 February 2024

SELLING RESTRICTIONS AND INVESTORS GENERALLY

Legal and regulatory restrictions

24 Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Only funds managed by German registered sub-threshold managers can be marketed on a private placement basis to professional and semi-professional investors in Germany. Also, marketing under the European venture capital funds regime is still rather simple and the regime provides an EU marketing passport. In the case of a fully licensed manager, the marketing of the fund requires Federal Financial Supervisory Authority (BaFin) approval.

Law stated - 20 February 2024

Types of investor

25 Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

It is possible to form a private equity fund for retail investors. However, market practice is that private equity funds are only formed for participations by semi-professional and professional investors.

Law stated - 20 February 2024

Identity of investors

26 Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

There are no regulatory filing requirements towards BaFin with regard to the identity of the fund investor. A fully licensed manager must notify BaFin of every change of ownership and every change of management with regard to the fund manager. A registered manager does not have these obligations. In the case of funds in the form of a limited partnership (KG), investors and any transfer of interests must be registered in the commercial register.

Law stated - 20 February 2024

Licences and registrations

27 Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

In principle, a person who sells financial instruments (including fund interests) needs a Markets in Financial Instruments (MiFID) licence under the Investment Firm Act. However, if the person sells only fund interests of a fund managed by a fully licensed alternative investment fund manager, a simpler licence under the German Trade Act suffices if the respective fund is approved for marketing in Germany. Germany has now adapted this simpler regime to the new MiFID II requirements on such a lighter-touch regime (with effect from August 2020). Unlike in the United Kingdom, German law considers the potential investor to be the regulatory client of the placement agent.

Law stated - 20 February 2024

Money laundering

28 Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The German Anti-Money Laundering Act is based on the EU Anti-Money Laundering Directive, and Germany implemented the most recent amendments of that Directive with effect from 2022. Every investor must be identified and the investor's beneficial owner must be disclosed (know-your-customer process). The obtained documents and information must be stored. In addition, Germany has implemented a transparency register with regard to beneficial owners in a vehicle. In a typical private equity structure, the aforementioned anti-money laundering requirements do not extend to the members of the sponsor (except for disclosures in the transparency register).

Law stated - 20 February 2024

EXCHANGE LISTING

Listing

29

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Private equity funds in Germany are typically structured as limited partnerships (KG). Partnership interests in these funds are not tradable on the stock exchanges. However, there are very few private equity companies structured as a corporation that are listed on the stock exchange. Such listing provides investors with greater liquidity as the shares are publicly traded, thus retail investors may invest. Unlike a fund organised as a partnership, however, a fund organised as corporation is not transparent, but is subject to German corporate tax at the fund level.

Law stated - 20 February 2024

Restriction on transfers of interest

30 To what extent can a listed fund restrict transfers of its interests?

According to German listing rules, it is practically impossible to restrict transfers of listed securities.

Law stated - 20 February 2024

PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS

Legal and regulatory restrictions

31 Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

There are no legal or regulatory restrictions for funds managed by German sub-threshold managers to participate in private equity transactions. Fully licensed alternative investment fund managers, however, must comply with the Alternative Investment Fund Managers Directive (AIFMD) anti-asset stripping rules and with the investment-related restrictions of the specific fund category. For instance, open-ended funds may invest only a limited percentage of their assets into unlisted companies.

Law stated - 20 February 2024

Compensation and profit-sharing

32 Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

The Federal Financial Supervisory Authority (BaFin) mentioned in an unofficial statement that carry beneficiaries may only be persons that promote the purpose of the fund. In addition, under the European Securities and Markets Authority's remuneration rules, carried interest is deemed to comply with the risk alignment and other requirements of the AIFMD if it is paid only after contributed capital and hurdle payments to the investors (and if there is a clawback). The taking of transactions fees should be disclosed in the fund documents. Typically, transaction fees are deducted from the management fee.

Law stated - 20 February 2024

UPDATE AND TRENDS

Key developments of the past year

33 What are the most significant recent trends and developments relating to private equity funds in your jurisdiction? What impact do you expect such trends and developments will have on global private equity fundraising and on private equity funds generally?

VAT exemption for all German AIFs

On 1 January 2024, the Act on Financing of the Future came into force. One of the key changes provided by this legislation is the VAT exemption for the management fee of all German AIFs. This exemption previously only applied to the management of UCITS and comparable AIFs, and certain venture capital funds. The VAT exemption now applies regardless of the type of regulation of the AIFM and the asset class the AIF is focusing on. Furthermore, in addition to all private equity and venture capital funds, the legislation also includes credit funds, real estate funds, infrastructure funds, any type of fund of funds, etc. At the same time, the qualification of the investors of the fund is no longer relevant. However, as the VAT exemption is linked to the regulatory qualification as an AIF, unregulated structures, such as single-investor funds (without the flexibility to accept further investors) or 'investment clubs' for which no capital has been raised, are not covered by the VAT exemption.

This general exemption of management fee from VAT aligns German law with the VAT regulations in most other EU member states, thereby eliminating a significant competitive disadvantage for Germany as a fund jurisdiction.

Anti-Tax Avoidance Directives

Following the implementation of the first two Anti-Tax Avoidance Directives (ATAD I and II) into German law, the EU Commission presented a draft of a new directive in December 2021. This draft was intended to adapt the ATAD and thus prevent the abuse of letterbox companies (shell companies) for tax purposes (ATAD III). The main goal of the proposal was to implement certain criteria to evidence that entities have sufficient substance on the ground to benefit from any national tax advantage.

Due to difficulties in reaching a political agreement on ATAD III, the Directive, which was originally scheduled to come into force in 2024, was provisionally suspended. A majority of EU member states reportedly support a change to the proposal that would see it implemented by way of an amendment to the Directive on Administrative Cooperation (DAC).

It remains to be seen whether the original proposal of an ATAD III will be continued on EU-level, or the new regulations implemented as an amendment to the DAC. In any case, substantial requirements for EU company entities will certainly not become less stringent.

Corporate Income Tax Modernisation Act

The Corporate Income Tax Modernisation Act entered into force on 1 January 2022. The main development is the provision of an irrevocable option for partnerships to be treated as corporates for tax purposes. This effectively results in a third form of tax treatment for alternative investment funds (AIFs) under the German tax laws. In addition to the options regarding the form and treatment of an AIF (ie, AIF in the form of a partnership treated under the general rules of German taxation for partnerships, or AIF formed as a corporation treated as an investment fund or specialised investment fund under the Investment Tax Act), there is now the option to treat an AIF formed as a partnership like a taxable corporate entity without falling within the scope of the German Investment Tax Act. While new and largely untested, this might be helpful to prevent foreign investors from tax declaration obligations in Germany and to retain the possible application of the taxation privilege for capital gains under section 8b of the German Corporation Tax Act (KStG) for German corporate investors, as well as the fund entity itself. This could potentially limit the tax leakage at the fund level. However, certain withholding tax issues likely make this option less attractive. It remains to be seen if, and in which scenarios, this third option will be adopted in practice.

New structuring options for domestic funds

The Act to Strengthen Germany as a Fund Jurisdiction also expanded the options available to fund managers with respect to permissible structuring options. The new range of permitted products includes, for instance, a master-feeder structure for closed-ended funds, the introduction of an open-ended infrastructure AIF in the form of a contractual fund, and a new option to use a contractual fund, which is opaque for tax purposes and subject to the German Investment Tax Act, as a closed-ended fund vehicle.

Other legislative developments include the German implementation of the amendment of the Alternative Investment Fund Managers Directive (AIFMD) regarding pre-marketing rules.

Markets in Crypto-Assets Regulation (MiCAR)

On 20 April 2023, the new Markets in Crypto-Assets Regulation (MiCAR) entered into force as part of a new regulatory framework for EU crypto-assets. The regulation covers the authorisation and supervision of both issuers of crypto-assets and their service providers. It also covers and defines the corresponding obligations concerning certain tokens (ie, value-referenced tokens – stablecoins, e-money tokens and, as a catch-all, crypto-assets). The main feature of the proposal is a comprehensive consumer protection regime for the issuance and trading of crypto assets, such as, in the case of cross-border EU distribution of crypto-assets, notification requirements or the mandatory publication of a prospectus-resembling crypto information sheet (white paper). At the same time, issuers and service providers of crypto-assets are to benefit from an EU passporting regime.

While some regulations of the MiCAR have been applicable since June 2023, other provisions will not apply until June or December 2024.

At present, Germany provides a legal framework for crypto commerce under national law as different types of crypto token are classified as financial instruments. However, the legal texts differ in their definition of crypto-assets; changes are thus to be expected for the German market.

Environmental, social and governance: taxonomy regulation

Regulation (EU) 2019/2088 on sustainabilityrelated disclosures in the financial services sector and Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment are going to challenge every participant on the financial market to assess the sustainability of their business and investments.

Since January 2022, funds that either seek to contribute to the achievement of an environmental goal (article 9 of the Sustainable Finance Disclosure Regulation (SFDR)) or advertise environmental features (article 8 of the SFDR) will be subject to further disclosure obligations according to the Taxonomy Regulation. In principle, these funds must disclose which environmental objectives the respective fund contributes to, and (likely even more difficult to implement) to what extent the fund invests in sustainable economic activity within the meaning of the Taxonomy Regulation.

As at January 2024, uncertainity remains as to certain aspects of the application of the SFDR and the Taxonomy Regulation. The Federal Financial Supervisory Authority has not issued guidelines on all aspects of sustainable investment funds, despite publishing a Q&A in September 2022, which most notably clarified the much-debated German translation of ‘promote’ in article 8 SDFR.

In September 2023 the European Comission started a comprehensive assessment of the SFDR to assess potential shortcomings. The consultation focuses on legal certainty, the useability of the SFDR and its ability to play its part in tackling greenwashing. It remains to be seen if the consultation might lead to significant changes in the disclosure requirements for issuers of financial products.

German Act to Modernise the Law on Partnerships (MoPeG)

After a transition period of around 2.5 years, a comprehensive reform of the German Law of Partnerships came into force on 1 January 2024. The reform adapts German partnership law to the requirements of a modern, diverse economic life, and codifies certain legal developments of the past decades that have already been carried out in case law, legal commentaries and practice. Among other important innovations (eg, a special new register for a standard German partnership), the law has certain implications for German limited partnerships as well (eg, the rules governing legal challenges to partnership resolutions).

AIFMD review

In November 2021, the EU Commission published a proposal for a directive amending the AIFMD and the UCITS Directive (AIFMD II). Two years later in November 2023, the final compromise text (Final Text) of the political agreement between representatives of the Council and the EU Parliament has been published as the result of trilogue negotiations. It must now be formally approved by both EU institutions. The vote in the European Parliament is scheduled for February 2024, with the Council vote expected to follow shortly afterwards. However, the amendments only supplement the Directives selectively.

Key developments in the Final Text are set out below.

Substance requirements

The EU Parliament and the Council saw a need for additions to the substance requirements for alternative investment fund managers (AIFMs). From now on, the competent supervisory authorities must be provided with more detailed information on the AIFMs' human and technical resources during the licensing procedure. It is required that (1) at least two natural persons decide on the management of the AIFM's business who are on a full-time basis either employed by the AIFM or executive members or members of the governing body of the AIFM and (2) who are domiciled, in the sense of having their habitual residence, in the Union. Regardless of this statutory minimum, more resources may be necessary depending on the size and complexity of the AIF.

Implementation of Liquidity Management Tools

The implementation of the Liquidity Management Tools (LMTs) simplifies liquidity management for open-ended funds. The LMTs contain mandatory rules as to how AIFMs of open-ended funds must ensure sufficient liquidity. It is now necessary to select at least two appropriate tools within the meaning of Annex V of the Amending Directive. The selection should be in line with the investment strategy, liquidity profile and redemption policy.

Reporting

The aim is to harmonise different reporting regimes through 'Level 2' measures, which the Commission will adopt at the proposal and elaboration of the European Securities and Markets Authority (ESMA). To better protect investors, the final version of the Amending Directive includes obligations to regularly disclose fees, charges and expenses that are borne by the AIFM and that are subsequently directly or indirectly allocated to the AIF or to any of its investments. AIFMs are also required to disclose all fees and expenses that were borne directly or indirectly by investors on an annual basis.

Delegation

A key development in the Final Text is the inclusion of delegation and sub-delegation reporting requirements for alternative AIFMs. In future, the competent national authorities need to be informed by the AIFM about delegation and sub-delegation arrangements as part of licence applications and regulatory reporting requirements. The information to be reported includes the total amount and the percentage of delegated assets under management (AuM), the organisational structure of the delegation and sub-delegation, and details of the delegates and their functions.

Loan-originating funds

Some changes provided by the Amending Directive will apply to all AIFs that grant loans, regardless of whether a specific threshold is reached. These include organisational requirements regarding the risk management of the AIFM, the ban on granting loans to governing bodies, a credit limit in relation to certain borrowers and the risk retention of the AIF.

Other, stricter rules will only apply to loan-originating funds (LOF), which are being comprehensively regulated and harmonised for the first time in the AIFMD II. A LOF has been defined as an AIF (1) whose investment strategy is primarily aimed at granting loans or (2) where the loans granted by the AIF account for at least 50 per cent of the net asset value of the AIF. LOF should generally be structured as closed-ended funds to avoid maturity mismatches and reduce credit default risks. AIFMs that wish to manage a lending AIF in an open-ended structure must be able to prove to the competent national supervisory authority that the AIF has liquidity management tools that are in line with its investment strategy and ensure fair treatment of investors. In the future, LOF are subject to a leverage limit of 175 per cent for open-ended funds and 300 per cent for closed-ended funds. This is intended to safeguard the stability and integrity of the financial system. The only exceptions apply to AIFs that exclusively grant shareholder loans.

Given the already rather strict German rules for LOF, we don't expect the currently discussed amendments to have a drastic effect on domestic AIFs.

Ancillary services

The list of ancillary services that can be provided by AIFMs has been extended by the final version. It now also includes administration of benchmarks, credit servicing and any other function or activity that is already provided by an AIFM in relation to an AIF that it manages, provided that any potential conflicts of interest are appropriately regulated. Contrary to the current regulation, ancillary services such as investment advice may even be provided in future if the AIFM does not engage in discretionary portfolio management.

Law stated - 20 February 2024

POELLATH+

Tarek Mardini tarek.mardini@pplaw.com
Enzo Biagi enzo.biagi@pplaw.com
Antonia Puglisi antonia.puglisi@pplaw.com

POELLATH

India

Divaspati Singh, Rahul Jain , Aditya Tandon
Khaitan & Co

Summary

EXCHANGE LISTING

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UPDATE AND TRENDS

FORMATION

Forms of vehicle

1 What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

Private equity funds in India (known as alternative investment funds (AIFs)) can be set up in the form of a trust under the Indian Trusts Act 1882, a company under the Companies Act 2013 (the Companies Act) or a limited liability partnership (LLP) under the Limited Liability Partnership Act 2008 (the LLP Act). AIFs in India are most commonly set up as trusts due to various structural efficiencies, lesser statutory compliance requirements, ease of setup, ease of operation and tax efficiency. Under Indian law, a trust is not a separate legal personality. The trustee is the legal and beneficial owner of the trust and holds the property in trust for the benefit of investors who hold a beneficial interest in the trust. The structure of an AIF set up as a trust involves:

- a settlor who settles the trust with an initial settlement amount;
- a trustee who is appointed by the settlor and is the legal owner of the trust;
- a manager who is appointed by the trustee to manage the assets of the trust and make investments or divestments; and
- contributors who are the investors and make capital commitments to the trust.

A company and an LLP are considered as legal personalities, separate from its shareholders and partners, respectively.

In a trust construct, investors will be 'contributors'; in an LLP they will be 'partners'; and in a company, they will be 'shareholders'. From a liability perspective, their obligations and liabilities will be limited to the extent of their capital commitments to the AIF.

The manager will be a separately appointed body pursuant to an agreement. The manager's liability under the SEBI (Alternative Investment Funds) Regulations 2012 (AIF Regulations) will stay the same irrespective of the nature of the AIF vehicle.

Law stated - 5 February 2024

Forming a private equity fund vehicle

2 What is the process for forming a private equity fund vehicle in your jurisdiction?

The process involves the following steps:

- identifying all the key stakeholders (ie, manager, sponsor, trustee (for trusts), merchant banker, etc);
- forming the fund vehicle;

- finalising the application form, private placement memorandum (PPM) of the first scheme of the AIF and the requisite documents and declarations; and
- filing the application with the Securities and Exchange Board of India (SEBI) for registration of the vehicle as an AIF under the AIF Regulations.

Pursuant to a recent amendment to the AIF Regulations, the application to SEBI is to be filed by a SEBI-registered merchant banker who is appointed by the manager.

AIFs can seek registration as a Category I (under any one of the multiple sub-categories, eg, venture capital fund, angel fund, infrastructure fund, etc), Category II or Category III AIF, and the category must be specified while filing the application.

A comparison table of some of the key parameters for each legal form of fund vehicle is set out below.

Trust	LLP	Company	
Incorporation process	Setup upon execution of the trust deed. Under the AIF Regulations, the trust deed is required to be registered with the sub-registrar, which takes approximately five to seven working days. The legal or regulatory service provider may assist in the incorporation and registration of the trust deed.	Filing of the incorporation form and requisite documents online. The Registrar of Companies (ROC) issues the certificate of incorporation once the form is approved. The legal or regulatory service provider may assist in incorporation.	Filing of the memorandum of association (MOA) and articles of association (AOA), the incorporation form and requisite documents online. The ROC issues the certificate of incorporation once the form is approved.
Timeline for setup	Two to three days post finalising the trust deed.	Three to four weeks.	Three to four weeks.
Minimum capitalisation	No.	No.	No.

Incorporation charges (approximate)	10,000 Indian rupees towards the initial settlement; and 2,000 Indian rupees towards registration and stamp duty.	30,000 Indian rupees.	30,000 Indian rupees.
Key stakeholders	• Trustee; • settlor; • manager; and • sponsor.	• Minimum two individual designated partners (one resident); • manager; and • sponsor.	• Minimum two shareholders and two directors (one resident); • manager; and • sponsor.
AIF application fee	100,000 Indian rupees (for all categories of AIF).		
AIF registration fee	• Category I: 500,000 Indian rupees; • Category I Angel Fund: 200,000 Indian rupees; • Category II: 1 million Indian rupees; and • Category III: 1.5 million Indian rupees.		
Timeline for SEBI approval	Three to four months from the date of application filing.		
Service providers and charges (approximate)	• Trustee (only for trust): one-time fee: 100,000 to 300,000 Indian rupees; and annual management fee: 100,000 to 300,000 Indian rupees; • ongoing compliances (per annum): company: 100,000 to 150,000 Indian rupees; and LLP: 50,000 to 60,000 Indian rupees; • merchant banker: PPM review and filing of application: 300,000 to 500,000 Indian		

	rupees; and ongoing engagement: 50,000 to 200,000 Indian rupees; and • auditor or legal professional (towards annual audit of PPM): 300,000 to 500,000 Indian rupees annually. Additionally, the following service providers are required (charges for these differ considerably depending on the service provider): • valuer (Category I and II AIFs must conduct biannual valuations. Category III AIFs must conduct monthly valuations); • registrar and transfer agent; • auditor; and • custodian (all AIFs shall appoint a custodian irrespective of their corpus).	

Law stated - 5 February 2024

Requirements

3 Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

There is no mandatory requirement for appointing a fund administrator. The manager of the AIF is responsible for managing the day-to-day activities of the AIF. While SEBI does not permit AIFs to outsource their core business activities (like investment-related activities of the AIF) and compliance functions, non-core activities can be outsourced. There are various administrator firms and third-party service providers in India who can provide these non-core services. Further, the manager needs to appoint a compliance officer for the AIF (typically an employee or director of the manager) to monitor compliances and notify SEBI of any lapses. Additionally, all categories of AIFs must appoint a custodian irrespective of their corpus.

The AIF is required to maintain a registered office in India. This may typically be the registered office of the manager or the trustee (in the case of a trust).

Further, AIFs set up as an LLP or company are required to statutorily maintain certain books and records and comply with other statutory requirements such as making regular filings with the ROC. These may be done by the manager or the AIF's employees or may be outsourced to a compliance service provider. There are no statutory compliances for AIFs set up as trusts. Additionally, the AIF Regulations prescribe reporting and compliance requirements for AIFs.

Law stated - 5 February 2024

Access to information

4 What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The registration details and registered address of an AIF are publicly available on SEBI's website. Information regarding the commercials of the AIF, identities of its investors and their capital commitments is not disclosed by SEBI on any public platform.

Further, the trust deed is a public document and may be accessible through the registrar's office. However, the trust deed typically does not contain any commercial details or names of the investors and is only a broad and overarching document. Most commercial details are contained in the contribution agreement, PPM and investment management agreement, which are not available on any public platform.

For AIFs set up as an LLP or company, the investors will be partners or shareholders respectively. The details of the same (including the LLP Agreement and MOA or AOA of the company) is publicly available only on the website of the Ministry of Corporate Affairs pursuant to payment of a small fee.

Law stated - 5 February 2024

Limited liability for third-party investors

5 In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

A shareholder's liability under the Companies Act is limited to the amount unpaid to the company with respect to the shares held by it. Similarly, a partner's liability under the LLP Act is limited to the amount that the partner has agreed to contribute to the LLP. A shareholder or partner may be held liable if the courts lift the corporate veil, which is usually done in limited circumstances such as any unauthorised acts, fraud or negligence. While courts may lift the 'corporate veil', but considering the limited role played by the investor and that the control is being exercised by the manager, the risk of this is fairly low from a third-party investor standpoint. In the case of trusts, the liability of each contributor is specified in the trust deed and the courts will typically respect that.

Law stated - 5 February 2024

Fund manager's fiduciary duties

6 What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

The manager and sponsor are obligated to act in a fiduciary capacity towards the investors of the AIF, disclose all conflicts of interest to investors as and when they arise and establish and implement written policies and procedures to identify, monitor and mitigate conflicts of interest. The manager is required to ensure transparency and periodically disclose information to investors.

Additionally, the manager is obliged under the AIF Regulations to:

- address all investor complaints;
- provide all information sought by SEBI;
- maintain all records specified by SEBI;
- take all steps to address conflicts of interest; and
- ensure transparency and make disclosures as required in the AIF Regulations.

Further, SEBI has introduced a code of conduct that AIFs, their managers and their key management personnel, trustee, trustee company and its directors, designated partners, directors of the AIF or members of the investment committee are required to adopt and abide by. Under the code of conduct applicable to managers of AIFs, the manager shall, inter alia, act in fiduciary capacity ensuring the decisions are taken in the interest of investors, maintain integrity, highest ethical and professional standards in all its dealings, ensure proper care and exercise due diligence and independent professional judgment in all its decisions, etc.

These fiduciary duties of the manager are set out in the AIF Regulations and therefore these cannot be modified by any agreement between parties.

Law stated - 5 February 2024

Gross negligence

7 Does your jurisdiction recognise a ‘gross negligence’ (as opposed to ‘ordinary negligence’) standard of liability applicable to the management of a private equity fund?

Typically, the fund documents restrict the manager’s liability to certain acts such as fraud, gross negligence and wilful misconduct, etc. The jurisprudence on ‘negligence’ suggests that Indian courts view negligence from a civil liability perspective for which a standard of care has been prescribed, whereas ‘gross negligence’ may be viewed in the context of criminal negligence imputing criminal liability, and not from the perspective of imputing any civil liability, and in such cases, courts will also assess whether there was any mala fide act involved or existence of moral turpitude.

Having said that, the AIF Regulations have mentioned the term ‘gross negligence’ in the code of conduct applicable to members of the investment committee, trustee, trustee company, directors of the trustee company, directors or designated partners of the AIF, where the aforesaid members shall not indulge in any unethical practice or professional misconduct or any act, whether by omission or commission, which is tantamount to gross negligence or fraud.

Law stated - 5 February 2024

Other special issues or requirements

8 Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

AIFs can raise funds only on a private placement basis by issuing a private placement memorandum (PPM) to investors. The PPM must be in the template PPM format issued by SEBI in 2020 (not applicable to angel funds and schemes of AIFs in which each investor commits 700 million Indian rupees and provides a waiver from such compliance) and must contain all material information that would assist the investors to make an informed decision about making an investment in the AIF. The template PPM mandates disclosures in relation to commercial terms like transfers, investor governance rights, expenses charged to investors, removal of the manager and investor giveback, etc; however, SEBI does not impose any restrictions in relation to these terms, provided they comply with the AIF Regulations.

There are no restrictions on transfers under the AIF Regulations; however, each investor must hold the minimum regulatory investment specified in the AIF Regulations. Further, Category I and II AIFs are close-ended, therefore, no withdrawals are possible. Redemptions are permitted only in the case of open-ended Category III AIFs.

Further, any material changes to the AIF documents including changes to the fee structure or hurdle rate, etc, which may result in higher fees being charged to investors have to be approved by at least 75 per cent of investors and dissenting investors have to be given an exit option.

Additionally, the AIF Regulations limit the maximum number of investors in a scheme of an AIF to 1,000 except schemes of angel funds, which cannot have more than 200 angel investors. Further, the Companies Act shall apply to AIFs set up as companies; therefore, they will have to adhere to the private placement norms set out in the Companies Act, including the compliance requirements specified therein.

Further, conversion or redomiciling to vehicles in India is not envisaged under the AIF Regulations.

Law stated - 5 February 2024

Fund sponsor bankruptcy or change of control

9 With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

The consequences of a bankruptcy, insolvency, restructuring or a similar transaction of the manager or sponsor are typically governed by the fund documents of the AIF and subject to negotiations between the fund and the investors. However, usually, a bankruptcy or insolvency of the manager or sponsor results in an automatic removal of the manager or sponsor. Further, according to the AIF Regulations, a change of control of the manager or sponsor requires prior approval of SEBI. In addition, SEBI has stated that a change in sponsor or manager (not including an internal restructuring within the group) or change in control of the manager or sponsor is a material change that can significantly influence the decision of an investor to continue to remain invested in the AIF. Therefore, in such circumstances, the manager is required to conduct a vote of the investors and in the event that it receives less than 75 per cent vote of investors, it is required to give the dissenting investors an exit option.

Law stated - 5 February 2024

REGULATION, LICENSING AND REGISTRATION

Principal regulatory bodies

10 What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The principal regulatory body that regulates alternative investment funds (AIFs) in India is the Securities and Exchange Board of India (SEBI), with which AIFs are required to register before they can accept commitments from investors and commence operations as AIFs. SEBI is the securities market regulator of India and is established under the SEBI Act 1992. The manager does not need to be separately registered with SEBI to be eligible to act as the manager of an AIF; however, it is regulated by SEBI under the SEBI (Alternative Investment Funds) Regulations 2012 (the AIF Regulations).

SEBI is empowered under the SEBI Act 1992 and the AIF Regulations to undertake inspection of books of accounts, records and documents related to AIFs for reasons including, but not limited to, ensuring that these are maintained in the manner set out in the AIF Regulations, inspecting complaints received from investors, clients that have a bearing on the activities of the AIF and ensuring compliance with the AIF Regulations, etc. Further, SEBI has the power to conduct searches and seizures, impose penalties and issue orders against the AIF and its manager.

Additionally, AIFs and their managers set up as limited liability partnerships and companies are also regulated by the Registrar of Companies under their respective legislation.

Reporting requirements

All categories of AIFs must submit reports to SEBI on a quarterly basis in the prescribed format. In addition, Category III AIFs must submit a report on leverage undertaken on a quarterly basis.

Category I and II AIFs must provide reports about the financial information of investee companies and details of material risks to investors annually within 180 days from the year-end. Category III AIFs are required to provide this information on a quarterly basis within 60 days of the end of the quarter. Further, Category I and II AIFs must undertake the valuation of their investments biannually. Category III AIFs must calculate the net asset value and disclose to investors on a quarterly basis for close-ended AIFs, and a monthly basis for open-ended AIFs.

The manager and sponsor are required to make periodic disclosures to the investors from a transparency and governance perspective, such as conflicts of interest, fees ascribed to the manager or sponsor, etc. Further, any changes to the key management personnel of the AIF and manager must be intimated to SEBI and the investors. Additionally, any changes to the private placement memorandum (PPM) and other fund documents of the AIF must be intimated to SEBI and investors on a consolidated basis within one month of the end of each financial year.

The manager is also required to prepare a compliance test report (CTR) at the end of each financial year and submit the same to the trustee of the AIF, and any violation of the AIF Regulations observed in the CTR needs to be reported to SEBI.

In a recent development, to ensure compliance with the terms of PPM, all AIFs (unless they are exempt under the AIF Regulations) are mandated to carry out an annual audit of such compliance. The manager has to report the findings of the audit, along with corrective steps, if any, to SEBI and the trustee, board of directors or designated partners of the AIF.

Law stated - 5 February 2024

Governmental requirements

11 What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

All pooling vehicles set up for the purposes of making investments are required to make an application and register with SEBI as AIFs prior to accepting commitments from investors and commencing operations as AIFs, unless there are specific carve-outs provided under the SEBI regulations.

Law stated - 5 February 2024

Registration of investment adviser

12 Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

While there is no requirement for the AIF manager or its officers, directors or key personnel to register as investment advisers in India, the manager will have to register as a co-investment portfolio manager with SEBI under the SEBI (Portfolio Managers) Regulations 2020 if it is offering co-investment opportunities to the AIF's investors.

Law stated - 5 February 2024

Fund manager requirements

13 Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

Every AIF is required to have a manager and sponsor (which could be the same entity as the manager). The manager needs to be located in India and needs to have the necessary infrastructure and manpower to carry out the activities of the manager of an AIF. Further, the manager and sponsor of the AIF are expected to satisfy the 'fit and proper person' criteria set out in the SEBI (Intermediaries) Regulations 2008 and submit a declaration to that effect to SEBI.

Further, the manager or sponsor are mandated by the AIF Regulations to maintain a continuing interest in the AIF at all times as 'skin in the game'. The continuing interest to be maintained is the lower of 2.5 per cent of the corpus or 50 million Indian rupees for a Category I and II AIF and the lower of 5 per cent of the corpus or 100 million Indian rupees for a Category III AIF.

Additionally, the key investment team of the AIF manager needs to have:

- at least one key personnel with a professional qualification in finance, accountancy, business management, commerce, economics, capital markets or banking from an institution recognised by the government or a foreign university or a Chartered Financial Analyst (CFA) charter from the CFA Institute; and
- at least five years' experience in advising or managing pools of capital or in fund, asset, wealth or portfolio management or in the business of buying, selling and dealing of securities or other financial assets.

The requirements under both points above can be fulfilled by the same person or by two separate individuals.

Law stated - 5 February 2024

Political contributions

14 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are no specific rules that restrict or require disclosure of political contributions by an AIF's manager or investment adviser or their employees in India.

Law stated - 5 February 2024

Use of intermediaries and lobbyist registration

15 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There are no specific rules of public pension plans or other governmental entities in India restricting or requiring disclosure of engagement of placement agents or other intermediaries by an AIF's manager while marketing the AIF to public pension plans and other governmental entities. However, if the AIF is going to bear any expenses in relation to placement agents or distributors, the same needs to be disclosed in the PPM.

Law stated - 5 February 2024

Bank participation

16 Describe any key legal or regulatory developments (including those emerging from the 2008 global financial crisis) that specifically affect banks with respect to investing in or sponsoring private equity funds.

The Reserve Bank of India (RBI) has imposed restrictions on the ability of Indian banks to make investments in AIFs. Banks in India are not permitted to invest more than 10 per cent of the paid-up capital or unit capital of a Category I or Category II AIF without RBI approval. Higher investment would require prior approval from RBI. However, there is an overall cap of 20 per cent of their net worth that is permitted for direct investments in shares, convertible bonds or debentures, units of equity-oriented mutual funds and exposures to AIFs. Further, banks are not permitted to invest in Category III AIFs. However, subsidiaries of banks can invest in Category III AIFs up to the regulatory minima prescribed by SEBI.

Law stated - 5 February 2024

TAXATION

Tax obligations

17 Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Indian tax law provides for a special tax regime with respect to Category I and Category II alternative investment funds (AIFs). Any income other than profits and gains from business or profession is exempt from tax in the hands of a Category I and Category II AIF but taxed in the hands of investors of Category I and Category II AIFs on a pass-through basis, as if such investments were directly made by the investors.

However, the income in the nature of profits and gains from business or profession is taxed in the hands of Category I and Category II AIFs and exempt from tax in the hands of investors.

There are comprehensive withholding tax provisions applicable with respect to certain specified payments to Indian tax residents and on all payments to non-residents. As per the specific provisions, income (other than profits and gains from business and profession) receivable by a Category I and II AIF is exempt from withholding of tax by the payor. On the distribution of income (other than profits and gains from business or profession) by Category I and II AIFs to the investors, Category I and II AIFs are required to withhold tax at 10 per cent in the case of Indian resident investors and at the rates in force for the non-resident investors.

In the case of a Category III AIF, the tax implications would differ depending on whether such AIF is in the form of a company or limited liability partnership (LLP) or a trust. In the case of a company, the income arising on investments will be taxed at the applicable corporate tax rate and subsequent distribution of profits as a dividend will be taxed in the hands of the shareholder (investors). The company would be required to withhold applicable taxes prior to the distribution of dividends. An LLP will be taxed on entire income at the applicable rate and any distribution to the partners (as a share of profit) is exempt from tax in the hands of LLP as well as the partners.

However, a Category III AIF is typically set up in the form of a trust with a share of each investor being defined under the investment documents. The income earned by a determinate trust could be taxed either in the hands of the trustee as a representative assessee of the investors or in the hands of the investors directly. Where the trustee is assessed as representative assessee of the investor, it should be taxed in the same manner as if the income was taxed directly in the hands of investors. There is though one exception to this principle: if the income includes profits and gains from business or profession, the entire income in respect of which the trustee is liable as representative assessee of the investor could be taxed at maximum marginal rate.

Further, there is a special tax regime with respect to a Category III AIF set up in the Gujarat International Finance Tec-City (GIFT City), the units of which are held by non-resident investors except for the sponsor and manager. Interest and dividend income earned by and in the hands of such AIF is taxed at 10 per cent. Capital gains on the sale of securities (other than shares held in an Indian company) are exempt from tax. The non-resident investors in such AIF are exempt from taxation.

Law stated - 5 February 2024

Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Yes, in the case of investment in a Category I or II AIF, income (other than profits and gains from business or profession) attributable to non-resident investors will be taxed directly in their hands. The tax rate would vary depending on the nature of income (ie, capital gains, dividend or interest income) and eligibility to tax treaty benefit, if any. Further, all the non-resident investors earning income from India need to file their annual income tax returns in India.

For non-resident investors in a Category III AIF being a trust, an income tax return is to be filed in India unless the trustee pays tax as representative assessee.

If the Category III AIF is a company and the non-resident investors have only earned dividend income from India, the income tax return is to be filed in India unless the tax on such dividend is withheld as per the rates provided under Indian tax law. However, if the Category III AIF is an LLP and investors has only received a share of profit, investors should not be required to file their tax return in India.

Further, where the AIF is situated in GIFT City, the non-resident investors in such AIF should not be required to obtain a Permanent Account Number (an Indian tax registration) and file an income tax return, provided such investor has earned income during the relevant financial year solely from the AIF in GIFT City and the AIF has withheld applicable taxes on income payable to the investor.

Law stated - 5 February 2024

Local tax authority ruling

19 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

At the outset, there is an option available for the taxpayers to approach the Board of Advance Ruling to determine the tax treatment of any particular transaction. However, it is not necessary for a private equity fund in India to obtain a ruling from the local tax authorities. Further, it is not generally desired as there is clarity on the tax treatment of income earned by a private equity fund and the process is time-consuming,

On the question of tax rules for Indian tax resident investors, such investors are liable to tax on their global income in India. In terms of differentiation, distribution by a Category I and II AIF to Indian resident investors is subject to withholding of tax at 10 per cent (in all cases) as against non-resident investors (for whom the applicable rate is to be applied).

Law stated - 5 February 2024

Organisational taxes

20

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

From an income tax perspective, Category I and II AIFs are subject to tax on the profits and gains from business or profession. Further, stamp duty will be payable on the setup of the fund vehicle as well as the issue of units by the AIF. While the stamp duty on the setup of a trust and LLP is insignificant, the stamp duty payable for the incorporation of a company would depend on the authorised share capital of the company. Additionally, the stamp duty payable on the issue of units will be 0.005 per cent of the value of the units (ie, stamp duty of 500 Indian rupees will be payable if units are issued for 10 million Indian rupees).

Law stated - 5 February 2024

Special tax considerations

21 Describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Generally, the sponsor would subscribe to the units for minimum capital commitment. The return on such units will be taxed as if the sponsor is a regular investor.

Additionally, the sponsor may be entitled to received carried interest. The tax implication for carried interest would primarily depend on whether such carried interest is in the nature of a performance fee or incentive, in which case it could be treated as business income or ordinary income or a return on investment that is taxable as a capital gain.

With respect to the management fee, the Indian manager would be taxed in India at an ordinary rate.

Law stated - 5 February 2024

Tax treaties

22 List any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

To date, India has tax treaties in place with more than 80 countries. As a principle, if a taxpayer is a non-resident in India and tax resident of a country with which India has a tax treaty, such taxpayer could be taxed as per the beneficial provisions under the applicable tax treaty. Therefore, if the non-resident investors in the fund are eligible for any tax treaty benefit, income attributable to such investor will be taxed in India as per those beneficial provisions. The eligibility to tax treaty benefit is a mixed question of law and fact and needs to be assessed appropriately.

Law stated - 5 February 2024

Other significant tax issues

23 Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

Under Indian tax law, where any person acquires shares or securities at a price lower than its fair value computed as per tax rules, the difference between such fair value and actual purchase price, is taxed as ordinary income for the recipient. The units in an AIF fall within the definition of securities and therefore, if the price paid by the investors for the purchase of units is lower than its fair value (open market value), the difference between such fair value and purchase price is taxable in the hands of investors.

Law stated - 5 February 2024

SELLING RESTRICTIONS AND INVESTORS GENERALLY

Legal and regulatory restrictions

24 Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Alternative investment funds (AIFs) are permitted to solicit and raise capital commitments from investors only on a private placement basis by issuing a private placement memorandum. The units cannot be issued to the public at large. An AIF as a product is meant for sophisticated and private investors who have the ability to commit a large quantum of capital to the AIF and are willing to accept the high risks involved in investments made by such vehicles. Each investor has to make a capital commitment of at least 10 million Indian rupees, except angel investors investing in angel funds (2.5 million Indian rupees) and accredited investors, and has to comply with know-your-customer (KYC) norms prescribed by the *S*ecurities and Exchange Board of India (SEBI) and the AIF manager. Further, the maximum number of investors in a scheme of an AIF is restricted to 1,000 except schemes of angel funds, which cannot have more than 200 angel investors. Further, the Companies Act shall apply to AIFs set up as companies; therefore, they will have to adhere to the private placement norms set out in the Companies Act, including the compliance requirements specified therein.

Law stated - 5 February 2024

Types of investor

25 Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

There are no restrictions on the types of investors that may invest in AIFs in India. Indian, foreign and non-resident investors are permitted to invest in AIFs. Investors in AIFs typically include institutional investors, high net worth individuals, banks, pension funds, insurance companies, family offices, sovereign wealth funds and fund of funds, etc. Banks, insurance companies and pension funds, etc, have to comply with restrictions imposed by their respective regulators in respect of their investments in AIFs. Each investor has to make a minimum capital commitment to the AIF.

In August 2021, SEBI introduced the concept of 'accredited investor' in the SEBI (Alternative Investment Funds) Regulations 2012. An accredited investor is a person who is granted a certificate of accreditation by an accreditation agency and who satisfies certain prescribed financial parameters. Accredited investors are exempt from the minimum 10 million Indian rupees investment threshold that is applicable to other investors.

Such investors should satisfy the following criteria for being eligible to apply for accreditation:

- in the case of an individual, Hindu undivided family, family trust or sole proprietorship, has:
    - an annual income of at least 20 million Indian rupees;
    - a net worth of at least 75 million Indian rupees, out of which not less than half is in the form of financial assets; or
    - an annual income of at least 10 million Indian rupees and a minimum net worth of 50 million Indian rupees, out of which not less than half is in the form of financial assets; and
- in the case of body corporate, has a net worth of at least 500 million Indian rupees;
- in the case of trust (other than a family trust), has a net worth of at least 500 million Indian rupees; and
- in the case of a partnership firm incorporated under the Indian Partnership Act 1932, each partner must independently meet the applicable eligibility criteria (detailed above) for accreditation.

Further, certain investors like the central government or state governments, developmental or fund entities set up by them, qualified institutional buyers under the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018, Category I foreign portfolio investors, sovereign wealth funds and multilateral agencies, and other entities notified by SEBI would be deemed to be accredited investors, with no requirement to obtain a certificate of accreditation.

Law stated - 5 February 2024

Identity of investors

26 Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

Yes, the AIF manager is required to file the electronic copy of each investor's KYC records with the Central KYC Records Registry. In the case of the transfer of units, the incoming investor has to comply with the KYC norms required by SEBI. India's foreign exchange regulations require AIFs issuing units to persons resident outside India to file Form InVi within 30 days of issuing the units; however, the identity of the investor to whom the units are being issued does not need to be disclosed.

Further, AIFs are required to inform SEBI if there is any change in the sponsor, manager or designated partners of the AIF or if there is any other material change from the information provided to SEBI at the time of registration of the AIF. Additionally, a change in control of the AIF, manager or sponsor requires the prior approval of SEBI.

Law stated - 5 February 2024

Licences and registrations

27 Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

No, there is no requirement for distributors or placement agents that offer interests in AIFs to obtain any licences or registrations for undertaking such activity in relation to an AIF.

Law stated - 5 February 2024

Money laundering

28 Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The Prevention of Money Laundering Act 2002 (PMLA) read with the Prevention of Money-Laundering (Maintenance of Records) Rules 2005 (the PMLA Rules) is India's principal legislation dealing with the prevention of money laundering. Additionally, SEBI, in February 2023, issued a master circular with guidelines on 'Anti-Money Laundering (AML) Standards and Combating the Financing of Terrorism or Obligations of Securities Markets intermediaries under PMLA and PMLA Rules' (the SEBI Master Circular).

According to the PMLA Rules and the SEBI Master Circular, reporting entities, including AIFs, are required to maintain records of cash transactions above the monetary threshold specified in the PMLA and suspicious transactions whether or not made in cash and including, inter alia, credits or debits into from any non-monetary account such as a demat or security account maintained by the AIF.

Further, AIFs must:

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appoint a 'principal officer' and 'designated director' and the principal officer is required to furnish information in accordance with the PMLA Rules to the director appointed under the PMLA by the central government; and

- adhere to client account opening procedures and maintain records of the aforesaid transactions. The records are to be maintained for a period of five years after the business relationship between the client and AIF has ended or the account has been closed, whichever is later.

The SEBI Master Circular mandates AIFs to adopt written AML procedures in respect of client due diligence (procedures for acceptance and identification of clients and monitoring transactions, etc), maintaining and storing records of clients and transactions in compliance with the PMLA and PMLA Rules, reporting of suspicious transactions to the Director of the Financial Intelligence Unit – India.

Further, the manager of the AIF is required to register with the Central KYC Records Registry and file the electronic copy of the client´s KYC records with the Central KYC Records Registry.

Law stated - 5 February 2024

EXCHANGE LISTING

Listing

29 | Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Yes, close-ended alternative investment funds (AIFs) are permitted to list their units on a stock exchange. The units can be listed only after the final closing of the fund and the minimum tradable lot has been prescribed under the SEBI (Alternative Investment Funds) Regulations 2012 to be 10 million Indian rupees. However, to date, no AIF has listed its units on a stock exchange. While the stock exchanges have enabled and notified the listing process, the listing agreement for the AIF under the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 has not been notified.

Law stated - 5 February 2024

Restriction on transfers of interest

30 | To what extent can a listed fund restrict transfers of its interests?

While there are no specific regulations notified that govern the listing of AIFs, practically, an AIF whose units are listed cannot restrict transfers of its interests, subject to the minimum lot size.

Law stated - 5 February 2024

PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS

Legal and regulatory restrictions

31 Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

Yes, all alternative investment funds (AIFs) have to comply with the diversification norms prescribed in the SEBI (Alternative Investment Funds) Regulations 2012 (the AIF Regulations). The following investment restrictions apply to all categories of AIFs:

- AIFs cannot invest more than 25 per cent of their investible funds (the corpus of the scheme of the AIF net of expenditure for administration and management of the AIF estimated for the tenure of the AIF) in equity or equity-linked instruments of companies incorporated outside India, subject to conditions or guidelines issued by the Reserve Bank of India;
- Category I and II AIFs cannot invest more than 25 per cent of their investible funds in an investee company directly or through investment in the units of other AIFs; however, for large value funds for accredited investors (schemes of AIFs in which each investor (other than the manager, sponsor, employees, directors of the AIF or manager) is an accredited investor and invests at least 700 million Indian rupees in the scheme. These funds are meant only for accredited investors, and, therefore, have been granted certain relaxations under the AIF Regulations), this limit is up to 50 per cent of the investible funds;
- Category III AIFs cannot invest more than 10 per cent of the investible funds in an investee company directly or through investment in units of other AIFs; however, for large value funds for accredited investors, this limit is up to 20 per cent of the investible funds in an investee company, provided that for investments in listed equity of an investee company, the 10 per cent/20 per cent limit (as applicable) would be calculated on either the investible funds or the net asset value. Any passive breach of the aforesaid investment limit in listed equities has to be rectified within 30 days of the breach;
- AIFs that are authorised under the fund documents to invest in units of AIFs cannot offer their units for subscription to other AIFs;
- AIFs cannot invest in (1) associates or (2) units of AIFs managed or sponsored by its manager, sponsor or associates of its manager or sponsor, without obtaining 75 per cent consent of investors by the value of their investment in the AIF;
- AIFs cannot buy or sell investments from or to (1) associates; (2) any AIF (including AIF schemes) managed or sponsored by the investment manager, sponsor or associates of the investment manager or sponsor; or (3) an investor who has committed to invest at least 50 per cent of the corpus of the AIF, without obtaining 75 per cent consent of investors by the value of their investment in the AIF;
- AIFs can invest in units of other AIFs without labelling themselves as a fund of funds.
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AIFs permitted to invest in other AIFs must ensure that they do not, directly or indirectly, invest more than 25 per cent in an investee entity (for Category I and II AIFs) and 10 per cent in an investee entity (for Category III AIFs).

In addition to the aforementioned, each category and sub-category of AIF is required to comply with the following restrictions applicable to them:

- Category I AIF: they can invest in investee companies, venture capital undertakings (VCU), special purpose vehicles (SPV), limited liability partnerships, units of Category I AIFs of the same sub-category or in units of Category II AIFs;
- Category I venture capital funds: at least 75 per cent of their investible funds should be invested in unlisted equity shares or equity-linked instruments of VCUs or in companies listed or proposed to be listed on a small and medium enterprise (SME) exchange or SME segment of an exchange;
- Category I SME funds: at least 75 per cent of their investible funds should be invested in unlisted securities or partnership interest of VCUs or investee companies that are SMEs or in companies listed or proposed to be listed on SME exchange or SME segment of an exchange, or in units of Category II AIF that invest primarily in such VCUs or investee companies;
- Category I social venture funds: at least 75 per cent of their investible funds should be invested in unlisted securities or partnership interest of social ventures;
- Category I infrastructure funds: at least 75 per cent of their investible funds should be invested in unlisted securities or units or partnership interest of VCUs or investee companies or SPVs, which are engaged in or formed for the purpose of operating, developing or holding infrastructure projects, or in units of Category II AIFs that invest primarily in such VCUs or investee companies or special purpose vehicles;
- Category I special situation funds: can invest only in special situation assets (as defined in the AIF Regulations) and may act as a resolution applicant under the Insolvency and Bankruptcy Code 2016;
- Category II AIF: they shall invest primarily in unlisted companies directly or through investment in units of Category I or Category II AIFs; and
- Category III AIF: they may invest in securities of listed or unlisted investee companies, derivatives, units of other AIFs or complex or structured products.

Law stated - 5 February 2024

Compensation and profit-sharing

32 Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

There are no restrictions in the AIF Regulations that affect the structuring of the manager's or sponsor's compensation and profit-sharing arrangements with respect to the AIF. However, the Securities and Exchange Board of India requires disclosure of all fees and charges that may be levied on the fund or investors in the private placement memorandum of the AIF.

Law stated - 5 February 2024

UPDATE AND TRENDS

Key developments of the past year

33 What are the most significant recent trends and developments relating to private equity funds in your jurisdiction? What impact do you expect such trends and developments will have on global private equity fundraising and on private equity funds generally?

The past year has seen multiple developments in the alternative investment fund (AIF) space in India. Some of the most important developments are set out below.

Introduction of modalities for AIFs to liquidate unliquidated investments upon expiry of their term

The Securities and Exchange Board of India (SEBI) has amended the AIF Regulations to provide for a mechanism by which alternative investment funds (AIFs) can, upon expiry of their term, liquidate investments that have not been sold due to lack of liquidity and wind up their operations. An AIF may, after obtaining the consent of 75 per cent of investors by the value of their investment in the AIF, either make in specie distributions of the unliquidated assets to the investors or launch a liquidation scheme during the liquidation period (a one-year period after the expiry of the term within which AIFs have to liquidate and wind up). If the AIF is unable to obtain the consent of 75 per cent of investors by the value of their investment for making in specie distributions or launching a liquidation scheme, the AIF would have to mandatorily distribute the unliquidated investments in specie to the investors or write off such investments. SEBI has also prescribed a detailed process to be followed for determining the value of the unliquidated portfolio investments of the AIF. This move by SEBI has been welcomed by the industry and the players, given that this provides a solution to a long-standing problem in relation to finding suitable exit opportunities for the portfolio investments made by AIFs. Further, this allows the investment manager requisite flexibility required to operate independently and assess and take informed decisions at the end of the AIF's life, in turn keeping the investors' interests in mind.

Introduction of an online dispute resolution mechanism for resolving disputes between investors/clients and market participants

SEBI issued a master circular dated 31 July 2023 that introduced a framework for resolving disputes that may arise between investors/clients and market participants, including AIF managers. In this regard, the AIF Regulations have been amended to state that all claims, differences or disputes between investors and the AIF or its investment manager related to activities in the securities market must mandatorily be submitted to a dispute resolution mechanism, namely, mediation, conciliation or arbitration, in accordance with procedure prescribed by SEBI from time to time. Investors/clients must strictly adhere to the process outlined in the master circular for grievance redressal and dispute resolution. In furtherance of the same, SEBI has prescribed that all arbitrations and conciliations must be initiated through the online dispute resolution portal established by market infrastructure institutions authorised by SEBI.

Standardised approach for valuation

SEBI, by way of its circular dated 21 June 2023, introduced a standardised approach for valuing portfolio investments of AIFs. Valuation of securities for which valuation norms have already been prescribed under the SEBI (Mutual Funds) Regulations 1996 (the MF Regulations) shall be carried out as per the norms prescribed under the MF Regulations, whereas valuation of securities for which valuation norms have not been prescribed under the MF Regulations shall be carried out as per the valuation guidelines endorsed by any industry association that in terms of membership represents at least 33 per cent of the number of SEBI-registered AIFs. In this regard, the Indian Venture and Alternate Capital Association (IVCA), which represents at least 33 per cent of the number of SEBI-registered AIFs, has recently endorsed the International Private Equity and Venture Capital Valuation (IPEV) Guidelines. The circular also prescribes eligibility criteria for independent valuers, and disclosures to be made to investors of AIFs in relation to valuation.

Mandatory direct plan and introduction of trail model of distribution commission

In April 2023, SEBI introduced a framework setting out the manner in which distribution fees would have to be paid to distributors engaged by AIF managers. Per the framework, AIFs are now mandatorily required to offer a direct plan option for investors who are onboarded directly without any intermediary, and no placement fee can be charged to such direct plan investors. Further, AIF managers may only pay up to one-third of the total fees or commissions to be paid to the distributors on an upfront basis; the remaining fee would have to be paid on an equal trail basis over the term of the AIF. Additionally, AIFs are now mandated to disclose the distribution or placement fee to the investors at the time of their onboarding. The intention of introducing this framework was to curb mis-selling and protect investor interests.

Law stated - 5 February 2024

Divaspati Singh divaspati.singh@khaitanco.com
Rahul Jain rahul.jain@khaitanco.com
Aditya Tandon aditya.tandon@khaitanco.com

Khaitan & Co

Japan

Makoto Igarashi, Yoshiharu Kawamata
Nishimura & Asahi

Summary

FORMATION

Forms of vehicle

1 What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

In Japan, a limited partnership formed under the Act concerning Investment Business Limited Partnership Agreements (the AIBLPA) (Act No. 90 of 1998) is the most typical vehicle for private equity funds. A limited partnership does not have a separate legal personality from its partners; therefore, the partners are deemed to hold the assets and liabilities of the partnership directly. Usually, an investor becomes a limited partner, whose liability is limited to the amount of its capital contribution, unless otherwise agreed, and the manager becomes, or has its affiliate become, the general partner of the partnership.

Law stated - 19 January 2024

Forming a private equity fund vehicle

2 What is the process for forming a private equity fund vehicle in your jurisdiction?

To form a limited partnership, a general partner must execute a limited partnership agreement, in writing, with at least one limited partner. In rare instances in Japan, a short-form agreement with a nominee limited partner for formation is used, which is later replaced with an amended and restated agreement upon negotiation and documentation with the initial investors. Therefore, the length of time required for formation depends on the offering activities for fundraising and documentation with the initial investors. Once the general partner executes the limited partnership agreement, it has to register the limited partnership with the relevant local legal affairs bureau within two weeks of the execution. A registration tax of ¥30,000 is imposed for the initial registration. The general partner may file the registration documents themselves, or through an attorney. The registration will be completed within one week or so, upon filing. Under the AIBLPA, all the partners are required to make capital contributions to the limited partnership, but there are no minimum capital requirements.

Law stated - 19 January 2024

Requirements

3 Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

Under the AIBLPA, the limited partnership needs to have a registered office in Japan. The general partner must prepare financial statements, request that a certified auditor audits the statements within three months of the end of each business year and maintains a copy of the audited financial statements, together with a copy of the partnership agreement and the auditor's opinion, at the principal office for a period of five years. Limited partners and creditors to the limited partnership may ask the general partner to allow them to review those documents. The general partner may have to retain a custodian under the Financial Instruments and Exchange Act (FIEA) in order to meet the asset-segregation requirements in connection with its licence or offering activities. There are no requirements for an administrator or a corporate secretary.

Law stated - 19 January 2024

Access to information

4 What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

A general partner must register the following information with a local legal affairs bureau within two weeks of the limited partnership agreement becoming effective:

- the business purpose of the limited partnership;
- the name of the limited partnership;
- the date when the limited partnership agreement became effective;
- the duration period of the limited partnership;
- the name and location address of the general partner;
- the location of the office of the limited partnership; and
- any additional dissolution events of the limited partnership that are not set forth under the AIBLPA.

When any information changes, the general partner must register the changed information within two weeks of the change occurring. If the general partner fails to file within this deadline, it may be subject to a monetary penalty of ¥1 million or less. Anyone may request that the registry issues a certified copy of the registered information, and may also access the information through the website, but information regarding the identities of the investors or the amount of their capital commitment is not publicly available.

Law stated - 19 January 2024

Limited liability for third-party investors

5 In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Generally, the limited liability for third-party investors is respected under the AIBLPA. However, if a limited partner has misled a third party to believe that it has power or authority to execute the business on behalf of the limited partnership, it shall owe the same responsibilities as the general partner with regard to such third party who entered into a transaction with the limited partnership on the basis of such misunderstanding.

Law stated - 19 January 2024

Fund manager's fiduciary duties

6 What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Under the AIBLPA, a general partner owes a 'duty of due care of a prudent manager' to the limited partners of the partnership. This duty, according to the prevailing interpretation thereof, requires the degree of care that a prudent and competent person engaged in the same line of business or endeavour would exercise under similar circumstances. If the general partner fails to exercise such due care, it may be liable to compensate the limited partners for the damages resulting therefrom. Upon agreement with the limited partners, it may modify the scope or extent of such duty, but may not remove such duty entirely. Note, however, that if the general partner assumes its role as a financial instruments business operator who engages in the discretionary investment management business or if the general partner relies on the qualified institutional investor (QII) business exemption, the FIEA expressly imposes on the general partner the duty of due care of a prudent manager and a duty of loyalty to the limited partner, as well as various other regulatory obligations and restrictions. In such an instance, it may not modify the duties to be inconsistent with such regulations.

Law stated - 19 January 2024

Gross negligence

7 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Japan recognises the gross negligence standard of liability in general, and upon agreement with the limited partners, a general partner may adopt such standard applicable to the management of a private equity fund.

Law stated - 19 January 2024

Other special issues or requirements

8 Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

The AIBLPA stipulates certain investment restrictions. A general partner may not invest the assets of the partnership into assets other than those listed under the AIBLPA. The AIBLPA covers almost all asset classes that private equity funds typically invest in, but a limited partnership is subject to a certain portfolio test if it wishes to invest in non-Japanese corporations. It may hold equity interests, warrants and bonds issued by non-Japanese corporations only if the total amount of the investments in non-Japanese corporations does not exceed 50 per cent of the total partnership assets.

Also, the offering activities of the interests in a limited partnership and the investment management activities are generally subject to the regulations under the FIEA. Therefore, unless respectively exempted thereunder, a general partner would have to obtain a business licence to conduct both activities in Japan, file the securities registration statement, prepare and deliver the prospectus to the investors for the public offering of the interests and continue the timely disclosure after the offering thereunder. In the usual cases, however, a general partner will comply with the requirements of the relevant exemptions, to avoid both licence requirements and public disclosure requirements.

Neither conversion nor redomiciling to limited partnerships in Japan from those of other jurisdictions is allowed.

Law stated - 19 January 2024

Fund sponsor bankruptcy or change of control

9 With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Unless otherwise specifically provided for in the limited partnership agreement, events affecting the fund sponsor's status, such as bankruptcy, insolvency, change of control or restructuring, will not trigger dissolution of the fund or removal of the general partner. Provided that, only if the sponsor is the sole general partner and becomes bankrupt, the limited partnership shall be dissolved, unless the other partners find a new general partner within two weeks, under the AIBLPA.

Law stated - 19 January 2024

REGULATION, LICENSING AND REGISTRATION

Principal regulatory bodies

10 What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

Unless exempted under the Financial Instruments and Exchange Act (FIEA), the general partner is required to register him or herself as a financial instruments business operator (FIBO) that engages in offering fund interest (Type II business) or discretionary investment management business. The Financial Services Agency (FSA) or the local financial bureaus (LFBs) are the principal regulatory bodies over a general partner of the fund. If a general partner registers itself as a FIBO, the FSA or the LFBs have broad power and authority to audit and inspect this general partner. It is also required to regularly provide investment management reports to investors and submit annual business reports to the relevant LFB, although they also are required to follow other continuous reporting requirements.

As a matter of practice, however, most of the general partners rely on the exemption from the above business licence requirements by satisfying certain conditions under article 63 of the FIEA (the qualified institutional investor (QII) business exemption). Even in such a case, the FSA or the LFBs maintain the right to monitor and inspect such general partners, but it is not on a regular basis. Such general partners are required to file and update certain matters with the LFBs. Such general partners must comply with certain conduct requirements equivalent to a FIBO, and they may be required to regularly provide investment management reports to investors depending on the status of investors. Such general partners must prepare and maintain records on their business, prepare and submit an annual business report to the LFBs, and make some parts of their business reports available to the public at their relevant offices or on their website.

Law stated - 19 January 2024

Governmental requirements

11 What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

As opposed to a corporate-type fund or unit trust, partnership-type funds do not need to be registered under the mutual fund law of Japan. However, if the interests are publicly offered in Japan, the general partner has to file the securities registration statement, prepare and deliver the prospectus to the investors, and conduct the ongoing disclosure under the FIEA. In connection with the FIEA, the location of significant investment activities does not make any difference in the application thereof.

Unless exempted under the FIEA, the general partner is required to register him or herself as a FIBO that engages in offering fund interest (Type II business) or discretionary investment management business. As a matter of practice, however, most of the general partners rely on the exemption from the above business licence requirements by relying on the QII business exemption.

Law stated - 19 January 2024

Registration of investment adviser

12 Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Once a general partner is registered as a FIBO on an entity basis, the officers or directors do not need to obtain a separate licence (their information is included in the FIBO application documents of the general partner). They may conduct their business as personnel of the licensed FIBO. A control person will, as the case may be, be required to file another report of its shareholding of the licensed FIBO under the FIEA.

There is no such registration requirement if the general partner relies on the QII business exemption (the information regarding the officers or directors is included in the notification (Form 20) to be filed by the general partner), and the requirement to report a control person is not applicable.

Law stated - 19 January 2024

Fund manager requirements

13 Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

If the general partner registers as a FIBO that engages in discretionary investment management, it must satisfy the following requirements for the registration:

- its permission, approval or registration necessary for financial instrument business or other business under the FIEA or other equivalent non-Japanese laws has not been rescinded within the preceding five years;
- it has not violated the FIEA or other laws, and has not been subject to a fine within the preceding five years;
- it has not engaged in business contrary to the public interest;
- it has sufficient staff to properly conduct financial instrument business;
- it has ¥50 million in stated capital or in total equity;
- it is either a Japanese corporation with a board of directors, or a foreign corporation equivalent thereto;
- it has net assets of at least ¥50 million;
- it does not engage in such business (other than permitted business under the FIEA) that it cannot properly control the risk;
- none of its directors, officers, others who have the power to manage it, fund managers or compliance officers fall into any of the excluded categories under the FIEA;

- if it is a Japanese corporation, none of its major shareholders fall into any of the excluded categories under the FIEA; and
- if it is a non-Japanese entity, the authorities in its home jurisdiction confirm that the solid and appropriate operation of its financial instrument business will not be prevented by any major shareholders.

If the general partner relies on the QII business exemption, it must satisfy the following requirements:

- its permission, approval or registration necessary for financial instrument business or other business under the FIEA or other equivalent non-Japanese laws has not been rescinded within the preceding five years;
- it has not violated the FIEA or other laws, and has not been subject to a fine within the preceding five years;
- none of its directors, officers, others who have power to manage it, fund managers or compliance officers fall into any of the excluded categories under the FIEA;
- if it is a non-Japanese person, any foreign regulatory authority in the jurisdiction where the general partner domiciles or is operating has signed the International Organization of Securities Commissions Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, or an equivalent bilateral agreement with the Japanese government; and
- if it is a non-Japanese person, it must appoint a representative in Japan.

Law stated - 19 January 2024

Political contributions

14 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

In Japan, no one may accept contributions for political activities from a non-Japanese person or a Japanese entity whose equities are mainly held by a non-Japanese person. Other than this restriction, a general partner may make political contributions, which are in principle disclosed to the public.

Law stated - 19 January 2024

Use of intermediaries and lobbyist registration

15 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There is no such restriction or requirement under Japanese law. We have not found any such internal rule or policy of public pension plans or governmental entities, based on publicly available information.

Law stated - 19 January 2024

Bank participation

16 Describe any key legal or regulatory developments (including those emerging from the 2008 global financial crisis) that specifically affect banks with respect to investing in or sponsoring private equity funds.

This is not a recent legal development, but owing to the voting equity holding restriction applicable to banking entities, a Japanese bank would hesitate to hold more than a 5 per cent interest in a partnership-type private equity fund unless specifically exempted thereunder. In the case of a limited partnership under the Act concerning Investment Business Limited Partnership Agreements, a bank may rely on the exemption if certain conditions are met, but usually requests that the general partner make further covenants to ensure its compliance with such regulations.

Law stated - 19 January 2024

TAXATION

Tax obligations

17 Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Under Japanese tax law, a limited partnership is itself a non-taxable entity, and income or gain arising from investment through the partnership will be allocated to each partner without imposition of a tax at the limited partnership level. All distributions made by the limited partnership to foreign investors (if they maintain a permanent establishment in Japan) are generally subject to a withholding tax at the rate of 20 per cent. Other than this, neither the limited partnership nor the general partner is required to withhold taxes regarding distributions to partners.

Law stated - 19 January 2024

Local taxation of non-resident investors

18 Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

According to a tax authority ruling, investment activities conducted by a general partner on behalf of a limited partnership are generally deemed to be activities jointly carried out by all partners of the partnership. Based on this idea, when a non-Japanese investor becomes a limited partner of a limited partnership, the investor is deemed to have a permanent establishment in Japan so that all investment income derived from the partnership is subject to Japanese taxation if at least one general partner of the limited partnership is a Japanese resident. Therefore, all distributions made by the limited partnership to foreign investors are generally subject to taxation in Japan. However, there is a statutory exemption, under which a foreign investor as a limited partner of a limited partnership is deemed to have no permanent establishment in Japan. In such cases, distributions made to the limited partner (that would otherwise be subject to taxation because of a permanent establishment) will not be subject to withholding tax in Japan and no obligation to file a Japanese tax return is imposed. To rely on the exemption, a foreign investor who satisfies all of the following requirements must file an application with the Japanese tax authorities via the general partner stating:

- it is a limited partner;
- it does not engage in business operations or management of the limited partnership;
- it does not hold 25 per cent or more of the whole of the partnership interests;
- it does not have any close capital relationship with the general partner; and
- it has no permanent establishment in Japan other than by virtue of having invested in the partnership.

Under Japanese tax law, even if a non-Japanese resident investor does not have a permanent establishment in Japan, when a non-Japanese resident investor possesses 25 per cent or more of the total issued shares of a Japanese corporation at any time within three years prior to the last day of the business year containing the date of transfer, and the investor transfers 5 per cent or more of the total issued shares, the transfer of shares is taxable in Japan (the 25 per cent/5 per cent rule). In calculating these ratios, the number of shares held or transferred by specific persons related to the investor is aggregated, and when the non-Japanese resident investor invests in a limited partnership that invests its partnership assets into shares of Japanese corporations, other limited partners of the limited partnership fall into the category of specially related persons. If, however, a non-Japanese resident investor that is a limited partner in a limited partnership satisfies certain conditions, it may exclude other partners' shares to calculate the 25 per cent/5 per cent rule. This exemption applies when the non-Japanese resident investor satisfies the following requirements:

- either the limited partnership is one to which the previously discussed exemption applies, or during the relevant three-year period, the non-Japanese resident investor was not involved in the conduct of the operations or management of the limited partnership;
-

at any time during the three-year period, no specially related person (other than other limited partners) of the non-Japanese resident investor held 25 per cent or more of the interest of the domestic company;

- the limited partnership held the relevant shares for at least one year;
- the investment target is not a proscribed type of insolvent financial institution; and
- the non-Japanese resident investor files certain documents with the Japanese tax authorities by 15 March of the following year (for an individual investor) or two months after the fiscal year-end (for a corporate investor).

Besides the above, capital gains resulting from any of the following share transfers are subject to Japanese tax unless otherwise exempted:

- the transfer of shares in a Japanese corporation by conducting certain market manipulations or greenmail activities against the Japanese corporation; and
- the transfer of more than 2 per cent (in the case of the listed shares, 5 per cent) of the shares in a corporation that derives 50 per cent or more of the value of its gross assets directly or indirectly from real estate (including related rights over real estate) in Japan by the non-Japanese resident investor and other specially related shareholders.

Law stated - 19 January 2024

Local tax authority ruling

19 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

There is no special necessity to obtain a ruling from the Japanese tax authorities.

Law stated - 19 January 2024

Organisational taxes

20 Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

To register the formation of a limited partnership, ¥30,000 must be paid as a registration tax.

Law stated - 19 January 2024

Special tax considerations

21

Describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

On the assumption that the general partner is a corporate entity (as opposed to an individual), there are no special considerations regarding carried interest and management fees from the viewpoint of Japanese taxation.

Law stated - 19 January 2024

Tax treaties

22 List any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Japan has entered into a number of tax treaties, and how those treaties apply to a specific fund vehicle or its partners depends on the specific facts, including the structure of that fund vehicle and the residence of the relevant parties.

Law stated - 19 January 2024

Other significant tax issues

23 Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

As with many other jurisdictions, the tax rules in Japan are complex and intricate. Nevertheless, tax matters occupy an important position in fund structuring, and we highly recommend that tax advisers are consulted with regarding the specific fund structure and investment.

Law stated - 19 January 2024

SELLING RESTRICTIONS AND INVESTORS GENERALLY

Legal and regulatory restrictions

24 Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

In connection with the private placement exemption for marketing interests in partnership-type funds, fewer than 500 investors in Japan shall acquire the interests, and the investors shall be notified that the offer of the interests has not been or will not be registered on the ground that they are securities set forth in item 5, paragraph 2, article 2 of the Financial Instruments and Exchange Act (FIEA) and that the offer of the interests falls under the category of a small number private placement exemption. Further, if the general partner relies on the qualified institutional investor (QII) business exemption, it shall comply with, among other things, the following conditions:

- it has at least one QII limited partner;
- it has no investors other than QIIs or eligible non-QIIs;
- it has no more than 49 eligible non-QII limited partners;
- it has no disqualified investors listed in the FIEA; and
- it complies with the transfer restrictions, in which the QII may not transfer its interests to a person other than a QII and an eligible non-QII may not transfer its interests to more than one person who is a QII or an eligible non-QII.

A QII is defined in item 1, paragraph 3, article 2 of the FIEA. An eligible non-QII is listed in paragraphs 1 and 2, article 17-12 of the Order for Enforcement of the FIEA, which includes, among others, financial instruments business operators (FIBOs), parent companies, subsidiaries and sister companies of a general partner and officers or employees thereof, listed companies, Japanese juridical persons with ¥50 million or more in stated capital or of net assets, foreign juridical persons, individuals who hold investment-type financial products equivalent to ¥100 million or more and opened securities accounts at least one year previously, and other certain persons.

In relying on the exemption, the general partner must file a notification (Form 20) with the relevant office of the local financial bureau (LFB) prior to any solicitation.

Law stated - 19 January 2024

Types of investor

25 Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

If a general partner relies on the QII business exemption, at least one limited partner shall be a QII, it may not accept a Japanese investor other than a QII or eligible non-QII and the number of eligible non-QII limited partners shall be 49 or less. Further, it may not accept a disqualified investor (eg, certain special-purpose companies and certain funds of funds in which a non-QII invests).

Law stated - 19 January 2024

Identity of investors

26 Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

If a general partner relies on the QII business exemption, it must specify each QII's name, and the name of the fund in the notification (Form 20) to, and be filed with, the LFBs; however, QIIs' names are not publicly available. Also, the general partner is required to update the notification without delay (within one month) if any matter described therein is changed. Further, in connection with the registration with the legal affairs bureau, it must update any registered matter to be changed, within two weeks of the change being effective.

Law stated - 19 January 2024

Licences and registrations

27 Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Unless otherwise exempted, a general partner or outside placement agents who offer fund interests are required to register themselves as a FIBO that engages in Type II business. However, if a general partner relies on the QII business exemption, such general partner does not have to register as a FIBO for offering their fund interests.

Law stated - 19 January 2024

Money laundering

28 Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The Act on Prevention of Transfer of Criminal Proceeds (APTCP) requires that a general partner who is registered as a FIBO or relies on the QII business exemption, before accepting a new investor, completes the investor identification process in accordance with the APTCP. At a minimum, the general partner must verify the identity of its investor prior to the execution of the subscription agreement with that investor and maintain records of the information used to verify the investor's identity. The general partner must promptly report to the regulatory authority if the general partner suspects that property received from an investor relating to its investment management business may be from criminal proceedings, or that an investor may have engaged in criminal conduct in connection with any transaction relating to its investment management business. The administrative guideline requires that the general partner avoids contact with 'antisocial forces'. An organised crime group, a member of an organised crime group, a quasi-member of an organised crime group, a related company or association of an organised crime group, a corporate racketeer and other equivalent groups are included in antisocial forces. The general partner shall not enter into any agreement with antisocial forces or entities controlled by antisocial forces.

Law stated - 19 January 2024

EXCHANGE LISTING

Listing

29 Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Under the Financial Instruments and Exchange Act, it is technically possible to list on a securities exchange, but no securities exchanges in Japan have rules that assume partnership interests are to be listed on the exchanges. Therefore, based on the current situation, private equity funds formed as partnerships are unable to be listed on securities exchanges in Japan.

Law stated - 19 January 2024

Restriction on transfers of interest

30 To what extent can a listed fund restrict transfers of its interests?

This is not applicable under the current exchange rules.

Law stated - 19 January 2024

PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS

Legal and regulatory restrictions

31 Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

Other than those described herein, there are no explicit legal or regulatory restrictions that a general partner should be concerned with when it establishes a limited partnership as an investment vehicle for private equity investments.

If the general partner retains a placement agent in Japan who is a financial instruments business operator engaging in Type II business or the general partner relies on the qualified institutional investor business exemption, it must make sure to segregate partnership assets from its own assets, in accordance with the Financial Instruments and Exchange Act. Also, in connection with the foreign exchange regulations of Japan, if the majority of the limited partnership interests are held by non-Japanese limited partners or a majority of the general partners are non-Japanese persons, the limited partnership needs to file a prior notification or a report of the acquisition of an equity share when the limited partnership acquires an equity share in a certain category of Japanese corporations.

Law stated - 19 January 2024

Compensation and profit-sharing

32 Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

There are no specific issues regarding this topic.

Law stated - 19 January 2024

UPDATE AND TRENDS

Key developments of the past year

33 What are the most significant recent trends and developments relating to private equity funds in your jurisdiction? What impact do you expect such trends and developments will have on global private equity fundraising and on private equity funds generally?

Since November 2021, a general partner of a partnership-type fund may be able to rely on a new exemption (Specially Permitted Business for Foreign Investors, etc) to conduct marketing activities and investment management activities without registration by filing a relatively simple notification with the authority in Japan. This foreign investors' exemption is similar to the qualified institutional investor (QII) business exemption, but its requirements are, to some extent, more relaxed in that it does not require a QII to be included as a limited partner. However, it is not necessarily easier to rely on the foreign investors' exemption in that:

- aggregate investment amounts contributed by non-Japanese investors must be more than 50 per cent of the total contribution amount of the fund;
- sufficient personnel structure and internal systems must be in place (certain internal documents including internal rule and policy documents of the general partner must be provided as attachments to the notification); and
- a business office of the general partner must be established in Japan.

Law stated - 19 January 2024

Makoto Igarashi m.igarashi@nishimura.com
Yoshiharu Kawamata y.kawamata@nishimura.com

Nishimura & Asahi

Luxembourg

Marc Meyers, Noémi Gémesi, Tom Hamen, Karin Finné
Loyens & Loeff

Summary

FORMATION

Forms of vehicle

1 What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

When opting for Luxembourg as their investment hub, initiators (or promoters or sponsors) generally opt for either a non-regulated ordinary commercial company (Soparfi) or one of the following fund regimes:

- an investment company in risk capital (SICAR), based on the Law of 15 June 2004, as amended, on the Investment Company in Risk Capital (the SICAR Law) (the SICAR is a vehicle specifically dedicated to private equity and venture capital investments, whether diversified or not); or
- a specialised investment fund (SIF), based on the Law of 13 February 2007, as amended, on Specialised Investment Funds (the SIF Law); or
- a reserved alternative investment fund (RAIF), based on the Law of 23 July 2016, as amended, on Reserved Alternative Investment Funds (the RAIF Law).

Luxembourg funds may also opt for one of the following European labels, each as amended from time to time, offering a marketing passport to the fund's manager, provided that the relevant regulatory requirements are complied with:

- the European long-term investment fund (ELTIF) label subject to ELTIF Regulation (EU) No. 2015/760 (the ELTIF Regulation);
- the European venture capital fund (EuVECA) label subject to EuVECA Regulation (EU) No. 345/2013; and
- the European social entrepreneurship fund (EuSEF) label subject to EuSEF Regulation (EU) No. 346/2013.

Although the SIF Law does not prescribe any quantitative, qualitative, geographical or other types of investment restrictions, the Luxembourg Financial Supervisory Authority (CSSF) has issued a circular (Circular 07/309), pursuant to which a SIF should generally not invest more than 30 per cent of its assets or commitments in securities of the same kind issued by the same issuer. Certain exemptions may apply to this rule (eg, in the case of a feeder fund structuring). While it is not subject to any direct regulatory approval or supervision, it is generally considered that a RAIF must comply with similar diversification rules. To the extent such restriction makes the SIF and the RAIF incompatible with non-diversified private equity investments strategies, an initiator would instead either opt for the Soparfi, taking advantage of a flexible and efficient fiscal and legal framework, for the SICAR, or for the RAIF with a corporate object restricted to investment in risk capital assets (within the same meaning as for SICARs), in which cases no diversification requirements apply. Funds opting in for the ELTIF label must also comply with strict restrictions on eligible assets, borrowing and diversification rules, as set out under the ELTIF Regulation.

The Soparfi and the SICAR can only be formed as a corporate form having a legal personality separate from that of their investors (except if the Soparfi or the SICAR is established as a special limited partnership (SCSp) that does not have legal personality), whereas the SIF and the RAIF may, in addition, be organised as a common fund (FCP) managed by a Luxembourg-based management company. There is no restriction as to the legal form that an ELTIF can take, provided that the fund vehicle is located in the EU and qualifies as an alternative investment fund (AIF) under the Law of 12 July 2013, as amended, implementing Directive 2011/61/EU of the European Parliament and the Council on alternative investment fund managers (AIFMD) into Luxembourg law (the AIFM Law). It is important to stress that the Soparfi, SICAR, SIF, RAIF and ELTIF acronyms do not refer to specific legal forms, but merely to a specific set of legal, regulatory and tax provisions, with the actual investment vehicle or entity being formed as one of the following:

- a public limited liability company (SA);
- a private limited liability company (SARL);
- a partnership limited by shares (SCA);
- a cooperative company in the form of a public limited liability company (Coop SA);
- a common limited partnership (SCS);
- an SCSp; or
- solely in respect of the SIF and the RAIF, an FCP.

The SCA, SCS, SCSp and FCP deserve special attention. The SCA, SCS and SCSp are formed by agreement between one or several general partners with unlimited liability and general management powers, together with limited partners who participate in any profits and share in any losses, generally, pro rata with their participation in the partnership and up to the amount of their commitment or contribution, as the case may be. Unlike the SCSp, which does not have legal personality, the SCA and SCS have full legal capacity distinct from that of their partners. The SCA, SCS and SCSp will further allow the initiator to structure the acquisition vehicle by using common law-style partnership concepts, well known to the international investor and initiator base. The SCS and SCSp can implement capital account mechanisms that are customary for common law limited partnerships. Under this mechanism, each limited partner has typically an account reflecting its contribution to the partnership, which is adjusted over time to reflect its participation in profits and losses of the partnership. This mechanism does not require the issuance of securities of any kind to the limited partners. The full significance of the limited partnership as an investment vehicle can be further appreciated when looking at its fiscal treatment.

The FCP is similar to a unit trust in the United Kingdom or a mutual fund in the United States. It is organised as a co-proprietorship whose joint owners are only liable up to the amount they have committed or contributed. The FCP does not have a legal personality and must be managed by a Luxembourg-based management company.

Law stated - 17 January 2024

Forming a private equity fund vehicle

2 | What is the process for forming a private equity fund vehicle in your jurisdiction?

A Soparfi, SICAR, SIF or RAIF may be formed within a relatively short period of time. While the Soparfi and the RAIF do not require any regulatory approved incorporation, SICARs and SIFs require prior CSSF approval before being allowed to do business. Upon completion of the regulatory review, both the SICAR and the SIF will be registered on an official list of regulated investment vehicles maintained by the CSSF. Funds wishing to opt in for the ELTIF label will also be required to obtain prior CSSF approval to benefit from the ELTIF regime. Once approved, the ELTIF will be recorded in a register of authorised ELTIFs maintained by the European Securities and Markets Authority (ESMA).

As a general rule, the investment vehicle will come into existence when its articles of association or the partnership agreement (of the Soparfi, the SICAR or the SIF) are approved in front of a Luxembourg notary public, although SCS and SCSp may also be formed under private seal. The SIF in the form of an FCP will come into existence upon the execution of its management regulations. The incorporation deed – or an excerpt thereof for the SCS, the SCSp and the FCP – will be thereafter filed with the Luxembourg Register of Commerce and Companies (RCS) and published in the Luxembourg official electronic platform of central publication in respect of companies and associations (RESA) (for the FCP, an excerpt of registration of the signed management regulations with the RCS will be published). The establishment of a RAIF under private seal as an FCP, an SCS or an SCSp shall be recorded in a notarial deed within five business days from its constitution. Within 15 business days of such notarial deed, a notice in respect of the RAIF's formation, with an indication of the RAIF's alternative investment fund manager (AIFM), shall be filed with the RCS with a view to being published in the RESA. RAIFs must be registered on a list held by the RCS within 20 business days of their formation. Any amendment to any information communicated with a view to be registered on the RAIF list held by the RCS must be declared to the latter within 20 business days.

The formation costs will comprise the notarial fees, the registration duty as well as publication costs. The minimum share capital amounts to €12,000 for a Soparfi in the form of a SARL and €30,000 for an SA or SCA. Investment funds taking a corporate form (SA, SARL, SCA or Coop SA) must open a bank account with a bank in Luxembourg and their shareholders must transfer the initial share capital to this bank account, prior to being incorporated before a Luxembourg notary. In addition, SICARs must have a minimum capitalisation of €1 million (including any issue premium), while SIFs and RAIFs must have a minimum capitalisation of €1.25 million (including any issue premium), to be reached within 24 months of the official CSSF registration. The SICAR, SIF and RAIF may, further, have a variable capital structure whereby their capital will at all times be equal to their net asset value.

Law stated - 17 January 2024

Requirements

3 | Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

In accordance with Luxembourg law, a SICAR, SIF or RAIF must have its registered office and head office (central administration) in Luxembourg. Luxembourg company law follows the real seat theory (versus the incorporation theory) whereby any company maintaining its central place of administration in Luxembourg becomes subject to Luxembourg law.

All investment regimes (Soparfi, SICAR, SIF and RAIF) may either be self-administered (eg, by renting their own premises and possibly hiring staff) or enter into a domiciliation (and administration) agreement with a third-party service provider. With Luxembourg being Europe's largest fund administration centre, a large selection of service providers will be available to the fund's initiators. The cost of these services (including a fund's ongoing maintenance costs) and the level of substance required to be kept in Luxembourg will have to be assessed on a case-by-case basis. The SICAR and the SIF will have to pay, in addition, an annual registration fee to the CSSF.

SICARs, SIFs and RAIFs must appoint a Luxembourg-based depositary bank or the Luxembourg branch of a foreign credit institution to safeguard their assets, with the objective being a higher standard of protection for investors. In carrying out its duties, the depositary must act independently and solely in the interests of the investors. The depositary shall be liable in accordance with Luxembourg law towards the SICAR, SIF or RAIF and to their respective investors for any loss suffered by them as a result of the depositary's wrongful failure to perform its obligations or its wrongful improper performance thereof.

Under the AIFM Law, it is expressly required that AIFMs have to appoint a depositary for each alternative investment fund (AIF) they manage (irrespective of whether the AIF is a non-regulated ordinary commercial company, or set up under the SICAR, the SIF or the RAIF regime). Such depository shall either be a credit institution, an investment firm or another category of institution eligible to act as depositary under Directive 2009/65/EU (Undertakings for Collective Investment in Transferable Securities (UCITS)). In respect of AIFs, which have no redemption rights exercisable during a period of five years from the date of the initial investments and which, in accordance with their investment policy, do not invest in financial instruments or invest in issuers or non-listed companies to potentially acquire control, the AIFM Law has embraced the option offered by the AIFMD to expand the scope of eligible depositaries. The AIFM Law has created the status of 'depositary of non-financial assets' under the Law of 4 April 1993 on the financial sector, as amended (the Banking Law), which can act as depositary in respect of those AIFs (irrespective of whether those AIFs are established as SICARs, SIFs, RAIFs or non-regulated commercial companies, to the exclusion of ELTIFs marketed to retail investors, which are required to appoint a UCITS-compliant depositary).

Law stated - 17 January 2024

Access to information

4 What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

Access to information is generally limited to what is disclosed in the formation deed in the RESA. This generally includes, but is not limited to, the identity of the founding shareholders or partners, the initial subscribed share capital, as well as information on management and shareholders' or partners' meetings. SICARs, SIFs and RAIFs set up with a variable capital structure will not disclose the identity of further subscribers in the event of additional subscriptions. If the SICAR, SIF or RAIF is formed as a SARL with fixed capital, the identity of its shareholders and the number of shares held by them will be published in the RESA and also publicly available at the RCS. As per the reform to the partnership legislation under the AIFM Law, the identity of the limited partners of an SCS are no longer published in the RESA. The same goes for the SCSp. In both instances (SCS and SCSp), only an extract comprising the following information will be published in the RESA:

- the identity of the general partners;
- the corporate denomination of the SCS or SCSp;
- its corporate object and registered office;
- the name of its managers and their signatory powers; and
- the term of the SCS or SCSp (inception and termination date).

Disclosure obligations are therefore rather limited. Luxembourg company law provides for a series of sanctions in the event mandatory information is not made available by publication in the RESA. Certain documents and extracts of documents will only be binding towards third parties from the day of their publication in the RESA, unless the company proves that the relevant third parties had prior knowledge thereof. Third parties may, however, rely upon documents or extracts thereof that have not yet been published. For transactions taking place before the 16th day following the day of publication, these documents or extracts of documents will not be binding towards third parties who can prove that it was not possible for them to have knowledge thereof. In the event of a discrepancy between the document filed and the document published in the RESA, the latter is not binding towards third parties unless the company can prove that they had knowledge of the contents of the document filed.

Based on the Law of 13 January 2019 introducing in Luxembourg a register of ultimate beneficial owners (UBOs) of companies and other legal entities (RBE), as amended, Luxembourg entities falling within the scope of this law (ie, most of the Luxembourg entities registered with the RCS) have to collect information about their UBOs, file it with the RBE, keep it up to date and give it to national authorities upon request.

In principle, the UBO is any natural person who ultimately owns or controls the entity through direct or indirect ownership of a sufficient percentage of the shares or voting rights or ownership interest in that entity or through control via other means (in principle a shareholding of 25 per cent plus one share shall be an indication of respectively direct or indirect ownership). Further to the judgment of 22 November 2022 of the Court of Justice of the European Union delivered in joined cases C 37/20 and C 601/20, access to the RBE has been restricted to professionals subject to the Luxembourg Law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended having signed an agreement with the RCS. However, the UBO is expressly given the right to request that the access to information recorded in the RBE be restricted (eg, if the UBO would otherwise be exposed to a risk of fraud or kidnapping). Any communication between the manager of the UBO register and the entities subject to disclosure obligations will occur via a secure electronic system that leaves a trace of such communication.

Law stated - 17 January 2024

Limited liability for third-party investors

5 In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

The corporate veil may only be pierced in very limited circumstances where, for example, there has been a mingling of the assets of the partners or shareholders and the assets of the entity, creating a false perception in the mind of third parties. In relation to investment vehicles formed as an SCA, SCS or SCSp, the involvement of limited partners in acts of management towards third parties could potentially put their limited liability at risk. Managers and directors could also under certain circumstances be held liable. In relation to limited partners' liability, the AIFM Law has introduced a list of permitted management acts that, if carried out by limited partners, would not trigger the loss of their limited liability. While exhaustive, the list is wide-ranging and covers the following:

- the exercise of partners' rights under the constitutive documents;
- any advice given by the limited partners to the SCA, SCS or SCSp;
- any supervisory authorisation powers given to limited partners under the constitutive documents; and
- the granting of loans-security arrangements to the SCA, SCS or SCSp.

Limited partners may also act as managers of the relevant partnership and represent it on the basis of a proxy without losing their limited liability status.

Law stated - 17 January 2024

Fund manager's fiduciary duties

6 What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Appointed managers and directors will be liable toward the investment entity, in accordance with general civil law principles, for the execution of the mandate entrusted to them and for any misconduct in the management of corporate affairs. They shall be jointly and severally liable both towards the Soparfi, SICAR or SIF and any third parties for damages resulting from a violation of the Luxembourg Law of 10 August 1915, as amended, on commercial companies (the Company Law) or the articles of association of the relevant entity.

The fiduciary duties of the directors and managers of Luxembourg companies will be governed by the same minimum duty of care standard to act as a bonus paterfamilias in similar circumstances for the execution of the mandate that has been entrusted to them. The constitutive documents of the entity may nevertheless provide for higher standards. It is debatable whether lower standards would be upheld by Luxembourg courts. In respect of SCA, SCS and SCSp, it should be pointed out that both internal management by one (or several) general partners or external management by a third-party manager is permitted. Liability status will differ in both instances. While the general partner of an SCA, SCS or SCSp is subject to joint, several and unlimited liability, a third-party manager will be liable in accordance with general civil law principles (as mentioned earlier).

Law stated - 17 January 2024

Gross negligence

7 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Luxembourg law does not distinguish between gross negligence and ordinary negligence, except that one's liability for gross negligence may not be validly limited or excluded.

Under Luxembourg company law, management is liable towards the company, in accordance with general civil rules, for the execution of its mandate and for any misconduct in the management of the company's affairs. Misconduct does not imply a fault on the part of the director, who may incur liability for his or her passive attitude, negligence or carelessness. Moreover, the Luxembourg company law provides for a joint and several liability of the directors towards the company as well as third parties for damages resulting from an infringement of the provisions of the Luxembourg company law or the articles of incorporation of the company.

In the case of bankruptcy, management and de facto managers of a company may be held personally, jointly and severally, or not jointly and severally, liable for all or part of the shortfall of assets over liabilities if they committed a manifestly serious fault that contributed to the bankruptcy of the company. The fact that this (serious) fault must be 'manifestly' serious seems to indicate a stricter standard of appreciation, namely that only a really strong, undisputable and unequivocal serious fault may give rise to this liability.

Law stated - 17 January 2024

Other special issues or requirements

8 Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Luxembourg law allows the migration or redomiciliation of foreign entities to Luxembourg with full legal and corporate continuity and thus their transformation into Luxembourg companies or partnerships, provided the jurisdiction of origin also allows the migration. It is possible to change the corporate form of the entity upon migration or to keep the original legal form, provided that such form also exists (possibly with some adjustments) under Luxembourg law. The underlying corporate form to be adopted will thus be determined in the light of a variety of legal, fiscal or commercial considerations. It is also possible to transform a foreign entity into a SICAR, SIF or RAIF upon arrival in Luxembourg, subject, in respect of a SICAR and a SIF, to the filing of a submission for regulation with the CSSF (containing all required documents). The migration will in some cases require the prior preparation of a valuation report to be drawn up by an independent Luxembourg auditor and confirming that the minimum capitalisation required under Luxembourg law is reached. The scope of the adjustments will depend on the corporate form chosen upon entry in the Luxembourg legal sphere. If the initiator decides to set the redomiciled entity up as a SARL, its shares will be subject to statutory transfer restrictions. The initiator may decide to retain the SCA, SCS or SCSp as the legal regime to replicate the common law-type limited partnership. The SARL or the SCA corporate forms are often chosen for US tax reasons, as they are not considered as corporations per se. The SARL will not be open to more than 100 investors and may not offer its shares or beneficiary shares publicly. The latter limitation also applies to the SCS.

Law stated - 17 January 2024

Fund sponsor bankruptcy or change of control

9 With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

The bankruptcy or change of control of the initiator of a SICAR, SIF, RAIF or Soparfi does not per se affect the vehicle from a legal point of view. For a SICAR and a SIF, although there is no requirement for an initiator to be formally approved by the CSSF, good practice dictates that any change of control at the level of the initiator should be communicated to the CSSF. Under certain circumstances, investors in a SICAR, SIF or RAIF may have to be given the right to exit the vehicle. All of the aforementioned comments are made without prejudice to any provision included in the fund documentation to the effect of triggering a dissolution or removal rights at the fund level.

Law stated - 17 January 2024

REGULATION, LICENSING AND REGISTRATION

Principal regulatory bodies

10 What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The below primarily addresses the investment company in risk capital (SICAR), specialised investment fund (SIF), reserved alternative investment fund (RAIF) and other funds opting in for the European long-term investment fund (ELTIF) label (the non-regulated ordinary commercial company (Soparfi) in principle escaping regulation, provided it does not offer its securities to the public and does not qualify as an alternative investment fund (AIF) under the Law of 12 July 2013, as amended, implementing Directive 2011/61/EU of the European Parliament and the Council on alternative investment fund managers (AIFMD) into Luxembourg law (the AIFM Law)). It also covers the implications of the AIFMD regime as implemented by the AIFM Law for each of those regimes.

SICARs, SIFs and funds opting in for the ELTIF label are always subject to prior authorisation and remain thereafter subject to the prudential supervision of the Luxembourg Financial Supervisory Authority (CSSF). The SICAR, SIF and ELTIF regimes apply upon formal election. The CSSF will verify that the SICAR, the SIF, the ELTIF and their representatives comply with the applicable legal provisions and contractual arrangements. When submitting an application to the CSSF, the legal representatives of the SICAR and the SIF (namely, their managers or directors, or both), as well as their service providers (namely, the depositary bank, the administrative agent, the register and transfer agent and the auditor) must demonstrate professional honour and sufficient experience. Any replacement is subject to the prior approval of the CSSF, although the managers and directors will not be required to register as investment advisers or otherwise in Luxembourg. The managers and directors of the SICAR, the SIF and the ELTIF will have to produce a detailed CV showing their track record and experience, and an extract from their criminal records as well as a declaration of honour to that effect clearing the applicant of any involvement in bankruptcy matters or other criminal acts.

The CSSF licence is further conditional on a show of evidence that the central administration of the SICAR or SIF is located in Luxembourg. The applicant thus needs to demonstrate that the main back-office operations (eg, accounting, subscription, the keeping of the shareholder register, redemptions, reporting, etc) are carried out in and from Luxembourg. The SICAR or SIF may, however, rely on the investment expertise of an investment adviser or manager established in another jurisdiction. Delegation of investment management functions is subject to specific conditions under the SIF law (including, prior notification to the CSSF; justification of the delegation structure by a more efficient conduct of business; and as far as portfolio or risk management functions are concerned, prior authorisation or registration of the delegate for the purpose of asset management (CSSF approval remaining possible in the absence of any such licence or registration)). Similar requirements are applicable to SICARs within the scope of the AIFM Law regime. EU AIFMs applying for approval of an alternative investment fund (AIF) they manage as an ELTIF are also required to provide information on delegation arrangements regarding portfolio and risk management, as well as administration to the CSSF in the context of their application. While ELTIFs are required to also qualify as AIFs and be located in the EU, it is important to note that the SICAR or SIF regimes are not applied selectively. Any initiator of whatever origin or qualification may thus apply for and organise a SICAR or SIF upon the satisfactory instruction of its application. Once authorised, the SICAR and the SIF will be entered into the official list maintained by the CSSF, and the ELTIF into an official register maintained by the ESMA.

The SICAR, the SIF and the ELTIF must comply with certain disclosure requirements. They must, inter alia, produce an issuing document (eg, in the form of a prospectus or private placement memorandum) and an annual report that they also need to communicate to the CSSF and investors. These documents must include the information necessary for investors to be able to make an informed judgment on the proposed investment and the related risks. The annual report must be finalised within six months of the end of the financial period to which it pertains. Although the annual reporting obligations are in line with the common reporting obligations of commercial companies, neither the SICAR nor the SIF is subject to consolidated reporting.

The annual accounts must be audited, further, by a certified Luxembourg independent auditor. The auditor is appointed and remunerated by the SICAR or SIF but will have to inform the CSSF about serious violations of the applicable legal provisions or about any facts or decisions that could potentially threaten the continuity of the SICAR or SIF.

A SICAR is invited to submit half-yearly financial information to the CSSF, including the following, at the very least:

- a statement of the SICAR's financial situation and notably the total of its assets;
- a detailed account of its portfolio;
- the amount of the SICAR's subscribed and paid-up capital, as well as the total of investors' subscription commitments;
- information concerning the profile of the investors that subscribed to the SICAR's shares; and
- where applicable, information on the level of the SICAR's indebtedness.

A SIF is invited to submit yearly and monthly financial information to the CSSF.

Since the implementation of the AIFMD as per the AIFM Law, it should be noted that unregulated funds (any investment vehicle not subject to the supervision of the CSSF, potentially a Soparfi) could qualify as an AIF within the meaning of the AIFMD, and its manager be subsequently subject to registration or authorisation under the AIFM Law. An AIF is defined by the AIFMD as a collective investment vehicle, including investment compartments thereof, which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors and does not require authorisation under Directive 2009/65/EU (Undertakings for Collective Investment in Transferable Securities). Being subject to regulatory supervision or authorisation is not a requirement to qualify as an AIF. The CSSF confirmed that it is the responsibility of the management body of the collective investment vehicle to self-assess if it qualifies as an AIF. Assuming AIFs are being managed, then the manager shall apply for an AIFM licence should the AIFMD thresholds of assets under management be met. The standard threshold is set at €100 million, including assets acquired through the use of leverage but is increased to €500 million, when the portfolio of assets managed consists of AIFs that are not leveraged and have no redemption rights exercisable during a period of five years following the date of the initial investment in each AIF. The AIFM licence can be applied for internally by the AIF itself (where the legal form of the AIF permits internal management) or the AIF may appoint a third-party AIFM (in Luxembourg or another EU jurisdiction, pending the extension of the AIFMD passport to non-EU AIFMs).

While managers of sub-threshold AIFs are not subject to authorisation under the AIFM Law, they are not entirely exempted from the AIFM Law requirements. Those managers are required to register themselves with the CSSF, disclose the AIF they manage (and their investment strategies) and regularly report to the CSSF the principal instruments in which they trade and the relating investment exposures. Managers of sub-threshold AIFs may nonetheless elect to subject themselves to the AIFM Law requirements (especially if they want to benefit from the EU passport attached to the licence).

Alongside non-regulated AIFs, the AIFM Law regime can also be applicable to SIFs and SICARs if:

- they do qualify as AIFs; and
- their manager reaches the applicable threshold of assets under management.

In this context, the AIFM Law has amended the SIF and SICAR laws to establish two types of SIF and SICAR, namely those managed by an AIFMD-compliant manager and those managed by an AIFMD non-compliant manager.

Any AIFMD-compliant SICAR or SIF manager is subject to the following regime, which is the same as the general SICAR or SIF regime, with some exceptions:

- the CSSF may approve a SIF or SICAR whose central administration is not in Luxembourg if it has delegated its management to an AIFMD-compliant manager who performs the functions required by the AIFMD;
- the valuation rules contained in the AIFM Law will apply together with the current valuation rules contained in the SICAR Law or the SIF Law;
- the content of a SIF or SICAR’s annual report must comply fully with the AIFM Law;
- the information to be communicated to the SIF or SICAR’s investors must be in line with the AIFM Law requirements;
- the AIFM Law delegation rules will have to be complied with;
- it will benefit from the AIFMD marketing passport; and
- it must align its depositary regime with AIFMD requirements.

As far as the reserved alternative investment fund (RAIF) is concerned, although it is neither subject to any prior regulatory approval nor any ongoing direct supervision, a RAIF must qualify as an AIF within the meaning of the AIFM Law. It is required to appoint an AIFMD-compliant AIFM and thus comply with all provisions of the AIFM Law. Similarly, only EU AIFs may opt in for the ELTIF regime.

In terms of reporting requirements, the AIFM Law contains obligations applicable to the manager of any AIF in scope. For SIFs and SICARs, those requirements will apply alongside the SIF or SICAR laws specific reporting rules, which, to a large extent, have anticipated the AIFM Law reporting rules. ELTIFs are directly subject to the AIFM Law reporting rules, supplemented by additional requirements under the ELTIF Regulation. The AIFMD reporting framework mainly consists of annual reporting and disclosure to investors and regulators requirements. Annual reports must be prepared at least once a year and within six months following the end of the financial year for each Luxembourg AIF managed or marketed in the European Union. The annual reports will be audited and provided to investors upon request as well as to the CSSF. Disclosure to investors requirements entails communication of certain information prior to their investments (generally contained in an issuing document). Such information relates, inter alia, to the AIF's investment strategy and objectives, techniques it may employ and associated risks, the use of leverage and collateral and the procedures for issue and sale of shares or units. Further aspects that need to be disclosed are as follows:

- the AIF's valuation procedure and pricing methodology;
- a description of liquidity risk management and redemption arrangements;
- a description of all fees, charges and expenses and maximum amounts thereof, which are directly or indirectly borne by the investors;
- the policy on ensuring fair treatment of investors; and
- a description of any preferential treatment of investors.

AIFMs are now subject to EU disclosure requirements with respect to the environmental, social and governance (ESG) criteria, both at the level of the AIFM itself and the level of the investment funds they manage, whether such funds have an ESG focus or not.

In respect of reporting to the CSSF, a Luxembourg-based AIFM should regularly report on the principal markets and instruments in which its AIFs trade and is required to disclose certain additional information encompassing, inter alia, the following:

- the percentage of the AIF's assets that are subject to special arrangements arising from their illiquid nature;
- any new liquidity management arrangements;
- the AIF's risk management systems;
- information on the AIF's main categories of assets; and
- the results of any stress tests.

The frequency of reporting is dependent on the threshold of assets under management.

SIFs, SICARs and Luxembourg-authorised AIFMs (among other entities) are required to complete a self-assessment questionnaire on a yearly basis regarding their compliance with the applicable legal and regulatory requirements in accordance with CSSF Circulars 21/789 and 21/790.

Law stated - 17 January 2024

Governmental requirements

11 What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

The level of investment in Luxembourg is without bearing on applicable rules and regulations.

Law stated - 17 January 2024

Registration of investment adviser

12 Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

While there is currently no registration or authorisation requirement for managers or directors of Luxembourg non-regulated investment vehicles, managers or directors of SICARs and SIFs must be authorised by the CSSF. The same approval requirement applies to Luxembourg-regulated management companies of SIFs or RAIFs set up as a common fund (FCP). In practice, the Luxembourg-based management of a SICAR, SIF or RAIF delegates the investment advisory function, under its responsibility, to advisers located outside Luxembourg. While recourse to a third-party investment adviser is not subject to prior regulatory approval, the delegation of investment management functions is subject to prior notification for any SIF and any SICAR falling in the scope of the AIFMD requirements. Relevant AIFMD delegation requirements must be complied with.

The Banking Law requires Luxembourg-based investment advisers (other than authorised management companies and AIFMs) to be authorised as investment advisers under article 24 of the Banking Law.

Law stated - 17 January 2024

Fund manager requirements

13 Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

Assuming AIFs are being managed, a manager shall apply for an AIFM licence should the AIFMD thresholds of assets under management be met.

Law stated - 17 January 2024

Political contributions

14 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

The Law of 21 December 2007 on the Financing of Political Parties, as amended, regulates contributions to political parties. This law provides that contributions to political parties by legal entities are forbidden and can only be made by natural persons. Natural persons must, however, provide their identity to the political party as anonymous contributions are not authorised. The identity of the contributors is recorded by the political party and a list of contributors and contributions amounting to more than €250 is filed together with the party's annual accounts.

Private equity fund managers, investment advisers or their employees who wish to make contributions to political parties are subject to this law. Therefore, their identity will be disclosed with the publicly available party's annual accounts, if the contribution is more than €250, or for contributions in kind if their value exceeds this threshold.

Law stated - 17 January 2024

Use of intermediaries and lobbyist registration

15 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

As far as the Luxembourg state pension scheme governed by the Luxembourg social security legislation is concerned, there is no possibility to invest in any type of investment vehicle. With regards to other supplementary pension schemes, there are no specific rules governing the marketing of regulated or non-regulated private equity investment vehicles to public pension plans and other governmental entities. In relation to SICARs and SIFs, the CSSF does, however, request information as to the means by which shares or interests issued by such vehicles are marketed or channelled to potential investors.

To the extent the relevant vehicle qualifies as an AIF, the applicable rules under the AIFM Law governing the marketing and distribution of AIFs will need to be complied with.

Law stated - 17 January 2024

Bank participation

16 Describe any key legal or regulatory developments (including those emerging from the 2008 global financial crisis) that specifically affect banks with respect to investing in or sponsoring private equity funds.

As Luxembourg private equity investment structures usually attract international investors and local (Luxembourg) banks rarely act as investors or sponsors to such vehicles, it is likely that investment in Luxembourg private equity funds will be affected much more by internationally driven changes to European legislation and the legislation of foreign jurisdictions, such as the Basel IV regulations providing for stricter capital requirements for banks as well as the US Dodd-Frank Act setting limitations on banks' investment in private equity funds, than by any changes to the domestic legislative framework.

Law stated - 17 January 2024

TAXATION

Tax obligations

17 Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

The analysis of the tax features of Luxembourg private equity investment vehicles requires a schematic approach. By and large, the available investment vehicles can be divided into vehicles that are in principle (if they are considered opaque) subject to, on the one hand, general taxation rules (non-regulated ordinary commercial company (Soparfi), an investment company in risk capital (SICAR) or reserved alternative investment fund (RAIF) SICAR-like), and on the other hand, vehicles that are generally exempt from tax (specialised investment fund (SIF) or the standard RAIF). Within each category, we further need to distinguish between entities that are fiscally opaque (private limited liability company (SARL), public limited liability company (SA) and partnership limited by shares (SCA)) and those that are fiscally transparent (eg, common limited partnership (SCS), special limited partnership (SCSp) or common fund (FCP)).

Soparfi

A Soparfi, whether in the form of an SA, SARL or SCA, is an ordinary fully taxable commercial Luxembourg resident company subject to income taxation (namely, corporate income tax plus an employment fund surcharge and municipal business tax) on its worldwide income (combined rate for the city of Luxembourg in 2024 is 24.94 per cent), subject to specific domestic or treaty exemptions, and indirect taxation (eg, value added tax (VAT)). However, exemptions apply as regards income and capital gains derived from qualifying participations (the participation exemption).

A Soparfi is also subject to a 0.5 per cent net wealth tax on its net asset value as of 1 January of each year (0.05 per cent tax rate for net assets exceeding €500 million). Exemptions apply as regards, inter alia, qualifying participations. Soparfis are subject to a minimum net wealth tax ranging from €535 to €32,100 (depending on the size of their balance sheet). A Soparfi whose assets comprise at least 90 per cent of financial assets and which has a total balance sheet exceeding €350,000 is subject to a minimum net wealth tax of €4,815. In November 2023, the Luxembourg Constitutional Court held that the legal provision in the net wealth tax law, which provides for a different treatment in minimum net wealth tax (ie, a flat rate or a progressive rate) depending on the company's balance sheet composition, is unconstitutional as it gives rise to a discriminatory treatment of persons being in a comparable situation (decision of 10 November 2023, Case No. 185). As a result, awaiting a legislative change, taxpayers whose total balance sheets sit between €350,000 and €2 million may benefit from a lower minimum net wealth tax of €1,605, rather than the €4,815 otherwise applicable.

Dividend distributions by a Soparfi are generally subject to Luxembourg dividend withholding tax at a rate of 15 per cent, although this rate may often be reduced to zero by the application of Luxembourg double tax treaties or the exemptions provided under Luxembourg tax law (notably, Luxembourg's implementation of the Parent-Subsidiary Directive or the withholding tax exemption available for certain shareholders that are resident in a country with which Luxembourg has a tax treaty in force and are subject to a corporate income tax considered as comparable to the Luxembourg one).

Liquidation surpluses distributed by a Soparfi to its shareholders are not subject to withholding tax in Luxembourg. Capital gains realised by non-resident shareholders (who were not Luxembourg residents for more than 15 years in Luxembourg and then non-residents in Luxembourg for less than five years before the sale of the Luxembourg participation) are taxable only if they have held a significant shareholding (at least 10 per cent) in a Luxembourg company for less than six months.

Luxembourg introduced a set of rules implementing Directive 2016/1164/EU (Anti-Tax Avoidance Directive 1 (ATAD 1) and Directive 2017/952/EU (Anti-Tax Avoidance Directive 2 (ATAD 2)). ATAD 1 and ATAD 2 target, in principle, taxpayers subject to Luxembourg corporate income tax. Alongside exit taxation, the controlled foreign company rules, the general anti-abuse rule and the anti-hybrid rules, these regulations include in particular interest deduction limitation rules, according to which the deduction of a taxpayer’s exceeding borrowing cost in a given fiscal year is in principle capped at the higher of:

- 30 per cent of such taxpayer’s taxable earnings before interest, tax, depreciation and amortisation; or
- €3 million.

Non-deductible borrowing costs that cannot be deducted in a given fiscal year can be carried forward without time limitation.

Unregulated transparent investment vehicle

An unregulated transparent investment vehicle, commonly taking the form of an SCS or SCSp, is not subject to corporate income tax or net wealth tax. It is further not subject to municipal business tax (6.75 per cent for 2024 for Luxembourg City) to the extent it does not or is not deemed to conduct a commercial enterprise in the sense of the Luxembourg municipal business tax law. In principle, when an SCS or SCSp qualifies as an alternative investment fund, its activities are deemed not to be commercial. The SCS or SCSp would be deemed to have a commercial activity if its Luxembourg general partner incorporated in the form of a capital company holds 5 per cent or more in the SCS or SCSp.

Being a transparent entity, an SCS or an SCSp is not entitled to claim tax treaty or EU directive benefits. Considering its tax transparency, investors in an SCS or an SCSp are deemed to directly hold the underlying assets and realise the income of the SCS or SCSp in proportion to their respective interests. The SCS and SCSp are not withholding tax agents.

As mentioned above, Luxembourg introduced ATAD 2, which aims at combating hybrid situations. Those anti-hybrid rules notably include the reverse-hybrid rule that is applicable as from the 2022 tax year. A reverse hybrid is an entity that is seen as transparent in its country of establishment but opaque by (some of) its investors. The reverse hybrid rules apply where non-resident investors who consider the fund as opaque are associated with the fund and own 50 per cent or more of interests, voting rights or rights to profits in the fund.

The reverse hybrid entity will become subject to corporate income tax on its income to the extent that its income is not taxed in any other jurisdiction (ie, at the level of the investors) and to the extent that such lack of taxation stems from a mismatch in how the jurisdictions view the entity (eg, the lack of taxation is not on account of an exemption from taxation or from a general lack of taxation within a jurisdiction). An exemption from the reverse hybrid rule applies if the SCS or SCSp qualifies as a collective investment vehicle (CIV). To qualify as a CIV, the following criteria should be met:

- the SCS or SCSp should be widely held;
- the SCS or SCSp should hold a diversified portfolio of securities; and
- the SCS or SCSp should be subject to investor protection rules.

SICAR

The SICAR can, generally speaking, be described as a tax-neutral vehicle for private equity investments.

Taxation of the SICAR: fiscally opaque

The SICAR regime for fiscally opaque entities (eg, an SA, SARL or SCA) follows the ordinary income tax regime of the Soparfi with a few risk capital-specific adjustments. The SICAR is thus also subject to corporate income taxes and specific domestic or treaty exemptions, and should qualify as a resident company for domestic and Luxembourg tax-treaty purposes. However, this type of SICAR benefits from a specific, objective, unconditional risk capital exemption: income from securities (namely, bonds, shares, other transferable securities as well as negotiable instruments giving the right to acquire the aforementioned risk capital securities), as well as income derived from the transfer, contribution or liquidation thereof is exempt. Income derived from temporarily invested idle funds also benefits from an exemption, provided that these funds are effectively invested in risk capital investments within a 12-month period. The SICAR is not eligible for the Luxembourg fiscal unity regime.

All other income is fully subject to ordinary Luxembourg direct taxation rules.

Fiscally opaque SICARs are exempt from net wealth tax. However, they are subject to a minimum net wealth tax in the same manner as Soparfis.

Taxation of the SICAR: fiscally transparent

A SICAR formed as a fiscally transparent SCS allows for the replication of a common law-type limited partnership vehicle. Although the limited partnership has its own legal personality separate from that of its partners, it is itself not liable for corporate income taxation or net wealth tax in Luxembourg and cannot benefit from double tax treaties concluded by Luxembourg. It should not be liable to municipal business tax, to the extent that its Luxembourg general partner incorporated as a capital company does not hold 5 per cent or more of interest in the SCS, as it is by law deemed not carrying on a business activity. The same applies to the SICAR formed as an SCSp, with the difference that the SCSp has no legal personality of its own.

SICARs that are fiscally transparent (incorporated as an SCSp or SCS) might also be concerned by the above-mentioned reverse hybrid rule. CIV exemption could potentially apply if the aforementioned conditions are met.

Taxation of distributions by the SICAR

The SICAR regime distinguishes itself from the rules applicable to Soparfis in that it always permits fiscally neutral (namely, without source taxation) profit repatriations: neither dividends nor liquidation proceeds distributed by a SICAR to investors are subject to withholding tax.

SIF

Generally speaking, a specialised investment fund (SIF) is characterised by its tax neutrality:

- it is exempt from tax on income or capital gains;
- it is also exempt from net wealth tax; and
- distributions (including dividends and liquidation surpluses) made by a SIF to investors are not subject to withholding tax in Luxembourg.

However, the SIF is subject to an annual subscription tax of 0.01 per cent. The taxable basis of the subscription tax is the aggregate net assets of the specialised investment fund as valued on the last day of each quarter. Certain money markets and pension funds or SIFs investing in other funds, which are already subject to subscription tax, are exempt from subscription tax.

SIFs are presumed to be CIVs for the purpose of the above-mentioned reverse hybrid rules, although it is a rebuttable presumption.

RAIF

RAIFs are also characterised by their tax neutrality. The default tax regime applicable to RAIFs mirrors the SIF regime. This means that the RAIF will only be subject, at the fund level, to an annual subscription tax levied at a rate of 0.01 per cent of its net assets calculated on the last day of each quarter. Depending on the investment assets, some exemptions from subscription tax apply to avoid a duplication of this tax. Irrespective of the legal form chosen for the RAIF, it is wholly exempted from corporate income tax, municipal business tax and net wealth tax, and distributions of profits by the RAIF do not give rise to a withholding tax.

However, RAIFs whose constitutive documents provide that their sole object is the investment in risk capital assets (the RAIF-SICAR) and that they are subject to article 48 of the RAIF law, are taxed according to the same tax rules as those applicable to SICARs. In the case of an umbrella fund, this option will apply to the entire umbrella and cannot be applicable to only some of the compartments involved. An auditor will have to certify annually that the investment requirement has been met during the accounting period.

Under these SICAR-mirroring tax rules, a RAIF-SICAR that takes a corporate legal form (eg, the SA, SARL or SCA) is fiscally opaque and is a normally taxable entity for corporate income tax purposes, but with an exemption for any profits and gains derived from securities and funds held pending investment in risk capital. Fiscally opaque RAIF-SICARs are subject to a minimum net wealth tax (as SICARs).

Likewise, a RAIF-SICAR that takes the form of a partnership (the SCS or SCSp) is tax transparent.

RAIFs are presumed to be CIVs for the purpose of the aforementioned reverse hybrid rules, although it is a rebuttable presumption.

Law stated - 17 January 2024

Local taxation of non-resident investors

18 Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

The answers that follow are given for non-resident investors who do not have a permanent establishment or representative in Luxembourg to which their holding in the respective fund is attributed.

Soparfi

Unless a reduced rate under a double tax treaty or an exemption (either domestic or under a tax treaty) applies, dividends distributed by a Soparfi are subject to 15 per cent withholding tax. A non-resident investor is not subject to any tax reporting formality in this respect – it is the company that has to file a withholding tax return – unless the investor wants to effect any entitlement to a (partial or total) reimbursement of the withholding tax on dividends.

Non-resident investors are taxed in Luxembourg for the capital gains realised upon the alienation of their shares in a Soparfi only if the investor has not held the shares in the Soparfi for more than six months and disposes of a participation representing more than 10 per cent of the share capital of the Soparfi. In all other cases, the capital gain is not taxable unless the non-resident investor has not been Luxembourg-resident for more than 15 years in Luxembourg and then non-resident in Luxembourg for less than five years before the sale of the Luxembourg participation. Liquidation surpluses distributed by Soparfis are not subject to withholding tax in Luxembourg.

It is important to note that in most cases, if a double tax treaty concluded by Luxembourg is applicable, the non-resident investor could benefit from treaty protection (subject to the increasingly common real-estate-rich-company-clauses, most of the double tax treaties concluded by Luxembourg stipulate that such capital gains are not taxable in Luxembourg, but the country of residence of the foreign investor).

Unregulated transparent investment vehicle

When incorporated under the form of an SCS or an SCSp, unregulated transparent investment vehicles are not withholding tax agents. Provided that the SCS or SCSp does not (or is not deemed to) conduct a commercial enterprise, non-resident investors should not be liable to any taxation in relation to their interest in the SCS or SCSp, as well as filing obligations in Luxembourg. However, as a result of the transparency, they may be subject to Luxembourg non-resident taxation in respect of Luxembourg assets held by the SCS or SCSp, and notably non-resident capital gains taxation as described earlier.

Further, dividends paid to the SCS or SCSp will be deemed paid directly to its investors. Hence when paid by a Luxembourg company, these dividends might attract 15 per cent withholding tax, unless the investors themselves would be entitled to an exemption or a reduction under a tax treaty.

SIF and RAIF (not opting for SICAR regime)

As a general rule, non-resident investors in a SIF or RAIF are not subject to Luxembourg income tax unless they invest in an FCP, SIF or RAIF and derive capital gains taxable in Luxembourg from an indirect participation in a Soparfi incorporated as a Luxembourg capital company (a rare scenario).

SIF and RAIF: fiscally transparent

Generally, non-resident investors are not taxed in Luxembourg on the income (dividends, liquidation surplus and capital gains) derived from a SIF or a RAIF incorporated under the form of an FCP, SCS or SCSp. However, if such SIF or RAIF holds a shareholding in a Soparfi, the non-resident investor would be deemed to hold directly the shares in the Soparfi owing to the tax transparency of the SIF or RAIF. In this case, the non-resident investor could be taxed on the capital gain realised on the alienation of its units only if the investor has not held the shares in the Soparfi for more than six months and has a participation representing more than 10 per cent of the share capital of the Soparfi via the fiscally transparent SIF or RAIF taxable in Luxembourg. It should be noted that such taxation could be mitigated if a double tax treaty concluded by Luxembourg (with the country of residence of the investor) was applicable and stipulated that such capital gain is not taxable in Luxembourg.

SIF and RAIF: fiscally opaque

Distributions made by a fiscally opaque SIF or RAIF (including dividends and liquidation surpluses) are not subject to taxation in Luxembourg in the hands of a non-resident investor.

Non-resident investors are not taxed in Luxembourg for the capital gains realised upon the alienation of their shares in a fiscally opaque SIF or RAIF.

SICAR and RAIF-SICAR

Dividends and liquidation surpluses distributed by any type of SICAR or by a RAIF-SICAR are not subject to Luxembourg taxation in the hands of non-resident investors (either fiscally opaque or transparent). The same rule applies to capital gains deriving from the sale of shares in the SICAR.

Law stated - 17 January 2024

Local tax authority ruling

19 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

The tax exemption applicable to SIFs and RAIFs does not need to be confirmed by way of a tax ruling. The same is generally true for SICARs. In certain instances, it may be desirable to obtain tax clearance from the tax authorities for the tax treatment of a Soparfi – whether the fund is a Soparfi itself or Soparfis as used by SIFs, RAIFs or SICARs as an investment vehicle – to get five years of certainty regarding certain tax matters. The tax authorities will charge an administrative fee ranging from €3,000 to €10,000 for the treatment of each tax ruling request. For ruling requests that meet the requirements (simply, a detailed description of the applicable facts and circumstances and a sufficiently detailed tax analysis), the responsible tax office will have to provide an answer. As of 1 January 2017, certain pieces of information on cross-border tax rulings and advanced pricing agreements are subject to automatic and spontaneous exchange of information obligations with jurisdictions affected by the cross-border tax ruling or advanced pricing agreement. A ruling is generally valid for a period of at most five years.

Finally, rulings issued before 1 January 2015 were automatically terminated as per the end of the tax year 2019 and are no longer valid as from the tax year 2020.

Law stated - 17 January 2024

Organisational taxes

20 Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

RAIFs, SICARs, SIFs and Soparfis are subject to an annual fee due to the Chamber of Commerce. SICARs and SIFs, given that they are regulated vehicles and supervised by the Luxembourg Financial Supervisory Authority (CSSF), have to pay certain fees to the CSSF. In certain instances, fixed registration duties of €75 become due upon the incorporation of a corporate vehicle or any changes made to its constitutional documentation.

Law stated - 17 January 2024

Special tax considerations

21 Describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

The initiators, to the extent that they are not residing in Luxembourg, of a RAIF, SICAR, SIF or Soparfi will generally be able to structure their carried interest and incentive payments in a fiscally neutral manner in Luxembourg.

In addition, a VAT exemption for management fees applies to management services when supplied to a range of fund vehicles.

Law stated - 17 January 2024

Tax treaties

22 List any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Luxembourg is currently party to 95 tax treaties covering most industrialised nations, according to data provided by the Luxembourg tax authorities, with some 4 additional treaties (including new treaties with countries having an existing treaty with Luxembourg) under negotiation or pending entry into force. Soparfis and fiscally opaque SICARs should be entitled to benefit from all the treaties currently in force. Insofar as SIFs are concerned, they might be able to do so for those countries for which the Luxembourg tax authorities state that investment companies with variable capital and investment companies with fixed capital can benefit from the respective tax treaty, which are the treaties with Andorra, Armenia, Austria, Azerbaijan, Bahrain, Barbados, Brunei, China, Croatia, the Czech Republic, Cyprus, Denmark, Estonia, Finland, France, Georgia, Germany, Guernsey, Hong Kong, Isle of Man, Indonesia, Ireland, Israel, Jersey, Kazakhstan, Kosovo, Laos, Liechtenstein, Macedonia, Malaysia, Malta, Moldova, Monaco, Morocco, Panama, Poland, Portugal, Qatar, Romania, San Marino, Saudi Arabia, Serbia, Seychelles, Singapore, Slovakia, Slovenia, Spain, Sri Lanka, Tajikistan, Taiwan, Thailand, Trinidad and Tobago, Tunisia, Turkey, the United Arab Emirates, the United Kingdom, Uruguay, Uzbekistan and Vietnam. For Bulgaria, Greece, Italy and South Korea, the applicability of the tax treaty is not clearly derived from its wording.

In June 2017, Luxembourg formally signed the Organisation for Economic Co-operation and Development's Multilateral Instrument (MLI) developed as part of BEPS Action 15. The MLI will implement in the tax treaties (between its signatories) certain recommendations arising from the BEPS project, for example, the prevention of treaty abuse and anti-hybrid rules. Luxembourg has not excluded any of its bilateral tax treaties from the scope of the MLI, but made a series of reservations regarding specific provisions. The Luxembourg parliament approved the ratification of the MLI on 7 March 2019. With respect to many double tax treaties, the MLI has been in force as of January 2020.

Law stated - 17 January 2024

Other significant tax issues

23 Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

As of 2021, a new real estate tax applies to certain investment vehicles such as SIF and RAIF. Certain non-transparent investment vehicles will be subject to a new real estate tax, at a flat rate of 20 per cent, on income derived directly or indirectly via a transparent entity held in real estate assets (rental income and capital gains) located in Luxembourg.

Also, to the extent that SICARs, SIFs or any kind of alternative investment funds (AIFs) (including RAIFs) typically rely on the services of specialist investment managers or advisers, a specific VAT exemption applies to fund management services in accordance with article 44.1.d) of the Luxembourg VAT Law implementing article 135.1.g) of Directive 2006/112/EC (the Value Added Tax Directive). This exemption also covers some of the administrative services generally provided to funds. The case law of the Court of Justice of the European Union confirmed that fund investment advisory services can be covered by the exemption, even when delegated to a third party, and irrespective of whether the fund investment adviser has a power of decision for the investment fund.

According to the Luxembourg VAT Authorities, funds benefiting from the VAT exemption for fund management services qualify as VAT taxable persons. Although this does not, per se, trigger an obligation for the SICARs, SIFs, RAIFs or other AIFs to register for VAT, the latter may have to do so, should they receive VAT-taxable services from suppliers located outside Luxembourg.

SICARs, SIFs, RAIFs and other AIFs are generally not able to recover VAT incurred on their costs. However, thanks to the broad application of the VAT exemption of article 44.1.d) of the Luxembourg VAT Law, the VAT leakage is in practice limited to the VAT due on services such as custodian, notary, auditor or lawyer services. Moreover, the Luxembourg VAT rate is the lowest in the European Union (17 per cent as of 1 January 2024, compared with an average of 21 per cent in the European Union).

On 22 December 2021, the European Commission released several legislative proposals that will impact corporate taxpayers. One of these is the proposed directive laying down rules to prevent the misuse of shell entities for tax purposes (the Unshell Directive). The Unshell Directive aims to avoid the use of legal entities and arrangements without minimal substance for tax avoidance or tax evasion purposes in a cross-border context. According to the original proposed text, the Unshell Directive was to enter into force on 1 January 2024. However, it is currently foreseen to not enter into force before 2026. The Unshell Directive aims to introduce a new substance standard within EU member states. Failing this standard would lead to an exchange of information on substance within the EU, and, depending on the final text of the proposal and the facts, an automatic denial of tax treaty and directive benefits or dry tax events for investors. Since the publication of the proposal, EU member states have failed to find an agreement on the final text of the directive. As a result, the timeline for its transposition and effects is currently uncertain. It is too early to determine the exact impact the Unshell Directive will have on the private equity industry in Luxembourg.

On 22 December 2023, the Luxembourg law implementing Pillar Two was published in the Luxembourg Official Gazette, in line with the schedule foreseen in the EU Directive. The law is likely to be further amended in 2024 to incorporate additional OECD guidance that goes beyond mere interpretation of existing rules.

For groups with a consolidated turnover of at least €750 million, the transitional rules already have effect as from December 2021. The income inclusion rule and the qualified domestic minimum top-up tax will become effective for fiscal years starting on or after 31 December 2023, whereas the undertaxed profits rule would become effective for fiscal years starting on or after 31 December 2024. As such, groups that are in scope of Pillar Two and have a presence in Luxembourg (whether through a separate entity or a permanent establishment) might have compliance obligations related to Pillar Two as from tax year 2024 (for taxpayers that have a book year aligned with the calendar year).

The Luxembourg legislator has also tried to implement most of the OECD guidance released up to summer 2023, and has confirmed in parliamentary documents the intention to (1) treat existing and additional OECD guidance as relevant sources of interpretation of the rules, and (2) implement (if appropriate) additional OECD guidance that may require a change of law. In particular, some additional clarifications for the fund industry and the implementation of the December OECD guidance could lead to amendments to be voted in the course of 2024. A qualified domestic minimum top-up tax applicable to tax years starting on or after 31 December 2023 may require groups to pay top-up tax on profits of low-taxed Luxembourg constituent entities of the group in Luxembourg rather than the ultimate parent entity's jurisdiction. The qualified domestic minimum top-up tax will be determined based on Lux GAAP or IFRS (depending on the group's situation) rather than on the basis of the financial accounting standard used by the ultimate parent entity of the group for consolidation purposes. This law does not address the implementation of the subject-to-tax rule through ratification of a multilateral convention released by the OECD.

Law stated - 17 January 2024

SELLING RESTRICTIONS AND INVESTORS GENERALLY

Legal and regulatory restrictions

24 Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Most private equity funds will be privately placed within or outside of Luxembourg. Assuming that any such offering falls outside the scope of application of Regulation 2017/1129/EU of 14 June 2017 (the Prospectus Regulation) and the Luxembourg Law of 16 July 2016 on prospectuses for securities (the Prospectus Law), the offering will not be subject to additional rules or regulations (other than those provided for under the investment company in risk capital (SICAR) or specialised investment fund (SIF) regimes).

In a scenario under Directive 2011/61/EU of the European Parliament and the Council on alternative investment fund managers (AIFMD), EU-based alternative investment fund managers (AIFMs) benefit from a European passport to market EU alternative investment funds (AIFs) throughout the European Union to professional investors. Extension of the passport to non-EU-based AIFMs is on the agenda but not yet available. Luxembourg AIFs that are regulated AIFs established as SIF or SICAR are automatically authorised for marketing to well-informed investors in the territory of Luxembourg. For Luxembourg non-regulated AIFs (eg, non-regulated ordinary commercial companies (Soparfis)) not qualifying as European long-term investment funds (ELTIF), marketing in Luxembourg is limited to professional investors. AIFs opting in for the ELTIF label benefit from the European marketing passport for retail investors, subject to compliance with the requirements of the the ELTIF Regulation (EU) No. 2015/760. In terms of marketing of non-Luxembourg AIFs in Luxembourg, those AIFs benefit from the passport to the extent that their manager is an authorised AIFM either in Luxembourg or in another EU jurisdiction. A non-EU manager must notify the Luxembourg Financial Supervisory Authority (CSSF) prior to any pre-marketing and marketing activities in Luxembourg relating to a foreign or Luxembourg AIF.

The Luxembourg Law of 21 July 2021 transposing Directive 2019/1160/EU on the cross-border distribution of collective investment undertakings in Luxembourg law, imposes specific de-notification rules to be complied with to discontinue the marketing of shares or interests in AIFs. AIFMs should consider that they cannot market interests in AIFs with a similar investment strategy within a period of 36 months following a de-notification in a jurisdiction.

Law stated - 17 January 2024

Types of investor

25 Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Luxembourg private equity investment vehicles, whether they are formed as regulated or non-regulated vehicles, generally obtain their funding from institutional, professional or sophisticated private investors. However, the SICAR, SIF and reserved alternative investment fund (RAIF) legislation restrict the offering of an interest in a SICAR, SIF or RAIF to three well-informed investor groups who are deemed able to adequately assess the risks associated with an investment in this type of vehicle. These three groups are:

- institutional investors;
- professional investors; and
- any other investors who meet one of the following conditions:
    - they confirm in writing that they adhere to the status of the well-informed investor and that they invest a minimum of €100,000 into the fund; or
    - alternatively, if they invest less than €100,000, they confirm in writing that they adhere to the status of the well-informed investor and ensure that

they have obtained an assessment made by (1) a credit institution within the meaning of Regulation 575/2013/EU, (2) an investment firm within the meaning of Directive 2014/65/EU on Markets in Financial Instruments, (3) a management company within the meaning of Directive 2009/65/EC, or (4) by an authorised AIFM, certifying their expertise, experience and knowledge in adequately appraising an investment in the SICAR, SIF or RAIF.

For SICARs, SIFs and RAIFs, these conditions apply neither to the general partners of limited partnerships and of partnerships limited by shares, nor to their managers or any other persons involved in their management.

In addition, the distribution of Luxembourg-based AIFMD-compliant funds within the European Union on the basis of the AIFMD distribution passport is restricted to professional investors. Professional investors are a slightly more restrictive circle of investors (as compared with well-informed investors) as they include institutional investors, professional 'per se' investors and 'opt-in' professionals, as further described in Annex II of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments II (MiFID II).

Regulated and unregulated funds opting in for the ELTIF label may also be marketed on the basis of the European distribution passport not only to well-informed or professional investors, as applicable, but also to retail investors, being investors not qualifying as professional investors, subject to compliance with the ELTIF Regulation.

Law stated - 17 January 2024

Identity of investors

26 Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

Investors in SICARs, SIFs or RAIFs are not subject to any notification, monitoring or approval from the CSSF. The CSSF may, however, request certain shareholder information when verifying the fund's compliance with applicable rules and regulations to ensure that only qualifying investors are invested in the fund. For SICARs, however, the CSSF requires that the identity of the controlling ultimate beneficial owner, if any, be disclosed to it. Any such communication is protected by professional secrecy rules. Any change in the management, administration or custody of assets will, each time, require prior approval from the CSSF. With respect to Luxembourg-based AIFMs, they are required to file to the CSSF any substantial change to the information provided to it when filing for the AIFM licence (which includes a change in the composition of ownership at the AIFM level).

Based on the Law of 13 January 2019 introducing in Luxembourg a register of ultimate beneficial owners (UBOs) of companies and other legal entities (RBE), as amended, Luxembourg entities falling within the scope of this law have to collect information about their UBOs, file it with the RBE, keep it up to date and give it to national authorities upon request.

Law stated - 17 January 2024

Licences and registrations

27 Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

One needs to establish whether the offeror is offering the investment on a professional basis or not. If the offeror is performing the services of an investment company or another regulated activity of the financial sector, it will need to hold the requisite licences either in Luxembourg or abroad.

Law stated - 17 January 2024

Money laundering

28 Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

Pursuant inter alia to the Luxembourg Law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended, to CSSF Regulation No. 12-02 of 14 December 2012, as amended, and to CSSF Circular 13/556 of 16 January 2013, Circular 18/698 of 23 August 2018, Circular 19/732 of 20 December 2019 and Circular 20/746 of 9 July 2020 and its subsequent versions released on a regular basis, obligations have been imposed on all professionals of the Luxembourg financial sector to prevent the use of investment companies for money laundering purposes. The same obligations have been extended to SICARs and SIFs by the Law of 13 July 2007 (as amended) on markets in financial instruments implementing the Directive 2004/39/EC on Markets in Financial Instruments into Luxembourg law.

In this context, a procedure for the identification of investors is being imposed on all investors. Investor due diligence measures shall include, but are not limited to, the following:

- identifying the investor and verifying the investor's identity on the basis of documents, data or information obtained from a reliable and independent source;
- identifying the beneficial owner and taking 'reasonable measures' to verify his or her identity using relevant information or data obtained from a reliable and independent source, and to understand the ownership and control structure of the investor;
- assessing and understanding the purpose and intended nature of the business relationship, and, as appropriate, obtaining information on the purpose and intended nature of the business relationship; and
- conducting ongoing due diligence of the business relationship including scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the professional's knowledge

of the investor, the business and risk profile, including, where necessary, the source of funds and ensuring that the documents, data or information collected under the customer due diligence process are kept up to date and relevant.

Professionals of the financial sector are responsible for verifying whether professionals situated in third countries are subject to equivalent anti-money laundering obligations in their own country.

The CSSF has reminded the professionals under its anti-money laundering (AML) and combating the financing of terrorism (CFT) supervision that investment funds should be registered on goAML, an electronic platform to be used to declare any suspicious transactions to the Luxembourg Financial Intelligence Unit (FIU). Investments funds supervised by the CSSF for AML-CFT purposes should further designate a person responsible for compliance with the professional obligations as regards the fight against money laundering and terrorist financing (RR), and a compliance officer at appropriate hierarchical level (RC) to be able to declare any suspicious transactions to the FIU without delay, as the case may be, and inform the CSSF accordingly. The RC of investment funds supervised by the CSSF for AML/CFT purposes is further required to file an AML/CFT report to the CSSF on a yearly basis.

Since 2022, the Luxembourg's Registration Duty, Estate and VAT Authority (AED) has been requiring unregulated funds structured as AIFs and RAIFs to appoint an RR and an RC and to submit a form for their identification to the AED. RAIFs are required to file an AML/CFT questionnaire as well as an RC report to the AED on a yearly basis, whereas AIFs are only required to file an AML/CFT questionnaire to the AED at this stage.

Participants in fund structures, like in any other industry, may have additional reporting obligations to the Luxembourg tax authorities under the Luxembourg implementation of Directive 2018/822/EU of 25 May 2018 on the disclosure of cross-border tax arrangements (DAC 6) if they are involved in a reportable cross-border arrangement and there is no EU intermediary involved in designing or assisting with setting up such an arrangement, or all intermediaries involved are exempt from the obligation to report such an arrangement.

To comply with the recommendations of the Financial Action Task Force and Directive 2015/849/EU (Anti-Money Laundering Directive 4), Luxembourg introduced tax swindle as well as aggravated tax fraud as a primary offence for acts committed as of 1 January 2017. A distinction has to be made between:

- simple tax fraud;
- aggravated tax fraud, qualified as such depending on the amount of annual tax evaded; and
- tax swindle, defined as fraud involving a significant amount of tax, which has been committed by the systematic use of fraudulent practices intended to conceal pertinent facts from the Luxembourg tax authorities.

While simple tax fraud is subject only to administrative sanctions, both aggravated tax fraud and tax swindle constitute criminal offences.

CSSF Circular 20/744 added specific indicators concerning the asset management industry likely to reveal a possible laundering of a predicate tax offence, such as the illegal use of the SICAR status.

CSSF Circular 21/788, published on 22 December 2021, clarified the content of the report that must be drawn up by the approved statutory auditor regarding the compliance by the Luxembourg AIFMs with the legal and regulatory AML and CFT obligations and provisions.

Law stated - 17 January 2024

EXCHANGE LISTING

Listing

29 Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

The Luxembourg Stock Exchange (LuxSE) operates the following two trading venues on which the widest range of securities can be admitted to trading:

- a regulated market within the meaning of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments II (MiFID II) and listed as such on the list of regulated markets on the website of the European Securities and Markets Authority (the Regulated Market); and
- an exchange-regulated market, set up as a multilateral trading facility (within the meaning of MiFID II) designated as the 'Euro multilateral trading facility market' (the Euro MTF Market).

Issuers of securities admitted to trading on the Regulated Market are subject to the obligations of various EU legislation, in particular:

- Regulation 2017/1129/EU of 14 June 2017, as amended (the Prospectus Regulation) together with the related Commission Delegated Regulation 2019/980/EU of 14 March 2019, as amended (the 2019 Delegated Regulation) and the Commission Delegated Regulation 2019/979 of 14 March 2019, as amended;
- the Luxembourg Law of 16 July 2019 on prospectuses for securities (the Prospectus Law);
- Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2005 on the harmonisation of transparency requirements, as amended (the Transparency Directive);
- the Luxembourg Law of 11 January 2008, as amended (the Transparency Law) implementing the Transparency Directive in Luxembourg;
- Regulation 596/2014/EU on market abuse, as amended (the Market Abuse Regulation);
- Directive 2014/57/EU on criminal sanctions for market abuse (the Market Abuse Directive); and

- the Law of 23 December 2016 on market abuse, as amended (the Market Abuse Law) implementing the Market Abuse Directive in Luxembourg.

The Prospectus Regulation, the Transparency Directive and the Transparency Law does not apply to units issued by collective investment undertakings (UCIs) other than the closed-end type.

The Luxembourg Financial Supervisory Authority (CSSF) is the competent authority to approve prospectuses related to offers of securities to the public as well as admission to trading on the Regulated Market drawn up in accordance with the Prospectus Regulation. One of the major advantages of drawing up a Prospectus Regulation compliant prospectus is that once the prospectus is approved in one of the EU member states it can be passported to any other member state for the purposes of offering securities to the public or for their listing on a regulated market, or both (within the meaning of MiFID II) located in another member state (the EU Passporting Regime).

The Euro MTF Market offers an alternative to the Regulated Market for issuers not willing to be subject to the more stringent and burdensome EU legislation and not intending to make use of the EU Passporting Regime.

Prospectuses for an admission to trading on the Euro MTF Market must be drawn up in accordance with the Rules and Regulations of the LuxSE (the Rules and Regulations).

The initial requirements for the admission to trading on the Regulated Market and the Euro MTF Market are similar. The application will consist of the following documents:

- a (draft) prospectus;
- an application form;
- a letter of undertaking on future compliance with ongoing obligations;
- a know-your-customer form;
- a declaration confirming, among other things, the compliance of the issuers' and securities' legal position and structure with applicable laws and the appointment of a financial institution to ensure the financial service of securities for securities holders in Luxembourg;
- the articles of association of the issuer; and
- the annual reports of the issuer for the past three years (or the initial balance sheet for a new issuer, for the period from incorporation until the date of the prospectus).

The authority empowered to approve the listing prospectus will depend on the trading venue chosen and the type of the fund issuing the securities to be listed:

- the Regulated Market:

- prospectuses for open-ended UCIs for distribution in Luxembourg are exempted from approval under the Prospectus Law;
- prospectuses for closed-ended UCIs shall be approved by the CSSF under the Prospectus Law and the Prospectus Regulation; and
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prospectuses for foreign open-ended UCIs not being distributed in Luxembourg shall be approved by the LuxSE pursuant to Part 3, Chapter 2 of the Prospectus Law; and

- the Euro MTF Market:

- prospectuses for closed-ended and foreign open-ended UCIs not being distributed in Luxembourg shall be approved by the LuxSE; and
- prospectuses for open- and closed-ended UCIs accepted by the CSSF for distribution in Luxembourg are exempt from approval by LuxSE.

The LuxSE also offers the possibility for issuers to have their securities listed on the Official List of the LuxSE without being admitted to trading on one of the aforementioned two trading venues. These securities are included in the Securities Official List (SOL), which is a dedicated section of the LuxSE's Official List. The SOL has been designed for issuers looking for visibility and for whom admission to trading is not a prerequisite and who do not intend to be subject to the regulations applicable to admission to trading (notably, the Market Abuse Regulation). The procedure to list securities on the SOL is fairly straightforward. An information notice shall be drawn up in accordance with the LuxSE SOL Rulebook and be approved by the LuxSE.

The ongoing and periodic disclosure requirements applicable to issuers of securities depend on the market where the securities are admitted to trading. More stringent ongoing obligations apply to companies admitted to trading on the Regulated Market.

For issuers whose securities are admitted to trading on the Regulated Market, these obligations mainly arise from the Transparency Law, the Rules and Regulations, the Luxembourg law of 24 May 2011 on the exercise of certain rights of shareholders in listed companies, as amended (the SRL), the Market Abuse Regulation and the Luxembourg Law of 19 May 2006 on takeover bids, as amended (the Takeover Law).

Issuers whose securities are admitted to trading on the Euro MTF Market do not fall within the scope of the Transparency Law, the SRL and the Takeover Law. However, the market abuse regime set out in the Market Abuse Regulation also applies to issuers with securities admitted to trading on the Euro MTF Market. Issuers with securities admitted to trading on the Euro MTF Market shall comply with the ongoing and periodic disclosure obligations set out in the Market Abuse Regulation and the Rules and Regulations. These obligations include the publication of annual reports and interim financial statements and the disclosure of all other important information affecting the securities or the issuer (eg, inside information).

As for securities listed on the SOL, ongoing disclosure obligations are limited to certain communication obligations to the LuxSE in accordance with the SOL Rulebook.

A listing may facilitate fundraising by reaching a larger number of investors and may increase the liquidity of otherwise rather illiquid investments. Certain institutional investors may only invest through listed private equity investment vehicles.

Law stated - 17 January 2024

Restriction on transfers of interest

30 | To what extent can a listed fund restrict transfers of its interests?

Listed private equity vehicles should, in principle, not be subject to any transfer restrictions (other than restrictions deriving from blue sky laws). This requirement needs to be reconciled with the fact that investments in investment companies in risk capital, specialised investment funds and reserved alternative investment funds are restricted to well-informed investors only. The transfer restrictions are thus a crucial issue. In practice, the fund regulations will therefore provide for a forced repurchase or exit of non-qualifying investors.

The LuxSE has established a professional segment of each, the Regulated Market and the Euro MTF Market (the Professional Segments). The Professional Segments are specifically designed for issuers targeting professional clients only within the meaning of MiFID II. Securities admitted to the Professional Segments are not accessible to retail investors as trading on the Professional Segments is only allowed between professional investors.

Issuers may opt for the Professional Segments when applying for an admission to trading of their securities on the Regulated Market or the Euro MTF.

Law stated - 17 January 2024

PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS

Legal and regulatory restrictions

31 | Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

A non-regulated ordinary commercial company (Soparfi) is not subject to any investment restrictions and thus may participate in a private equity transaction of any type or size. An investment company in risk capital (SICAR) or a reserved alternative investment fund (RAIF) SICAR-like may solely invest in risk-bearing (private equity) securities, being the direct or indirect contribution of assets to entities in view of their launch, development or listing in the stock exchange. This potentially qualifies any type of investment, whether in the form of equity or debt.

As far as the SICAR regime is concerned, the parliamentary documents give a further indication of the legislator’s intent to provide maximum flexibility owing to the hybrid nature of true risk-capital financing. Listed companies therefore may also qualify as risk-bearing investments to the extent that the investment aims at the financing of, for example, a new business development or where the target company is to be taken private again. Most importantly, however, the SICAR is not subject to any risk-diversification rules and may thus concentrate its resources on a single target. The law, further, does not impose any geographical or sector restrictions. A SICAR may be set up either as a single or as a multi-compartment (umbrella) entity, with each compartment of such a vehicle being linked to a specific portfolio of assets and liabilities that is segregated from the portfolio of assets and liabilities of the other compartments. Although the umbrella SICAR constitutes one single legal entity, the assets of a compartment are exclusively available to satisfy the rights of investors in relation to that compartment and the rights of creditors whose claims have arisen in connection with the operation of that compartment, unless a clause provided in the constitutive documents of the SICAR provides otherwise.

As far as the specialised investment fund (SIF) and the RAIF are concerned, although the principle of spreading risk still applies, there are no pre-set quantitative, qualitative or other investment restrictions other than the 30 per cent safe harbour rule (and which applies on a compartment-by-compartment basis for a SIF or a RAIF set up as an umbrella vehicle). The SIF and RAIF initiators may thus freely determine their investment policies (eg, within a single or multi-compartment (umbrella) SIF), investment restrictions or limitations. SIFs and RAIFs, further, are not bound by any borrowing restrictions.

Law stated - 17 January 2024

Compensation and profit-sharing

32 Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

While the SICAR Law, the SIF Law, the RAIF Law, as well as the Luxembourg Financial Supervisory Authority (CSSF) do not impose specific restrictions on the structuring of the carried interest or the management compensation package, general rules and regulations will apply as to the structuring thereof and the remuneration rules contained under the Law of 12 July 2013, as amended, implementing Directive 2011/61/EU of the European Parliament and the Council on alternative investment fund managers (AIFMD) into Luxembourg law (AIFM Law) may become applicable (both for SICARs, SIFs and RAIFs and non-regulated commercial companies within the scope of the AIFM Law). Different classes of securities can be created within a SICAR, SIF or RAIF, such classes potentially having different characteristics, notably as regards the fee structure, the type of targeted investors or the distribution policy. As far as the SICAR and SIF regimes are concerned, the CSSF will merely ensure that any such scheme is properly disclosed, giving investors the possibility to understand the full bearing thereof and, further, that it does not prejudice their interests. Should the AIFMD remuneration requirements be applicable, those requirements will be applicable at the AIFM level and require the latter to establish remuneration policies and practices that promote sound and effective risk management for those categories of staff whose professional activities have a material impact on the risk profiles of alternative investment funds (AIFs) they manage. These categories of staff should at least include senior management, risk-takers, control functions and any employees receiving total remuneration that takes them into the same remuneration bracket as senior management and risk-takers. The AIFM shall set up remuneration policies and practices in accordance with the principles listed in Annex II to the AIFMD setting forth, inter alia, the following:

- that guaranteed variable remuneration should be exceptional and only occur in the context of hiring new staff and must be limited to the first year;
- that subject to the legal structure of the AIF, a substantial portion of any variable remuneration consists of units or shares of the AIF concerned; and
- that a substantial portion of the variable remuneration component is deferred over a period that is appropriate in view of the life cycle and redemption policy of the AIF concerned and is correctly aligned with the nature of the risks of the AIF in question.

Compliance with these principles may take into account the appropriateness of the principles considering the size, internal organisation and the nature, scope and complexity of the relevant AIFM. Guidelines have been issued by the European Securities Market Authority in relation to the remuneration principles contained under Annex II of the AIFMD. These guidelines notably address how to apply the proportionality principle and remain to be incorporated by the CSSF in its supervisory practice.

Law stated - 17 January 2024

UPDATE AND TRENDS

Key developments of the past year

33 What are the most significant recent trends and developments relating to private equity funds in your jurisdiction? What impact do you expect such trends and developments will have on global private equity fundraising and on private equity funds generally?

While on the one hand, investors' appetite for products compliant with Directive 2011/61/EU of the European Parliament and the Council on alternative investment fund managers (AIFMD) has continued to grow significantly over the past years, on the other hand, managers have been using Luxembourg increasingly as their hub, both for the formation of their vehicles and for the pooling of resources.

This development has also led to the increased complexity of Luxembourg fund structures, comprising, in the same jurisdiction, various layers, including parallel entities, feeders, co-investment and carry entities, depending on investors' or managers' needs. In this context, the entry into force of the Law of 21 July 2023 amending, inter alia, the Law of 13 February 2007, as amended, on specialised investment funds, the Law of 15 June 2004, as amended, on the investment company in risk capital, the Law of 23 July 2016, as amended, on reserved alternative investment funds and the Law of 12 July 2013, as amended, on alternative investment fund managers, significantly modernised the Luxembourg toolbox for investment funds and fund managers by providing greater consistency among Luxembourg fund regimes in the context of the democratisation of alternative investment funds, thus helping to reinforce Luxembourg's position as a jurisdiction of first choice for private equity fund managers.

Furthermore, in the context of the so-called 'retailisation' of alternative investment funds, there is an increased interest of fund managers to structure and offer open-ended private asset funds to broaden their investor base and target the non-institutional type of investors, which include private banking clients. This trend is expected to continue in 2024, notably in light of the application from 10 January 2024 of the European long-term investment fund (ELTIF) Regulation 2.0, adopted on 15 February 2023, which is expected to significantly increase the attractiveness of the ELTIF regime in Luxembourg.

At the European level, the AIFMD is currently being revised, with a final text adopted on 7 February 2024 by the European Parliament, providing key developments regarding delegation, loan origination, liquidity management tools, depositaries and alternative investment fund managers.

Law stated - 17 January 2024

LOYENS LOEFF
Law & Tax

Marc Meyers marc.meyers@loyensloeff.com
Noémi Gémesi noemi.gemesi@loyensloeff.com
Tom Hamen tom.hamen@loyensloeff.com
Karin Finné karin.finne@loyensloeff.com

Loyens & Loeff

Netherlands

Mariska Enzerink, Abe Stegenga
De Brauw Blackstone Westbroek

Summary

FORMATION

Forms of vehicle

1 | What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

In the Netherlands, alternative investment funds (AIFs) are generally structured as a limited partnership (CV) or as a cooperative with excluded liability (cooperative) or a combined structure with a cooperative beneath a CV. Furthermore, contractual funds for joint account (FGR) are often used in the Netherlands for specific asset classes due to the flexibility the FGR regime offers. They are, however, not commonly used for private equity structures due to tax inefficiencies attached to the use of an FGR and will therefore be disregarded for the purposes of this contribution.

CV

A CV is a limited partnership between one or more general partners with unlimited liability, and one or more limited partners with limited liability. A CV has no legal personality. Therefore, the assets of the fund cannot be held by the CV itself, but are instead held by a legal title holder for and on behalf of the CV. Dutch law provides for much flexibility on the terms and conditions to be set out in the limited partnership agreement of the CV.

Investors participate as limited partners in the CV. In principle, limited partners are not liable for the obligations of the CV vis-à-vis third parties.

Cooperative

A cooperative is a Dutch entity with legal personality. The terms and conditions of the fund are usually laid down in a members' agreement. Investors participate as members in the cooperative and receive a membership interest in the cooperative. A cooperative does not have a capital divided into shares. Dutch law allows to exclude or limit the liability of members. This level of liability needs to be included in the name of the cooperative. A cooperative with excluded liability is mostly used in an investment fund context.

Law stated - 28 January 2024

Forming a private equity fund vehicle

2 | What is the process for forming a private equity fund vehicle in your jurisdiction?

Formation process

Forming a private equity fund has various stages. The first step is a preparatory phase, in which the manager considers the structuring of a potential new fund and tests the investor appetite for a new fund. The preparatory phase will usually be heavily tax driven, as the investor appetite to participate in a fund will also rely on the tax structuring of the fund. Once a proposed structure has crystallised, a manager can start sounding investors. Since the implementation of the cross-border distribution framework (Directive EU 2019/1160 and Regulation EU 2019/1156), this sounding generally requires a pre-marketing notification to be made with the Dutch regulator, the Netherlands Authority for Financial Markets (AFM). A manager may, but is not required to, appoint a placement agent to help with its fundraising efforts. In accordance with the cross-border distribution framework, a placement agent assisting with pre-marketing requires a licence as either a credit institution, investment firm, UCITS or Alternative Investment Fund Managers Directive (AIFMD) management company or a Markets in Financial Instruments Directive (MiFID) tied agent.

Subject to the investor sounding having the desired outcome, the fund documents can be drafted. Input of the investor sounding will, of course, be taken into account in drafting the fund documents. In addition to drafting the fund agreement (such as a limited partnership agreement or a membership agreement), this phase will usually also entail the drafting of accompanying documents such as a private placement memorandum and subscription documentation.

Once this process has been finalised and the manager wishes to formally file the fund for registration under its AIFMD licence with the AFM, the AFM has an initial review period of one month. This can be extended by one more month, which is in practice usually the norm. If the AFM requires more information, the review period may be suspended. Therefore, it generally takes two to three months to register a fund in the Netherlands. Once the fund is registered under the AIFMD management licence of the manager, the fund can be marketed to professional investors within the EEA. This does require the manager to apply for an outgoing passport upon the registration of the fund with the AFM.

Below threshold managers

The above process sets out the regime for managers of private equity funds holding a full-fledged AIFMD licence. We note that smaller managers may not yet be subject to a licence requirement due to their assets under management remaining below the AIFMD licence requirement thresholds (the AIFMD light managers, in brief being managers with less than €100 million assets under management when leverage is employed or less than €500 million assets under management when no leverage is employed at fund level). These managers are subject to a limited set of ongoing requirements with the AFM. New private equity funds will need to be registered; no passporting regime applies, and marketing into other EEA jurisdictions is subject to national requirements.

Minimum capital requirements

No minimum capital requirements apply at fund level. At manager level, minimum capital, solvency and liquidity requirements do apply.

Costs

The AFM applies a dual system of costs charges to licensed entities, based on ongoing costs of supervision and fixed amounts for one-off requirement involvement of the AFM. The ongoing costs charged are comprised of (1) a set amount of €7,140 for each licence holder and (2) an increase based on a charge per million of asset under management. The AFM charges a one-off amount of €4,400 for the notification of a new alternative investment fund or a sub fund under the licence of an AIFMD manager. The costs brackets for supervisory costs are fixed up to and including 2024; as per 2025, the joint regulators of the financial markets in the Netherlands (the AFM and the Dutch Central Bank, DNB), will reassess the division of the aggregate supervision costs between the various types of regulated entities.

Law stated - 28 January 2024

Requirements

3 Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

Licensed alternative investment fund managers (AIFMs) have to appoint a depositary for each AIF under their management. The depositary is responsible for the safekeeping of the assets of the fund and for performing various supervisory duties in respect of the fund. In the Netherlands, such depositary is generally subject to a licence requirement (unless a specific exemption applies).

In addition, funds without legal personality (in a private equity context primarily CVs) are required to appoint a dedicated legal title holder. The legal title holder is generally structured as a foundation under Dutch law; the articles of association of such foundation need to include that the sole purpose of the legal title holder is holding the legal title to the assets and liabilities of the AIF.

Law stated - 28 January 2024

Access to information

4 What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

In the Netherlands, all legal entities need to be registered with the Dutch Chamber of Commerce. In addition, CVs can also be registered with the Dutch Chamber of Commerce. The information to be made available concerns among other things the following: the company's name, its registered seat, address details, date of incorporation, its managing director and a description of the company's actual activities. In addition thereto, for CVs the aggregate capital contributions of the limited partners need to be registered.

Identities of investors are not required to be disclosed and can be kept confidential unless an investing entity qualifies as an ultimate beneficial owner (UBO). However, for entities that qualify as a tax-transparent entity for Dutch tax purposes all the partners need to consent before a new limited partner can be admitted. Consequently, the identity of the limited partners is in such a way disclosed among the partners.

UBOs in a CV are the individuals that have an interest of more than 25 per cent in the CV, who can exercise more than 25 per cent of the voting rights in the CV or who can exercise effective control over the CV. If there is no individual that can be identified as a UBO based on the aforementioned criteria, one or more individuals that hold the position of senior managing official qualify as a UBO and need to be registered accordingly.

Law stated - 28 January 2024

Limited liability for third-party investors

5 In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

In principle, limited partners of a CV are not liable for the obligations of the CV. However, limited partners can be held liable in specific circumstances, namely:

- where the names of the limited partners (or any portions thereof) are used in the name of the CV;
- where limited partners perform any acts of management or control or present themselves as involved with such acts; or
- where a limited partner that has committed a tort qualifies as a policymaker or co-policymaker of the general partner, or voluntarily assumes liability for the obligations of the general partner.

In general, investors in a CV seek comfort, via a legal opinion to be issued by the legal counsel of a manager, that no liability is incurred solely by exercising the rights and obligations vested in limited partners under the limited partnership agreement.

A cooperative does have legal personality and assumes rights and obligations in its own name. For a cooperative, the limited liability of investors depends on the limitation of exclusion of the liability as set out in articles of association of a cooperative. In general, private equity funds in the form of a cooperative are structured as a cooperative UA (a cooperative with excluded liability for its members, meaning that liability of investors is capped at the committed amount). A member of a cooperative with excluded liability is not liable for a deficit of the cooperative. The other exceptional circumstances in which investors can be held liable for the obligations of the cooperative are comparable to the circumstances for limited partners in a CV as set out above.

Law stated - 28 January 2024

Fund manager’s fiduciary duties

6 What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

According to the AIFMD and Dutch law, fund managers are required to act in the best interest of the fund and its investors and treat investors in a fair and equal manner. If disclosed to other investors, unequal treatment is allowed (subject to the conditions as set out in the AIFMD), but this may never result in a material disadvantage to other investors and needs to be substantiated based on objective criteria.

Furthermore, the principle of reasonableness and fairness are the core tenants of Dutch contract law. All contracts to be concluded, including limited partnership agreements governing CVs needs to be construed and interpreted in accordance with this principle.

Law stated - 28 January 2024

Gross negligence

7 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Dutch law does not distinguish between 'gross negligence' and 'ordinary negligence'. The standard of care generally included in fund documents is gross negligence (or attributable failure).

Law stated - 28 January 2024

Other special issues or requirements

8 Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Restrictions on transfers and withdrawals vary from fund to fund and typically addressed in the fund documents. The same applies to special governance rights on matters such as removal of the manager and early dissolution of a fund.

One of the restrictions often seen in fund documents of a CV is the 'consent requirement', in accordance with the Decree of the Dutch Ministry of Finance of 15 December 2015, No. BLKB2015/1209M, in order for a CV to classify, and continue to classify, as a tax transparent entity for Dutch tax purposes. In short, this means that the unanimous and unconditional prior consent from all limited and general partners is required before a new limited partner can be admitted to a CV. This also applies to a transfer of a partnership interest. This consent right needs to be built into the limited partnership agreement of the fund. In practice, fund documents include that such consent may not be unreasonable withheld by the partners and will be deemed to be given if a partner has not objected within a certain time period. Such deemed consent mechanism is market practice in the Netherlands.

However, the Dutch government has adopted a bill as a result of which the consent requirement to classify a CV as tax transparent for Dutch tax purposes will be abolished as of 1 January 2025. After that date, a CV will generally classify as tax transparent for Dutch tax purposes.

Under Dutch law, a legal entity can be converted into another legal form if certain requirements are taken into account. These requirements vary per legal form, noting that a redomiciliation of an already existing private equity fund is almost never seen in practice.

Law stated - 28 January 2024

Fund sponsor bankruptcy or change of control

9 With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Events such as bankruptcy, insolvency, change of control or restructuring at the level of the manager will result in regulatory consequences, following from both the AIFMD and Dutch law. Moreover, the fund documents usually include provisions in relation to these events, including the consequences thereof. For example, a change of control at the level of the manager requires a notification to the Dutch regulator. Furthermore, it is considered market practice that the fund documents include a change of control provision in relation to the manager or general partner of the fund, or both. The bankruptcy or insolvency of a manager or general partner usually leads to the dissolution of the fund and winding up of its affairs.

Law stated - 28 January 2024

REGULATION, LICENSING AND REGISTRATION

Principal regulatory bodies

10 What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

In the Netherlands, the Netherlands Authority for Financial Markets (the AFM) is the primary supervisor for investment fund managers that are licensed or registered under the Alternative Investment Fund Managers Directive (AIFMD). The AFM is responsible for the initial licensing process and ongoing supervision in respect of conduct and compliance. The Dutch Central Bank (DNB) is involved for prudential supervision aspects.

In line with the system of the AIFMD and similar legislation, it is the manager that is regulated and not the fund itself. Audit rights and inspection rights for regulators against the manager, as well as reporting requirements to investors, are implemented into Dutch law in conformity with AIFMD provisions. No Dutch law specific gold-plating has taken place. We note that individual investor audit rights, as are negotiated in the context of individual portfolio management agreements within the meaning of MiFID, are not applicable nor customary in the Dutch market in a fund manager–investor relationship.

In terms of regulatory reporting, the minimum standard is set by the reporting requirements under the AIFMD. Additional reporting and information requests are usually agreed between a fund manager and an investor in a side letter.

For non-EEA managers, the AIFMD reporting standards of the private placement regime apply. Until 2023, these reportings were not specifically enforced by DNB. However, non-EEA managers offering units to qualified investors in the Netherlands are, as of Q1 2023, required to submit AIFMD reports via the online portal of the AFM.

In addition to obligations following from the AIFMD, reporting requirements are also governed by specialist regulatory frameworks such as the EU Sustainable Finance Disclosure Regulation (Regulation (EU) 2022/2088) and the Taxonomy Regulation (Regulation (EU) 2022/852). These frameworks impose requirements that are broad in scope and also apply to below-threshold (ie, non-licensed, but registered) alternative investment fund managers (EuVECA), European Venture Capital Fund Regulation and European social entrepreneurship fund managers (EuSEF).

Law stated - 28 January 2024

Governmental requirements

11 What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

In line with the system of the AIFMD, the manager is regulated and not the fund itself. Upon the set-up of a new fund, an AIFMD licensed or registered manager is required to register the fund under its licence with the AFM to be able to manage market this.

There are no additional requirements triggered by the location of investment activities in the Netherlands; the licence and registration requirements are triggered by the manager having its legal seat in, or offering units in investment funds managed by it in, the Netherlands.

Law stated - 28 January 2024

Registration of investment adviser

12 Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Dutch law does not include specific registration or authorisation requirement relating to a private equity manager or its officers, directors or controllers that are similar to the US investment adviser concept. Fund managers are generally required to obtain an AIFMD licence, register as a manager under EuVeCA, EuSEF or ELTIF or register under the AIFMD below-threshold regime for smaller managers in order to perform their activities (AIFMD light regime).

Where a fund management entity itself would undertake advisory activities in addition to its collective fund management tasks, additional (MiFID top-up) licensing for advisory investment-specific services is required.

Law stated - 28 January 2024

Fund manager requirements

13 Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

Requirements at entity level

To obtain a licence as an AIFM, a legal entity will need to comply with a number of mandatory requirements relating to its organisation and operational set-up, as well as governance-specific requirements. An AIFM will need to meet a minimum capital requirement of the higher of:

- €125,000 plus 0.02 per cent of the amount that the assets under management of the aggregated AIFs managed by it exceed €50 million; or
- 25 per cent of the fixed costs of the AIFM, with the amount of own funds maximised at €10 million.

Requirements at board level

Each licensed manager will need to have at least two day-to-day policy makers. The daily policy-makers of a manager (in general its statutory board members, as well as potential executive committee members) will need to be vetted for integrity and suitability by the AFM. The same applies to potential supervisory board members.

The suitability screening is aimed at determining if the relevant persons to be appointed are fit for their intended position and the tasks that they will be responsible for. Detailed requirements, including requirements related to required leadership and board experience, are included in a dedicated policy rule on fitness. Upon each proposed appointment, detailed information on the proposed candidate will need to be provided. In addition, the AFM will also reassess the suitability of the collective management board or supervisory board to ascertain that the collective comprises a mix of people with complementary areas of expertise and skills to further ensure a sound governance. As suitability is very specific to a certain board position or management entity, changes in function or responsibilities will require an additional suitability screening.

The integrity screening is aimed at determining if the propriety of a person to be involved with a manager, either at board or shareholder level, is beyond doubt. Intentions, actions and personal background that may be considered an impediment for appointment are considered, primarily in view of safeguarding the integrity of the management entity and its governance. Specific attention is given to a person's background and potential past or pending other board positions, as well as potential past incidents relating to for example legal, tax or enforcement action against the relevant person or a legal entity at which a board position was held. Once a person has been successfully vetted for integrity, the integrity screening remains valid for other appointments in the financial sector. Relevant facts or circumstances will need to be notified and may form the basis for a re-assessment on integrity.

Requirements at shareholder level

Co-policymakers (in general these comprise management board members of majority (in)direct shareholders of a manager) need to be vetted on integrity. The information to be provided, as well as the timelines, are identical to those of an integrity screening for board members.

The AFM will moreover need to be informed of all changes to the shareholder base of a licensed AIFM and has a one-month review period, which may be elongated by another month, to assess if the intended changes are acceptable.

Law stated - 28 January 2024

Political contributions

14 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

No Dutch law specific restrictions apply.

Law stated - 28 January 2024

Use of intermediaries and lobbyist registration

15 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

The use of third-party service providers by a manager will typically need to be disclosed in the offering documentation of the fund when the costs of the use of such third-party service providers are charged to the fund as part of its organisational or operational expenses. This requirement follows from the AIFMD rules on costs transparency.

Specifically in a context where US investors seek to invest, we usually see that placement agent disclosure requirements are applied at side letter level.

Law stated - 28 January 2024

Bank participation

16 Describe any key legal or regulatory developments (including those emerging from the 2008 global financial crisis) that specifically affect banks with respect to investing in or sponsoring private equity funds.

From a Dutch law perspective, there are no specific developments to mention. Investments by banks are governed by bank-specific regulation at EEA level and do not entail specific Dutch law gold plating.

Law stated - 28 January 2024

TAXATION

Tax obligations

17 Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Dutch private equity funds are typically organised as cooperatives with excluded liability (cooperative) (single cooperative structure) or as a Dutch limited partnership that holds all equity interests in a holding cooperative (a limited partnership (CV)-cooperative structure). Income and gains from portfolio companies are generally fully exempt from Dutch corporate income tax pursuant to the participation exemption. Cooperatives are treated as normal taxpayers, as a result of which their worldwide profits are, in principle, subject to Dutch corporate income tax at rates up to 25.8 per cent. However, profits, both gains and dividends, from qualifying participations are fully exempt pursuant to the participation exemption. Application of the participation exemption is generally subject to the cooperative holding at least 5 per cent of the nominal paid-up share capital of the portfolio company and the portfolio company meeting either a non-portfolio investment test, subject-to-tax test or asset test. Generally, satisfaction of these tests is manageable in the case of active operating portfolio companies. In a CV-cooperative structure, the Dutch limited partnership (the CV) is organised as transparent as a result of which it is not subject to any Dutch corporate income tax.

Distributions by the aforementioned fund structures are not subject to Dutch dividend withholding tax. Distributions by cooperatives are only subject to Dutch dividend withholding tax if (1) the cooperative is a ‘holding cooperative’, meaning that its activities count for at least 70 per cent of holding equity participations or (in)directly providing loans to related parties; and (2) the distribution is made to a 5 per cent or more equity holder. Typically, in single cooperative structures the cooperative is not considered a holding cooperative, due to its active management of its investments. In a CV-cooperative structure, distributions by the cooperative to the CV are treated as distributions to the investors in the CV due to the tax transparent treatment of the CV. In this structure, the cooperative is generally considered to qualify as a holding cooperative. However, distributions by such a cooperative are not subject to Dutch dividend withholding tax nonetheless either because (1) it is attributable to an investor holding an interest of less than 5 per cent through the tax transparent CV or (2) it is exempt pursuant to a domestic law exemption from Dutch dividend withholding tax.

Law stated - 28 January 2024

Local taxation of non-resident investors

18 Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Non-resident investors are typically not subject to Dutch corporate income tax or income tax, subject to the following.

In a single cooperative structure, investors who are natural persons with tax residence outside the Netherlands are generally not subject to Dutch personal income tax if they hold an interest of less than 5 per cent in the cooperative and they do not operate a Dutch (deemed) permanent establishment to which the interests in the cooperative are attributable. Corporate entities with tax residence outside the Netherlands are not subject to Dutch corporate income tax unless (1) they hold a 5 per cent or more interest and (2) such interest is held by the entity as part of an artificial arrangement to avoid Dutch personal income tax of another person. In the absence of such non-resident tax liability, no filing obligations apply.

Natural persons generally do not participate directly in a CV-cooperative structure because it would subject them to Dutch personal income tax on business profits at progressive rates up to 49.5 per cent. Natural persons generally participate in a tax-opaque feeder vehicle. Foreign corporate entities are typically considered to operate a Dutch permanent establishment by virtue of their investment in the CV and accordingly be treated as a non-resident corporate income taxpayer. However, any profits are considered derived through the equity interests in the cooperative and accordingly fully exempt pursuant to the participation exemption, regardless of the interest of the investor in the cooperative (the 5 per cent threshold does not apply to interests in cooperatives). Such foreign investors may be required to file a straightforward ‘nil’ tax return, declaring no taxable income.

Law stated - 28 January 2024

Local tax authority ruling

19 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

Generally, it is considered desirable for Dutch private equity funds to seek an advance tax ruling confirming the Dutch corporate income tax and dividend withholding tax treatment of investors.

Law stated - 28 January 2024

Organisational taxes

20 Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

This is not applicable in the Netherlands.

Law stated - 28 January 2024

Special tax considerations

21 Describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Management fees paid by private equity funds are generally treated as exempt from VAT based on the exemption for management of collective investment funds. This is the case if the purpose of the Dutch fund vehicle is to collectively invest in securities or other financial assets, or both. Further, the Dutch fund vehicle must have at least two investors, must invest its commitments pursuant to the principle of risk diversification, must be subject to special authorised government control and the investment risk should be borne by all investors.

To date, carried interest rights held by managers who are taxable in the Netherlands are typically structured to the effect that benefits become taxable at a rate of up to 33 per cent in the year of actual realisation. The structuring requires the use of a tax-opaque carried interest holding entity. The tax treatment of managers who live or work outside the Netherlands depends on the place of residence or work, and structuring preference may differ from managers taxable in the Netherlands. Therefore, the structuring of carried interest rights of cross-border private equity teams warrants careful attention.

Law stated - 28 January 2024

Tax treaties

22

List any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

The Netherlands has concluded over 100 treaties for the avoidance of double taxation with other states, which may be relevant depending on the tax resident jurisdiction of the investors and the portfolio companies. In the aforementioned fund structure, the cooperative should generally be entitled to the benefits of a tax treaty subject to satisfaction of relevant conditions, including limitation of benefits or other anti-abuse tests and specific conditions.

Law stated - 28 January 2024

Other significant tax issues

23 Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

As of 2024, a new withholding tax applies with respect to distributions, including distributions by any Dutch cooperative, at the same rate as the headline corporate income tax rate (25.8 per cent), which can be credited against Dutch dividend withholding tax paid (if any). This withholding tax only applies to distributions to corporate entities that hold, alone or as part of a collaborating group, a controlling interest in the company and qualify as tainted investors because they:

- are resident or operated through a permanent establishment in a low-taxed or non-cooperative jurisdiction;
- are a (reverse) hybrid entity, subject to a rebuttal regime; or
- have been interposed as part of an artificial arrangement to avoid the withholding tax.

This new withholding tax may be relevant to some CV-cooperative structures if tainted investors are involved in such structure.

Further, the Dutch government has adopted a bill as a result of which, among others, the consent requirement for tax-transparent classification of a limited partnership will be abolished, effective as of 1 January 2025. After that date, a CV will generally be classified as tax transparent for Dutch tax purposes. This will benefit tax-transparent fund structures like the CV-cooperative structure, but may also raise administrative questions with respect to CV-cooperative structures.

Law stated - 28 January 2024

SELLING RESTRICTIONS AND INVESTORS GENERALLY

Legal and regulatory restrictions

24

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Offers and sales of interest in private equity funds formed in the Netherlands are restricted in that managers can only market their funds to professional investors in the Netherlands and throughout the EEA. This marketing may be conducted on the basis of the Alternative Investment Fund Managers Directive (AIFMD) passporting regime. This regime is applicable to marketing aimed at professional investors and non-professional investors that are treated as professional investors at their request (ie, the 'opt-up').

For retail investors that cannot meet the opt-up criteria, national top-up requirements apply and additional requirements upon fund registration will need to be met. The national top-up regime in the Netherlands imposes additional disclosure, reporting and compliance requirements and is based on the requirements for undertakings for collective investment in transferable securities (UCITS). If a private equity fund is open for commitments with an initial value of at least €100,000, the Dutch retail top-up rules do not apply. However, to qualify for this regime, the amounts have to be called at once and not in tranches. Furthermore, the use of this national regime does not exempt managers from the requirement to prepare a key investor information document (PRIIPS KIID). In the Netherlands, there are very few precedents of private equity funds registered for marketing to retail directly (also in view of liquidity restrictions and the closed-end nature of a private equity fund).

For non-EEA managers, Dutch law includes a private placement regime based on article 42 of the AIFMD. On the basis of this regime, managers may market to qualified investors in the Netherlands after registering with the Dutch regulator the Authority for Financial Markets (the AFM) and subject to certain ongoing requirements.

Law stated - 28 January 2024

Types of investor

25 Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Other than the offering restrictions that may apply, there are no additional restrictions on the types of investors that may participate in private equity funds. Subject to obtaining the appropriate registration at the AFM, both professional and retail investors may be targeted.

Law stated - 28 January 2024

Identity of investors

26 Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

No regulatory notifications of filings are required for transfers of interest, or in relation to the identity of investors in a fund. It can be the case that managers, on the basis of a spot check in relation to sound and prudent business operations, will be asked to disclosure certain investor specific files in order for the regulator to determine regulatory compliance in relation to, for example, anti-money laundering or know-your-customer or sanctions law. This is, however, incidental and does not comprise an ongoing obligation. Regulators are subject to appropriate confidentiality restrictions, meaning the information will not become publicly available.

Any change of ownership will require filing with the AFM. The AFM will need to be informed of all changes to the shareholder base of a licensed AIFM (no materiality threshold) and has a one-month review period, which may be extended by another month, to assess if the intended changes are acceptable.

For a change of fund manager, the new manager will need to notify the AIF under its licence in line with the notification procedure.

Law stated - 28 January 2024

Licences and registrations

27 Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

This depends on the specific service provided by the relevant person. A manager may, but is not required to, appoint a placement agent to help with its fundraising efforts. In accordance with the cross-border distribution framework, a placement agent assisting with pre-marketing requires a licence as either a credit institution, investment firm, UCITS or AIFMD management company or a Markets in Financial Instruments Directive (MiFID) tied agent.

For marketing activities, a licence or registration is required if the relevant person is deemed to perform investment services or activities within the meaning of MiFID (such as investment advice or the receipt of transmission of orders). This is highly case-specific and will depend on the actual services provided.

Law stated - 28 January 2024

Money laundering

28 Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

AIFMD managers are subject to anti-money laundering provisions as they apply in the Netherlands. These provisions are based on the amended Fourth Anti-Money Laundering Directive ((EU) 2018/843) and included in the Dutch Act on the prevention of money laundering and terrorist financing and the Dutch Sanction Act 1977 (including any regulatory guidance in relation thereto).

Law stated - 28 January 2024

EXCHANGE LISTING

Listing

29 Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

On paper, private equity funds can indeed be listed on one of the markets of Euronext or another active securities exchange in the Netherlands. However, due to the illiquid nature of private equity funds and the high initial investment amounts for participants, examples of listed private equity funds are rather limited.

We do see new initiatives being discussed or introduced into the market, including semi-illiquid feeder structures and other types of listed funds that offer exposure to private equity and liquidity. Another example is tokenisation, where part of a fund is 'tokenised' (for example, by a digital assets firm) and tokenised units are offered and traded for smaller investment minimums than the underlying private equity fund itself.

Law stated - 28 January 2024

Restriction on transfers of interest

30 To what extent can a listed fund restrict transfers of its interests?

The restriction of transferability of interests in private equity funds is not prohibited by law and can generally be arranged in (contractual) fund terms. However, for listed funds this is slightly different, as these will need to be (to an extent) transferable in accordance with the rules of the relevant market they are being traded on. This is highly market-specific. Examples are markets that are only accessible for trading by parties meeting certain criteria (such as those of a professional investor).

Law stated - 28 January 2024

PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS

Legal and regulatory restrictions

31 Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

From a Dutch law perspective, there are no legal or regulatory requirements for funds to participate in private equity transactions. However, when participating in private equity transactions, the asset stripping rules as implemented in the Netherlands often become relevant when planning and structuring such transactions. Consequently, the impact of the asset stripping rules should be carefully considered by managers when participating in private equity transactions that are in scope of the asset stripping rules.

Law stated - 28 January 2024

Compensation and profit-sharing

32 Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

The Dutch Act on the Remuneration Policy of Financial Undertakings (Wbfo) applies, among others, to alternative investment fund managers (AIFMs) with a seat in the Netherlands. The requirements and restrictions on remuneration as imposed by the Wbfo apply on top of the requirements as set out in the Capital Requirements Directive (CRD IV) and the Alternative Investment Fund Managers Directive. Although the bonus cap of 20 per cent as set out in the Wbfo does not apply to AIFMs, the Wbfo includes various other restrictions and requirements. In relation to the structuring and the manager's ability to take management fees and carried interest mainly tax considerations need to be taken in to account.

Law stated - 28 January 2024

UPDATE AND TRENDS

Key developments of the past year

33 What are the most significant recent trends and developments relating to private equity funds in your jurisdiction? What impact do you expect such trends and developments will have on global private equity fundraising and on private equity funds generally?

AIFMD II

In November 2023, the final text of the Alternative Investment Fund Managers Directive II (AIFMD II) was published. The amendments to the AIFMD will introduce, among other things, a harmonised regime for loan-originating funds, changes to the delegation provisions and a broadened scope of permitted activities for AIFMs. As member states will have 24 months to implement the AIFMD II into national law, the changes will come into effect early 2026.

Continuation funds

One of the recent trends in the Dutch market is the increase of continuation funds and general partner-led transactions. Although these types of transactions are not new (there are various precedents for 'recapitalisations' that are structurally equivalent), continuation funds are now seen as a real exit alternative. In 2023, these transactions were typically initiated in respect of the 'crown jewels' of a fund. We expect there to be a continued strong presence of continuation vehicle structures in 2024, potentially with more inclination towards multi-asset vehicles to limit concentration and single exposure risks.

Changes to the sustainability framework

Looking ahead, more regulatory focus on sustainability in private equity is expected. For example, in 2023 the European Commission released its consultation of the review of the EU Sustainable Finance Disclosure Regulation (SFDR). Under the SFDR, Dutch managers are currently required to make certain pre-contractual disclosures on the fund website and in the private placement memorandum, and periodic disclosures in the annual report of a fund, depending on the SFDR-classification of the particular fund. The consultation invites respondents to provide their views on a wide range of questions on existing SFDR requirements, and could result in changes to the current framework in the future.

ESG profiling

Environmental, social, and corporate governance (ESG) profiling is also expected to become an even more important factor in fundraisings. On the back of several large pension funds, there are more and more institutional investors that are looking to invest in fund structures with an – at minimum – article 8 SFDR qualification. This will require managers to tailor their investment policies and procedures in such way that ESG factors are promoted via the investments they make.

DORA

Another key issue for managers in 2024 will be the preparation for the implementation of the Digital Operational Resilience Act (DORA.) The DORA aims to ensure that financial institutions, including managers, have better control of IT risks and so are more resilient to cyber threats. Managers must comply with the DORA as of mid-2025. The DORA requires managers to (1) make changes to their governance to ensure that digital resilience is part of the competencies within its management body; and (2) review existing arrangements with third parties – both outsourcing and purchasing agreements – to ascertain if they fall under the remit of the new DORA provisions, which would require them to be amended. We expect the DORA to be relevant for a large number of managers that make use of ICT or digital enhanced services for matters such as reporting, valuation or pricing.

Retail investors

Now that allocation restrictions from existing investors are expected to affect further growth in funding for (at least some) private equity managers, we expect there to be more focus on the potential 'retailisation' of private equity. While the democratisation of private markets started in the United States, it is now rapidly fanning out globally. The updated European Long-Term Investment Funds (ELTIF) regulation will apply from early 2024 and aims to help to extend private equity funds to retail investors.

Law stated - 28 January 2024

DE BRAUW BLACKSTONE WESTBROEK

Mariska Enzerink mariska.enzerink@debrauw.com
Abe Stegenga abe.stegenga@debrauw.com

De Brauw Blackstone Westbroek

Spain

Alejandra Font, Carlos de Cárdenas, Manuel García-Riestra
Alter Legal

Summary

FORMATION

Forms of vehicle

1 What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

Spanish Law No. 22/2014 of 12 November 2014 (the Law on Venture Capital Entities), recently amended by the new Law for the Creation and Growth of Businesses (Law No. 18/2022), contemplates three main different types of venture capital entities:

- private equity funds (FCRs);
- private equity companies (SCRs); and
- venture capital entities for small and medium-sized investments (ECRs-Pyme).

The Law on Venture Capital Entities refers to FCRs, SCRs and ECRs-Pyme as venture capital entities (ECRs).

FCRs, SCRs and ECRs-Pyme must be registered with the Spanish Securities Exchange Commission (CNMV). ECRs are regulated and supervised by the CNMV.

Venture capital entities can be managed by management companies of closed-ended collective investment entities (SGEICs) or by management companies of collective investment schemes (SGIICs). Both management entities require authorisation by the CNMV and are subject to supervision and regulation by the CNMV.

FCRs

An FCR is a pool of assets divided into units, without legal personality. An FCR must comply with the provisions contained in the Law on Venture Capital Entities and with its own regulations as established in its constitution documents.

Owing to its lack of legal personality, an FCR must be managed by an SGEIC or by an SGIIC.

SCRs

SCRs are corporate entities that are subject to the provisions of the Law on Venture Capital Entities and are therefore subject to a particular regulatory and tax regime. They are also subject to the provisions of the Spanish Corporate Law. An SCR may either be self-managed (through its own governing body), or managed by an SGEIC or an SGIIC. Self-managed SCRs require authorisation by the CNMV prior to their incorporation.

Investors in the FCR and shareholders in the SCR are liable respectively for the FCR and SCR's liabilities, up to the amount contributed through the subscription of units or shares.

Investors who wish to have a direct involvement usually prefer to invest in SCRs. In addition, Spanish resident investors intending to benefit from certain tax incentive schemes for corporations in Spain may prefer to invest in SCRs (such tax incentives may not apply to FCRs).

On the other hand, FCRs are not subject to legal requirements generally applicable to corporations that give shareholders substantial rights to participate in, or to control, the governing body (as is the case of SCRs). The role of investors in FCRs is generally passive, which makes FCRs more appropriate for investment funds managed independently.

ECRs-Pyme

ECRs-Pyme are considered a special type of ECR, which may adopt the form of FCR or SCR.

ECRs-Pyme must comply with specific investment restrictions. In particular, they must invest at least 75 per cent of their assets in equity or equity-related instruments in small and medium-sized enterprises that:

- are not listed;
- have fewer than 499 employees;
- have annual assets not exceeding €43 million or turnover not exceeding €50 million;
- are not a financial or a real estate company;
- are not a collective investment scheme; and
- are established in an EU country or third country that is not designated as a 'non-cooperative country or territory' by the Financial Action Task Force on Money Laundering, or that has subscribed with Spain an agreement to avoid double taxation with an information exchange clause or an agreement to exchange tax information.

ECRs may have different classes of units or shares, which may help to set up a more tax-efficient carried-interest structure for founders and promoters.

In addition to the above, the Spanish Law on Venture Capital Entities regulates two types of close-ended collective investment entities:

- close-ended collective investment companies (SICCs); and
- close-ended collective investment funds (FICCs).

SICCs and FICCs are generally subject to the legal regime applicable to SCRs and FCRs, respectively, with certain exceptions, which results in a more flexible regulatory regime for EICCs compared with ECRs. For instance:

- EICCs are not subject to the investment restrictions applicable to ECRs;
- EICCs are not subject to the minimum capital requirements applicable to ECRs; and
-

EICCs may only invest in securitisations whose originator retain at least 5 per cent and will be subject to the limitations on the securitisation positions provided in the Delegated Regulation 231/2013/EU of 19 December 2012.

Lastly, new Law No. 18/2022:

- regulates a new type of close-ended collective investment entity (EICCP) whose principal purpose consists of investing in invoices, loans, credits and commercial papers habitually used in commercial traffic; and
- incorporates references to the European Long-Term Investment Funds (ELTIFs), regulated by Regulation 2015/760/EU of 29 April 2015, so that ELTIFs fall under the supervision of the CNMV.

Law stated - 19 January 2024

Forming a private equity fund vehicle

2 | What is the process for forming a private equity fund vehicle in your jurisdiction?

ECRs may be formed in Spain by virtue of a public deed of constitution granted by a public notary, and their constitution should be registered with the Mercantile Registry. However, those requirements are not required if the ECR takes the form of an FCR, which may be formed by virtue of a private agreement of constitution that is not required to be filed with the Mercantile Registry.

Once the ECR has been duly established, all relevant documentation and information shall be filed with the CNMV. The CNMV will proceed to the registration of the ECR with the relevant Registry once the CNMV has reviewed all relevant documentation and has considered such documentation complete. Notwithstanding the above, a self-managed SCR is subject to an authorisation process before the CNMV, prior to its incorporation.

If the promoters wish to promote an FCR, or an SCR managed by an SGEIC, the latter (the management company) would need to be incorporated and registered with the CNMV prior to filing the documentation related to the ECR. The SGEIC, once it has obtained the required approval by the CNMV, will have to be registered with the Mercantile Registry and with the CNMV. SGEICs and SCRs will also be required to submit to the Spanish the Executive Service of the Commission for the Prevention of Money Laundering and Monetary Offences (the Spanish financial intelligence unit), their anti-money laundering policy.

Generally, the approval process of an SGEIC or a self-managed SCR should take at least four months from the date of the application for authorisation to the CNMV or the date on which all documentation requested by the CNMV has been submitted.

The documentation required for the formation of an FCR shall include its agreement of constitution (which may be formalised by virtue of a public deed, or a private document) the management regulations, and its prospectus. The agreement of constitution should state among others the name of the FCR, its purpose (consistent with the Law on Venture Capital Entities), the amount of subscribed capital, and the name and domicile of its management company. FCRs must have a minimum subscribed capital of €1.65 million of which, according to CNMV interpretation of the Law on Venture Capital Entities, at least €165,000 should be paid upon the date of constitution.

The documentation required for the formation of an SCR shall include the prospectus, its public deed of incorporation, and the company by-laws. The company by-laws shall state the SCR's investment policy (consistent with the Law on Venture Capital Entities) and may contemplate the possibility of delegating the management of the SCR's investments to a management company. SCRs must have a minimum subscribed capital of €1.2 million (€900,000 for ECRs-Pyme) on the date of their incorporation, 25 per cent of which must be paid upon such date.

SGEICs shall have a minimum capital of €125,000, which shall be subscribed and fully paid upon the date of incorporation. Such amount shall be increased if the portfolio under management exceeds €250 million, in accordance with article 48 of the Law on Venture Capital Entities.

Establishment costs of ECRs generally include legal advisers' fees, notary fees and registrar fees. ECRs must be audited. Additionally, no capital duty shall have to be paid on the incorporation or capital increase of ECRs. Management services rendered by SGEICs to their managed ECRs are value added tax exempt.

Law stated - 19 January 2024

Requirements

3 Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

FCRs must be managed either by an SGEIC or by an SGIIC. SCRs are corporations that may be self-managed (through its own governing body), or may delegate their management to an SGEIC or an SGIIC. Like any other corporation, an SCR will be required to maintain locally a registered office and books and records and, additionally, office space, IT equipment and human resources sufficient to properly carry out its regulated activity, as assessed by the CNMV.

It is the SGEIC or the SGIIC who must ensure that the FCR, or the SCR managed by it, meets certain requirements in relation to human, technical and material resources, rather than the ECRs themselves. SGEICs and SGIICs must have a registered office (which will also be the registered office of the FCR), a governing body, and a certain minimum number of employees (which will vary depending on the number of ECRs managed by them, the assets under management and the number of expected investments). SGEICs and SGIICs must also keep their own books and records.

SGEICs shall appoint a depositary in relation to each of the ECRs managed by them if the assets under management exceed the limits established in article 72.1 of the Law on Venture Capital Entities, or if the SGEIC commercialises ECRs to non-professional investors.

Annual accounts of ECRs must be prepared by the governing body of the SCR, the SGEIC or the SGIIC, within five months of the end of the financial year, and then submitted to the general shareholders meeting for approval within six months of the end of the financial year. The financial statements of ECRs and SGEICs, which have to be audited, must be filed with the CNMV and, in the case of SCRs and SGEICs, also before the Spanish Mercantile Registry within seven months of the end of the financial year.

Law stated - 19 January 2024

Access to information

4 What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

Public access to information relating to ECRs is regulated in Title II, Chapter II, section 3 of the Law on Venture Capital Entities. In addition, pursuant to the Spanish Law on Transparency, Access to Public Information and Good Governance (Law No. 19/2013), entities controlled by public administrations, corporations majority-owned by public administrations or companies that are recipients of government subsidies, will be subject to certain public disclosure obligations.

Generally, FCRs' constitutional documents and modifications are available to the public, as they are filed with the CNMV's registry, which is a public registry.

An SCR's deeds of incorporation and their by-laws must also be registered with the Mercantile Registry, which is also available to the public.

Investors subscribing for units of an FCR on the date of its formation will appear in the constitutional documents, and therefore their identities and the amount of their investment will be available to the public. The same will apply to investors subscribing for shares of an SCR, not only on the incorporation of the SCR, but also upon each subsequent share capital increase.

An ECR's annual accounts must be audited and are available to the public. The audit report and the audited annual accounts have to be filed with the CNMV. The same applies to SCRs, except that the filing should also be made with the Mercantile Registry.

The annual report of the SGEICs shall include information relating to the remuneration policy of the SGEIC. An SGEIC shall file its audit report and accounts with the CNMV within six months of the end of the financial year.

Failure to comply with these obligations may entail monetary fines and, in certain cases, may even result in the revocation of the CNMV's authorisation and exclusion of the ECR from the relevant CNMV registry.

Law stated - 19 January 2024

Limited liability for third-party investors

5 In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Generally, under Spanish law, the liability of investors with respect to their investment in an ECR is limited to the share capital subscribed or to the units acquired. Under very exceptional circumstances, Spanish courts may approve the 'piercing of the corporate veil' of an SCR and agree that the shareholders of the SCR be held liable for the SCR's liabilities.

Law stated - 19 January 2024

Fund manager's fiduciary duties

6 What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Article 84 of the Law on Venture Capital Entities refers to the rules of conduct to which SGEICs, SGIICs that manage ECRs and self-managed SCRs are subject. SGEICs, SGIICs that manage ECRs, and self-managed SCRs, must prepare and approve a mandatory internal code of conduct that regulates the operation of their management bodies, directors and employees. This code of conduct shall develop the principles established in the consolidated version of Law No. 6/2023 (the Spanish Securities Market Law).

Directors of an SGEIC or SGIIC and directors of SCRs are subject to the following obligations:

- to act with due diligence and transparency for the benefit of investors;
- to prevent and avoid risks derived from conflicts of interest, or to regulate appropriate procedures to ensure that if any conflict arises, priority is given to the interest of the investors;
- to undertake prudent management, and to take care of investors' interests as if they were their own interests; and
- to ensure that all investors are treated fairly.

Generally, such duties cannot be waived by agreement by the parties.

Law stated - 19 January 2024

Gross negligence

7 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Directors and officers of ECRs and their management companies are required by law to undertake prudent management and to take care of the investors' interests as if they were their own interests. Additionally, both the Spanish Law on Venture Capital Entities and the general corporate legislation provide for a strict regime on directors' liability under which directors of an ECR management company (or directors of an SCR) may be held liable towards the company, its shareholders or third parties, if they fail to act as a prudent business person or as a loyal representative.

Law stated - 19 January 2024

Other special issues or requirements

8 Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

ECRs are required by the Law on Venture Capital Entities to invest at least 60 per cent of their assets in equity or equity-related instruments (including, subject to certain limits or specific requirements, profit-sharing loans and invoices, loans, credits and commercial effects in portfolio companies). Investments in certain real estate companies, financial entities (other than those whose activity is supported on the application of technology to new business models) or listed companies (other than public-to-private transactions) will generally not qualify within the mentioned 60 per cent.

The remaining assets may be invested in the share capital of other companies, profit-sharing loans, other types of financing to portfolio companies or certain other securities.

Additionally, ECRs are subject to certain diversification and borrowing limits.

ECRs-Pyme must invest at least 75 per cent of their assets in equity or equity-related instruments in small and medium-sized enterprises.

Generally, conversion or re-domiciling of foreign private equity funds into ECRs would not be possible as such. An application to obtain the CNMV's authorisation or approval for registration would have to be submitted under the form of an SCR or FCR.

Documentation governing FCRs may include most of the standard market terms and conditions governing private equity funds, such as investment restrictions, investors' governance rights, transfer restrictions, reporting provisions, distribution waterfall, etc. However, some difficulties may be found in implementing certain market terms in an SCR, as it is a corporate entity in which shareholders have substantial rights to interfere with the management. Also, there would be some difficulties in reflecting usual opt-out or exclusion provisions as, in principle, investors should participate in each of the ECR's assets and liabilities, pro rata to their participation in the capital of the ECR.

Finally, the Law on Venture Capital Entities regulates the European venture capital funds and the European social entrepreneurship funds, institutions formed under Regulation 345/2013/EU of 17 April 2013 and Regulation 346/2013/EU of 17 April 2013, respectively, and that now have to be registered with the CNMV. Also, Law No. 18/2022 incorporates references to ELTIFs, regulated by Regulation 2015/760/EU of 29 April 2015, so that ELTIFs fall under the supervision of the CNMV.

Law stated - 19 January 2024

Fund sponsor bankruptcy or change of control

9 With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

In general terms, the bankruptcy, insolvency, change of control, restructuring or similar transaction affecting an ECR sponsor should not have, per se, direct legal or regulatory consequences for the ECR.

The bankruptcy or insolvency of the ECR's management company may have relevant consequences for the ECR, which should either replace the management company, or be liquidated itself (article 57.3 of the Law on Venture Capital Entities).

Finally, under article 53 of the Law on Venture Capital Entities, the SGEIC's authorisation may be revoked, among other circumstances, when the SGEIC is declared bankrupt or insolvent, or it can be reasonably considered by the CNMV that the influence exercised over the SGEIC by an investor holding a relevant stake in such SGEIC may be detrimental to the SGEIC's proper and prudent management and could potentially result in severe damage of its financial situation.

Law stated - 19 January 2024

REGULATION, LICENSING AND REGISTRATION

Principal regulatory bodies

10 What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The Spanish Securities Exchange Commission (CNMV) is the main supervisory and regulatory body for venture capital entities (ECRs) and has very wide inspection rights within its authority and functions.

The CNMV must be notified of changes in the documents previously submitted to the CNMV in the authorisation and constitution process, including changes related to directors and top executives of the ECR or its management company (some of these changes may require the CNMV's prior approval). Also, the CNMV must be regularly provided with accounting reporting, which has to be submitted to the CNMV in the way of annual accounts after the end of the fiscal year. Management companies are also required to provide the CNMV with certain documents containing economic information related to the ECRs managed by them, including the audited annual accounts.

Additional reporting requirements may apply, pursuant to article 72 of Law No. 22/2014 of 12 November 2014 (the Law on Venture Capital Entities), if the management company or the assets of the ECRs managed by it exceed certain thresholds (€100 million for leveraged funds and €500 million for unleveraged funds) or are marketed to non-professional investors, including the following:

- annual report for investors and the CNMV to be provided within six months after the year-end;
- audited annual accounts of the management company and the ECR within six months after the year-end;
- any new measures to manage liquidity as well as any changes in the leverage and guarantees policy of the ECR;
- reports regarding the leverage of the ECR; and
- information regarding the acquisition of significant stakes in non-listed companies not considered small or medium-sized companies.

ECRs and their management companies are also supervised by the Spanish Executive Service of the Commission for the Prevention of Money Laundering and Monetary Offences (SEPBLAC).

Law stated - 19 January 2024

Governmental requirements

11 What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

ECRs must be registered with the CNMV, and only self-managed private equity companies (SCRs) require the CNMV's administrative approval prior to their registration. SCRs must be incorporated in a notarial public deed and registered with the Mercantile Registry prior to their registration with the CNMV. Incorporation in a notarial public deed and registration with the Mercantile Registry is not required for private equity funds.

The level of investment activity that ECRs may have in Spain would not directly make any difference in relation to its registration requirements. However, for a new ECR to obtain the regulatory registration (or authorisation in the case of a self-managed SCR), the level of investment activity will generally be taken into account by the CNMV when assessing the minimum human and material resources that SCRs, management companies of closed-ended collective investment entities (SGEICs) or management companies of collective investment schemes (SGIICs) should reasonably have to perform proper management and administration.

Following the above, ECRs or management companies whose ECRs exceed certain size thresholds or are marketed to non-professional investors are subject to a more complex and stringent regulatory regime and additional structure requirements, including:

- specific compensation policies;
- conflict-of-interest procedures;
- risk-management procedures and units;
- liquidity-management systems;
- periodic asset valuation (by internal or external valuers); and
- additional information requirements, etc.

Therefore, to authorise or register (as applicable) these types of ECRs and management companies, the CNMV will usually request more detailed information regarding such matters, as well as a higher degree of human and material resources.

Law stated - 19 January 2024

Registration of investment adviser

12 Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

ECRs and their management companies are required to be registered and supervised by the CNMV, and they are expressly authorised to provide investment advisory services to entities within the scope of their corporate activity. Consequently, they do not need, for these purposes, to initiate a different procedure to register as investment advisers.

Directors and officers of SGEICs, SGIICs and SCRs are also subject to regulatory supervision and therefore, for such purposes, do not need to be registered individually as investment advisers either.

Law stated - 19 January 2024

Fund manager requirements

13 Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

The directors and officers of SGEICs and SCRs must meet certain requirements regarding integrity and reputation. In this respect, they must complete a specific form and questionnaire required by the CNMV. Additionally, the CNMV will require that the directors and officers of SGEICs or SCRs have appropriate knowledge and experience regarding financial or business management. In principle, such experience should include, as a minimum, three years of management or advisory services in financial entities or executive management posts in other public or private companies.

Law stated - 19 January 2024

Political contributions

14 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are substantial restrictions under Spanish law in relation to political contributions by individuals or private entities to political parties. Political parties may not accept contributions from private businesses that provide services to public administrations or companies majority-owned by public administrations. Additionally, annual contributions to political parties by an individual or private entity cannot exceed certain stringent thresholds.

Law stated - 19 January 2024

Use of intermediaries and lobbyist registration

15 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

Usually, the CNMV will request that the ECR's prospectus includes the name of the intermediaries that are marketing the ECR (if any). Likewise, the CNMV may ask or request additional information from the management company or the sponsors during the ECR's approval process regarding the use of intermediaries for the marketing of the relevant ECR. Finally, in general terms, intermediaries that wish to market or place an ECR among investors must be previously authorised to act as financial intermediaries in Spain pursuant to the applicable legislation.

To date, no legislation relating to any register of lobbyists has been approved in Spain.

Law stated - 19 January 2024

Bank participation

16 Describe any key legal or regulatory developments (including those emerging from the 2008 global financial crisis) that specifically affect banks with respect to investing in or sponsoring private equity funds.

With the exception of the limitations deriving from the own funds' requirements for banks set forth in Regulation 575/2013/EU of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation 648/2012/EU, the potential implications of the Volcker Rule and Basel III, and the sustainability regulations, no other specific regulations on Spanish banks may have a material impact with respect to banks investing in or sponsoring private equity funds.

Law stated - 19 January 2024

TAXATION

Tax obligations

17 Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Spanish venture capital entities (ECRs) are opaque entities for Spanish tax purposes and therefore, are subject to Spanish corporate income tax (CIT).

In general terms, pursuant to the CIT general tax regimen (article 21 of the CIT Act), entities subject to CIT will benefit from a 95 per cent exemption on dividends and gains obtained from their participation in Spanish resident and non-resident companies (other than companies resident in tax haven), when the following requirements are met:

- that the participation is held for at least one year and represents at least 5 per cent of the capital of the investee company; and
- in the case of stakes in non-resident investee companies, that said companies be subject to a CIT that applies at least a 10 per cent tax rate (presumed to be the case if the investee company is resident in a country that has a double tax treaty with Spain with an information exchange clause).

If the investee company receives dividends or gains from participating companies that represent more than 70 per cent of its income, to benefit from this exemption for the income received attributable to said indirectly participating company, the indirect participation in said entity must also comply with the above-mentioned requirements.

Notwithstanding the above, pursuant to article 50 of the CIT Act, ECRs do enjoy an even more privileged tax regime on dividends and gains derived from 'typical' or 'qualified investments' as set out by Law No. 22/2014 of 12 November 2014 (the Law on Venture Capital Entities), and also with respect to distributions made to Spanish corporate investors and non-resident investors (except tax haven investors).

The main features of the special CIT regime applicable to ECRs can be summarised as follows.

ECR special tax regime under Spanish corporate income tax

Dividends and gains obtained by an ECR from 'typical investments' in accordance with the Law on Venture Capital Entities (generally, investments in non-listed companies – other than public to private transactions – either Spanish or non-Spanish that do not qualify as real estate entities or certain financial entities) will be subject to the ECR special tax regime pursuant to Chapter IV of Title VII of the Spanish CIT Act, which states the following:

- capital gains obtained by the ECR from the transfer of securities representing a participation in the share capital of the investee company (considered as an ECR typical investment) will benefit from a 99 per cent CIT exemption at the level of the ECR, provided that the investment holding period is longer than one year and does not exceed 15 years (subject to the approval of the Spanish Tax Authorities, this term may be extended to up to 20 years in certain cases). Notwithstanding the above, this exemption shall not apply in any of the following cases:
    - if the purchaser is resident in a tax haven jurisdiction or the gain is obtained through a tax haven;
    - if the purchaser is related to the ECR pursuant to the CIT Act (unless it is another ECR); or
    - if the participation was acquired by the ECR from a related person or entity pursuant to the CIT Act; and
- dividends obtained from said Spanish resident or non-resident investee companies (except if obtained through a tax haven) will benefit at the recipient ECR level from the 95 per cent tax exemption provided in article 21.1 of the CIT Act, regardless of the investment holding period and the percentage stake held in the company paying out the dividend.

Capital gains and dividends derived from certain investments which do not qualify for the compulsory investment quota, will be fully taxed at the level of the ECR in accordance with the general tax regime established in the CIT Act. Therefore, although the ECR would not benefit from the above-mentioned ECR privileged tax regime with respect to such investments, the ECR may be able to benefit from the general tax credits and exemptions applicable pursuant to the CIT Act (eg, article 21 of the CIT Act). Likewise, interest, royalties and any other income that does not qualify as dividends, distribution of profits or gains from ECR typical investments, will be subject to the CIT general regime at the ECR level.

Law stated - 19 January 2024

Local taxation of non-resident investors

18 Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Income obtained by non-resident entities or individuals without a permanent establishment in Spain, deriving from their participation in the ECR (ie, dividends, distribution of benefits or capital gains from the reimbursement or transfer of their stake in the ECR, but excluding interests or other types of income) will not be considered to have been obtained in Spain for Spanish tax purposes and, consequently, will not be subject to taxation in Spain (articles 50.3 and 50.4 of the CIT Act). Notwithstanding the above, if the income or gains received by the non-resident investor are attributable to income obtained by the ECR through a tax haven jurisdiction, this special tax regime may not be applicable and the relevant domestic and international tax treaties shall apply. Likewise, if the non-resident receives income from the ECR through a tax haven jurisdiction or when the acquirer is a tax haven resident, this special tax treatment shall not apply (article 50.5 of the CIT Act). Pursuant to the above, non-resident investors may have to provide the ECR with a tax residence certificate to ascertain their proper non-resident status.

Law stated - 19 January 2024

Local tax authority ruling

19 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

The ECRs' special tax regime is expressly regulated by the Spanish tax law and applies to all ECRs duly registered in the Spanish Securities Exchange Commission (CNMV); therefore, its application is not subject to a tax ruling. However, an investor may request from the Spanish tax authorities the issuance of a ruling to confirm or clarify any doubt or question regarding the application of the Spanish ECRs' regime or any other Spanish tax laws or regulations.

Tax treatment of companies resident in Spain, investing in ECRs

Spanish resident companies subject to CIT investing in ECRs will benefit from the ECR special tax regime (articles 50.3 and 50.4 of the CIT Act) as follows:

- for gains obtained from the transfer or redemption of ECRs' shares or units, the Spanish CIT investor will benefit from the 95 per cent tax exemption in article 21.3 of the CIT Act regardless of the holding period and the percentage stake held in the ECR (article 50.4 of the CIT Act); and
- for dividends and benefits distribution, the Spanish CIT investor will benefit from the tax exemption in article 21.1 of the CIT Act, regardless of the holding period and the percentage stake held in the ECR (article 50.3 of the CIT Act).

Notwithstanding the above, if the income or gains received by the Spanish resident company are attributable to income obtained by the ECR through a tax haven jurisdiction, this special tax regime would not be applicable and the CIT general regime would apply.

Tax treatment of individuals resident in Spain, investing in ECRs

No particular tax regime applies with respect to individuals resident in Spain investing in ECRs, who will be subject to the general Spanish personal income tax regime.

Law stated - 19 January 2024

Organisational taxes

20 Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

At present, there is no capital duty applicable on the establishment or capital increase of ECRs or any other Spanish company. However, capital duty may be due in the case of a share capital reduction or winding-up of a private equity company that results in distributions to its investors (generally, 1 per cent over the amount obtained by investors).

Notwithstanding the above, the use of adequate tax planning may help to reduce said capital duty.

Finally, the registration of the ECRs in the CNMV registries is currently subject to registration fees.

Law stated - 19 January 2024

Special tax considerations

21 Describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Regarding an ECR management company, management fees obtained by it from the management service provided to an ECR are exempt from value added tax (VAT). Therefore, generally, VAT borne by an ECR management company will not be deductible (or may be partially deductible only), depending on the VAT pro rata applicable to the ECR management company, taking into account the services provided to other parties subject to VAT.

If, apart from the ECR management company, there are other sponsors or third parties that provide administrative or advisory services to the ECR, such services should not be subject to VAT.

The ECR management company is subject to the general CIT regime, and therefore its annual benefits are taxed under Spanish CIT general tax rates (25 per cent being the standard tax rate).

Spanish personal income tax law has been amended to provide for a beneficial tax treatment of carried interest. From 2023, and provided that certain conditions are met, the amount of carried interest obtained by Spanish residents will benefit from a 50 per cent reduction when calculating the tax basis for the purposes of personal income tax.

Law stated - 19 January 2024

Tax treaties

22 List any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Spain has a wide tax treaty network with third countries. In particular, Spain currently has double tax treaties in force with the following countries: Albania, Algeria, Andorra, Argentina, Armenia, Australia, Austria, Azerbaijan, Barbados, Belarus, Belgium, Bolivia, Bosnia and Herzegovina, Brazil, Bulgaria, Canada, Cape Verde, Chile, China, Colombia, Costa Rica, Croatia, Cuba, Cyprus, the Czech Republic, Denmark, the Dominican Republic, Ecuador, Egypt, El Salvador, Estonia, Finland, France, Georgia, Germany, Gibraltar, Greece, Hungary, Iceland, India, Indonesia, Iran, Ireland, Israel, Italy, Jamaica, Japan, Kazakhstan, Kuwait, Latvia, Lithuania, Luxembourg, Macedonia, Malaysia, Malta, Mexico, Moldova, Morocco, New Zealand, the Netherlands, Nigeria, Norway, Oman, Pakistan, Panama, Philippines, Poland, Portugal, Qatar, Romania, Russia, Saudi Arabia, Senegal, Serbia, Singapore, Slovakia, Slovenia, South Africa, South Korea, states of the former Soviet Union (except Russia), Sweden, Switzerland, Thailand, Trinidad and Tobago, Tunisia, Turkey, the United Arab Emirates, the United Kingdom, the United States, Uruguay, Uzbekistan, Venezuela and Vietnam.

This extensive tax treaty network provides the ECR with a significant advantage when structuring investments in foreign companies in a tax-efficient manner.

Income obtained by non-resident investors (other than tax haven investors) from an ECR (ie, dividends, distribution of profits or gains, but excluding interests or other types of income) is generally considered not to have been obtained in Spain for tax purposes and consequently not subject to taxation in Spain, whether or not there is a tax treaty in force with Spain.

Law stated - 19 January 2024

Other significant tax issues

23 Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

The Spanish special tax regime applicable to ECRs contains a number of anti-abuse rules applicable to transactions made by ECRs with related entities, and to transfers to tax haven residents, which may result in the non-application of the ECRs' special tax regime to certain transactions. Such rules must be considered when planning a deal with related parties or involving tax haven residents, parties or accounts.

ECRs may also be entitled, if they meet certain requirements, to other tax regimes, deductions, exemptions and incentives generally applicable to Spanish CIT payers, or even to Spanish individual investors.

In summary, the ECR regime is a very competitive one for setting up private equity funds, to raise money and investing in Spain and abroad (as the ECR's privileged tax regime applies with respect to both Spanish and non-Spanish investments), and it is also very favourable for Spanish corporate investors and foreign investors in ECRs.

Law stated - 19 January 2024

SELLING RESTRICTIONS AND INVESTORS GENERALLY

Legal and regulatory restrictions

24 Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Venture capital entity (ECR) marketing rules and requirements are regulated under Law No. 22/2014 of 12 November 2014 (the Law on Venture Capital Entities).

ECR interests may only be marketed to the following persons or companies:

- investors considered as professional clients as set out in the Spanish Securities Market Law and Royal Decree 813/2023;
- investors considered as non-professional clients who:
    - commit to investing at least €100,000 and declare in writing that they are aware of the risks of such investment; or
    - commit to investing as a result of advice from a financial advisor (in this case investors may commit less than €100,000 provided that, if their financial worth does not exceed €500,000, they shall invest at least €10,000 and such investment does not exceed 10 per cent of such financial worth);
- directors, executives or employees of its management company or the ECR itself; and
- investors who can prove experience in the management or advisory capacity of ECRs similar to the ones they wish to invest in.

When the ECR is marketed to investors considered as non-professional clients, the investor must receive, prior to investment, an information prospectus that shall include, among other information, the by-laws or management regulations of the ECR, the key information document, the management company agreement and the ECR annual report. These documents will be filed before the Spanish Securities Exchange Commission (CNMV) and included in the CNMV registries. Likewise, the management company of ECRs that market ECRs to investors considered as non-professional clients will have to comply with the additional regulatory requirements set out in Title II of the Law on venture Capital Entities for management companies that exceed certain ECR assets under management thresholds (€100 million for leveraged ECRs and €500 million for non-leveraged ECRs), even if they do not exceed them.

The marketing of foreign private equity funds in Spain is also regulated under the Law on Venture Capital Entities by different rules depending on the place of incorporation of the foreign private equity fund and its management company and their legal status pursuant to the Alternative Investment Managers Directive 2011/61/EU and Directive 2019/1160/EU on cross-border distribution of collective undertakings.

In general terms, the marketing of EU private equity funds managed by an EU management company to professional investors that have requested to avail from the passport regime in Spain shall require:

- a previous notification by the corresponding EU country supervisor to the CNMV, including the main documents and information of said EU private equity fund; and
- the payment to the CNMV of fees to process the passport file and an annual supervisory fee.

The marketing of EU private equity funds to non-professional investors or of any other type of private equity funds will require compliance with additional requirements and previous registration and authorisation by the CNMV.

Pre-marketing is also contemplated, only for professional investors, by the Law on Venture Capital Entities on the same terms as in the aforementioned Directive 2019/1160/EU and will require the manager to notify the CNMV indicating in which EU member states pre-marketing activities will be conducted; thereafter, the CNMV will notify the relevant member states' authorities. Any subscription by professional investors in the relevant member states will be deemed to be made under marketing activities hence excluding any reverse solicitation possibility.

Finally, all foreign private equity funds and their management companies marketed in Spain shall comply with the marketing and publicity regulations applicable in Spain for this type of investment.

Law stated - 19 January 2024

Types of investor

25 Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Certain Spanish institutional investors, because of their own regulatory restrictions, may not be able to invest in non-listed ECRs or may find such investment subject to stringent investment restrictions or limitations (eg, Spanish pension funds and certain Spanish collective investment schemes).

Additionally, the unfavourable tax treatment applicable to tax haven residents investing in ECRs has discouraged their direct investment in ECRs.

Law stated - 19 January 2024

Identity of investors

26

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

The Law on Venture Capital Entities requires ECR management companies and self-managed ECRs to provide information on the identity of all direct or indirect shareholders who have a qualifying holding and the amounts of their holdings as part of the authorisation procedure and any subsequent changes to the information provided.

Regarding ECR investors, the CNMV has established an obligation to report to the CNMV, on a confidential basis, certain aggregated information from the investors for statistical and supervision purposes (eg, commitment range, type of investor and classification according to the Law on Venture Capital Entities). Although there is no specific obligation provided by law to provide information regarding the identity of the investors, given its broad supervisory powers, the CNMV could, eventually, request any ECR management company to provide such information about its direct or indirect investors.

Additionally, the appointment or dismissal of managers and directors of an ECR management company or a private equity company (SCR) must be notified to the CNMV as well as the appointment, removal or replacement of the ECR management company itself, and any other material change in relation to the documents approved by the CNMV in the process of approval of the ECR or its management company.

Finally, as a consequence of the implementation under Spanish Law of US Foreign Account Tax Compliance Act (FATCA) and Organisation for Economic Co-operation and Development Common Reporting Standard (CRS) regulations, the management company may have to disclose the identity of foreign investors who meet the relevant FATCA and CRS criteria to the Spanish authorities.

Law stated - 19 January 2024

Licences and registrations

27 Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Yes, the offering of interests in an ECR can only be performed by authorised financial intermediaries as provided by the Law on Venture Capital Entities.

Law stated - 19 January 2024

Money laundering

28 Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

ECR management companies and self-managed SCRs are subject to a number of money laundering prevention obligations, including the following:

- approving and complying with a money laundering prevention handbook drafted in accordance with the anti-money laundering regulations in force;
- duly identifying each investor in the ECR management company or the ECR, and keeping records of the investors' identification documents as well as of the transactions;
- complying with the relevant FATCA and CRS regulations and filings as implemented under Spanish law;
- training its directors and employees in the relevant money-laundering prevention procedures and handbook;
- reporting any suspicious transaction or investor to the Bank of Spain; and
- having an annual independent expert provide reports regarding compliance with money laundering obligations.

Law stated - 19 January 2024

EXCHANGE LISTING

Listing

29 Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

An Alternative Securities and Exchange Market was established in 2006 (now Bolsas Mercados Españoles (BME)) to facilitate the listing of collective investment schemes incorporated as companies, small and medium-sized companies and other particular entities (eg, venture capital entities (ECRs)) whose specific characteristics (eg, liquidity and size) would make their listing difficult in the Spanish Stock Exchange. In June 2007, this market opened a specific segment for the listing of ECRs, although so far, only one ECR has been listed.

The principal and continuing requirements for listing are as follows:

- the BME will obtain the pertinent documentation from the Spanish Securities Exchange Commission's (CNMV's) registries, including the ECR's annual report and prospectus;
- the ECR must appoint a specialised entity as responsible for the ECR's shareholders' or unitholders' register;
- the ECR shall inform of the liquidity and counterparty commitments reached with a BME member or participating entity in their capacity as a specialist in the securities issued by the ECR;
-

the ECR must undertake to send to the BME any relevant information that might affect trading of its shares, in accordance with applicable legislation and market regulations; and

- the BME board of directors shall authorise the admission to trading of the ECR's securities.

The main advantages for trading are enhanced liquidity, a more efficient and secure transfer of shares, increased transparency and broadening of the investor base (including access to certain institutional investors who may be subject to regulatory restrictions to invest in non-listed ECRs).

The main disadvantages of listing are the administrative and regulatory costs derived from such listing, the increase of information, accounting and filing obligations, and the difficulties in establishing, on a regular basis, a valuation and liquidation price for the ECR's securities.

Law stated - 19 January 2024

Restriction on transfers of interest

30 | To what extent can a listed fund restrict transfers of its interests?

The restriction on the transfer of securities in listed ECRs is, in general terms, not allowed by the BME market authorities.

Law stated - 19 January 2024

PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS

Legal and regulatory restrictions

31 | Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

A venture capital entity (ECR) must invest at least 60 per cent of its assets or 75 per cent for ECRs for small and medium-sized investments in certain equity, equity-related instruments in companies and debt instruments (subject to certain limits), other ECRs or foreign private equity funds that meet certain requirements.

Investments in certain real estate companies, financial entities or listed companies (other than public-to-private transactions) will not generally qualify within the mentioned 60 per cent. The remaining assets, up to a maximum of 40 per cent, may be invested in:

- the share capital of other companies;
- profit-sharing loans to any company;

- other types of financing but only to companies included in its main corporate purpose;
- fixed-income securities; or
- cash.

Likewise, the Spanish special tax regime applicable to ECRs contains a number of anti-abuse rules applicable to transactions made by ECRs with related entities, and to transfers to tax haven residents, which may result in the non-application of the ECRs' special tax regime to certain transactions.

In addition to the above, article 71 of Law No. 22/2014 of 12 November 2014 (the Law on Venture Capital Entities) imposes certain information requirements and anti-asset stripping provisions to ECRs and their management companies that exceed the thresholds or are marketed to non-professional investors regarding the acquisition and holding of stakes in entities not considered to be small and medium-sized companies, such as the following:

- the obligation to notify the Spanish Securities Exchange Commission (CNMV) of the acquisition of any relevant stake (10, 20, 30, 50 or 75 per cent and above) either individually or together with other private equity funds in companies;
- the obligation following the acquisition of control (ie, more than 50 per cent of voting rights) to inform the CNMV, the portfolio company and its shareholders of the following:
  - the ECR identity;
  - the ECR conflict of interest and communications policy;
  - the terms of the financing used for said acquisition; and
  - the ECR intentions regarding the future activities of the company and their consequences or implications in the company's employment; and
- the prohibition, when said stake acquired is higher than 50 per cent and for a period of 24 months, to approve certain share capital reductions, as well as, depending on the net asset value and balance sheet situation of the company, certain dividend distributions or the acquisition of the company's shares by the company.

Other than the above, there are no particular legal or regulatory restrictions that would normally affect or prevent an ECR's participation in private equity transactions.

Law stated - 19 January 2024

Compensation and profit-sharing

32 Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

The Law on Venture Capital Entities provides that ECR management companies must have remuneration policies and practices for prescribed categories of staff that:

- are consistent with and promote sound and effective risk management; and
- do not encourage risk-taking that is inconsistent with the risk profiles, rules or instruments of incorporation of the ECRs they manage.

In addition, the European Securities and Market Authority's Guidelines on Sound Remuneration Policies under the Alternative Investment Fund Managers Directive set out guidance explaining how firms may comply with the remuneration principles.

An ECR may pay management fees and success fees as compensation for the management services provided by its management company as long as such fees have been duly regulated in the ECR's constitutional documents and comply with the applicable remuneration policies and principles. Although the management company may also charge transaction fees, monitoring fees or other similar fees if they are established in these documents, it is best market practice that any such fees would give rise to offset management fees. The ECR management company may also receive fees for the rendering of advisory or other services, on an arm's-length basis, to portfolio companies or prospective portfolio companies, although pursuant to market practice, the provision of such services is usually subject to some kind of investors' consent, or at least, disclosure obligations.

As for profit-sharing arrangements other than success fees, ECRs may issue different classes of units or shares, and therefore different profit-sharing compensation schemes can be structured through the investment in such units or shares.

Law stated - 19 January 2024

UPDATE AND TRENDS

Key developments of the past year

33 What are the most significant recent trends and developments relating to private equity funds in your jurisdiction? What impact do you expect such trends and developments will have on global private equity fundraising and on private equity funds generally?

Capital raising will continue to be difficult, especially for first time fund managers, as investors will continue to favour investing in managers with strong and consistent track records.

The liquidity needs of the current situation may generate secondary transactions for some investors and funds with mature portfolios.

There has been a significant increase in the number and size of fund-of-funds raised, partially in order to diversify portfolios and as a strategy for non-Spanish managers to raise capital from non-professional investors in Spain. The recent modification of the hedge fund regime (FIL), which is now a very flexible and tax-efficient vehicle for developing a funds-of-funds strategy in Spain and which is available for retail investors, is relevant in this regard. Such amendments are expected to have a positive effect on the development of Spain's alternative fund industry.

Law stated - 19 January 2024

Alejandra Font alejandra.font@alterlegal.es
Carlos de Cárdenas carlos.decardenas@alterlegal.es
Manuel García-Riestra manuel.garcia-riestra@alterlegal.es

Alter Legal

Read more from this firm on Lexology

United Kingdom

Robert Lee, Owen Lysak, Yash Rupal
Simpson Thacher & Bartlett LLP

Summary

FORMATION

Forms of vehicle

1 What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

In England and Wales, private equity funds are typically formed as English limited partnerships (ELPs) pursuant to the Limited Partnerships Act 1907 (the 1907 Act) and are also subject to relevant provisions of the Partnership Act 1890 (the 1890 Act) and common law and equity principles (unless, subject to certain overriding principles, modified by agreement between the partners in the ELP).

An ELP comprises a general partner (GP) and one or more limited partners (LPs). The liability of LPs for the debts and obligations of an ELP is limited to the amount of capital each such LP contributed to the ELP provided that the LPs do not take part in the management of the business of the ELP. In contrast, the GP of an ELP will have unlimited liability for the debts and obligations of an ELP. The GP may act as manager of the ELP, or may, on behalf of the ELP, alternatively appoint a separate manager who is not a partner in the ELP to manage the business of the ELP. The appointment of a separate manager is common practice for private equity sponsors with multiple funds looking to ring-fence the unlimited liability of a GP in respect of each fund. Managing a private equity fund is also a regulated activity that requires authorisation. Having a separate authorised manager who can act as a manager across different funds avoids the need to undertake multiple authorisations, which can be both costly and time-consuming. In such circumstances, the sponsor's regulated manager will be appointed to manage the ELP, with a new entity with limited assets established to act as GP in respect of each fund.

In 2017, the Legislative Reform (Private Fund Limited Partnerships) Order 2017 (the 2017 Order) introduced a sub-class of ELPs, private fund limited partnerships (PFLPs), into English law. The primary aim of the UK government in creating this sub-class of ELPs was to improve the attractiveness of ELPs as a vehicle of choice for private funds by simplifying certain administrative requirements and clarifying certain matters that apply to a standard ELP. In particular, LPs in a PFLP benefit from a white list of actions that are expressly stated not to constitute the management of the business of the ELP and accordingly may be taken by LPs without the risk of loss of their limited liability. The PFLP has accordingly become the vehicle of choice for private equity sponsors establishing funds in England and Wales LPs.

ELPs do not have separate legal personality and accordingly cannot hold property in their own right or enter into contracts on their own behalf. Accordingly, ELPs act through their general partners or managers as agents of the ELP, who will hold the property of the ELP on trust. However, Scottish limited partnerships (which are also subject to the 1907 Act but differ from ELPs in certain respects) do have separate legal personality and accordingly are commonly used as vehicles that are partners in ELPs (eg, carried interest vehicles or feeder funds).

Law stated - 14 February 2024

Forming a private equity fund vehicle

2 | What is the process for forming a private equity fund vehicle in your jurisdiction?

An ELP requires at least one GP and one LP who agree to carry out a business in common with a view to profit. A GP may be a natural person, a corporate entity or another partnership with separate legal personality. To ensure that the ELP is not a qualifying partnership for the purposes of the Companies and Partnerships (Accounts and Audit) Regulations 2013 (2013 Regulations) and accordingly is not subject to a requirement to file public accounts with Companies House, it has become common practice for sponsors utilising ELPs as fund vehicles to appoint at least one GP that is not a limited company, such as a limited liability partnership. Unless the ELP is a PFLP, an LP must contribute to the capital of the ELP on admission to the ELP to obtain limited liability status (there is no such requirement for the GP). However, this need only be a nominal amount.

Given that both the 1907 Act and the 1890 Act contain default statutory provisions that apply unless the partners in the ELP otherwise agree, it is typical for the GP and the LPs to enter into a limited partnership agreement (LPA), which sets out the terms governing the partnership. The LPA does not need to be filed with Companies House and is not publicly available.

The name of an ELP must end with the words 'limited partnership' or the abbreviation 'LP'.

An ELP must be registered at Companies House pursuant to a Form LP5 (for standard ELPs) or Form LP7 (for PFLPs). Form LP5 requires submission of certain basic information, including;

- the name of the ELP;
- its principal place of business;
- the general nature of its business;
- the names of each of the GPs and LPs;
- the term of the ELP; and
- the amount of capital contributed to the ELP by each LP and whether it is contributed in cash or in specie.

Form LP7 requires submission of similar information, save that the general nature of its business, its term and the amount of capital contributed to the ELP by each LP need not be specified. Each form must be signed by each GP and each LP and dated. The form, along with the registration fee of £20 or £100 for same-day registration (applications must be marked as 'same-day service' and submitted by 3pm), must be sent physically to Companies House (there is currently no ability to submit an online application). However, since the covid-19 pandemic, the same-day registration service has not been available. Where there are any changes made to the information submitted in Form LP5 or Form LP7, a Form LP6 must be filed with Companies House detailing the changes within seven days of such changes occurring. There is no fee for filing a Form LP6, but if the filing is made after seven days of such changes occurring, the GP will be subject to a fine of £1 per day for each day beyond such period. In addition, PFLPs are required to advertise in the London Gazette in the event that any GP ceases to act as general partner, ELPs are required to advertise in the London Gazette in the event that any GP becomes an LP, and standard ELPs (but not PFLPs) are required to advertise in the London Gazette in the event that any LP assigns its interest in the ELP, for which a fee of £109.20 plus value added tax is payable.

Once an ELP is registered, Companies House will issue a certificate of registration, which is conclusive evidence that the ELP came into existence on the date of registration and, in respect of PFLPs, has been designated as a PFLP.

An ELP requires at least one GP and one LP who agree to carry out a business in common with a view to profit. A GP may be a natural person, a corporate entity or another partnership with separate legal personality. To ensure that the ELP is not a qualifying partnership for the purposes of the Companies and Partnerships (Accounts and Audit) Regulations 2013 (2013 Regulations) and accordingly is not subject to a requirement to file public accounts with Companies House, it has become common practice for sponsors using ELPs as fund vehicles to appoint at least one GP that is not a limited company, such as a limited liability partnership. Unless the ELP is a PFLP, an LP must contribute to the capital of the ELP on admission to the ELP to obtain limited liability status (there is no such requirement for the GP). However, this need only be a nominal amount.

Given that both the 1907 Act and the 1890 Act contain default statutory provisions that apply unless the partners in the ELP otherwise agree, it is typical for the GP and the LPs to enter into a limited partnership agreement (LPA), which sets out the terms governing the partnership. The LPA does not need to be filed with Companies House and is not publicly available.

The name of an ELP must end with the words ‘limited partnership’ or the abbreviation ‘LP’.

An ELP must be registered at Companies House pursuant to a Form LP5 (for standard ELPs) or Form LP7 (for PFLPs). Form LP5 requires submission of certain basic information, including;

- the name of the ELP;
- its principal place of business;
- the general nature of its business;
- the names of each of the GPs and LPs;
- the term of the ELP; and
- the amount of capital contributed to the ELP by each LP and whether it is contributed in cash or in specie.

Form LP7 requires submission of similar information, save that the general nature of its business, its term and the amount of capital contributed to the ELP by each LP need not be specified. Each form must be signed by each GP and each LP and dated. The form, along with the registration fee of £20 or £100 for same-day registration (applications must be marked as 'same-day service' and submitted by 3pm), must be sent physically to Companies House (there is currently no ability to submit an online application). However, since the covid-19 pandemic, the same-day registration service has not been available. Where there are any changes made to the information submitted in Form LP5 or Form

LP7, a Form LP6 must be filed with Companies House detailing the changes within seven days of such changes occurring. There is no fee for filing a Form LP6, but if the filing is made after seven days of such changes occurring, the GP will be subject to a fine of £1 per day for each day beyond such period. In addition, PFLPs are required to advertise in the London Gazette in the event that any GP ceases to act as general partner, ELPs are required to advertise in the London Gazette in the event that any GP becomes an LP, and standard ELPs (but not PFLPs) are required to advertise in the London Gazette in the event that any LP assigns its interest in the ELP, for which a fee of £109.20 plus value added tax is payable.

Once an ELP is registered, Companies House will issue a certificate of registration, which is conclusive evidence that the ELP came into existence on the date of registration and, in respect of PFLPs, has been designated as a PFLP.

In October 2023 the UK government enacted the Economic Crime and Corporate Transparency Act (the ECCTA), which aims to increase transparency and prevent UK structures from being used for illegal purposes. The ECCTA includes certain reforms to UK limited partnership law. The timing for the new rules to come into force has yet to be confirmed (further updates are expected during the course of 2024) and secondary legislation on implementation has, at the time of writing, yet to be published. Once in force, however, these changes will impact both existing UK limited partnerships (following a six-month transition period) and new UK limited partnerships being registered. Among other changes for ELPs, the ECCTA will require:

- more detailed information to be provided for each partner as part of the registration process (which will differ according to whether a partner is an individual or legal entity, and for legal entities will include its address, legal form and the law by which is it governed);
- ELPs to have a registered office with a UK connection;
- the appointment of registered officers (who will need to have their identity verified), with named contacts for GPs that are legal entities (such as companies or LLPs);
- the appointment of an 'authorised corporate service provider', who will need to have their identity verified and will be responsible for making certain filings on behalf of the ELP; and
- if requested by the UK tax authority, the preparation and delivery by the GP of audited accounts. In addition, the ECCTA introduces certain additional filing requirements, such as an annual statement confirming that all required information has been duly delivered to Companies House.

Law stated - 14 February 2024

Requirements

3 Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

An ELP must have a 'principal place of business' in England or Wales on establishment. Accordingly, it is typical for the GP of an ELP on establishment to be an English or Welsh entity. However, there is currently no requirement to maintain a principal place of business in England or Wales following establishment, and, accordingly, the GP may transfer its interest to a GP that is not an English or Welsh entity and the principal place of business of the ELP may be migrated to the jurisdiction of such GP following establishment. However, the recently enacted Economic Crime and Corporate Transparency Act will (once in force, which is expected later in 2024) require ELPs to have a registered office with a UK connection. This will need to be located such that documents delivered to the registered office would come to the attention of someone acting on behalf of the ELP and where delivery is capable of being recorded. The registered office will need to be at either the ELP's principal place of business, the address of its GP or the address of its 'authorised corporate service provider'.

An ELP is not required to maintain a local administrator or corporate secretary. In addition, unless the ELP is an alternative investment fund (AIF) for the purposes of Directive 2011/61/EU (Alternative Investment Fund Managers Directive) (AIFMD), there is no requirement to maintain a custodian. ELPs that are AIFs managed by persons authorised in the United Kingdom as alternative investment fund managers (AIFMs) are required to appoint a depositary to perform certain custody and other functions mandated by the AIFMD.

Unless otherwise agreed between the partners, the books of the partnership must be kept at the ELP's principal place of business. It is typical for the ELP's governing documentation to detail the reporting and accounting requirements applicable to the ELP and how such reports and accounts may be accessed. Unless the ELP is a 'qualifying partnership' for the purposes of the 2013 Regulations, there is no requirement to file accounts with Companies House or make the accounts of the ELP publicly available.

Law stated - 14 February 2024

Access to information

4 What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

Certain forms are required to be filed with Companies House, which are publicly available and may be accessed online via the Companies House website. These forms include the names of LPs and, in respect of ELPs that are not PFLPs, the amount of capital contributed to the ELP (which typically represents a small component of their overall commitment to a fund). In addition, the recently enacted Economic Crime and Corporate Transparency Act (the ECCTA) will, once in force (which is expected later in 2024), require detailed information to be provided on each partner. For partners that are legal entities, the information required is expected to include the partner's name, principal office, service address, legal form, law by which it is governed and, for general partners only, details of any register on which such entity is registered. For partners who are individuals, the information required is expected to include the partner's name, date of birth, nationality, former names, residential address and, for general partners only, a service address. Certain personal data will be kept private by the Registrar. The ECCTA is expected to introduce fines that can be levied for failing to comply with these requirements.

Law stated - 14 February 2024

Limited liability for third-party investors

5 In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Under the 1907 Act, any LP that takes part in the management of the business of an ELP shall be liable for all debts and obligations of the ELP incurred while the LP takes part in the management as though the LP were a GP. The 1907 Act does not contain any guidance on which activities would constitute taking part in the management of the business of an ELP, nor are there any clear guidelines arising from case law on this issue. However, in the context of PFLPs, the 2017 Order specified a white list of activities that an LP in a PFLP may undertake without being deemed to take part in the management of a PFLP and accordingly losing its limited liability status, which include:

- appointing a representative to a limited partner advisory committee;
- taking part in a decision approving or authorising an action proposed to be taken by the GP;
- reviewing or approving valuations of the PFLP's assets; and
- acting as a director, shareholder or agent of the GP, provided that as a result, the LP will not be taking part in the management of the PFLP's business.

The white list is not exhaustive and accordingly, LPs may undertake other activities that will not necessarily constitute taking part in the management of the business of the PFLP.

Under the 1907 Act, LPs in a standard ELP (but not a PFLP) are not permitted to withdraw or otherwise have their contributed capital returned during the life of the ELP. In the event that an LP's capital is withdrawn or otherwise returned during the life of the ELP, such LP will be liable for the debts and obligations of the ELP up to the amount withdrawn or returned. Accordingly, if all amounts contributed by an LP to an ELP are contributed as capital to the ELP, then such LP would potentially remain liable for any distributions up to the amount of such contributions. For this reason, it is typical for private equity funds constituted as standard ELPs to employ a construct where a nominal amount of an LP's commitment is structured as a capital contribution that is funded by the LP on admission to the ELP, with the remainder structured as a loan or advance drawn down as and when investments are made, which may then be returned to the LP without being subject to the restriction on return of capital contributed to the ELP. In contrast, LPs in a PFLP are not required to contribute to the capital of the ELP, and the restriction on returning capital contributed by LPs during the life of the ELP does not apply.

Law stated - 14 February 2024

Fund manager's fiduciary duties

6 What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

It is a core principle of English partnership law that each partner in an English partnership owes a duty of utmost good faith to the other partners in the partnership. Under the 1890 Act, the partners in a partnership are also bound by various duties, including to render true accounts and full information on all things affecting the partnership to any partner. The GP of an ELP will accordingly be subject to such duties in managing the business of an ELP and must act in the best interests of the ELP when acting in its capacity as GP. Accordingly, care should be taken when drafting the ELP's governing documents to distinguish between the circumstances when the GP is acting in its capacity as GP of the ELP and accordingly must act in accordance with its fiduciary duties, and when it is acting in a principal capacity and accordingly may act in its own interest. While it may be possible to limit the application of certain fiduciary duties under English law, it is not possible to exclude fiduciary duties that are at the core of the fiduciary relationship, such as the duty of utmost good faith owed between partners. In addition, it is not possible to exclude liability for fraud or dishonesty under English law.

In the event that a separate manager is appointed to manage the ELP, then unless otherwise agreed and subject to such exclusions being permitted by law, such manager will also owe fiduciary duties to the ELP (and the partners therein) in exercising its management functions.

If the GP or separate manager is a UK-authorised AIFM, it will be subject to the duties imposed by the AIFMD, which include a duty to act with due care and skill, a duty to act in the best interests of investors in the ELP and a duty to treat all investors in the ELP fairly (including an obligation to disclose any preferential treatment received by certain investors or classes of investors).

Law stated - 14 February 2024

Gross negligence

7 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Although under English civil law there is no concept of 'gross negligence', the English courts have consistently accepted that, where the term appears in a contract, they will seek to interpret such term as requiring conduct beyond that of ordinary negligence. However, the English courts have made clear that the meaning of the term 'gross negligence' is a matter for interpretation dependent on the wording of the relevant clause and the context of the contractual arrangements as a whole.

Law stated - 14 February 2024

Other special issues or requirements

8 Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Restrictions on transfers and withdrawals, restrictions on operations generally, and special investor governance rights on matters such as removal of the GP or early dissolution of an ELP are all matters typically addressed in the provisions of the ELP's governing documents and will vary from fund to fund. There is no limit on the number of LPs that may participate in an ELP. Typically, the governing documents will require the consent of the GP to effect a transfer of a partnership interest in the ELP. This requirement enables the GP to maintain the ELP's compliance with applicable legal, tax and regulatory requirements, as well as evaluate the appropriateness as a commercial matter of the proposed transferee. It is also typical for the governing documents to provide for withdrawal rights for LPs only in exceptional circumstances (eg, the LP's continued participation in the ELP causing the LP to breach law or regulation).

If the ELP is not a PFLP, an LP will not be permitted to have capital contributed by it to the ELP returned during the life of the ELP, and for this reason, it is typical for the commitment of LPs to a private equity fund structured as an ELP to be split into a nominal capital amount with the balance contributed as a loan or advance.

It is not currently possible for partnerships formed in other jurisdictions to be converted or redomiciled as ELPs.

Law stated - 14 February 2024

Fund sponsor bankruptcy or change of control

9 With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

The bankruptcy or insolvency of a GP will normally dissolve the partnership in the absence of an alternative GP having been appointed.

The governing documents for a private equity fund will typically provide that the GP may transfer its interest to other members of the sponsor group, and may also provide for the GP to transfer its interests to persons outside the sponsor group, although this will typically require the consent of LPs representing a majority or supermajority of commitments to the ELP. In addition, the governing documents for a private equity fund structured as an ELP may include certain investor protections in the event that there is a change of control of the GP, such as restricting the ELP's ability to acquire new investments unless a majority or supermajority of commitments to the ELP approves the change of control.

Further, if the GP or manager of the ELP is a UK-authorised firm, it will be subject to the UK statutory regime for the change of control of authorised firms, which requires pre-authorisation from the Financial Conduct Authority (typically considered to be triggered by any acquisition of 10 per cent (20 per cent for AIFMs) or more of the shares or voting rights in the authorised firm).

Law stated - 14 February 2024

REGULATION, LICENSING AND REGISTRATION

Principal regulatory bodies

10 What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The UK rules and regulations governing fund management focus on the regulation of the entity responsible for the management, rather than the funds themselves. Fund managers established in the United Kingdom that provide portfolio and risk management services to funds (alternative investment fund managers (AIFMs)) are required to be authorised and regulated by the Financial Conduct Authority (FCA) pursuant to the UK laws, rules and regulations implementing Directive 2011/61/EU (Alternative Investment Fund Managers Directive) (AIFMD) and associated regulations.

Post-Brexit, the Alternative Investment Fund Managers (Amendment) (EU Exit) Regulations 2018 have been issued, under which the United Kingdom continues to apply the substantive requirements of the AIFMD, but with adjustments necessary to apply that law in the United Kingdom as a sovereign state independent of the European Union. It is possible that, in time, UK domestic law will diverge from EU law but for now the AIFMD (as adjusted) continues to apply.

Powers of supervision and intervention of the FCA in relation to AIFMs include the powers to:

- access any document in any form and to receive a copy of it;
- require information from any person related to the activities of the AIFM or the alternative investment fund (AIF) and if necessary to summon and question a person;
- carry out on-site inspections with or without prior announcements; and
- require existing telephone and existing data traffic records.

In addition, under the AIFMD, AIFMs are subject to extensive reporting requirements that broadly fall into the following categories:

-

pre-investment investor disclosures pursuant to a prescribed list of topics prior to their investment in the AIF;

- annual reporting both to investors in the AIF and the FCA containing audited financial statements, information about any material changes to the pre-investment disclosure and information about the AIFM's remuneration;
- periodic (otherwise known as Annex IV) reporting to the FCA on the matters set out in a prescribed template; and
- notifications to the FCA and other stakeholders in the event that an AIF managed by the AIFM acquires certain holdings or control of non-listed companies that have their registered offices in the United Kingdom.

However, AIFMs that manage AIFs whose assets do not exceed, on an aggregated basis, €100 million (or €500 million for closed-ended unleveraged AIFs) will be subject to a lighter regulatory regime, which does not, for example, require compliance with the majority of the reporting obligations referred to above.

Law stated - 14 February 2024

Governmental requirements

11 What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

The AIFMD is intended to regulate the manager of the fund (ie, the AIFM), rather than the fund. Private equity funds that do not make an offering to the general public are not required to be licensed or registered in the United Kingdom. However, an AIFM must seek approval from the FCA in respect of each new fund under management, which must be accompanied by a copy of the governing documentation for the fund and the prescribed pre-investment disclosures. The FCA has one month to review such an application.

Law stated - 14 February 2024

Registration of investment adviser

12 Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

A firm that carries on the regulated activity of managing an AIF as the AIFM is required to be authorised by the FCA. The application process is detailed, and the FCA aims to process an application for authorisation within six months of receiving a complete application. Additional regulatory permissions may be required to the extent that a firm is managing arrangements that are not AIFs, such as separate managed accounts.

The obligations imposed on authorised AIFMs (other than AIFMs that manage AIFs whose assets do not exceed, on an aggregated basis, €100 million (or €500 million for closed-ended unleveraged AIFs)) are extensive and include, among others, capital adequacy requirements, rules governing how employees of the AIFM may be compensated, a requirement to appoint a depositary in respect of the assets of each AIF managed by the AIFM and disclosure and reporting requirements, both to investors and the FCA.

Law stated - 14 February 2024

Fund manager requirements

13 Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

An authorised AIFM is required to hold minimum capital. The amount of capital depends on whether the AIFs it manages are internally or externally managed and whether the AIFM decides to hold capital for professional indemnity liability or has separate professional indemnity insurance. Private equity funds are normally externally managed. An external AIFM is currently required to have an initial capital of €125,000. Where the value of the portfolios of AIFs managed by the AIFM exceeds €250 million, the AIFM must have an additional amount of own funds equal to 0.02 per cent of the amount by which the value of the portfolios of the AIFM exceeds €250 million, but the required total of the initial capital and the additional amount is capped at €10 million. Where a UK AIFM is authorised to also carry out additional regulated activities (including advising), it would be subject to additional capital rules in respect of its business relating to these additional regulated activities under the UK's Investment Firms Prudential rules, which are broadly in line with the EU's Investment Firms Regulation and Directive.

As part of the authorisation process, the FCA must be satisfied that the persons who effectively conduct the business of the AIFM are of sufficiently good repute and are sufficiently experienced in relation to the investment strategies to be pursued by the AIFs managed by the AIFM, but there is no specific qualification that must be attained to serve as an officer, director or control person.

The United Kingdom operates a senior managers and certification regime (SM&CR), which applies to firms authorised by the FCA. The FCA has designated particular functions as senior manager functions (SMFs). SMFs include the chief executive function, executive director function, compliance oversight, and money laundering reporting officer. Anyone who performs an SMF within an authorised AIFM needs to be approved by the FCA before they can perform their role. In addition, the SM&CR requires firms to confirm and certify at least annually that persons performing certain functions that are not SMFs, but which can have a significant impact on customers, the firm or market integrity, are competent to do their job. Persons engaged in investor relations would typically be certification staff.

Law stated - 14 February 2024

Political contributions

14 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are no specific rules in the United Kingdom that would require a private equity fund sponsor to disclose political contributions made by it or its employees outside the UK regimes in respect of political contributions generally, which require UK companies to obtain shareholder approval prior to the making of political donations or expenditure in excess of £5,000 in any 12-month period, and also require political donations or expenditure in excess of £2,000 in any financial year to be included in the directors' reports. In addition, political bodies and candidates may be required to report donations they receive in excess of certain de minimis thresholds to the UK Electoral Commission. Any political contribution made with an intent to secure an advantage may be a criminal offence under the UK Bribery Act 2010.

Law stated - 14 February 2024

Use of intermediaries and lobbyist registration

15 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There are no UK rules that restrict or require such disclosure by a private equity sponsor, although it is typical for the private placement memorandum of a private equity fund to disclose if a placement agent has been appointed in respect of the fund.

Law stated - 14 February 2024

Bank participation

16 Describe any key legal or regulatory developments (including those emerging from the 2008 global financial crisis) that specifically affect banks with respect to investing in or sponsoring private equity funds.

Directive 2013/36/EU (Capital Requirements Directive IV) (CRD IV) and Regulation 575/2013/EU (the Capital Requirements Regulation) (CRR) were adopted following the global financial crisis to address the perceived shortcomings of financial institutions. The CRD IV and CRR implement the Basel III agreement, which is designed to improve the amount and quality of capital that banks are required to hold to cover the risks to which they are exposed. This includes enhanced requirements for both quality and quantity of capital, strengthened liquidity and leverage requirements, rules relating to counterparty risk and other macroprudential standards such as countercyclical buffers.

Post-Brexit, the United Kingdom has implemented the Capital Requirements (Amendment) (EU Exit) Regulations 2018, under which the United Kingdom continues to apply the substantive requirements of the CRD IV and CRR. It is possible that, in time, UK domestic law will diverge from EU law, but for now CRD IV and CRR (subject to certain adjustments) continue to apply.

Law stated - 14 February 2024

TAXATION

Tax obligations

17 Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

A private equity fund vehicle constituted as an English limited partnership (ELP) would not itself be subject to UK tax in respect of its income and gains. Instead, the income and gains (or losses) of the ELP would be attributed, as and when they arise, to the investors in the ELP according to the investors' entitlement to income and capital as set out in the governing documents of the ELP.

A private equity fund structured as an ELP would not be required to withhold UK tax from distributions to investors. This is on the basis that an ELP is treated as being transparent for UK tax purposes such that, from a UK tax perspective, investors are taxed on their share of the ELP's income and gains as and when such income and gains arise, rather than when the income and gains are distributed to investors. The ELP may, however, be required to withhold UK tax from payments of interest to an investor in respect of a loan made by that investor to the ELP.

Law stated - 14 February 2024

Local taxation of non-resident investors

18 Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Non-resident investors in an ELP should generally not be liable to UK tax on their share of the ELP's income arising from sources in the United Kingdom, except to the extent that UK tax is deducted or withheld from that income at source. Although the UK does not currently impose withholding tax on dividends, interest is subject to UK withholding tax (currently at the rate of 20 per cent) unless a specific exemption applies or the loan has a term of less than one year.

In addition, non-resident investors in an ELP should not be liable to UK tax on their share of the ELP's gains arising from sources in the United Kingdom, except to the extent the gain arises from the disposal of UK land or certain interests in UK land-rich assets (broadly, vehicles deriving at least 75 per cent of their value from UK land).

This UK tax treatment may not apply if the non-resident investor holds its interest in the ELP as part of a trade (eg, a securities dealer) or if the ELP itself is treated as carrying on a trade for UK tax purposes. Although this will depend on the particular terms and investment strategy of the particular fund, a typical private equity fund that acquires securities in unlisted companies with the intention of holding them as investments will generally be treated as carrying on an investment activity rather than a trade.

Non-resident investors in an ELP should generally not be required to file a UK tax return, although the ELP itself will be required to file a tax return that will include details of the income and gains (or losses) allocated to each investor. This may require a non-resident investor to obtain a unique taxpayer reference number in the United Kingdom, although an exception may apply where the ELP separately reports information about that investor under the Foreign Account Tax Compliance Act or the Common Reporting Standard rules.

Law stated - 14 February 2024

Local tax authority ruling

19 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

A tax ruling would not normally be sought with respect to the tax treatment of a private equity fund formed in the United Kingdom.

There are various tax rules that may apply to UK resident investors in a private equity fund, particularly in relation to any investments the fund makes outside the United Kingdom. The most significant of these are:

- the controlled foreign companies' rules;
- the attribution of gains of non-UK companies' rules;
- the transfer of asset abroad rules; and
- the offshore fund rules.

These rules, among other matters, may subject UK resident investors to tax in the United Kingdom on the income and gains of non-resident companies a private equity fund invests into as and when the income and gains arise (irrespective of whether they are distributed to the private equity fund) and may also require such investors to pay income tax (rather than capital gains tax) on certain gains from the disposal of interests in non-resident companies.

Law stated - 14 February 2024

Organisational taxes

20

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There are no significant taxes associated with the establishment of a private equity fund in the United Kingdom.

Law stated - 14 February 2024

Special tax considerations

21 Describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

A sponsor of a private equity fund structured as an ELP will typically receive returns from the fund in two ways:

- carried interest receipts; and
- an annual management fee.

A significant consideration for a private equity fund sponsor will be to ensure the carried interest receipts are treated as an allocation of partnership profits (rather than a payment akin to a performance fee) so that, to the extent their share of partnership profits represent gains of the ELP from the disposal of its assets, the carried interest is treated as capital gains subject to tax at capital gains tax rates.

However, various law changes since 2015 have been introduced that can undermine this capital gains treatment. In particular, for carried interest holders to maintain capital gains treatment, the average holding period of all of the fund's investments (calculated by reference to the value of those investments) must be at least 40 months. Carried interest will be subject to income tax rates (of up to 45 per cent) if the average holding period is less than 36 months and will be apportioned between income and capital gains tax if the average holding period is between 36 and 40 months.

Carried interest holders will need to consider whether the right to carried interest has any value at the time that it is awarded, particularly if the fund has been in existence for some time before the award is made, and, if so, whether the award could be subject to tax as employment income either when the carried interest is received or when the holder becomes entitled to income and gains from the fund. Some carried interest may be held back to be released (eg, to senior management) in later years. Any such warehousing structures will need careful consideration.

In a typical UK private equity fund, the general partner (GP) will be remunerated for acting as general partner by an allocation of partnership profits by the ELP to the GP (commonly referred to as the priority profit share (PPS)) or, in the earlier years before the fund becomes profitable, a loan from the ELP, which is then set off against future allocations of PPS to the GP. The PPS will generally be taxed in the same way as the investors' share of the ELP's profits such that the UK tax treatment of the PPS will depend on the nature of the profits (eg, dividends, interest or gains) allocated to the GP in satisfaction of the PPS.

Where the GP is also the investment manager, if the GP is a UK company, it should be able to claim a tax deduction for its expenses of an income nature such as salaries of staff.

If the investment manager is an entity in the fund sponsor's group separate from the GP, typically such investment manager will be structured as a company or limited liability partnership that provides management services to, and receives a management fee from, either the GP or the fund itself. The management fee will be taxed as trading income of the investment manager. The disguised investment management fee rules enacted in 2015 seek to ensure that any sums arising to the fund sponsor's management team are taxed as trading income, except to the extent the sums fall within specific exclusions for carried interest and genuine co-investment. Care should be taken when applying these rules as the circumstances in which amounts are treated as 'arising' to the fund sponsor's management team are broad and, in particular, do not require any amounts to actually be received by the individual management team members.

Where the management fee is paid to the investment manager by the GP, the management fee will be funded out of the PPS. If the GP is a UK company, it should be able to claim a tax deduction for the management fee it pays to the investment manager. Where the management fee is instead paid to the investment manager by the fund itself, UK corporate tax-paying investors in the fund may be entitled to claim a tax deduction for their share of the management fee as an expense of management of their investment business.

The UK tax treatment of carried interest, PPS and management fees is a complex area that is heavily fact-dependent, and specialist advice should be taken at an early stage when structuring funds with a UK nexus.

Law stated - 14 February 2024

Tax treaties

22 List any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

The United Kingdom is a party to a significant number of tax treaties. However, a private equity fund structured as an ELP will typically not be entitled to rely on the benefits provided in the tax treaties to which the United Kingdom is a party on the basis that such a fund will generally be transparent for UK tax purposes. An investor in the fund may, however, be entitled to rely on one of the UK's tax treaties in relation to their share of the fund's income and gains to the extent such income and gains have a source in the United Kingdom (where the investor is not resident in the United Kingdom) or where the investor is resident in the United Kingdom (and the income and gains arise outside the United Kingdom).

Law stated - 14 February 2024

Other significant tax issues

23 Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

The main area of focus is likely to be the value added tax (VAT) treatment of fees payable in the structure. The GP in an ELP would normally be remunerated through a priority profit share, which should not attract VAT. VAT would generally be levied on annual management fees charged by a separate investment manager, although it may be possible to avoid such VAT, for example, by taking advantage of the VAT grouping rules.

Private equity funds and their sponsors will also need to give consideration to any tax reporting required under regimes such as the Common Reporting Standard rules and the EU's and Organisation for Economic Co-operation and Development's (OECD) mandatory disclosure regime. A fund structured as an ELP will generally be required to obtain information about investors who are tax resident in the European Union or in jurisdictions with which the United Kingdom has entered into an agreement to exchange information automatically and report that information to HMRC. A fund sponsor based in the United Kingdom or the European Union may also be required to report information to their domestic tax authorities pursuant to the EU's and OECD's mandatory disclosure regime concerning certain cross-border tax-planning arrangements.

Another area of focus for a private equity fund structured as an ELP will be its 'under-the-fund' structuring and, in particular, whether to use one or more holding companies to acquire its investments and the location of any such holding companies. In this regard, significant tax benefits are available for qualifying asset holding companies held by qualifying funds and certain other investors. This will be of interest to private equity funds that wish to hold their underlying investments through a UK holding company. Qualifying UK asset holding companies benefit from a broad range of tax reliefs, for example, an exemption for capital gains on the disposal of investments (other than investments in UK land-rich companies), an exemption from UK withholding tax on interest, the ability to deduct profit participating interest and the ability to repatriate gains by way of a share buyback without jeopardising capital gains tax treatment for investors.

Law stated - 14 February 2024

SELLING RESTRICTIONS AND INVESTORS GENERALLY

Legal and regulatory restrictions

24 Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Under the Financial Services and Markets Act 2000 (FSMA 2000), there is a general restriction on anyone who is not an authorised person communicating, in the course of business, an invitation or inducement to engage in investment activity and a restriction on promoting interests in unregulated collective investment schemes (which would typically include private equity funds structured as English limited partnerships (ELPs)).

Alternative investment fund managers authorised by the Financial Conduct Authority (FCA) are not subject to the financial promotion restriction, but are prohibited from promoting interests in an unregulated collective investment scheme, unless an exclusion applies. Such exclusions include a UK-authorised AIFM marketing to ‘professional investors’ (generally, institutional investors and certain types of family offices and other persons who are capable of electing to be treated as professional investors because they meet certain restrictive criteria based on their knowledge and experience) and, in respect of certain strategies, to certain high net worth and sophisticated investors in the United Kingdom.

A non-UK fund manager would typically be a non-authorised person for the purposes of FSMA 2000 and providing marketing materials or offering documents for a private equity fund to a prospective investor in the United Kingdom would constitute a prohibited financial promotion unless an exclusion applies. Such exclusions include a non-UK fund manager marketing to professional investors pursuant to the UK’s national private placement regime. If a non-UK fund manager is seeking to market a fund in the United Kingdom under the national private placement regime, it must notify the FCA using an online form that contains certain general information about the fund manager and the fund, and it will also be subject to certain ongoing reporting requirements to investors and to the FCA, as well as notification and disclosure requirements in the event that the fund acquires or disposes of a substantial stake in a UK non-listed company, and restrictions on certain capital distributions if the fund acquires control of a UK company.

For the above purposes, a fund manager will be ‘marketing’ in the United Kingdom if it (or someone on its behalf) is making a direct or indirect offering or placement of units or shares in a fund it manages to investors domiciled or with a registered office in the United Kingdom.

Given that ‘marketing’ is an activity that must be at the initiative of the manager, where an investor seeks information about a private equity fund strictly at its own initiative, the manager would not be regarded as marketing in the United Kingdom.

However, the financial promotion restriction and the restriction on the promotion of unregulated collective investments schemes under FSMA 2000 predate the transposition of Directive 2011/61/EU (Alternative Investment Fund Managers Directive) into UK law. Accordingly, even if a fund manager is not ‘marketing’ the fund in the United Kingdom, care should be taken that it is not making a financial promotion or promoting an unregulated collective investment scheme in the United Kingdom without the benefit of an exclusion.

Law stated - 14 February 2024

Types of investor

25 Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

There is technically no restriction on the type of investor that may participate in a private equity fund, but there is a restriction on the categories of person to whom sponsors of a private equity fund are permitted to promote or market that fund in the United Kingdom. A UK-authorised AIFM is entitled to market (and promote) an alternative investment fund (AIF) under its management to ‘professional investors’ (generally, institutional investors and certain types of family offices and other persons who are capable of electing to be treated as professional investors because they meet certain restrictive criteria based on their knowledge and experience) in the United Kingdom.

Although the United Kingdom does allow the promotion of certain types of funds to other categories of persons, such as high-net-worth individuals and sophisticated investors, it is common to restrict participation in an AIF to professional investors (including those who may, on request, be treated as professional investors) to remain outside the scope of Regulation 1286/2014/EU on key information documents for packaged retail and insurance-based investment products (PRIIPs Regulation). An interest in a private equity fund is a packaged retail and insurance-based investment product and thus if it is made available to a retail client, the sponsor must provide, publish and maintain on its website a key information document (KID). A KID must be in prescribed form and must include information prepared in accordance with regulatory technical standards.

In addition, the UK has introduced new rules on certain disclosure requirements when making promotions of private equity funds (and certain other high-risk investments) to non-professional investors. These include a risk warning and a summary of risks, both in a prescribed format with prescribed content, and a 24-hour cooling off period during which the investor is permitted to walk away from the investment.

Law stated - 14 February 2024

Identity of investors

26 Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

The identity of the limited partners (LPs) in an ELP is required to be specified in Form LP5 or Form LP7 on establishment of the ELP, and any changes in the composition of the LPs in an ELP (including by way of transfers of interest) are required to be specified in a Form LP6 submitted within seven days of such change occurring. Each Form LP5, LP7 and LP6 filed with Companies House is publicly available and may be accessed online via the Companies House website. ELPs are required to advertise in the London Gazette in the event that any general partner (GP) becomes an LP, and 'standard' ELPs (but not private fund limited partnerships) are required to advertise in the London Gazette in the event that any LP assigns its interest in the ELP. Form LP6 would also be required to be filed in the event of a change of GP of an ELP. The recently enacted the Economic Crime and Corporate Transparency Act will, once in force, require notification of any changes to the information provided with respect to an ELP within 14 days as well as the filing of an annual confirmation statement confirming that all information on the register remains correct (or otherwise providing relevant updated information).

In addition, if the GP or manager of the ELP is a UK-authorised firm, it will be subject to the UK statutory regime for the change of control of authorised firms, which requires pre-authorisation from the FCA in respect of a change of control of an authorised firm.

Law stated - 14 February 2024

Licences and registrations

27 Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

If the person offering interests in a private equity fund is an AIFM authorised by the FCA, then no additional licences or registrations are required to offer interests in a private equity fund to persons in the United Kingdom. If the person offering interests in the private equity fund is not so authorised, it must rely on the UK's national private placement regime, pursuant to which it must file a notification with the FCA using an online form that contains certain general information about the fund manager and the fund, and it will also be subject to certain ongoing reporting and notification requirements.

Law stated - 14 February 2024

Money laundering

28 Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The current UK regime regulating money laundering and terrorist financing is set out in the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the MLRs), as amended by the Money Laundering and Terrorist Financing (Amendment) Regulations 2019, implementing EU directives and will remain in effect post-Brexit, with adjustments necessary to make that body of law operate properly in the United Kingdom as a sovereign state independent of the European Union. However, it is possible that, in time, UK domestic law will diverge from EU law.

In the United Kingdom, the Joint Money Laundering Steering Group publishes comprehensive industry guidance, including guidance for private equity firms.

In the United Kingdom, firms subject to the MLRs are required to implement effective procedures for detecting money laundering but may adopt a risk-based approach to customer due diligence (CDD), with the application of enhanced due diligence (EDD) where the customer presents a higher risk. Higher risk situations include a business relationship with persons that do not involve face-to-face interactions, dealing with politically exposed persons or dealing with investors from third countries designated as high risk. In such circumstances, firms must apply EDD measures to manage and mitigate the associated risks, including:

- gathering additional information on the customer and beneficial owners;
- obtaining senior management approval for establishing or continuing the business relationships; and
- conducting an enhanced level of monitoring.

Firms are obliged to verify customers' identities on the basis of documents, data or information obtained from an independent and reliable source and to take reasonable steps to understand their customers' beneficial ownership and control structure (including, for these purposes, identifying any natural person holding more than 25 per cent ownership interest) and to document the CDD measures they have taken.

Staff of authorised firms must file a report with the National Crime Agency (NCA) if they know or suspect, or have reasonable grounds for knowing or suspecting, that a person is engaged in money laundering or terrorist financing. Such a report would include the identity of the relevant person. The firm must obtain consent from the NCA before proceeding with a suspicious transaction or entering into the relevant business arrangements. It is a criminal offence to tip-off another person that a disclosure has been made or prejudice an investigation.

Law stated - 14 February 2024

EXCHANGE LISTING

Listing

29 Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

While it is possible for private equity funds to list on certain securities exchanges in the United Kingdom such as the London Stock Exchange's main market and its specialist funds segment, this is by no means customary for private equity funds. Although listing would provide sponsors with the benefits of a potential increased pool of capital (given that retail investors may invest in listed securities), the increased regulatory, administrative and reporting burdens created by the requirements to comply with UK legislation applicable to UK listed companies make listing an unattractive option for most private equity fund sponsors. In the event that a private equity fund sponsor does intend to list a private equity fund, it is typical for such a fund to be structured as a company rather than an English limited partnership.

Law stated - 14 February 2024

Restriction on transfers of interest

30 To what extent can a listed fund restrict transfers of its interests?

In principle, subject to certain limited exceptions, shares in companies admitted to a UK securities exchange must be free from any restriction on the right of transfer. However, the UK listing authorities have permitted UK-listed entities to include restrictions on transfers of their shares to prevent them falling within the scope of onerous overseas legislative requirements. However, the UK listing authorities have stated that such provisions must be carefully drafted so that they identify the specific legislative provisions in question, and restrictions that are drafted in general or catch-all terms will not be permitted.

Law stated - 14 February 2024

PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS

Legal and regulatory restrictions

31 Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

English limited partnerships (ELPs) do not have a separate legal personality and accordingly cannot hold property in their own right or enter into contracts on their own behalf. Accordingly, ELPs act through their general partners or managers as agents of the ELP, who will hold the property of the ELP on trust (or, less commonly, a nominee company may be appointed to hold such property as the ELP's nominee).

In addition, alternative investment fund managers (AIFMs) authorised in the United Kingdom (other than sponsors that manage alternative investments fund (AIFs) whose assets do not exceed, on an aggregated basis, €100 million (or €500 million for closed-ended unleveraged AIFs)), and non-UK fund managers who have marketed to investors in the United Kingdom under the national private placement regime, are also subject to the asset-stripping rules set out in Directive 2011/61/EU (Alternative Investment Fund Managers Directive) (AIFMD), which prohibit certain types of capital distributions in the event that the relevant fund acquires control of a UK non-listed company for a period of 24 months following the acquisition of control.

Law stated - 14 February 2024

Compensation and profit-sharing

32 Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

Sponsors authorised in the United Kingdom to manage AIFs (other than sponsors that manage AIFs whose assets do not exceed, on an aggregated basis, €100 million (or €500 million for closed-ended unleveraged AIFs)) are subject to the remuneration code set out in the Financial Conduct Authority (FCA) Handbook (the Remuneration Code) and to the ESMA Guidelines on sound remuneration policies under the AIFMD (which have been retained in UK law following Brexit). Sponsors that have permissions in addition to managing AIFs may be subject to additional remuneration requirements.

Under the Remuneration Code, an AIFM must implement and maintain remuneration policies for relevant staff (code staff) that promote sound and effective risk management and do not encourage risk-taking that is inconsistent with the risk profile of the AIFs it manages. Code staff include:

- senior management;
- risk-takers;
- control functions; and
- any employees receiving compensation that takes them into the same remuneration bracket as senior management.

The remuneration policy must take into account a number of principles set out in the Remuneration Code, including providing guaranteed remuneration, balancing fixed and variable remuneration, ensuring early termination payments do not reward failure, and the payout process rules (which prescribe, among other things, that at least 50 per cent of variable remuneration must be paid out in interests in the AIF, that at least 40 per cent of variable remuneration must be deferred for a period of at least three years, and that variable remuneration is subject to vesting and a comprehensive adjustment mechanism for all risks to the financial situation of the AIFM).

However, an AIFM is expected to comply with the Remuneration Code in a way and to the extent that is appropriate to its size, internal organisation and the nature, scope and complexity of its activities, and the FCA has published guidance to assist firms in applying the payout process rules in a proportionate manner.

AIFMs are also required to disclose certain information about the remuneration of their code staff in the AIF's annual report.

Law stated - 14 February 2024

UPDATE AND TRENDS

Key developments of the past year

33 What are the most significant recent trends and developments relating to private equity funds in your jurisdiction? What impact do you expect such trends and developments will have on global private equity fundraising and on private equity funds generally?

Following Brexit, various strategies were employed to enable marketing of funds by UK managers in the European Union, including seconding employees to a firm authorised in the European Union, seeking appointment as a tied agent of an EU-authorised investment firm or to obtain cross-border licences in jurisdictions that permit it. Both the secondment and tied agent models are under increasing regulatory scrutiny, and the introduction of the pre-marketing regime under Directive 2019/1160/EU with regard to cross-border distribution of collective investment undertakings has reduced the attractiveness of obtaining cross-border licences in those jurisdictions where non-EU alternative investment fund managers (AIFMs) are unable to pre-market. Marketing strategies employed by UK managers targeting EEA investors are likely to continue to require careful analysis in this changing landscape.

The UK announced that it will not implement the SFDR into national law following the UK's withdrawal from the EU. Nonetheless, the UK has introduced ESG-related disclosure requirements for asset managers, including disclosures for certain UK asset managers that align to the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) including UK AIFMs and UK advisers in private equity structures. The largest asset managers (with at least £50 billion AUM (assets under management)) had to make their first disclosures by 30 June 2023. Asset managers with less than £50 billion AUM but more than £5 billion will be required to make their first disclosures by 30 June 2024. Firms with less than £5 billion under management are exempt.

In addition, the FCA published rules on 28 November 2023 (to apply from July 2024 onwards) establishing a new regime for sustainability disclosure requirements (SDR) and investment labels, and including new naming and marketing requirements for funds that have sustainability characteristics. As part of the SDR, the FCA has also introduced an anti-greenwashing rule that is expected to apply from 31 May 2024 along with accompanying guidance, which the FCA is currently developing.

In June 2023, the International Sustainability Standards Board, part of the IFRS Foundation, published its first two sustainability disclosure standards: IFRS S1 (General Requirements)and IFRS S2 (Climate-related Disclosures) (the ISSB Standards). The IFRS sustainability standards set out voluntary disclosure requirements on sustainability-related risks and opportunities for companies. The UK has supported the ISSB's development of the sustainability disclosure standards and the Secretary of State for Business and Trade will consider the endorsement of the IFRS standards to create a dedicated set of UK sustainability disclosure standards (SDS), which will be based on the ISSB Standards, by July 2024. As the ISSB Standards are developed and endorsed in the UK, the FCA has also stated that it intends to update its climate-related disclosure rules to reference the ISSB Standards replacing references to the TCFD, which itself has been subsumed into the ISSB Standards.

Alongside the Prudential Regulation Authority (PRA), the FCA recently consulted on proposals to introduce a new regulatory framework on diversity and inclusion (D&I) in the financial sector for all UK firms authorised to carry out regulated activities. The proposals include measures aimed at better integration of non-financial misconduct considerations into staff fitness and propriety assessments as well as additional reporting on particular D&I data. The consultation closed in December 2023, and the FCA has proposed that any rules that are developed would have an implementation date of 12 months after the publication of a policy statement.

The United Kingdom has introduced a new type of fund vehicle called the Long-Term Asset Fund, which is an authorised open-ended alternative investment fund created to facilitate investment in long-term, illiquid assets, such as venture capital and private equity. It must be managed by a UK authorised AIFM and may invest in UK and non-UK assets but it must invest at least 50 per cent in unlisted securities and other long-term assets.

The United Kingdom has now enacted its long-awaited reforms to UK limited partnership law in the form of the Economic Crime and Corporate Transparency Act. The Act aims to increase transparency and, once in force (which is expected during the course of 2024), will introduce various additional disclosure requirements for ELPs amongst other requirements.

A general election is expected in 2024. With the prospect of a Labour government, important changes designed to tax carried interest more heavily are expected.

Law stated - 14 February 2024

Simpson Thacher

Robert Lee robert.lee@stblaw.com
Owen Lysak owen.lysak@stblaw.com
Yash Rupal yash.rupal@stblaw.com

Simpson Thacher & Bartlett LLP

USA

Peter H Gilman, Jessica A O'Connell, Russell Reed, Henry Litwhiler
Simpson Thacher & Bartlett LLP

Summary

FORMATION

Forms of vehicle

1 | What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

In the United States, private equity funds are typically formed as limited partnerships in the State of Delaware, pursuant to the Delaware Revised Uniform Limited Partnership Act (DRULPA). A limited partnership formed under the DRULPA will have a separate legal personality, the existence of which will continue until cancellation of the limited partnership's certificate of limited partnership. A Delaware limited partnership offers investors the benefits of limited liability as well as flow-through tax treatment in the United States. The personal liability of a limited partner is generally limited to the amount of the capital contributed or that has been agreed to be contributed (or returned) by such investor. The 'manager' is the general partner of the fund with control over and, subject to certain limitations, general liability for the obligations of the partnership.

Law stated - 8 February 2024

Forming a private equity fund vehicle

2 | What is the process for forming a private equity fund vehicle in your jurisdiction?

A limited partnership requires at least one general partner and one limited partner, neither of which needs to be a Delaware entity. To form a limited partnership, the general partner must execute and file a brief certificate of limited partnership setting forth certain basic information about the partnership. In Delaware, this filing is made with the secretary of state's office. Each Delaware limited partnership must have and maintain (and identify in its certificate of limited partnership) a registered office and a registered agent for service of process on the limited partnership in Delaware. The certificate of limited partnership must also identify the name of the partnership and the name and address of the general partners, although the names of the limited partners need not be disclosed. In addition, depending on the US jurisdictions in which the private equity fund conducts its business, it may be required to obtain qualifications or authorisations (as well as comply with certain publication requirements) to do business in such jurisdictions. There is generally no time delay associated with filing the certificate of limited partnership; it can normally be prepared and filed on a same-day basis. The initial written limited partnership agreement to be entered into in connection with the formation of a limited partnership can be a simple form agreement, which can be amended and restated with more detailed terms at a later date. For a limited partnership formed in Delaware, the partnership agreement need not be (and generally is not) publicly filed. The fee for filing a certificate of limited partnership in Delaware is US$200 (although an additional nominal fee may be charged for certified copies of the filing or for expedited processing).

There is an annual franchise tax of US$300. The fees for obtaining authorisation to do business in a particular jurisdiction are usually nominal, but may be more costly in certain states. There are no minimum capital requirements for a Delaware limited partnership.

A private equity fund will typically engage counsel to draft the certificate of limited partnership and the related partnership agreement. Filings in Delaware, as well as in other jurisdictions where an authorisation to do business is required, are typically handled by a professional service provider for a nominal fee (which also provides the registered agent and registered office services referred to earlier).

Law stated - 8 February 2024

Requirements

3 Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

A Delaware limited partnership must have and maintain a registered office and a registered agent for service of process in the state of Delaware. This requirement is typically satisfied by the limited partnership engaging for a nominal fee for a professional service provider to act in these capacities. Although under the DRULPA a limited partnership must maintain certain basic information and records concerning its business and its partners (and in certain circumstances provide access thereto to its partners), there is no requirement that such documents be kept within the State of Delaware. There is no requirement under Delaware law to maintain a custodian or administrator, although registered investment advisers under the US Investment Advisers Act of 1940, as amended (the Advisers Act), must generally maintain client assets with a qualified custodian to comply with the requirements of Rule 206(4)-2 (the custody rule) thereunder.

Law stated - 8 February 2024

Access to information

4 What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

Although the DRULPA provides that limited partners are entitled (if they have a proper purpose and subject to such reasonable standards as may be set forth in the partnership agreement or otherwise established by the general partner) to receive a list of the names, addresses and capital commitments of the other partners, a copy of the partnership agreement and any amendments thereto and certain other information, the limited partnership's partnership agreement may limit or expand this. Further, the partnership agreement may, and typically does, provide that any such information provided to limited partners is confidential and is not to be disclosed by a limited partner to third parties. Therefore, the public is not generally entitled to information (other than the identity of general partners, which is set forth in the certificate of limited partnership) about Delaware limited partnerships. Nevertheless, as a result of the US Freedom of Information Act (FOIA), certain similar state public records access laws and other similar laws, certain limited partners who are subject to such laws may be required to disclose certain information in their possession relating to the partnership. Generally, the information that has been released to date pursuant to FOIA and similar laws has typically been 'fund level' information (eg, overall internal rates of return, other aggregate performance information, amounts of contributions and distributions, etc) but not 'portfolio company level' information (eg, information relating to individual investments by the fund). Also, limited partnership agreements and the list of limited partners have generally been protected from disclosure to the public. A general partner's failure to comply with the reporting requirements of applicable law or the partnership agreement (or both) could result in a limited partner seeking injunctive or other equitable relief, monetary damages, or both.

Law stated - 8 February 2024

Limited liability for third-party investors

5 In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Under Delaware partnership law, a limited partner is not liable for the obligations of a limited partnership unless such limited partner is also a general partner or, in addition to the exercise of the rights and powers of a limited partner, such limited partner participates in the 'control of the business' of the partnership within the meaning of the DRULPA. It is generally possible to permit limited partners to participate in all aspects of the internal governance and decision-making of the partnership without jeopardising the limited liability status of a limited partner, as long as it is done in a prescribed manner. Even if the limited partner does participate in the control of the business within the meaning of the DRULPA, such limited partner is liable only to persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner.

In addition, under the DRULPA, a limited partner who receives a distribution made by a partnership and who knew at the time of such distribution that the liabilities of the partnership exceeded the fair value of the partnership's assets is liable to the partnership for the amount of such distribution for a period of three years from the date of such distribution, and partnership agreements of private equity funds commonly impose additional obligations to return distributions. There may be additional potential liabilities pursuant to applicable fraudulent conveyance laws. In any case, limited partners are liable for their capital contributions and any other payment obligations set forth in the limited partnership agreement or related agreement (eg, a subscription agreement) to which they are a party.

Law stated - 8 February 2024

Fund manager's fiduciary duties

6 What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

A general partner of a limited partnership generally will owe fiduciary duties to the partnership and its partners under Delaware law, which include the duties of candour, care and loyalty. However, under Delaware law, to the extent that, at law or equity, a partner or other person has duties (including fiduciary duties) to a limited partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement, the partner's or other person's duties may be expanded or restricted or eliminated by the provisions in the partnership agreement, provided that the partnership agreement may not eliminate the implied contractual covenant of good faith and fair dealing. Under Delaware law, a partnership agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a partner or other person to a limited partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement, provided that a partnership agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing. In addition, practitioners should note that contractual standards of duty or conduct set forth in the partnership agreement will replace common law fiduciary duties with respect to Delaware limited partnerships (whether such standards are higher or lower); therefore, precise crafting of the language in a partnership agreement with respect to fiduciary duties relating to a Delaware limited partnership is important.

In addition, investment advisers (whether or not registered) owe fiduciary duties to their clients. Such fiduciary duties are not specifically set forth in the Advisers Act or established by rules promulgated by the Securities and Exchange Commission (SEC), but are imposed on investment advisers by operation of law because of the nature of the relationship between the investment advisers and their clients. Such fiduciary duties are embodied in the anti-fraud provisions of section 206 of the Advisers Act.

In June 2019, the SEC published an interpretation of the standard of conduct for investment advisers (the Interpretation). The Interpretation stated that the Advisers Act fiduciary duty requires that an adviser, at all times, serve the best interest of its client and that this overarching obligation to act in a client's best interest encompasses both a duty of care and a duty of loyalty. According to the Interpretation, the duty of care consists of the duty to:

- provide advice in the best interest of the client;
- seek best execution of a client's transactions where the adviser has the responsibility to select broker-dealers to execute client trades; and
- provide advice and monitoring over the course of the client relationship.

The duty of loyalty requires that an adviser not place its own interest ahead of its client's interests. The Interpretation reaffirmed that, to fulfil its duty of loyalty, an adviser must:

-

make full and fair disclosure to its clients of all material facts relating to the advisory relationship and all conflicts of interest that might incline an adviser – consciously or unconsciously – to render advice that is not disinterested; and

- obtain a client's informed consent to such facts and conflicts.

Moreover, the Interpretation indicated that the Advisers Act fiduciary duty follows the contours of the adviser's relationship with its client and that the adviser and client may shape that relationship by agreement, provided that there is full and fair disclosure and informed consent.

Law stated - 8 February 2024

Gross negligence

7 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Delaware does recognise a 'gross negligence' standard of liability to the extent such standard is provided for in the applicable partnership agreement. As a matter of market practice, the exculpation and indemnification provisions in a private equity fund's limited partnership agreement typically carve out acts or omissions that constitute gross negligence, but under Delaware law, a partnership agreement could expressly exculpate or indemnify for such acts or omissions.

Law stated - 8 February 2024

Other special issues or requirements

8 Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Restrictions on transfers and withdrawals, restrictions on operations generally, provisions regarding fiscal transparency and special investor governance rights on matters such as removal of the general partner or early dissolution of the private equity fund are all matters typically addressed in the provisions of the partnership agreement and will vary from fund to fund. Typically, the partnership agreement will require the consent of the general partner to effect a transfer of a partnership interest in a limited partnership. This requirement enables the general partner to maintain the fund's compliance with applicable legal, tax and regulatory requirements and exemptions, as well as evaluate the appropriateness as a commercial matter of the proposed transferee. Although there is generally no right for a limited partner to withdraw from a Delaware limited partnership under the DRULPA, the limited partnership agreement for a private equity fund may provide for certain withdrawal rights for limited partners, typically only in limited circumstances for legal and regulatory reasons. Limited partners have the right to petition the Delaware Court of Chancery for withdrawal or similar equitable relief in egregious circumstances (eg, fraud); however, obtaining such relief can be difficult.

In converting or redomiciling a limited partnership formed in a non-US jurisdiction into a limited partnership in a US jurisdiction (eg, Delaware), particular attention should be given to requirements of the certificate of limited partnership domestication and certificate of limited partnership that may be required to be filed, as well as any other requirements of the applicable state's laws relating to maintaining a limited partnership in such jurisdiction. In addition, depending on where the redomiciled fund conducts its business, it may be required to obtain qualifications or authorisations to do business in certain jurisdictions. Any provisions of the partnership law of the state into which such domestication is effected that are otherwise inconsistent with the pre-existing governing agreement of such partnership should be reviewed and modified as necessary to ensure conformity with the applicable law. Consideration should also be given to the tax consequences of converting or redomiciling a limited partnership.

Certain aspects of US securities laws apply differently with respect to US and non-US private equity funds. For example, in determining whether a private equity fund formed in the United States will qualify for exemption from registration under the Investment Company Act of 1940, as amended, all investors, both US and non-US, are analysed for determining the fund's compliance with the criteria for exemption. By contrast, in the case of a private equity fund formed in a jurisdiction outside the United States, the staff at the SEC has taken the position that only US investors must be analysed for the purposes of making that same determination (assuming certain other requirements are met).

Section 12(g) of the Securities Exchange Act of 1934, as amended (the Exchange Act) generally requires that any issuer having 2,000 or more holders of record (or 500 or more holders who are not 'accredited investors' as defined by the SEC) of any class of equity security and assets in excess of US$10 million register the security under the Exchange Act and comply with the periodic reporting and other requirements of the Exchange Act. This section has the practical effect of imposing a limit of 1,999 investors in any single US-domiciled private equity fund. In addition, Rule 12g3-2(a) under the Exchange Act provides an exemption from the registration requirement described above for a non-US domiciled private equity fund that qualifies as a 'foreign private issuer' and has fewer than 300 holders of equity securities resident in the United States. Rule 3b-4(c) under the Exchange Act provides that a private equity fund that is organised outside of the United States generally qualifies as a foreign private issuer unless more than 50 per cent of its outstanding voting securities are held by US residents and any of the following applies:

- a majority of its executive officers and directors are US citizens or residents;
- more than 50 per cent of its assets are located in the United States; or
- its business is administered principally in the United States.

For purposes of generally accepted US accounting principles, to avoid consolidation of the financial statements of a private equity fund with its general partner, which is an issue of particular concern for some publicly listed private equity fund sponsors, the fund must provide its unaffiliated limited partners with the substantive ability to dissolve (liquidate) the fund (and appoint a third party as liquidator) or otherwise remove the general partner without cause on a simple majority basis (often referred to as kick-out rights).

Law stated - 8 February 2024

Fund sponsor bankruptcy or change of control

9 With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Depending on the structure of a private equity fund and its general partner and the specific provisions of their operating agreements, the bankruptcy or insolvency of the ultimate sponsor of a private equity fund could result in the bankruptcy or dissolution of the private equity fund's general partner or investment adviser or of the fund itself. Moreover, such a bankruptcy or insolvency event could result in the inability of the sponsor to meet its funding obligations with respect to its capital commitment to the private equity fund. Depending on the terms of the private equity fund's partnership agreement, such a default could constitute a 'cause' event and thereby trigger rights of the limited partners to remove the private equity fund's general partner, dissolve the private equity fund itself or cause the forfeiture of all or a portion of the general partner's unrealised carried interest, or all of these. In addition to such 'cause' protections, a sponsor bankruptcy may result in a private equity fund's limited partners seeking to exercise the 'no-fault' remedies included in many partnership agreements, which often permit termination of the investment period, removal of the private equity fund's general partner or dissolution of the private equity fund. With respect to US bankruptcy law, a sponsor that has filed for reorganisation under Chapter 11 of the US Bankruptcy Code should still be permitted to operate non-bankrupt subsidiaries (including, eg, related private equity funds and their general partners) as ongoing businesses, although this raises a variety of operational issues including, for example, whether ordinary course investment and private equity fund management decisions must be approved by the bankruptcy court.

A change of control or similar transaction with respect to an institutional sponsor may also give rise to statutory and contractual rights and obligations, including one or both of the following:

- a requirement under the Advisers Act for registered investment advisers and those required to be registered to obtain effective 'client' consent (namely, consent of the private equity fund's limited partners or a committee thereof) to transactions involving an 'assignment' of the sponsor's investment advisory contract (which a change of control often triggers); and
- the ability of the private equity fund's limited partners to cancel the commitment period, dissolve the fund, remove the general partner or sue the general partner for a breach of a negative covenant against transfers of interests in the general partner under the terms of the private equity fund's partnership agreement.

Law stated - 8 February 2024

REGULATION, LICENSING AND REGISTRATION

Principal regulatory bodies

10 What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

Advisers Act registration requirements and exemptions

Under the US Investment Advisers Act of 1940 (the Advisers Act), the Securities and Exchange Commission (SEC) has the authority to regulate investment advisers, defined as any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities. Investment advisers may also be subject to regulatory requirements at the state level. Under the Advisers Act, all investment advisers to private equity funds are generally required to be registered with the SEC under the Advisers Act unless they meet one of the following limited exemptions from such registration:

- The venture capital fund adviser exemption: investment advisers solely to venture capital funds (private funds that represent themselves to their investors and prospective investors as pursuing a venture capital strategy and that comply with other significant requirements, including limitations of the amount of leverage they may incur and type of assets in which they may invest).
- The foreign private adviser exemption: investment advisers who are not holding themselves out to the public in the United States as an investment adviser or advising registered funds, have no US place of business, have fewer than 15 US clients and US investors in total in private funds, and have assets under management (AUM) from such US clients and US investors of less than US$25 million.
- The private fund adviser exemption: investment advisers solely to qualifying private funds with AUM of less than US$150 million in the United States (which would be all assets for advisers with a principal place of business in the United States). 'Qualifying private funds' are pooled investment vehicles exempted from being 'investment companies' under either section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940:
    - section 3(c)(1) is available to a fund that does not publicly offer its securities and has 100 or fewer beneficial owners of its outstanding securities; and
    - section 3(c)(7) is available to a fund that does not publicly offer its securities and limits its owners to 'qualified purchasers', which generally include natural persons who own at least US$5 million in investments.

However, for an investment adviser whose 'principal office and place of business' is outside the United States, the private fund adviser exemption provides that such an adviser would not be required to register as long as the following is true:

- it has no client that is a US person except for qualifying private funds; and
- any assets managed by such adviser at a place of business in the United States are solely attributable to private fund assets, the total value of which is less than US$150 million.

AUM includes 100 per cent of any securities portfolios or private funds for which an investment adviser provides continuous and regular supervisory or management services, regardless of the nature of the assets held by the portfolio or the private fund. In addition, AUM includes 100 per cent of any uncalled capital commitments to private funds and any securities portfolios that consist of proprietary assets or assets managed without receiving compensation.

In determining whether an investment adviser can rely on the private fund adviser exemption, the SEC considers an investment adviser's principal office and place of business as the location where the investment adviser controls, or has ultimate responsibility for, the management of private fund assets; although day-to-day management of certain assets may take place at another location. An investment adviser with its principal office and place of business in the United States must count all private fund assets, including those from non-US clients, toward the US$150 million limit in calculating AUM. An investment adviser with its principal office and place of business outside of the United States need only count private fund assets it manages at a place of business in the United States toward the US$150 million limit. The key to determining whether an adviser is managing assets at a US place of business is whether activities are being conducted there that are intrinsic to providing investment advisory services such as solicitation, regular communications with clients or 'continuous and regular supervisory and management services'. An investment adviser provides 'continuous and regular supervisory or management services' with respect to a private fund at a place of business in the United States if its US place of business has 'ongoing responsibility to select or make recommendations' as to specific securities or other investments the fund may purchase or sell and, if such recommendations are accepted by the fund, the investment adviser's US place of business is responsible for arranging or effecting the purchase or sale. However, the SEC does not view merely providing research or conducting due diligence (in other words, activities not considered 'intrinsic to providing advisory services') to be continuous and regular supervisory or management services at a US place of business if a person outside of the United States makes independent investment decisions and implements those decisions. Therefore, a private fund adviser with its principal office and place of business outside of the United States that cannot meet the terms of the foreign private adviser exemption because it has raised more than US$25 million from US investors can often rely on the private fund adviser exemption because the number of non-US clients and the amount of assets managed outside of the United States are not taken into account when calculating the AUM of an investment adviser with its principal office and place of business outside the United States.

Investment advisers relying on the venture capital fund adviser exemption or the private fund adviser exemption are considered to be exempt reporting advisers (ERAs) and are required to report with the SEC by filing certain portions of Form ADV, Part 1 within 60 days of relying on the exemption. These portions require disclosure of certain basic information with respect to the investment adviser, its activities and the private funds that it advises. An investment adviser's Form ADV filing must be amended at least annually, within 90 days of the end of the investment adviser's fiscal year, and as necessary through an other-than-annual amendment if the disclosure for certain specific items becomes materially inaccurate.

On the other hand, subject to certain exceptions, investment advisers with less than US$100 million in AUM are generally prohibited from registering with the SEC under the Advisers Act and must instead register as an investment adviser in the state in which they maintain a principal office and place of business, and be subject to examination as an investment adviser by the applicable securities commissioner, agency or office.

Advisers withmore than US$100 million of AUM ('large advisers') must register with the SEC unless an exemption is available.

Advisers with at least US$25 million but less than US$100 million in AUM ('mid-sized advisers') may be required to register, depending on certain factors, including the regulation of the state in which the adviser has its principal place of business.

Advisers with less than US$25 million in AUM ('small advisers') are prohibited from registered with the SEC on the basis of AUM (and may be required to register with the states), but may have other bases for registration.

The SEC also maintains regulatory oversight over ERAs and is authorised to require an ERA to maintain records and provide reports, and to examine such ERA's records, which means an ERA's books and records are subject to SEC inspection. The SEC staff has in the past indicated that it intends to examine ERAs as a part of the SEC's routine examination programme. ERAs are not required to file Form PF. Investment advisers relying on the foreign private adviser exemption are not required to file reports with the SEC. In addition to the aforementioned exemptions, certain investment advisers are excluded from the definition of 'investment adviser' and thus are not required to register under the Advisers Act or report with the SEC as an ERA. For example, a 'family office', which is generally a company owned and controlled by family members that provides investment advice only to family clients and does not hold itself out to the public as an investment adviser, is so excluded from the definition.

Form PF

A registered investment adviser with at least US$150 million of 'private fund' AUM (ie, a fund relying on 3(c)(1) or 3(c)(7)) is required to file Form PF with the SEC, which requires disclosure of certain information regarding each private fund an investment adviser advises, including gross and net asset value, gross and net performance, use of leverage, aggregate value of derivatives, a breakdown of the fund's investors by category and concentration (eg, individuals, pension funds, governmental entities, sovereign wealth funds), a breakdown of the fund's equity held by the five largest investors and a summary of fund assets and liabilities.

In connection with recently adopted amendments to Form PF, a private equity fund adviser (ie, US$150 million in private fund AUM) is required to file Section 6 of Form PF within

60 days of quarter-end upon the occurrence of certain private equity reporting events ('triggering events'), which include (1) execution of an adviser-led secondary transaction and (2) investor election to remove a fund's general partner or similar control person or to terminate a fund's investment period of a fund.

- Adviser-led secondary transactions (Item B) – upon the completion of an 'adviser-led secondary transaction', which is defined as any transaction initiation by the adviser (or related person) that offers fund investors the choice to: (1) sell all or a portion of their interests in the fund; or (2) convert or exchange all or a portion of their interests in the private fund for interests in another vehicle advised by the adviser or any of its related persons. This would include, for example, the completion of a GP-led tender offer or GP-led roll of LPs into a continuation vehicle but wouldnot include LP-initiated liquidity.
- Election to remove GP, terminate the fund, or terminate its investment period (Item C) – upon the adviser's (or related person's) receipt of notice that a fund's investors have: (1) removed the GP or similar control person of the fund; (2) elected to terminate the reporting fund's investment period; or (3) elected to terminate the fund pursuant to the fund's governing documents. This reporting event only applies to circumstances where action is taken by fund investors, not other ordinary course occurrences of these events (eg, where an investment period expires but not is extended).

In addition, the Form PF amendments require a large private equity fund adviser (ie, US$2 billion in private fund AUM) to file Section 4 of Form PF annually within 120 calendar days of fiscal year end with respect to each private equity funds it advises. Large private fund advisers are required to report more extensive information in their annual Form PF filing, with the nature of the information dependent upon their strategy. Additional disclosure requirements apply to registered investment advisers to private equity funds with at least US$2 billion in AUM (ie, large private equity advisers) but the occurrence of events that require disclosure do not necessitate off-cycle quarterly reporting. Such disclosure requirements focus on GP or LP clawback(s) in excess (in the aggregate) of 10 per cent of a fund's aggregate capital commitments, fund investment strategies and country exposures (exceeding 10 per cent or more of its NAV), fund level borrowings, events of default and use of bridge financing.

Unlike Form ADV filings, which are available on the SEC's website, Form PF filings are confidential and such information is exempt from requests for information under the Freedom of Information Act. However, the SEC is required to share information included in Form PF filings with the Financial Stability Oversight Council and, in certain circumstances, US Congress and other federal departments, agencies and self-regulatory organisations (in each case, subject to confidentiality restrictions).

Private Fund Adviser Rules

On 23 August 2023, the SEC adopted previously proposed new rules and amendments (collectively, the Private Fund Adviser Rules) to existing rules under the Advisers Act specifically related to registered advisers and their activities with respect to private funds they advise. In particular, the Private Fund Adviser Rules will, among other changes:

- increase reporting requirements by private funds to investors concerning performance, fees and expenses;
- require registered advisers to obtain an annual audit for all private funds;
- enhance requirements in connection with adviser-led secondary transactions (also known as GP-led secondaries), to include the need to obtain a fairness or valuation opinion and make certain disclosures;
- restrict advisers from engaging in certain practices unless they satisfy certain disclosure requirements, and in some cases, consent requirements, such as charging private fund clients for fees and expenses associated with an examination, seeking reimbursement for certain investigation expenses, making non-pro rata fee and expense allocations and borrowing money from a private fund client;
- prohibit advisers from engaging in certain forms of preferential treatment related to liquidity and information rights if they would be reasonably expected to have a material negative effect on other investors and otherwise require new disclosure regarding preferential treatment of investors in order for an adviser to provide preferential treatment in side letters or other arrangements; and
- prohibit an adviser from having a private fund bear the costs of any fees or expenses related to an investigation resulting in a violation of the Advisers Act.

The Private Fund Adviser Rules are complemented by amendments to the books and records and compliance rules under the Advisers Act that require registered investment advisers to private funds to retain certain records evidencing their compliance with the Rules and all registered investment advisers to document their annual compliance review.

While the full extent of the Private Fund Adviser Rules' impact on the private fund adviser industry cannot yet be determined, the adoption of these rules is likely to have a significant effect on private fund advisers and their operations, including increasing compliance burdens and associated regulatory costs and enhancing the risk of regulatory action including public regulatory sanctions, and may create additional regulatory uncertainty. The compliance dates for the Private Fund Adviser Rules are September 2024 or March 2025. There is active and ongoing litigation regarding the Private Fund Adviser Rule, but it is uncertain whether such legal challenge will be successful.

Regulation applicable to unregistered advisers

Even unregistered investment advisers (whether ERAs or not) are subject to the general anti-fraud provisions of the Securities Exchange Act of 1934, as amended (the Exchange Act), the Advisers Act, state laws and, if required to register as a broker-dealer with the Financial Industry Regulatory Authority (FINRA), similar rules promulgated by FINRA, and the SEC and many of the analogous state regulatory agencies retain statutory power to bring actions against a private equity fund sponsor under these provisions.

US Commodity Futures Trading Commission regulations

The US Commodity Futures Trading Commission (CFTC) has the authority to regulate commodity pool operators (CPOs) and commodity trading advisers (CTAs) under the US Commodity Exchange Act. The CFTC regulations broadly include most derivatives as ‘commodity interests’ that cause a private equity fund holding such instruments to be deemed a ‘commodity pool’ and its operator (typically the general partner, in the case of a limited partnership) to be subject to CFTC jurisdiction as a CPO or its adviser (typically the investment adviser) to be subject to CFTC jurisdiction as a CTA, and, unless an exemption is available, to become a member of the National Futures Association (NFA), the self-regulatory organisation for the commodities and derivatives market. The CFTC regulations will generally apply on the basis of holding any commodity interest, directly or indirectly and, as such, CPO and CTA status should be considered with respect to all investment activities and products, including, for example, private funds, real estate investment trusts, business development companies, separate managed account arrangements and any subsidiary entities, alternative investment vehicles and other related entities and accounts. CPOs managing private equity funds may claim certain exemptions from registration with the CFTC, which may include no-action relief (including for CPOs of ‘funds of funds’, real estate investment trusts and business development companies), the ‘de minimis’ exemption under CFTC Rule 4.13(a)(3) (providing relief for CPOs that engage in limited trading of commodity interests on behalf of a commodity pool) and ‘registration lite’ under CFTC Rule 4.7 (providing relief from certain reporting and record-keeping requirements otherwise applicable to a registered CPO if the interests in such pool are offered only to ‘qualified eligible persons’ (which includes a ‘qualified purchaser’ and ‘non-United States persons’) in a private offering of securities (including an offering that complies with Rule 506(c) under the Securities Act)), and corresponding exemptions are available to CTAs of private equity funds. Notably, beginning in September 2020, the ‘de minimis’ exemption under CFTC Rule 4.13(a)(3) was revised to prohibit sponsors from relying on the exemption if the sponsor or any of its ‘principals’ is subject to certain specified covered statutory disqualifications. Both US and non-US private equity fund sponsors should monitor whether their activities will deem their private equity funds to be commodity pools (eg, because the funds hedge their currency or interest rate exposure by acquiring swaps), and, to the extent applicable, sponsors should assess the registration requirements for CPOs and determine whether they can rely on an exemption from such registration, which requires consideration of a number of factors early in the process of structuring a fund and throughout its term. If an exemption or other relief is not available, a sponsor of a fund that invests in commodity interests (including derivatives) may be required to register with the CFTC and NFA, in which case it will become subject to reporting, record-keeping, advertising, ethics training, supervisory and other ongoing compliance obligations and certain of its personnel will become subject to certain proficiency requirements (eg, the Series 3 exam) and standards of conduct.

Law stated - 8 February 2024

Governmental requirements

11 What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

The offering and sale of interests in a private equity fund are typically conducted as 'private placements' exempt from the securities registration requirements imposed by the Securities Act, the regulations thereunder and applicable state law. In addition, most private equity funds require their investors to meet certain eligibility requirements to enable the funds to qualify for exemption from regulation as investment companies under the Investment Company Act of 1940, as amended (the Investment Company Act). Accordingly, there are no approval, licensing or registration requirements applicable to a private equity fund that offers its interests in a valid private placement and qualifies for an exemption from registration under the Investment Company Act.

As a general matter, if 25 per cent or more of the value of any class of equity interests in a private equity fund is held by 'benefit plan investors' (disregarding the value of interests held by the sponsor and its affiliates, and anyone providing investment advice to the private equity fund and its affiliates, unless they themselves are 'benefit plan investors'), the private equity fund must be operated to qualify as an 'operating company' such as a venture capital operating company (VCOC) or a real estate operating company (REOC). In general, for purposes of applying the 25 per cent test, the term 'benefit plan investors' includes only those plans and arrangements that are subject to the fiduciary responsibility standard of care under Title I of the Employee Retirement Income Security Act of 1974 (ERISA) or the prohibited transaction rules under Title I of ERISA or section 4975 of the Internal Revenue Code of 1986 (the Code), such as US corporate pension plans and individual retirement accounts as well as entities whose assets include 'plan assets' (eg, a fund of funds). Plans that are not subject to the fiduciary responsibility standard of care under Title I of ERISA or the prohibited transaction rules under Title I of ERISA or section 4975 of the Code, such as US governmental pension plans and pension plans that are established or maintained outside of the United States primarily for the benefit of employees residing outside of the United States and are not subject to ERISA or the Code, are not counted for purposes of the 25 per cent test. Qualification as a VCOC generally entails the private equity fund having on its initial investment date and annually thereafter at least 50 per cent of the private equity fund's assets, valued at cost, invested in 'operating companies' as to which the private equity fund obtains direct contractual 'management rights'. The private equity fund must also exercise such management rights with respect to one or more of such operating companies during the course of each year in the ordinary course of business. Qualification as a REOC generally entails the private equity fund having on its initial investment date and annually thereafter at least 50 per cent of the private equity fund's assets, valued at cost, invested in real estate that is managed or developed and with respect to which the private equity fund has the right to, and in the ordinary course of its business does, substantially participate directly in the management or development activities.

The sponsor of a private equity fund engaging in certain types of corporate finance or financial advisory services may be required to register as a broker-dealer with FINRA and be subject to similar audit and regulation.

Law stated - 8 February 2024

Registration of investment adviser

12 | Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

In the absence of an applicable exemption, exception or prohibition, a private equity fund's manager will be subject to registration as an investment adviser under the Advisers Act.

Those investment advisers registered under the Advisers Act (whether voluntarily or because an exemption, exception or prohibition is not available) are subject to a number of substantive reporting and record-keeping requirements and rules of conduct that shape the management, operation and marketing of their business, as well as periodic compliance inspections conducted by the SEC.

As part of the shift towards more systematic regulation and increased scrutiny of the private equity industry, the SEC continues to focus on the examination of private equity firms. Certain private equity industry practices have received significant attention from the SEC and have led to a number of enforcement actions against private equity fund advisers in recent years. Areas that the SEC has highlighted to be of particular concern include, among others, the following:

- marketing materials, and the presentation of performance information generally (eg, presenting net performance alongside gross performance, with at least equal prominence, and the adequacy of disclosures regarding the impact of fund-level leverage on presented performance results);
- allocation of expenses to funds or portfolio companies, or both, without full and fair pre-commitment disclosure and consent from investors (including for overhead expenses and for the compensation of operating partners, senior advisers, consultants and seconded and other in-house employees of private equity fund advisers or their affiliates for providing services (other than advisory services) to funds or portfolio companies or both);
- full allocation of broken deal expenses to funds instead of separate accounts, co-investors, co-investment vehicles, employee side-by-side vehicles, or friends and family funds without full and fair pre-commitment disclosure and consent from investors;
- receipt by private equity firms of compensation from funds or portfolio companies, or both, which is outside the typical management fee or carried interest structure without a corresponding management fee offset, without full and fair pre-commitment disclosure and consent from investors as well as an acceleration of monitoring fees;
- receipt by private equity firms of transaction-based or other compensation for the provision of brokerage services in connection with the acquisition and disposition of portfolio companies without being registered as a broker-dealer;
- allocation of investment opportunities among investment vehicles they manage and between such funds and the private equity fund advisers, affiliates or employees;
- allocation of co-investment opportunities;
- fee-sharing arrangements with co-investors whereby a portion of fees received from portfolio companies are shared with such co-investors and the impact of such arrangements on management fee offsets;
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disclosure of other conflicts of interests to investors, including those arising out of the outside business activities, affiliate relationships and personal financial dealings of a private equity sponsor's employees and directors;

- valuation methods and fee calculation policies;
- receipt of service provider discounts by private equity firms that are not given to the funds or portfolio companies without full and fair pre-commitment disclosure and consent from investors;
- plans to mitigate or respond to cybersecurity events;
- failure to fully allocate fees from portfolio companies to management fee paying funds to offset such management fees without full and fair pre-commitment disclosure and consent from investors;
- allocation of interest from a loan to the private equity fund adviser only to the adviser or its affiliates without full and fair pre-commitment disclosure and consent from investors;
- pay-to-play rule violations;
- late submission of required filings (eg, Form PF);
- policies and procedures relating to the receipt of material;
- non-public information; and
- fund restructurings.

Law stated - 8 February 2024

Fund manager requirements

13 Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

There are no particular educational or experience requirements imposed by law on investment advisers, although the education and experience of certain investment advisers' personnel are disclosable items in Form ADV. As a matter of market practice, the required experience level of an investment adviser's management team will be dictated by the demands of investors. If required to register as a broker-dealer with FINRA, a private equity fund sponsor would need to satisfy certain standards in connection with obtaining a registration (eg, no prior criminal acts, minimum capital, testing, etc). In addition, broker-dealers are subject to a prescriptive set of rules as well as certain conduct requirements including Regulation Best Interest. Also, a private equity fund's sponsor is typically expected to make a capital investment either directly in or on a side-by-side basis with the private equity fund (but there are limitations on sponsor commitments in bank-sponsored private equity funds). Investors will expect that a significant portion of this investment be funded in cash, as opposed to deferred-fee or other arrangements.

Law stated - 8 February 2024

Political contributions

14 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

The SEC has adopted Rule 206(4)-5, a broad set of rules aimed at curtailing 'pay-to-play' scandals in the investment management industry. The rules, subject to certain de minimis exceptions, prohibit a registered investment adviser, as well as an ERA and a foreign private adviser (covered advisers), from providing advice for compensation to any US government entity within two years after the covered adviser or certain of its executives or employees (covered associates) has made a political contribution to an elected official or candidate who is in a position to influence an investment by the government entity in a fund advised by such investment adviser. The rules also make it illegal for the covered adviser itself, or through a covered associate, to solicit or coordinate contributions for any government official (or political party) where the investment adviser is providing or seeking to provide investment advisory services for compensation to a government entity in the applicable state or locality. Investment advisers are also required to monitor and maintain records relating to political contributions made by their employees.

In addition to the SEC rule, certain US states (including California, New Jersey, New Mexico and New York) have enacted legislation and certain US public pension plans have established policies that impose similar restrictions on political contributions to state officials by investment advisers and covered associates.

Law stated - 8 February 2024

Use of intermediaries and lobbyist registration

15 Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

With effect from 20 August 2017, the SEC's pay-to-play rules discussed above broadly prohibit a covered adviser from making any payment to a third party, including a placement agent, finder or other intermediary, for securing a capital commitment from a US government entity to a fund advised by the investment adviser unless such placement agent is registered under section 15B of the Exchange Act and subject to pay-to-play rules adopted by the Municipal Securities Rulemaking Board or FINRA. The ban does not apply to payments by the investment adviser to its employees or owners.

Certain US states have enacted legislation regulating or prohibiting the engagement or payment of placement agents by an investment adviser with respect to investment by some or all of such state's pension systems in a fund advised by such investment adviser. Such regulations and prohibitions vary from state to state.

Counties, cities or other municipal jurisdictions may require lobbyist registration or disclosure or both. For example, in New York City, local rules effectively require investment advisers and their employees who solicit local pension plans to register as lobbyists.

In addition, public pension plans may have their own additional requirements. In states where state law does not ban placement agent fees or require disclosure, the public pension plans themselves may have such bans or requirements.

Law stated - 8 February 2024

Bank participation

16 Describe any key legal or regulatory developments (including those emerging from the 2008 global financial crisis) that specifically affect banks with respect to investing in or sponsoring private equity funds.

In 2013, the five US regulatory agencies responsible for implementing the 'Volcker Rule' provisions of Dodd-Frank (the agencies) approved final rules (the Final Rules) that generally prohibit 'banking entities' from acquiring or retaining any ownership in, or sponsoring, a private equity fund (and engaging in proprietary trading). On 24 May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the Reform Act) was enacted and, among other financial regulatory changes, modified the Volcker Rule's 'banking entity' definition. For purposes of the Volcker Rule, as implemented by the Final Rules and as amended by the Reform Act, the term 'banking entity' means any insured depository institution (other than certain limited-purpose trust institutions and insured depository institutions that do not have, and are not controlled by a company that has, more than US$10 billion in total consolidated assets or total trading assets and trading liabilities that are more than 5 per cent of total consolidated assets), any company that controls such an insured depository institution, any company that is treated as a bank holding company for purposes of the International Banking Act (eg, a foreign bank that has a US branch, agency or commercial lending subsidiary) and any affiliate or subsidiary of such entities.

There are a number of exceptions to the basic prohibition on banking entities investing in or sponsoring private equity funds. In particular, banking entities are permitted to invest in covered private funds that they sponsor, provided that the investment does not exceed 3 per cent of the fund's total ownership interest on a per-fund basis, or 3 per cent of the banking entity's 'Tier 1 capital' on an aggregate basis, and provided that certain other conditions are met. For these purposes, covered funds generally include funds that would be investment companies but for the exemptions provided by section 3(c)(1) or section 3(c)(7) of the Investment Company Act, subject to certain exclusions.

In 2019, the agencies responsible for implementing the Volcker Rule adopted certain targeted amendments to the Volcker Rule regulations to simplify and tailor certain compliance requirements relating to the Volcker Rule. In 2020, the agencies adopted additional revisions to the Volcker Rule's current restrictions on banking entities sponsoring and investing in certain covered hedge funds and private equity funds, including by proposing new exemptions allowing banking entities to sponsor and invest without limit in credit funds, venture capital funds, customer facilitation funds and family wealth management vehicles (the Covered Fund Amendments). The Covered Fund Amendments also loosen certain other restrictions on extraterritorial fund activities and direct parallel or co-investments made alongside covered funds. The Covered Fund Amendments should therefore expand the ability of banking entities to invest in and sponsor private funds.

Law stated - 8 February 2024

TAXATION

Tax obligations

17 Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Generally, a private equity fund vehicle, such as a limited partnership or limited liability company, that is treated as a partnership for US federal income tax purposes, would not itself be subject to taxation with respect to its income or gains. Instead, each partner would take into account its distributive share of the partnership's income, gain, loss and deduction. However, liability for audit adjustments to a fund's tax returns may be imposed on the fund itself in certain circumstances in the absence of an election to the contrary.

If the fund generates income effectively connected with the conduct of a US trade or business (ECI), including as a result of an investment in US real estate or certain real estate companies, the fund will be required to withhold US federal income tax with respect to such income that is attributable to the fund's non-US investors, regardless of whether it is distributed. In general, subject to an exception for investments in certain real estate companies, trading in stock or securities (the principal activity of most private equity funds) is not treated as generating ECI. Gain or loss from the sale or exchange of an interest in a fund by a foreign partner will be considered ECI and therefore subject to US tax to the extent that such partner would have been allocated ECI if the fund sold all of its assets at fair market value as of the date of the sale or exchange. The transferee of an interest in a partnership engaged in a US trade or business to withhold 10 per cent of the amount realised by the transferor on the sale or exchange, and the fund would be required to withhold from future distributions to the transferee if the transferee fails to properly withhold. Funds that hold investments that generate ECI often allow non-US investors to participate in such investments indirectly through one or more entities treated as corporations for US tax purposes, in which case such corporations would file US tax returns and pay tax associated with such ECI investments in lieu of such non-US investors. Non-US investors may still be subject to US withholding tax on dividends or interest paid by such corporations.

The fund will also be required to withhold with respect to its non-US investors' distributive share of certain US-source income of the fund that is not ECI (eg, US-source dividends and interest) unless, in the case of interest, such interest qualifies as portfolio interest. Portfolio interest generally includes (with certain exceptions) interest paid on registered obligations with respect to which the beneficial owner provides a statement that it is not a US person. A non-US investor who is a resident for tax purposes in a country with respect to which the United States has an income tax treaty may be eligible for a reduction or refund of withholding tax imposed on such investor's distributive share of interest and dividends and certain foreign government investors may also be eligible for an exemption from withholding tax on income of the fund that is not from the conduct of commercial activities.

The Foreign Account Tax Compliance Act requires all entities in a broadly defined class of foreign financial institutions (FFIs) to comply with a complicated and expansive reporting regime or be subject to a 30 per cent withholding tax on certain payments. This legislation also requires non-US entities that are not FFIs either to certify they have no substantial US beneficial ownership or to report certain information with respect to their substantial US beneficial ownership or be subject to a 30 per cent withholding tax on certain payments. This legislation could apply to non-US investors in the fund, and the private equity fund could be required to withhold on payments to such investors if such investors do not comply with the applicable requirements of this legislation.

The taxation of a private equity fund vehicle as a partnership for US federal income tax purposes is subject to certain rules regarding 'publicly traded partnerships' that could result in the partnership being classified as an association taxable as a corporation. To avoid these rules, funds are not commonly traded on a securities exchange or other established over-the-counter market and impose limitations on the transferability of interests in the private equity fund vehicle.

Law stated - 8 February 2024

Local taxation of non-resident investors

18 Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Non-resident investors that invest directly in a private equity fund organised as a flow-through vehicle in the United States would be subject to US federal income taxation and return filing obligations if the private equity fund (or an entity organised as a flow-through vehicle into which the private equity fund invests) generates ECI (including gain from the sale of real property or stock in certain 'US real estate property holding corporations'). In addition, all or a portion of the gain on the disposition (including by redemption) by a non-US investor of its interest in the fund may be taxed as ECI. Similar US state and local income tax requirements may also apply.

Law stated - 8 February 2024

Local tax authority ruling

19 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

Generally, no tax ruling would be obtained with respect to the tax treatment of a private equity fund vehicle formed in the United States. While there are many special taxation rules applicable to US investors, of particular relevance are those rules that apply to US tax-exempt investors in respect of unrelated business taxable income.

Law stated - 8 February 2024

Organisational taxes

20 Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There are no significant taxes associated with the organisation of a private equity fund in the United States.

Law stated - 8 February 2024

Special tax considerations

21 Describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Special consideration is given to structure the carried interest such that it is treated as a partnership allocation eligible for taxation on a flow-through basis. It is sometimes desirable to separate the general partner (namely, the recipient of the carried interest) and the investment manager (namely, the recipient of the management fee) into separate entities.

Under section 1061 of the Code, the fund must have a three-year holding period (rather than the standard one-year holding period) for an investment or asset in order for carried interest distributions to be eligible for favourable long-term capital gain treatment, and this requirement may implicate gains with respect to capital contributions made by sponsors and their employees. In addition, an individual carried interest participant will only be eligible for long-term capital gain treatment upon disposition of any interests in a carry vehicle (other than capital interests) if such participant has a three-year holding period for the interests. Further, Congress has previously proposed legislation that, if enacted, would result in carried interest distributions that are currently subject to favourable capital gains tax treatment being subject to higher rates of US federal income tax than are currently in effect. Whether such legislation would be enacted in addition to changes in the tax reform legislation enacted in 2017 (the 2017 Tax Reform Bill) is uncertain.

In addition, some sponsors implement arrangements in which a sponsor waives its right to all or a portion of management fees in order for it or an affiliate to receive an additional distributive share of the private equity fund's returns. Proposed regulations, if finalised, could treat participants in such management fee waiver arrangements as receiving compensatory payments for services rather than allocations of the fund's underlying income. The preamble to the proposed regulations also indicates that existing safe harbours that treat the grant of a 'profits interest' as a non-taxable event may not apply to management fee waiver arrangements.

Law stated - 8 February 2024

Tax treaties

22 List any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

The United States has an extensive network of income tax treaties. How a treaty would apply to the fund vehicle depends on the terms of the specific treaty and the relevant facts of the structure.

Law stated - 8 February 2024

Other significant tax issues

23 Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

The 2017 Tax Reform Bill has resulted in fundamental changes to the Code. Among the numerous changes included in the 2017 Tax Reform Bill are:

- a permanent reduction to the corporate income tax rate;
- a partial limitation on the deductibility of business interest expense;
- an income deduction for individuals receiving certain business income from pass-through entities;
- changes in the treatment of carried interest, which generally requires the fund to have a three-year holding period for an investment or asset in order for carried interest distributions to be eligible for favourable long-term capital gain treatment;
- a partial shift of the US taxation of multinational corporations from a tax on worldwide income to a territorial system (along with a transitional rule that taxes certain historical accumulated earnings and rules that prevent tax planning strategies that shift profits to low-tax jurisdictions); and
- a suspension of certain miscellaneous itemised deductions, including deductions for investment fees and expenses, until 2026.

The partial limit on the deductibility of business interest expense disallows deductions for business interest expense (even if paid to third parties) in excess of the sum of business interest income and 30 per cent of the adjusted taxable income of the business. Business interest includes any interest on indebtedness related to a trade or business, but excludes investment interest, to which separate limitations apply.

US tax rules are very complex and tax matters play an extremely important role in both fund formation and the structure of underlying fund investments. Consultation with tax advisers with respect to the specific transactions or issues is highly recommended.

Law stated - 8 February 2024

SELLING RESTRICTIONS AND INVESTORS GENERALLY

Legal and regulatory restrictions

24 Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Exemptions from requirement to register fund interests

To ensure that a private equity fund offering securities in the United States will satisfy the requirements necessary to avoid registration of the interests in the fund with the Securities and Exchange Commission (SEC), a private equity fund sponsor will customarily conduct the offering and sale of interests in the private equity fund to meet a private placement exemption under the Securities Act. The most reliable way to do this is to comply with the safe harbour criteria established by Rule 506 under Regulation D under the Securities Act. Offers and sales of securities that comply with Regulation D will not be deemed to be a transaction that involves a public offering. The applicability of the exemptions will depend on the manner of the offering. Under the Rule 506(b) exemption, the private equity fund sponsor must not make any offers or sales by means of general solicitation or general advertising. In addition, the private equity fund cannot have more than 35 non-accredited investors. Each such non-accredited investor, either individually or with a representative, must also be sophisticated (ie, must have sufficient knowledge and experience in financial or business matters to make them capable of evaluating the merits and risks of the potential investment).

Under the Rule 506(c) exemption, the private equity sponsor may broadly solicit and generally advertise the offering, so long as, among other requirements, 'reasonable steps' are implemented to ensure that each investor in the private equity fund is an accredited investor at the time of the sale of securities to that investor.

An 'accredited investor', as defined in Rule 501 under Regulation D, generally includes:

- a natural person with a net worth (either individually or jointly with a spouse or spousal equivalent) of more than US$1 million or income above US$200,000 in the past two years (or US$300,000 in joint income with a spouse or spousal equivalent for those two years and a reasonable expectation of reaching the same income level in the current year);
- a natural person holding one or more of the following certifications in good standing:
  - General Securities Representative licence (Series 7);
  - Private Securities Offerings Representative licence (Series 82); or
  - Investment Adviser Representative licence (Series 65);
- any natural person who is a 'knowledgeable employee', as defined in rule 3c5(a)(4) of the Investment Company Act of 1940, as amended (the Investment Company Act); and

- certain entities with more than US$5 million in total assets.

For the purposes of the aforementioned US$1 million net-worth test, the value of the investor's primary residence is excluded from the calculation of the investor's total assets and the amount of any mortgage or other indebtedness secured by an investor's primary residence is similarly excluded from the calculation of the investor's total liabilities, except to the extent the estimated fair market value of the residence is less than the amount of such mortgage or other indebtedness. There is also a timing provision in the net-worth test designed to prevent investors from artificially inflating their net worth by incurring incremental indebtedness secured by their primary residence to acquire assets that would be included in the net worth calculation. Under the timing provision, if a borrowing occurs in the 60 days preceding the purchase of securities in an exempt offering and is not in connection with the purchase of the primary residence, the amount of such incremental indebtedness must be treated as a liability for the net worth calculation. The SEC is authorised to adjust the 'accredited investor' definition for individuals every four years as may be appropriate to protect investors, further the public interest or otherwise reflect changes in the prevailing economy.

Rule 506(c) provides some non-exclusive, non-mandatory methods of verifying that a natural person is accredited (eg, reviewing tax returns or bank account statements) and, to the extent these methods are not used, or a sponsor is verifying the accredited investor status of an entity, in determining whether the steps taken by an issuer to verify eligibility are objectively reasonable, sponsors should consider the particular facts and circumstances of each offering and each purchaser, including the following:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be;
- the amount and type of information that the issuer has about the purchaser; and
- the nature, terms and manner of the offering.

Although the SEC has in the past indicated that, in certain circumstances, the 'reasonable steps determination' may not be substantially different from an issuer's development of a 'reasonable belief' for purposes of Rule 506(b), given that these increased verification measures with respect to sales under Rule 506(c) generally result in increased compliance burdens and costs for issuers, and in some cases, investors are reluctant to provide or are sensitive about providing the additional information required as part of the enhanced verification procedures, private equity firms are not yet widely relying on the Rule 506(c) exemption, and this exemption is not expected to play a significant role in private equity fundraising in the future.

Another factor impeding utilisation of the Rule 506(c) exemption by private equity firms is that the use of general solicitation in reliance on Rule 506(c) may affect other aspects of a private equity sponsor's regulatory compliance regime. For example, it is possible that the use of general solicitation or general advertising by a private equity fund under Rule 506(c) could have an adverse impact on its private placement under the securities laws of other jurisdictions in which it conducts its offering as the securities laws thereof may not permit general solicitation in their current form.

A private equity fund relying on a private placement exemption contained in Regulation D under the Securities Act must file electronically with the SEC a notice on Form D within 15 calendar days after the date of first sale of securities. Form D sets forth certain basic information about the offering, including the amount of securities offered and sold as well as whether any sales commissions were paid to any broker-dealers and, if so, the states in which purchases were solicited by such broker-dealer. For the purposes of the Form D filing deadline, the SEC considers the first date of sale to occur on the date on which the first investor is irrevocably contractually committed to invest. Therefore, depending on the terms and conditions of the contract, such date could be deemed to be the date on which a private equity fund receives its first investor subscription agreement and not necessarily the typically later closing date. In the past, the SEC has proposed amendments to Regulation D, which would impose additional procedural requirements on issuers seeking to rely on Rule 506(c) to engage in a general solicitation by requiring that an initial Form D (with heightened disclosure requirements) be filed at least 15 days before commencing any such general solicitation and that a final amendment to Form D be filed within 30 days of the termination of any such offering. Under other previously proposed amendments, failure to comply with the Form D filing requirements (whether or not involving a general solicitation) would result in an automatic one-year disqualification from relying on a Rule 506 exemption.

In addition to federal securities law compliance, most states have similar notice-filing requirements. While state registration of securities is pre-empted under the Securities Act, private equity sponsors should be cognisant of the state law notice-filing requirements in the various jurisdictions in which they will or have offered or sold limited partnership interests to investors. Many states require a notice filing, consisting of a copy of a Form D and a filing fee, to be made within 15 calendar days after the date of first sale in the state. Anti-fraud provisions under applicable state laws apply despite the pre-emption described earlier.

Under Rule 506(d), issuers are prohibited from relying on the Rule 506 exemptions (whether or not the proposed offering involves a general solicitation), if the issuer or any other ‘covered person’ was subject to a ‘disqualifying event’. Covered persons include the issuer and its predecessors, affiliated issuers (ie, issuers that issue securities in the same offering, eg, parallel funds and related feeder funds), directors and certain officers, general partners and managing members of the issuer, beneficial owners of 20 per cent or more of an issuer’s outstanding voting equity securities calculated on the basis of voting power (which could include limited partners in related private equity funds if the issuer and such related fund vote together), any investment manager to a pooled investment fund issuer, any ‘promoter’ connected with the issuer in any capacity at the time of the sale and any persons compensated (directly or indirectly) for soliciting investors (eg, placement agents), as well as the general partners, directors, officers and managing members of any such investment manager or compensated solicitor. For the purposes of these ‘bad actor’ rules, disqualifying events include certain criminal convictions, court injunctions and restraining orders, final orders of state and federal regulators, SEC disciplinary orders, stop orders and cease-and-desist orders, suspension or expulsion from a securities self-regulatory organisation and US Postal Service false representation orders. A number of these disqualifying events are required to occur in connection with the purchase or sale of securities and include a look-back period of five to 10 years depending on the particular facts surrounding the disqualifying event. Disqualification is not triggered by actions taken in jurisdictions other than the United States. While only disqualifying events that occur after the rule's effective date (23 September 2013) will disqualify an issuer from relying on a Rule 506 exemption, Rule 506(e) provides that disqualifying events that occurred prior to such date but within the applicable look-back period would nonetheless be required to be disclosed to investors in connection with any sales of securities under Rule 506 within a reasonable time prior to such sale. Under Rule 506(e), a failure to provide this disclosure will not prevent an issuer from relying on a Rule 506 exemption if an issuer can show that it did not know and, in the exercise of reasonable care could not have known, that the issuer or any other covered person was subject to a disqualifying event, although this reasonable care exception requires factual inquiry into whether any disqualifications exist. This factual inquiry will depend on the facts and circumstances concerning, among other things, the issuer and the other offering participants. Additionally, the SEC may grant waivers from disqualification under certain circumstances, including if the issuer has undergone a change of control subsequent to the disqualifying event.

Exemptions from requirement to register funds

To ensure that a private equity fund will satisfy the requirements necessary to avoid regulation as an 'investment company' under the Investment Company Act, the fund must be excluded from the definition of investment company. Under section 3(c)(7) of the Investment Company Act, each investor in the fund will typically be required to represent that it is a qualified purchaser. In the event that not all of a private equity fund's investors are qualified purchasers, the fund may still be excluded from the definition of an 'investment company' under section 3(c)(1) of the Investment Company Act by limiting the number of investors to not more than 100 (all of which must still be accredited investors for Regulation D purposes and with respect to which certain 'look through' attribution rules apply). A qualified purchaser as defined in section 2(a)(51)(A) of the Investment Company Act generally includes a natural person (or a company owned directly or indirectly by two or more natural, related persons) who owns not less than US$5 million in investments, a company acting for its own account or the accounts of other qualified purchasers that in the aggregate owns and invests on a discretionary basis not less than US$25 million in investments and certain trusts. To rely on section 3(c)(1) or 3(c)(7), a private equity fund sponsor must not be making or presently proposing to make a public offering. One way that a sponsor can meet this requirement is by complying with Regulation D, as mentioned earlier.

Certain rules under the Investment Company Act provide additional clarification for the above requirements. Rule 3c-5 under the Investment Company Act provides that 'knowledgeable employees' (namely, executive officers and directors of the sponsor and most investment professionals who, as part of their regular functions or duties, have been participating in the private equity fund's investment activities, or substantially similar functions or duties for another fund, for at least 12 months) are ignored for the purposes of the 100-person limit for purposes of section 3(c)(1) and the qualified purchaser requirement for purposes of section 3(c)(7). Similarly, for funds organised outside the United States, the SEC staff has taken the position that non-US investors are generally ignored for purposes of the 100-person limit of section 3(c)(1) and the qualified purchaser requirement of section 3(c)(7).

For real estate funds, section 3(c)(5)(C) of the Investment Company Act provides another exclusion from the definition of 'investment company' for any issuer who is primarily engaged in purchasing and acquiring mortgages or other liens on and interests in real estate.

If the sponsor of a private equity fund is a registered investment adviser under the Investment Advisers Act of 1940, as amended (the Advisers Act), then in circumstances where the sponsor charges a fee that is based in part on the capital appreciation of the underlying investments, each investor may need to represent that it is a 'qualified client' as defined in Rule 205-3 under the Advisers Act. A qualified client generally includes a natural person or company with a net worth exceeding US$2.2 million or that has US$1.1 million under management with the investment adviser, although the SEC is required every five years to adjust these dollar amounts for inflation, excluding the value attributable to such person's primary residence (as mentioned earlier). A qualified client also includes both qualified purchasers as defined in the Investment Company Act and nearly all persons that fall under the 'knowledgeable employee' definition above (with the exception of an advisory board member, who is not included in the definition of 'qualified client').

Law stated - 8 February 2024

Types of investor

25 Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

US persons and entities, including US private equity funds, are subject to sanctions laws and regulations that are principally administered by the Office of Foreign Assets Control (OFAC) of the US Department of the Treasury. These sanctions laws and regulations prohibit, among other things, certain types of transactions and dealings with designated countries, territories, entities and individuals such as those listed on OFAC's Specially Designated Nationals and Blocked Persons List. These sanctions programmes may prohibit the fund from admitting investors who are the subject of sanctions, or are located in a country or territory that is embargoed. Depending upon the fund's geographic scope, it may also be subject to similar sanctions programmes implemented in other jurisdictions. Relatedly, private equity funds ordinarily implement anti-money laundering procedures to diligence potential investors and their source of funds to ensure compliance with these and other laws and regulations.

Otherwise, as a general matter, there are no such restrictions other than those imposed by applicable securities laws described earlier or that may arise under the laws of other jurisdictions. Sponsors of private equity funds may choose to limit participation by certain types of investors in light of applicable legal, tax and regulatory considerations and the investment strategy of the fund. Restrictions may be imposed on the participation of non-US investors in a private equity fund in investments by the private equity fund in certain regulated industries (eg, airlines, shipping, telecommunications and defence). Further, funds may elect to limit or forgo investments from persons or countries that could introduce additional regulatory risks relating to oversight from governmental authorities such as the Committee on Foreign Investment in the United States and the Defense Counterintelligence and Security Agency, among others. There are also recently enacted restrictions on bank holding companies investing in private equity funds.

Law stated - 8 February 2024

Identity of investors

26 Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

There is generally no requirement to notify the state of Delaware or the SEC as a result of a change in the identity of investors in a private equity fund formed in Delaware (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership of the fund. However, in the case of a manager who is an investment adviser registered under the Advisers Act or an exempt reporting adviser, changes in identity of certain individuals employed by or associated with the investment adviser must be reflected in an amendment to Part 1 of the investment adviser's Form ADV promptly filed with the SEC, and in certain circumstances, a change of management or control of the fund or of the manager or investment adviser may require the consent of the investors in the private equity fund. In the event of a change of the general partner of a Delaware limited partnership, an amendment to the fund's certificate of limited partnership would be required to be filed in Delaware and such change would need to be accomplished in accordance with such limited partnership's partnership agreement. Additionally, a private equity fund that makes an investment in a regulated industry, such as banking, insurance, airlines, telecommunications, shipping, defence, energy and gaming, may be required to disclose the identity and ownership percentage of fund investors to the applicable regulatory authorities in connection with an investment in any such company.

Law stated - 8 February 2024

Licences and registrations

27 Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Generally, the sponsor of a private equity fund in the United States would not be required to register as a broker or dealer under the Securities Exchange Act of 1934, as amended (the Exchange Act) as they are not normally considered to be 'engaged in the business' of brokering or dealing in securities. The rules promulgated under the Exchange Act provide a safe harbour from requiring employees and issuers to register as a broker or dealer subject to certain conditions, including such employees not being compensated by payment of commissions or other remunerations based either directly or indirectly on the offering of securities. If compensation is directly or indirectly paid to employees of the sponsor in connection with the offering of securities, the sponsor may be required to register as a broker-dealer. If a private equity fund retains a third party to market its securities, that third party generally would be required to be registered as a broker-dealer.

Money laundering

28 Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

Although private equity funds generally have historically not been subject to the anti-money laundering regulations of the Patriot Act, on 25 August 2015, the Financial Crimes Enforcement Network (FinCEN), a bureau of the US Department of the Treasury, proposed regulations that would impose anti-money laundering obligations on investment advisers registered with the SEC under the Advisers Act (Covered Advisers). Covered Advisers would be included in the definition of 'financial institution' in regulations implementing the Patriot Act and, consequently, would be required, among other things, to establish and implement risk-based anti-money laundering programmes and file suspicious activity reports with FinCEN. The proposed rules do not, however, include a customer identification programme requirement, as required for other financial institutions. FinCEN proposes delegating authority to the SEC to examine compliance with the proposed rules.

Although these proposed rules are not currently effective, as a best practice many private equity funds have already put into place anti-money laundering programmes to address these issues. These practices include the following:

- developing internal policies, procedures and controls, including with respect to the establishment of the identity of each investor, any beneficial owners, and their source of funds, and to ensure compliance with economic sanctions and other applicable laws and regulations;
- designating an anti-money laundering compliance officer;
- implementing an employee training programme; and
- having an independent audit function to test the programme.

If an investment adviser to a private equity fund is registered under the Advisers Act, the investment adviser must disclose on Form ADV the educational, business and disciplinary background of certain individuals employed by or associated with the investment adviser. Similar disclosure may be required for investment advisers that are or have affiliates that are broker-dealers registered with the Financial Industry Regulatory Authority.

FinCEN's Beneficial Ownership Information (BOI) Rule, issued pursuant to the US Corporate Transparency Act (CTA), went into effect on 1 January 2024 and requires certain domestic and foreign entities to report information identifying beneficial owners and persons with 'substantial control' over the entity to FinCEN, which will maintain such information in a non-public registry.

Many fund managers and private funds are exempt from reporting beneficial ownership information to FinCEN under the BOI Rule, including:

- SEC-registered investment advisers;

- venture capital advisers filing with the SEC as an except reporting adviser;
- broker dealers in securities;
- large operating companies (companies with 20 or more full-time employees in the United States with filed US federal taxes demonstrating more than $5 million in gross receipts); and
- pooled investment vehicles (domestic funds affiliated with such advisers where that fund either (1) is an investment company as defined in section 3(a) of the Investment Company Act or (2) would be an investment company under that section but for the exclusion in paragraphs (c)(1) or (c)(7) of that section and are identified as such on the advisers' Form ADV).

However, the BOI Rule's applicability to certain entities in the private equity fund structure – such as parallel funds, intermediary and holding GPs (general partners), feeder vehicles, aggregator funds, and offshore funds – and funds' portfolio investments should be analysed on a case-by-case basis, as there may not be exemptions applicable to such entities.

Non-exempt reporting companies created or registered prior to 1 January 2024 will have one year to file their initial reports, those created or registered in 2024 have 90 days after receiving notice of their creation or registration, and those created on or after 1 January 2025 will have 30 days after receiving notice of their creation or registration.

Law stated - 8 February 2024

EXCHANGE LISTING

Listing

29 Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Because of certain adverse tax consequences arising from the status as a publicly traded partnership and the difficulty that such a listing would impose on being able to establish an exemption from registration under the Investment Company Act of 1940, as amended, private equity funds do not typically list on a securities exchange in the United States. The applicable listing requirements would be established by the relevant securities exchange.

Law stated - 8 February 2024

Restriction on transfers of interest

30 To what extent can a listed fund restrict transfers of its interests?

Private equity funds do not typically list on any US exchange. However, if listed, the ability of such a fund to restrict transfers of its interest would be dictated by the listing requirements of the relevant securities exchange as well as the other governing agreements of such fund.

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PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS

Legal and regulatory restrictions

31 Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

The primary restrictions concerning the types of investments that a private equity fund may make are typically contained in the private equity fund's limited partnership agreement. These restrictions often include limits on the amount of capital (typically expressed as a percentage of the fund's capital commitments) that may be deployed in any one investment, a restriction on participation in 'hostile' transactions, certain geographic diversification limits, a restriction on investments that generate certain types of tax consequences for investors (eg, unrelated business taxable income (UBTI) for US tax-exempt investors, or income effectively connected with the conduct of a US trade or business (ECI) for non-US investors), a restriction on certain types of investments (eg, venture capital investments, 'blind pool' investments, direct investments in real estate or oil and gas assets) and so on. Individual investors in a private equity fund may also have the right (either pursuant to the partnership agreement or a side letter relating thereto) to be excused from having their capital invested in certain types of investments (tobacco, military industry, etc) and to participate in certain types of investments in a certain manner (eg, to participate in UBTI or ECI investments through an alternative investment vehicle or an entity treated as a corporation for US federal tax purposes, or both).

There may also be limits on and filing requirements associated with certain types of portfolio investments made by a private equity fund. For example, investments in certain media companies may implicate the ownership limits and reporting obligations established by the US Federal Communications Commission. Other similarly regulated industries include shipping, defence, banking and insurance. Regulatory considerations applicable to mergers and acquisitions transactions generally (eg, antitrust, tender-offer rules, etc) also apply equally to private equity transactions completed by funds. Consideration should also be given to the potential applicability of the Sarbanes-Oxley Act and applicable US state laws relating to fraudulent conveyance issues.

In addition, in general, if 'benefit plan investors' within the meaning of the Employee Retirement Income Security Act of 1974 (ERISA) hold 25 per cent or more of the total value of any class of equity interests in the private equity fund, the private equity fund may, to avoid being subject to the fiduciary responsibility standard of care under the Employee Retirement Income Security Act of 1974 (ERISA) and prohibited transaction rules under Title I of ERISA and section 4975 of the Internal Revenue Code of 1986 (the Code), need to structure its investments in a manner to ensure that the private equity fund will qualify as a venture capital operating company (VCOC) or a real estate operating company (REOC) within the meaning of the ERISA plan asset regulations. Qualification as a VCOC generally entails having on its initial investment date and annually thereafter at least 50 per cent of the private equity fund's assets, valued at cost, invested in operating companies as to which the private equity fund obtains direct contractual 'management rights' and exercising such management rights with respect to one or more of such operating companies during the course of each year in the ordinary course of business. Qualification as a REOC generally entails the private equity fund having on its initial investment date and annually thereafter at least 50 per cent of its assets, valued at cost, invested in real estate that is managed or developed and with respect to which the private equity fund has the right to, and in the ordinary course of its business does, substantially participate directly in the management or development activities. The need to structure its investments in a manner that ensures the private equity fund will qualify as a VCOC or a REOC may restrict the private equity fund from making certain investments than might have otherwise been the case without the need for such qualification.

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Compensation and profit-sharing

32 Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

Depending on the state in which a private equity fund is formed and operates, there may be tax advantages to forming separate entities to receive the carried interest and management fee (and other fee) payments in respect of the fund and other unique structuring requirements. For example, funds whose manager has a place of business in New York City typically use this bifurcated structure. Additionally, the Code requires funds to have a three-year holding period (rather than the standard one-year holding period) for an investment or asset in order for carried interest distributions to be eligible for favourable long-term capital gain treatment. In addition, an individual carried interest participant will only be eligible for long-term capital gain treatment upon disposition of any interests in a carry vehicle (other than capital interests) if such participant has a three-year holding period for the interests. Further, Congress has previously proposed legislation that, if enacted, would result in typical carried interest distributions being taxed at a higher rate, and proposed regulations and related guidance may limit the tax benefits of management fee waiver arrangements. Moreover, tax rules may limit a sponsor's ability to use fee deferral arrangements to defer payment of tax on compensation and similar profits allocations.

The sponsor's ability to take transaction fees is likely to be the subject of negotiation with investors in the fund, who may seek to have a portion of such fees accrue for their account as opposed to that of the sponsor through an offset of such fees against the management fee otherwise to be borne by such investors. In certain circumstances, depending on the structure of a private equity fund, the manner in which a sponsor may charge a carried interest or management fee can be affected by the requirements of ERISA or the US Investment Advisers Act of 1940.

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UPDATE AND TRENDS

Key developments of the past year

33 What are the most significant recent trends and developments relating to private equity funds in your jurisdiction? What impact do you expect such trends and developments will have on global private equity fundraising and on private equity funds generally?

While global private equity fundraising continued to decline in 2023 from an all-time high in 2021, funds across buyouts, venture capital, growth equity, secondaries and other strategies gathered US$785 billion (all statistics in this section are derived from preliminary data provided by Private Equity International). This figure represents the third-largest amount raised in any single year, after US$868 billion in 2021 and US$823 billion in 2022. Moreover, the number of funds closed in 2023 declined relative to 2022 to its lowest number since 2019; 1,757 funds held a final close by the end of December 2023, compared to 2,217 funds in 2022. The amount raised in 2023 is impressive, considering the macroeconomic factors, including inflationary pressures, hawkish fiscal policy and geopolitical uncertainty, affecting the global economy.

Consistent with 2021 and 2022, capital was largely concentrated in mega-funds (ie, funds raising approximately US$5 billion or more) of recognised, top-performing sponsors. This concentration demonstrates the continued consolidation in the private equity industry in favour of larger, established sponsors with proven track records as a result of institutional limited partners seeking to make larger commitments to fewer funds, consolidate manager relationships and invest with sponsors with whom they had prior relationships. Specifically, the 10 largest funds that reached a final close in 2023 together raised close to US$192 billion, which represents approximately 24 per cent of total capital raised during 2023. This indicates a slight increase in consolidation from 2022, where the 10 largest funds that reached a final close in 2022 raised approximately 23 per cent of total 2022 capital raised. Additionally, the average fund size for 2023 was the largest on record, at US$608 million. This represents an increase of US$52 million over 2022.

Regarding the distribution of capital across different types of private equity funds, buyout funds accounted for one-quarter by number of the 853 funds that closed from January to September of 2023, and 53 per cent of the capital raised during such period (a slight increase from 48 per cent in 2022). Growth equity funds accounted for the second largest sector by the amount of capital raised during such period. This strategy raised US$99 billion through the third quarter of 2023, compared to US$130 billion in the same period of 2022. Venture capital funds constituted 51 per cent of the total 2023 fund count, and 14 per cent of the amount of capital raised through the third quarter of 2023 (consistent with 2022). Secondaries fundraising increased this year through the third quarter of 2023. US$69 billion was closed in secondaries funds over this period, compared to US$24 billion in the same period of 2022, and secondaries funds represented 12 per cent of total capital raised, compared to less than 5 per cent in the same period of 2022.

Geographically, fundraising in 2023 remained strong for North America-focused funds. The amount of capital raised from January to September by North America-focused funds slightly increased from US$218 billion in 2022 to US$227 billion in 2023. Similarly, the percentage of total capital raised in the first three quarters of 2023 by Europe-focused funds increased to 14 per cent, compared to 8 per cent in the same period of 2022. Comparatively, for the same periods, the capital raised by funds focused on multiple regions increased slightly from 37 per cent to 40 per cent.

It is expected that overall fundraising levels will keep pace in the near term, despite macroeconomic headwinds that are expected to impact market activity. A record 5,952 funds in the global market are targeting US$1.16 trillion. Further, the top 10 funds in the global market are looking to raise almost US$182 billion, and at least 17 funds are targeting US$10 billion.

A crowded private equity fundraising environment and market headwinds impacting exits have resulted in extended fundraising cycles. Many investors are also placing a premium on managers with established track records that have navigated a number of past economic cycles. As larger institutional investors will continue to consolidate their relationships with experienced fund managers, and competition for limited partner capital among private equity funds will continue to increase, with alternative fundraising strategies (eg, customised separate accounts, co-investment structures, continuation funds, early-closer incentives, umbrella funds, anchor investments, core funds, growth equity funds, impact funds, GP minority stakes investing, secondaries funds and complementary funds (ie, funds with strategies aimed at particular geographic regions or specific asset types)) playing a substantial role. As a result, established sponsors with proven track records should continue to enjoy a competitive advantage, and first-time funds will need to accommodate investors by either lowering fees, expanding co-investment opportunities, focusing on unique investment opportunities or exploring other alternative strategies. Moreover, it is anticipated that private equity fundraising will continue to focus on established, dominant markets in North America and Europe. Finally, it is also expected that the US Securities and Exchange Commission will continue to focus on transparency (eg, full and fair pre-commitment disclosure and informed consent from investors), including with respect to conflicts of interest (including, among others, conflicts of interest arising out of the allocation of costs and expenses to funds and portfolio companies, the allocation of investment opportunities and co-investment opportunities and the receipt of other fees and compensation from funds, portfolio companies or service providers). Given this, larger private equity firms with the resources in place to absorb incremental compliance-related efforts and costs are likely to continue to enjoy a competitive advantage among their peers.

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Simpson Thacher

Peter H Gilman pgilman@stblaw.com
Jessica A O'Connell jessica.o'connell@stblaw.com
Russell Reed russell.reed@stblaw.com
Henry Litwhiler henry.litwhiler@stblaw.com

Simpson Thacher & Bartlett LLP