The Central Bank of Ireland

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The authors review the regulatory regime in place in Ireland for both real estate and private equity funds and demonstrate how Irish securitization vehicles are being used to gain access to Ireland's double taxation treaty network.

While Ireland is widely recognized as a centre for UCITS funds and it led the way in the development of regulated hedge fund structures, its offering in relation to real estate and private equity funds is less well known. Real estate and private equity funds have generally been established in off-shore jurisdictions such as the Channel Islands or using structures such as the English limited partnership. More recently, Luxembourg has used its double taxation treaty network to facilitate the establishment of efficient real estate and private equity fund structures investing through multiple conduit structures in Europe, Asia and beyond. The development of similar products in Ireland was hampered by the perception that Irish funds did not possess these inherent tax advantages.

Qualifying Investor Funds

Real estate and private equity funds cannot be established as UCITS and while there are other structures in place, it is the Qualifying Investor Fund ("QIF") that is the structure of choice for such private funds. The QIF is aimed at institutional and sophisticated private investors who must meet minimum subscription requirements. As a tax exempt vehicle, the QIF is exempt from Irish tax on its income and gains and is also exempt from withholding tax on its income distributions to non-Irish resident investors, provided a non-resident declaration is in place. A qualifying investor is defined as a natural person with minimum net worth (excluding main household and residence goods) in excess of €1,250,000 or an institution owning or investing, on a discretionary basis, a minimum of €25,000,000. There is an initial minimum subscription requirement in the QIF of €250,000 (or its equivalent in other currencies) per investor and no limit on subsequent subscriptions.

Regulatory Framework and Legal Structures

QIFs are established in Ireland under the non-UCITS regulatory regime and are governed by the Financial Regulator's Guidance Note 1/07 and the Non UCITS Notice NU 24. While the regulatory framework in relation to appointment of service providers and governance applies to QIFs, they are not subject to any investment or borrowing restrictions, and QIFs established as investment companies or investment limited partnerships are exempted from the requirement to produce

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half-yearly reports. QIFs are most commonly established as investment companies or unit trusts, but they may also be established as investment limited partnerships or common contractual funds. As onshore EU domiciled funds, QIFs will meet the requirements of, and be passportable under, the Alternative Investment Fund Managers Directive.

Investment Restrictions

While there are no investment or borrowing restrictions for QIFs, there are a number of factors that must be taken into consideration when structuring a QIF.

- A QIF that invests more than 50 percent of its assets in any one collective investment scheme ("CIS") will be considered to be a feeder fund, necessitating disclosure in relation to the underlying fund.
- While the Financial Regulator does not generally impose risk diversification requirements, QIFs established as investment companies are required to comply with the principle of risk spreading and it is a matter for the board to ensure that this occurs. This risk spreading requirement does not apply to non-corporate structures such as unit trusts, investment limited partnerships and common contractual funds.
- While QIFs cannot raise capital from the public through the issue of debt securities, the Financial Regulator does not object to the issue of notes by authorized CIS, on a private placement basis, to a lending institution in order to facilitate financing arrangements, provided such arrangements are clearly and fully disclosed in the QIF's prospectus.
- An initial offer period of up to a year is permissible, provided that investors are not prejudiced by this.
- The investment objectives and investment and borrowing policies must be comprehensive and accurate, readily comprehensible to investors and be sufficient to enable investors to make an informed judgment of the investment proposed to them.

24 Hour Authorization Process

The most significant feature of the QIF product is that, provided that all of the parties to the QIF (most importantly, the directors and the investment manager) have been approved, then a letter of authorization will issue on the day following the submission of a complete application to the Financial Regulator.

The application will contain a form of certificate from the QIF that all regulatory requirements have been complied with and the QIF will look to its chosen law firm to ensure that this certificate can be given.

However, the Financial Regulator expects applicants to discuss proposals that have novel or unusual features in advance of submitting a formal application and, again, the chosen law firm will have a key role in advising what constitutes "novel or unusual" features.

Use of Subsidiaries and SPVs

QIFs are permitted to establish multi-layered special purpose vehicles ("SPVs"), provided they are wholly owned by the QIF or by its wholly owned subsidiary(ies) and

subject to certain criteria relating to the registration of their shares. The QIF custodian must be appointed to each SPV and be in a position to demonstrate that it has controls in relation to each layer of the SPV structure. The assets of the SPV must be valued as if they were assets of the QIF.

The intention to establish SPVs must be clearly disclosed in the prospectus, and the periodic reports of the QIF must disclose the names and place of establishment of all SPVs. While, as a general rule, the Financial Regulator will require the majority of directors appointed to the board of the SPV to be directors of the QIF, derogations or exemptions may be granted, provided that at least one director is common to the SPV and the QIF.

Closed-Ended and Limited Liquidity Schemes

Real estate and private equity funds would typically be closed-ended — meaning that they will be subject to the provisions of the EU Prospectus Directive and be required to comply with the regulatory requirements for the publication of a prospectus in the markets where the funds are marketed and listed. One of the advantages of complying with the Prospectus Directive is that a QIF that obtains approval for its prospectus in Ireland may avail of the passporting provisions of the Prospectus Directive to market in other EU jurisdictions. Some QIFs may decide to opt-in to the provisions of the Prospectus Directive to avail of these opportunities. However, as QIFs by virtue of their minimum investment amount come within the exemption for compliance with the Prospectus Directive, most opt not to produce a Prospectus Directive-compliant prospectus. However, in so doing, promoters should ensure that the offering document is not styled as a prospectus and is called an offering memorandum instead.

Prior to the implementation of the Prospectus Directive, QIFs that offered redemption facilities less frequently than quarterly were considered to be closed-ended and, therefore, subject to the provisions of the Prospectus Directive. To address this, the Financial Regulator introduced the concept of investment funds with limited liquidity — meaning those that offer liquidity less frequently than quarterly. For these QIFs, the limited nature of the redemption facilities must be clearly set out in the prospectus and QIFs that offer liquidity at least annually may style themselves as "open-ended with limited liquidity."

Real Estate Funds

The key regulatory requirements for real estate funds established as QIFs are set out in a letter from the Financial Regulator to the industry on 13 October 2006 and the Financial Regulator's Guidance Note 1/07 on the authorization of QIFs.

These requirements are set out below.

- Because real estate is not generally a regulated asset class, the Financial Regulator will consider the appointment of unregulated promoters and investment managers where appropriate expertise can be demonstrated, and subject to a review of the applicant's fitness and probity.
- There must be full disclosure in the prospectus in relation to the use of partly paid shares and commitments.
- An independent valuer must be appointed, the basis of the appointment must be set out in the prospectus, and

details of valuers appointed must be set out in the periodic reports.

- Properties must be valued twice yearly at "market value". At least one valuation shall be based on a full physical valuation, but the second valuation may be a desk-top valuation.
- Valuation must take place in accordance with recognized professional standards, such as those established by the Royal Institute of Chartered Surveyors.
- Subsidiaries and SPVs may be used as described above.
- Real estate-related assets can include other collective investment schemes, real estate derivatives and investment through unit-linked schemes.
- While properties may be registered in the name of the QIF and not the custodian, detailed procedures must be put in place to ensure that properties cannot be disposed of without the prior consent of the custodian.
- Warehousing of assets is permitted, provided that details of the arrangement (including fees) are disclosed in the prospectus and assets are acquired at the lower of market value or cost price.

Private Equity Funds

The private equity fund regime has developed in tandem with the real estate regime, as similar issues with respect to liquidity, partly paid units, commitments and drawdowns arise.

Minimizing Tax Leakage

As discussed above, QIFs are tax-exempt vehicles. While the advantages of tax-exempt status are obvious, there is a concern that, in certain jurisdictions, the benefits of Ireland's extensive double taxation treaty network will not apply to persons who are not subject to tax in Ireland. This may result in withholding tax leakage in certain jurisdictions. The way to avoid this leakage is to structure the QIF's investment through entities that are subject to tax on their profits in Ireland and, thereby, obtain treaty access.

Using Section 110 Companies

Section 110 of the Taxes Consolidation Act 1997 of Ireland refers to Irish resident companies established in accordance with the Companies Acts 1963–2009 that hold or manage a wide range of financial assets, including shares, loans, futures, options and swaps ("Section 110 Companies"). Section 110 Companies are not subject to a minimum capital requirement or to specific local management requirements. There is no withholding tax on interest payments made or dividends paid by Section 110 Companies to persons resident in the EU or in any tax treaty country.

In accordance with the SPV requirements set out above, the Section 110 Company would be established as a wholly owned subsidiary of the QIF. The Section 110 Company would also issue a profit participating note to the QIF, which would strip out the profits of the Section 110 Company. The residual profits of the Section 110 Company would be taxed at 25 percent and, as a taxable entity, the Section 110 Company that would be the investing vehicle for the QIF would have access to Ireland's double taxation treaties. The Section 110 Company would

then make its interest and dividend payments to the QIF on a gross basis.

This structure has been utilized successfully by private funds across not only real estate and private equity funds but also by loan funds and life settlement funds. Specialist tax and legal advice will be required regarding the application of this structure in particular jurisdictions, based on the relevant double taxation treaties and on the structure's application to particular asset classes.

Conclusion

Ireland's emergence as a real estate and private equity fund domicile is timely, given the likely application of the Alternative Investment Managers Directive and the renewed interest in these asset classes as the global economy edges toward recovery while still affording opportunities with respect to distressed assets. Many of the principal fund administrators and custodians have put in place separate teams to service these products. In addition to ease of establishment, as one of Europe's most open economies and as a common law jurisdiction, the Irish legal, tax, banking and real estate regimes are well used to dealing with the cross border aspects of real estate and private equity fund transactions.