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Trends in Private Equity and Credit Funds

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Italy

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The Netherlands

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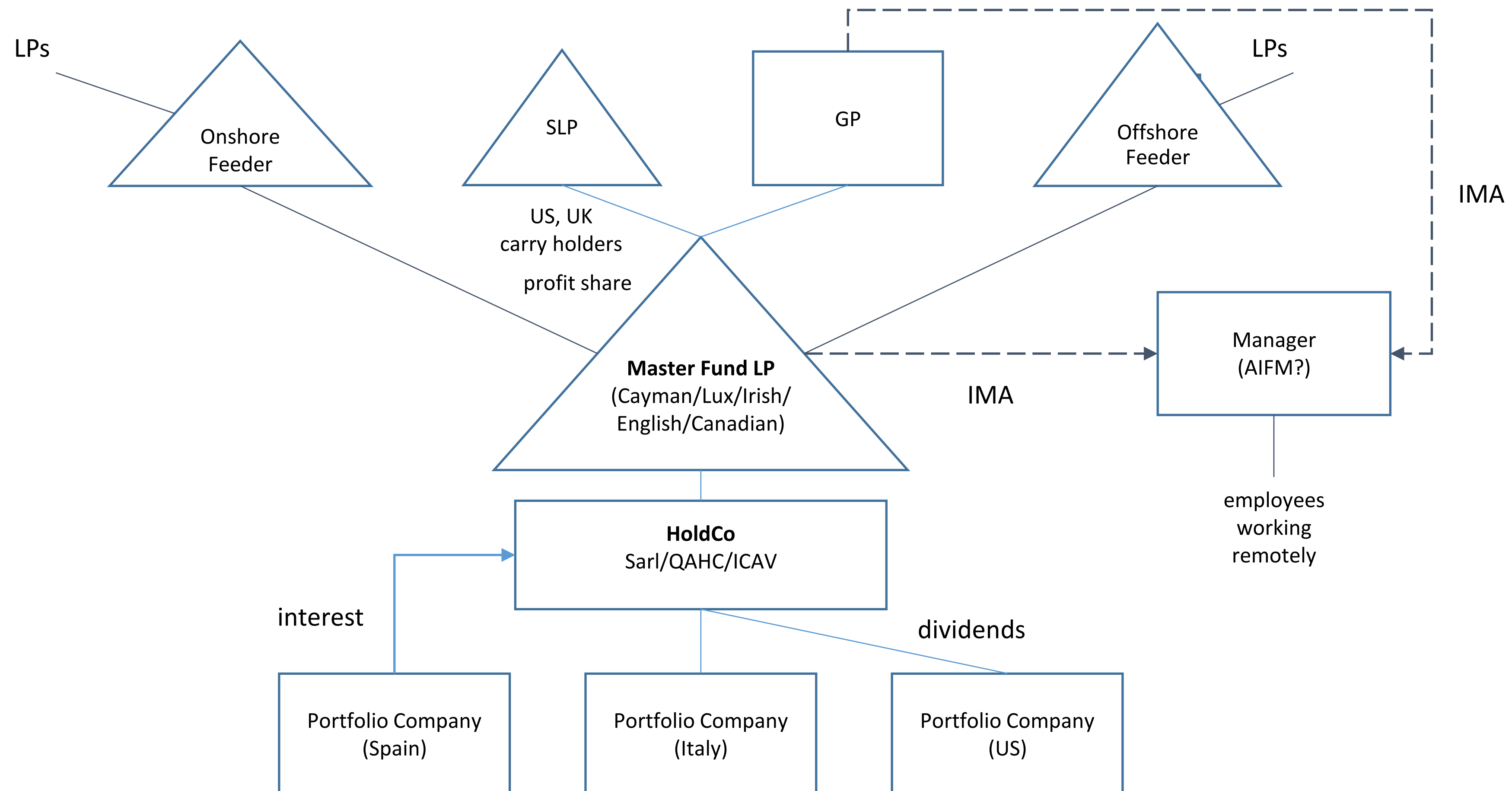
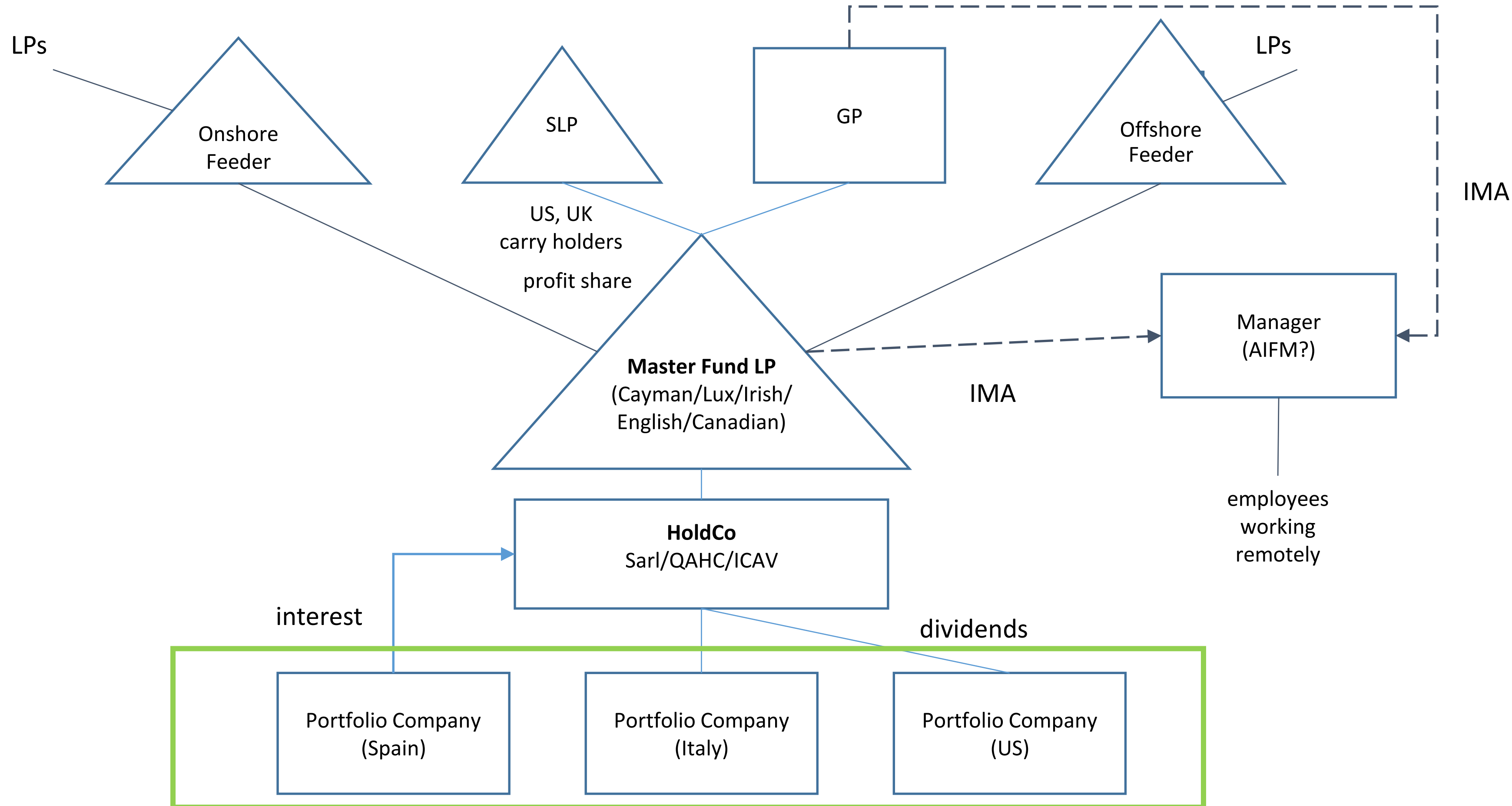
Typical (Simplified) Example of a Private Equity and Credit Fund Structure



Trends at
Portfolio Companies Level

Trends at Portfolio Companies Level



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Trends at Portfolio Companies Level

United States of America

Base-Broadening Trends Impacting US Portfolio Companies

- The US corporate tax rate was significantly lowered to 21 % as part of the 2018 Tax Cuts and Jobs Act (the "TCJA"), which in a departure from the US's historic worldwide tax regime also effectively exempts from corporate tax earnings from active businesses of non-US corporate subsidiaries.
- The TCJA tightened (i) the US "controlled foreign corporation" rules with a base broadening tax on "global intangible low taxed income" ("GILTI") and (ii) the US corporate tax rules more generally with new "anti-hybrid" rules and a minimum tax on certain base-eroding related-party payments (the "BEAT").
- The TCJA also introduced new thin capitalization rules, which generally limit interest deductions to 30% of EBIT effective for tax years starting in 2022 (formerly 30% of EBITDA). This recent change may cause an effective tax rate increase for companies with significant depreciation and amortization deductions.

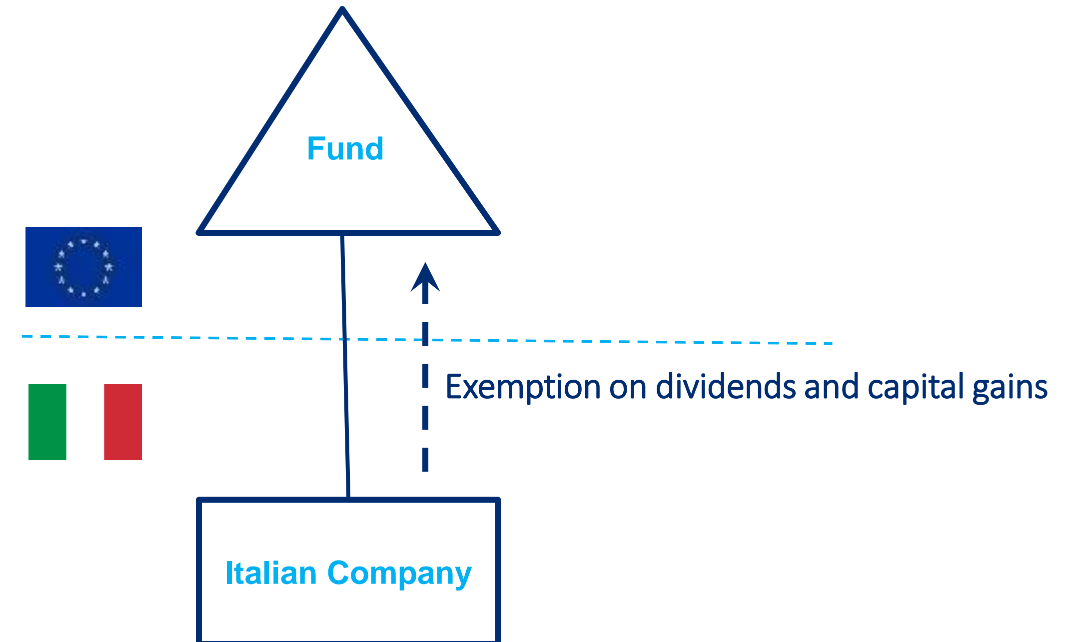
Base-Broadening Trends Impacting US Portfolio Companies

- The 2022 Inflation Reduction Act includes a 15 percent corporate alternative minimum tax on large corporations' (other than S Corporations, RICs or REITS) book income (with certain adjustments), effective 2023.
- Generally, a large corporation is one whose average annual adjusted book income ("AFSI") for 3 consecutive years exceeds $ 1 billion. A corporation that is a member of a foreign parented multinational group must have at least $ 100 million from US operations. Corporations in scope with significant amounts of foreign income may be impacted by this new base broadening provision.
- Importantly, aggregation rules can operate to include the income of affiliates in AFSI. In particular, there is some concern that investing, owning and disposing of corporate subsidiaries (i.e. typical PE Fund activity) could be treated as a "trade or business" for this purpose—in which case portfolio company AFSI is maybe subject to aggregation.

Trends at Portfolio Companies Level **Italy**

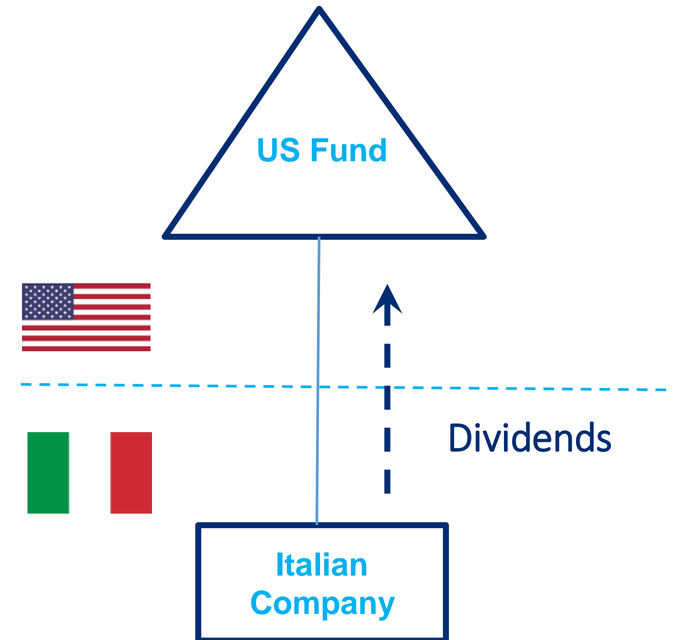
Italy – exemption for EU/EEA regulated funds

- Effective from 1 January 2021
- Dividends from Italian companies and capital gains from the sale of shares in Italian companies are exempt from Italian taxation
- Eligible funds:
  - Non-Italian undertakings for collective investment compliant with the UCITS Directive established in EU or EEA member states that allow an effective exchange of information
  - Non-Italian undertakings for collective investment established in EU or EEA member states, managed by a regulated fund manager under the AIFM Directive
- Investment through an intermediate vehicle



Italy – Non-EU funds

- Possible discrimination
  - Under current rules, Italian funds are not subject to any taxation on dividends
  - Non EU-funds are not eligible for the exemption on dividends and capital gains
- Italian Supreme Court (decision No. 21454 of 6 July 2022):
  - US fund received dividends subject to 15% Italian WHT under the US/Italy tax treaty
  - US fund claimed the refund of the difference between the WHT applied and the tax treatment applicable *ratione temporis* to resident funds
  - Violation of the EU principle of the free movement of capital: non-EU funds should be subject to the same tax treatment applicable to Italian funds



Trends at Portfolio Companies Level

Spain

Parent Subsidiary Directive and Spanish anti-abuse regulation.

GAAR Parent Subsidiary Directive (Council Directive (EU) 2015/121 of 27 January 2015)

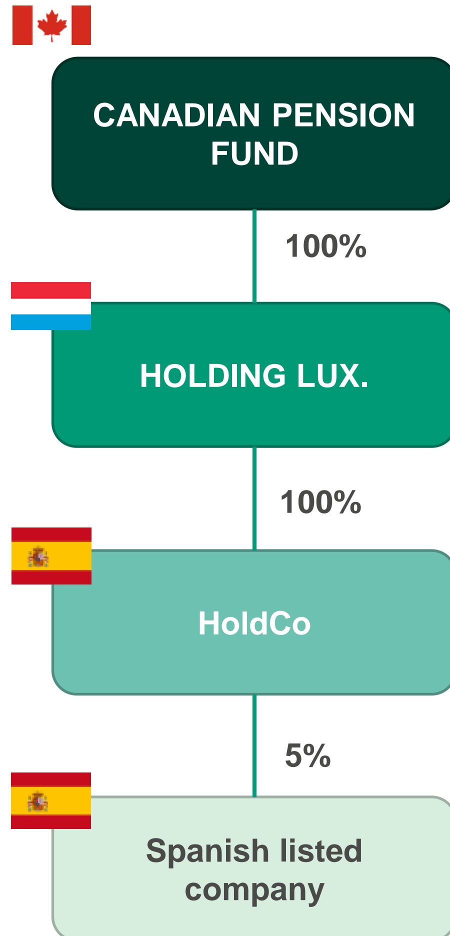
In Directive 2011/96/EU, Article 1(2) is replaced by the following paragraphs:

> *"2. Member States* ***shall not grant the benefits*** *of this Directive* ***to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage*** *that defeats the object or purpose of this Directive,* ***are not genuine*** *having regard to all relevant facts and circumstances.*
>
> *An arrangement may comprise more than one step or part.*
>
> *3. For the purposes of paragraph 2,* ***an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality****.*
>
> *4. This Directive* ***shall not preclude the application of domestic*** *or agreement-based* ***provisions*** *required for the prevention of tax evasion, tax fraud or abuse."*

PSD GAAR. Spain : Art. 14.1.h) NRIT Law

- **Exempt dividends paid to EU/EEA residents**.
  - Requirements: basically, at least 5% interest during a minimum holding period of 1 year.
- **Anti-abuse clause** (where **majority of voting rights ultimately controlled by non-EU shareholder**) applicable to **dividends and royalties** under the scope of their respective P/S Directives:
  - Not applicable "where the formation and operations of the recipient of the dividend or royalty are based on **valid economic grounds and business reasons with substance**".
- Is our anti-abuse rule compliant with EU P/S Directive (after ECJ 7 September 2017 C-6/16 Equiom) and ECJ 20 december 2017 C-504/16 and C-613/16 Deister Holding and Juhler Holding).

Canada – Global Noray – CLH (N.A. Court May 21, 2021)



- The criteria adopted are those reflected in the Judgment of the CJEU in the Equiom case (September 7, 2017) and in the Deister Holding and Juhler Holding cases (December 20, 2017):
  - The Parent-Subsidiary Directive is opposed to national rules which make the conferring of the tax advantage conditional on the company being controlled by EU or EEA residents (general presumption of fraud or abuse). **Restriction of freedom of establishment**.
  - The **anti-abuse clause should be interpreted restrictively**.
  - **Burden of proof**: the tax administration is required to have, at least, prima facie evidence of a lack of economic reasons or indicators of fraud or abuse.
  - In this particular case, the administration failed to demonstrate the **absence of valid economic reasons**.
- Same position adopted further in Qatar - Iberdrola (N.A. Court May 31, 2021) whilst contemporary judgment Acciona (N.A. June 18, 2021 and July 22, 2021) applies art. 14.1.h) NRIT Law. Global Noray case appeal to the Supreme Court already has been admitted (June 15, 2022) and is now pending.

Beneficial ownership

Beneficial ownership concept: Spain

- Not a concept in our law.
- Some court-cases have dealt with BO mainly in connection with license rights and Hungary (image rights - National High Court 26 March 2007 -, National High Court 18 July 2006 and Criminal Court of Barcelona 2 April 2007).
- In the past, tax authorities have tried to challenge back-to-back lending structures by using the BO concept. Spanish National Appellate Court, in its judgement dated October 31, 2017 (Colomer) and TEAC October 4, 2018 rejected this approach.

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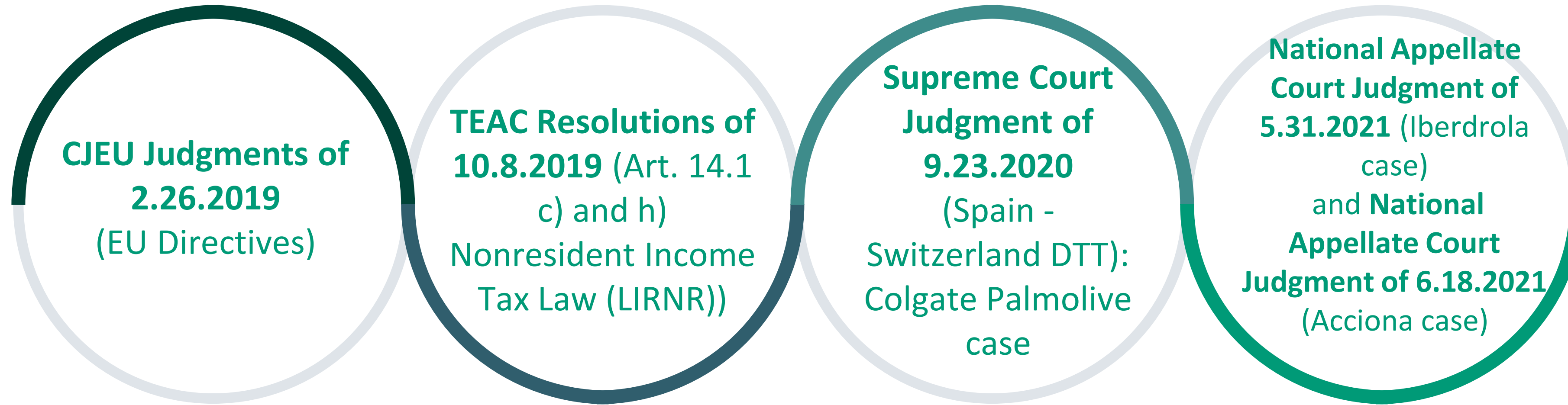
Beneficial ownership concept: Spain



- Is the beneficial owner provision an **anti-abuse clause** or an **objective rule for access to exemptions**?
- What are the factors or indicators to be considered when determining whether the recipient of a payment is the beneficial owner? (Judgment of the CJEU of February 26, 2019).
- Who does the **burden of proof** rest with?
- Can the exemption be applied to the **beneficial owner** if it is not the **recipient** of the income?
- Application of DTT in the **absence** of an expressly stipulated **beneficial owner** clause?

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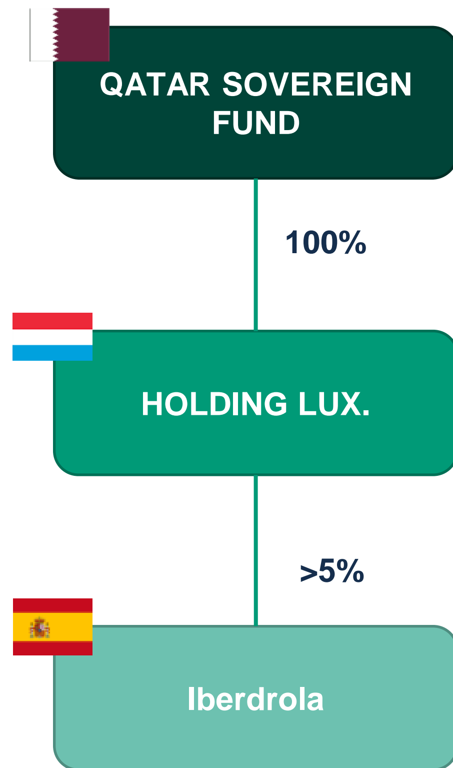
TEAC resolutions October 8, 2019 (re Danish cases)

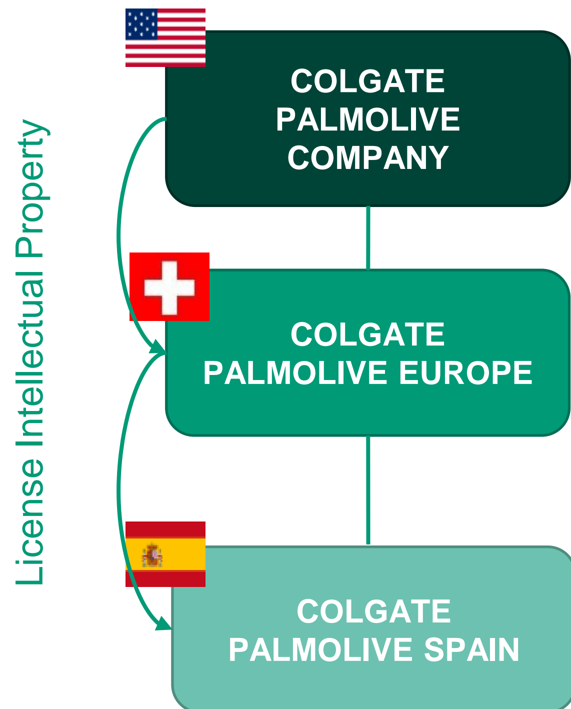
- Investment by a third country in a company listed in Spain via a holding company in Luxembourg.
- The TEAC **rejected the exemption on the grounds of a lack of "substance"** (the company had no employees in Luxembourg and half of the directors were provided by a service company) and because **the holding company transferred the dividends received to its shareholder and could therefore not be considered the beneficial owner of those dividends**.
- **Danish cases overrule Equiom CJEU case** and SNA October 31, 2017.
- **Beneficial ownership is a material requirement in order to apply the exemption in dispute. Absence in internal legislation is irrelevant.**
- As such, the TEAC decision illustrates the **importance of financial analysis** (cash flow, regardless of whether the payment from Luxembourg to the beneficial owner is in respect of dividends or the repayment of debt instruments).
- The TEAC also considered that since the parent company in Luxembourg was not the beneficial owner of the dividend distributed by its subsidiary, **the DTA was not applicable either**; Consequently, withholding tax had to be made at the general rate (19%).
- Similar judgment for interest paid to a company in the Netherlands

Qatar - Iberdrola (N.A. Court May 31, 2021)



- Anti-abuse clause art. 14.1 h) NRIT Law and NA Court judgment of May 21, 2021 (Global Noray – CLH case). Adoption of Equiom EU case law.
- **Triple test**
  - **Substance test**. Economic activity of holding company: **portfolio management** and necessary substance.
  - **Beneficial ownership test**.
    - Although this was not a key aspect of the judgment, the National Appellate Court accepted that the parent company was the beneficial owner of the dividends, since it was an **investment platform** which, in part, reinvested the profits obtained in other investments.
  - **Valid economic reasons:** State Tax Agency has not proven otherwise.

Colgate (Supreme Court app. 1996/2019, September 23)

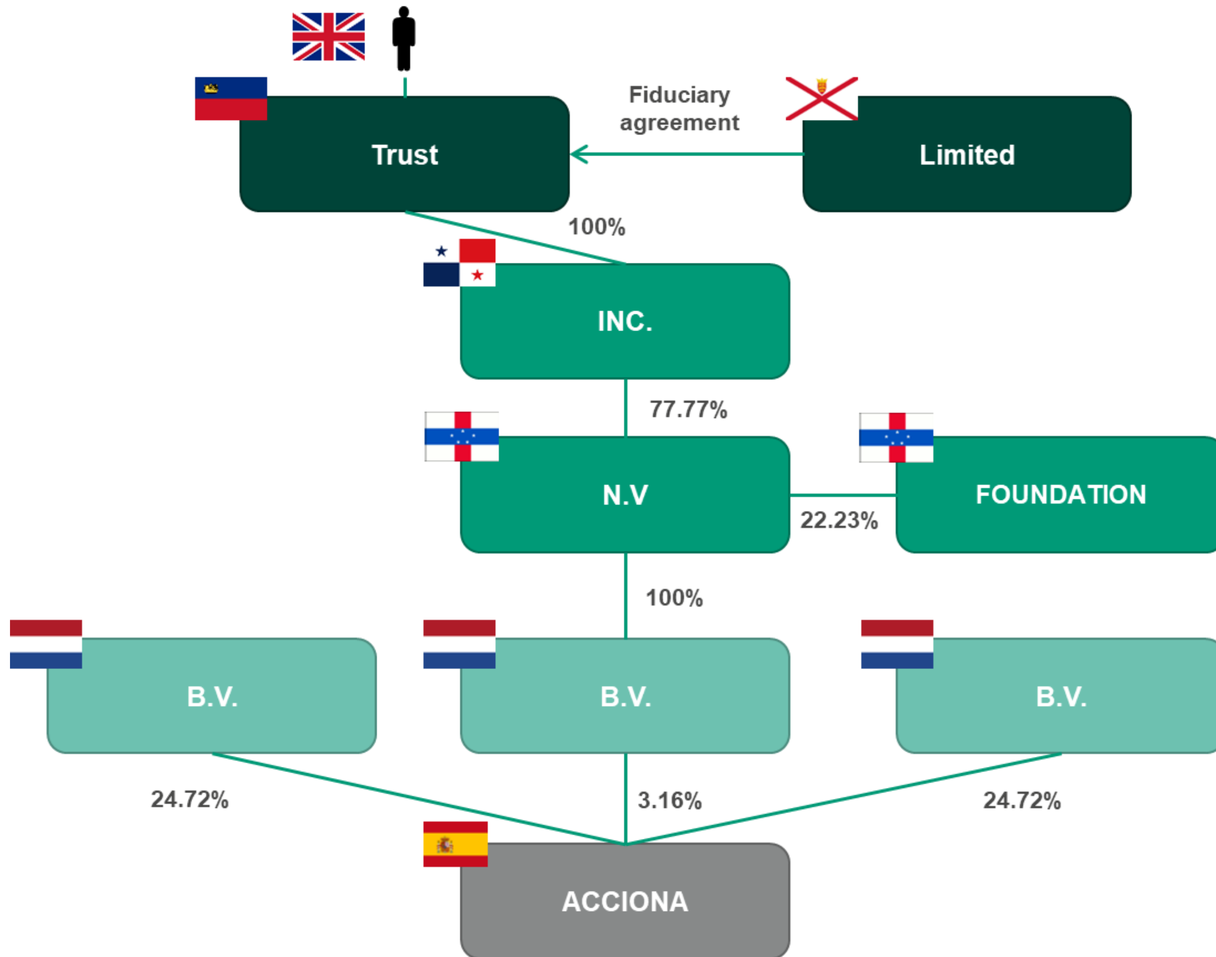


- The argument that BO status is implicit pursuant to article 12 (royalties) of the Spain-Switzerland double tax treaty is rejected.
- Article 12 of the Spain-Switzerland DTT does not require the recipient of the royalties to be the BO.
- Neither is the indirect application of the DTT with USA accepted.

CONCLUSIONS

- **Commentary on the OECD Model Convention** = interpretative guidelines; they **do NOT form part of the legal system**, are not a source of law, and cannot take the place of the rules in force.
- The **concept of beneficial ownership is not a clause deriving from natural law.**
- In **no circumstances this commentary should be applied retroactively**.
- The **DTT with USA should be applied if the DTT with Switzerland is not applied**.
- **Potential effects to art. 14.1 c) NRIT Law (exemption of interest paid to EU beneficiaries)?**

Acciona (N.A. June 18, 2021 and July 22, 2021)



- It applied the anti-abuse clause of article 14.1.h of the NRIT Law (Supreme Court Judgment of April 4, 2012 and National Appellate Court Judgment of November 8, 2012). It did not apply the criterion adopted in recent National Appellate Court Judgments.
- The application of the exemption was denied because The **existence of an economic activity and valid economic reasons had not been demonstrated**.
- The **reduced rate established in the Spain-Netherlands DDT was accepted since it does not include expressly a beneficial owner clause** in relation to dividends (the criterion adopted was that seen in the Supreme Court Judgment of September 23, 2020, in the Colgate case).
    - Limits on the dynamic interpretation of the DTT.
    - Is this the same situation as seen in the Colgate case? When the DTT with the Netherlands was approved (1971), there was no beneficial owner clause in the OECDMC.

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Annual Tax and Customs Control Plans for 2021 and 2022

- Annual **Tax** and Customs **Control Plans** for **2021 and 2022**

  “**The main areas on which procedures shall focus are**:

  *A) **Anti-avoidance measures** [...] EU case law has helped provide reinforcement in the application of anti-abuse measures, by declaring the prohibition of abusive tax practices to be a general principle of EU law, clarifying the cases which call for the use of the beneficial owner clause and general or specific anti-abuse measures in relation to the application of the **exemptions** for certain **payments of dividends, interest and royalties to non-residents”.***

  *c) **IRNR (Nonresident Income Tax) with and without a permanent establishment**: [...] one area pinpointed as a priority focus is the verification of correct reporting of the **Nonresident Income Tax** withholdings required to be made, in particular, by large companies making dividend, interest and royalty payments **to nonresidents without a permanent establishment** in Spain. Similarly, it will be verified **whether or not** the person receiving those amounts of income has **beneficial owner status** in order to check that there has been no abuse of the European legislation aimed at facilitating the free movement of capital within EU territory”**

- ** Text of the 2022 Plan*

Some practical lessons learned from recent jurisprudence

- Is the burden of proof transferred to the administration or is it shared?
- In any case, it indicates the approach the administration will be adopting in future inspections and starts to create a body of doctrinal material as regards structures based on substance.
- In the case of international structures, evidence with respect to the following will be key:
  - **Substance (which level of substance is enough?)**
  - **Existence of valid economic reasons.**
  - **Beneficial owner.**

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Tax treatment of interest paid and capital gains obtained by EU resident taxpayers. Proof of tax residence.

Interest paid to and capital obtained by EU resident tax payers (Art. 14.1. c) of NRIT Law)

- **Full exemption of interest paid and capital gains on movable property obtained by resident taxpayers in the EU or EEE** without a permanent establishment in Spain.
- Exception applicable to capital gains related to the transfer of shares in companies where the main assets are direct or indirectly real estate (potential EU discrimination as domestic participation exemption applies to similar cases in domestic context).
- Although the Spanish law does not contemplate the beneficial ownership as an anti-abuse rule, **has beneficial ownership to be inferred from this law?**
- **Practical considerations:**
  - Shadow banking (EU funds)
  - Private equity exits and tax treatment of capital gains.
  - EU AIFs vs foreign and the proof of residence.

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Proof of tax residence of EU AIFs

- Proof of residence for EU AIF (subject to AIFMD) for the purpose of art. 14.1 c) NRIT Law (exemption on interest paid to and capital gains on sale of shares obtained by residents in the EU)
  - The management company can certify whether the entity is fiscally transparent or non-transparent. In case of a **transparent entity**, the management company can also certify the percentage of EU resident interest-holders. In case of a **non-transparent entity**, the entity is resident for tax purposes in the EU.
  - Tax treatment of dividends will depend on the entity being resident or not within the meaning of a Tax Treaty with Spain.

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Trends at Portfolio Companies Level

The Netherlands

Target level - No capital gains tax upon exit

- In case of an exit whereby a non-Dutch Holdco sells a Dutch portfolio company, capital gains are only taxable if Holdco holds the shares in the Dutch portfolio company:
  - with the main purpose (or one of the main purposes) to avoid Dutch personal income tax of another person (subjective test); and
  - there is an arrangement or series of arrangements that is considered to be artificial (objective test).

- Effectively, this will only be the case if:
  - an individual (natural person) holds (indirectly) 5% or more of the shares or a class of shares in the Dutch portfolio company;
  - the individual cannot benefit from a tax treaty limiting taxation on dividends to 15% and allocating the right to tax capital gains to its country of residence; and
  - there are no valid commercial reasons for Holdco's position in the structure.

- Therefore, in practice, any capital gain on exit realized at Holdco level is normally not subject to tax in the Netherlands.

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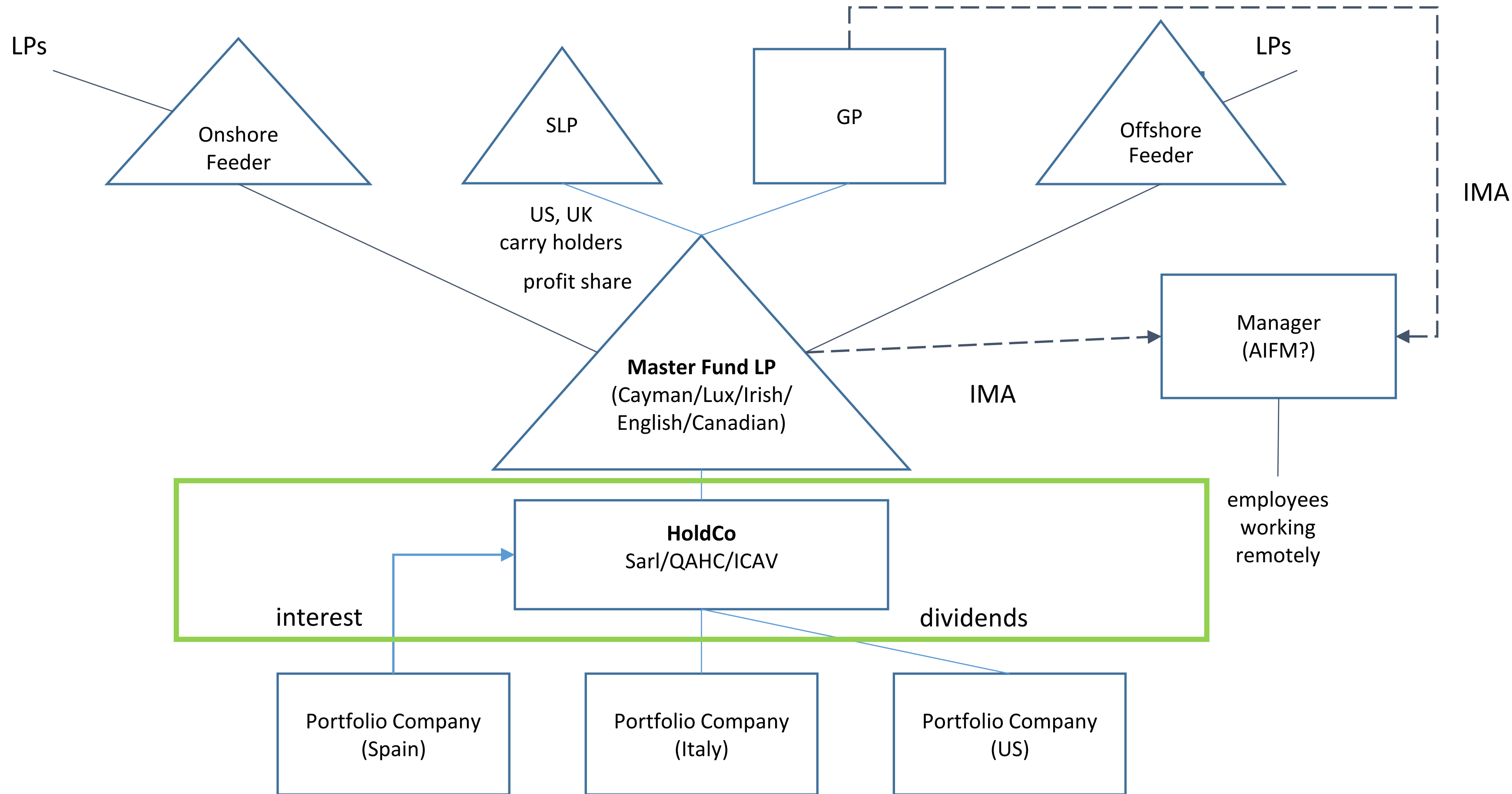
Trends at Holdco Level

Trends at Holdco Level



Trends at Holdco Level

Luxembourg

Luxembourg HoldCo's / Master HoldCo's still widely used

- Lux authorities keen to preserve tax neutrality of Lux funds and Holdco's (e.g. participation exemption, exit strategies, minimum tax)
- Substance: largely aligned since the introduction of AIFMD, regulatory and tax requirements. Expectation is that the detailed guidance in Unshell / ATAD3 Directive will set a standard however, wide carve-out expected for subsidiaries of AIFs
- Beneficial ownership (Danish cases): strong resilience
- Sustainability of offshore funds using Lux HoldCo's
- Interest limitation rule generally not an issue due to large domestic exemptions

Trends at Holdco Level

United Kingdom

Tax Treatment of the QAHC

Exemption for Gains	• simple corporation tax exemption on gains from 'qualifying shares' and overseas land
No Withholding Tax	• interest can be paid gross
Taxed on Income	• proportionate to its activities as a holding company
Amended Corporation Tax Rules	• results dependent interest, anti-hybrid, late paid interest
Ring Fencing	• special tax rules only apply to qualifying QAHC activity

Tax Treatment for Investors

Status Quo Preserved	• income is income, gains are gains
Share Buybacks	• capital treatment but corporate law unchanged
Transaction in Securities	• switched off
Remittance Basis	• amended for fund execs to track UK and overseas returns
Management Teams	• share buybacks are not capital, TIS rules apply • PPLs may be QCBs, no rollover or loss relief

QAHCs and Stamp Duty

Share/Loan Capital Buybacks	• no stamp (provided not effectively a sale of the QAHC)
Share/Loan Capital Transfers	• normal rules apply

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Eligibility criteria

- The UK QAHC regime is subject to eligibility criteria to ensure it can only be accessed by the investment fund industry. Broadly, the QAHC will need to be held by widely held qualifying funds or institutional investors and meet certain other conditions

Ownership Conditions

- Relevant interests held by persons who are not “good investors” (Category A investors) should not exceed 30%
- Category A investor includes a qualifying fund i.e. a collective investment scheme that meets the diversity requirements or a CIS or AIF that is not ‘close’ or controlled 70 per cent or more by category A investors

Activity Condition

- Main activity is carrying on an investment business

Investment Strategy

- Investment strategy does not involve acquisition of listed securities other than for purpose of taking public to private

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Trends at Holdco Level

The Netherlands

Holdco level – Shareholder loans scrutinized

- In principle, at arm's length interest payments on shareholder loans are deductible for Dutch CIT purposes.
- The two most important interest deductibility limitations included in Dutch law comprise of:
  - 20% EBITDA rule (earnings stripping rule based on ATAD I); and
  - anti-base erosion rule (article 10a Dutch CITA 1969).
- The anti-base erosion rule normally is a point of attention in a PE structure where:
  - the loan is granted by a related party (1/3 interest); and
  - the loan proceeds have been used for the acquisition of a participation.
- Interest remains deductible if the loan and the transaction are based on business reasons or the interest income is sufficiently taxed (at least 10% effective tax rate).
- Recent case law relating to shareholder loans, including in PE structures, provides further insight. A few interesting points are:
  - "Fraus legis" was demonstrated in a PE structure where -formally- all conditions for interest deductibility were met. Although the acquisition of the relevant target company was based on business reasons, the acquisition structure was considered abusive. The "collaborating group" concept was added to broaden the scope of the "related party" definition.

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Holdco level – Shareholder loans scrutinized

- If a related party loan is effectively financed by a third party, the loan should be considered "based on business reasons" (i.e. not abusive), even if there is a hybrid mismatch in the structure.
- The fact that income from participations is exempt whilst the interest on the loans used to finance such participations is deductible is not abusive in itself. This is different if the interest would be set off against acquired profits or profits that were otherwise artificially created.
- A loan can only be considered non-business like based on a "re-routing" of such loan if this "re-routing" takes place within the group.
- The Dutch Supreme Court requested a preliminary ruling from the CJEU to understand if the Netherlands may apply the anti-base erosion rule if the interest itself is at arm's length (e.g. Lexel).

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Holdco level – WHT attention points

- The Netherlands levies a dividend withholding tax of 15% on dividends to companies outside of the EU that do not have a tax treaty with the Netherlands.
  - In PE funds, this normally affects dividends to e.g. PE funds in Cayman and Bermuda.
  - Repayment of (nominal) capital is not subject to dividend withholding tax.
  - Payments to hybrid entities remains a point of attention (discussed at Fund level).
  - Anti-abuse rules may apply in case of artificial arrangements. Substance at Fund level is often no problem, but often remains an attention point in the intermediate Holdco jurisdiction(s).
- As of 2024, an additional conditional withholding tax on dividends will apply, effectively increasing the withholding tax rate to the highest applicable CIT rate (currently 25.8%) to related entities resident in listed (low taxing or non-cooperative) jurisdictions (e.g. Cayman and Bermuda).
- A withholding tax on interest applies where payments are made to a related party (50% interest) in a listed (low taxing or non-cooperative) jurisdiction. The tax rate is equal to the highest applicable CIT rate (currently 25.8%).
  - Similar attention points apply as in relation to dividends (see above).

Trends at Holdco Level

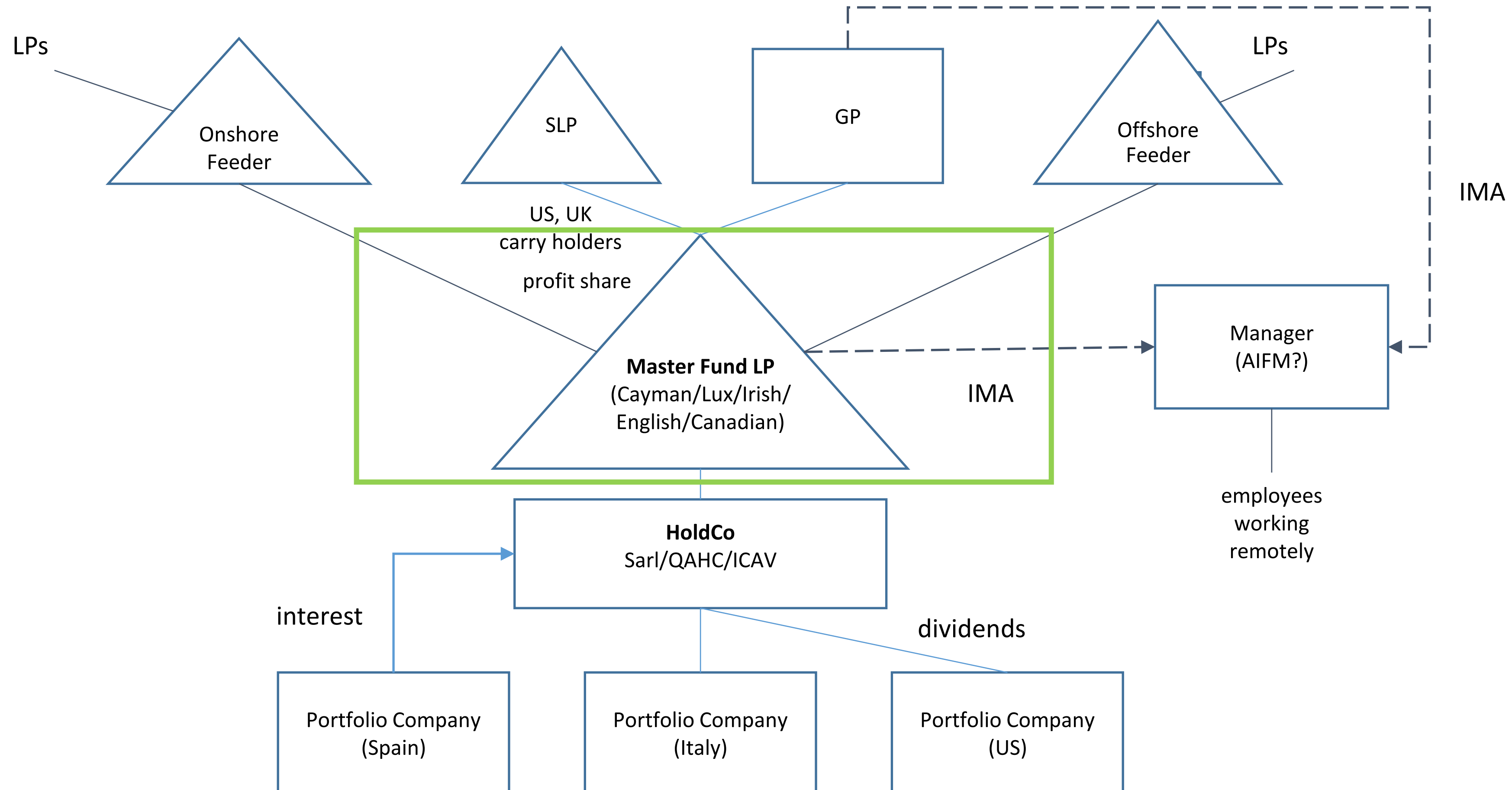
United States of America

Recent Changes Affecting US LPs in Non-US Holding Structures

- 2021 regulations implementing the TCJA's changes to the U.S. "controlled foreign corporation" ("CFC") regime generally adopt a taxpayer-favorable "aggregate" approach to US tax partnerships , in contrast to prior law's "entity" approach under which small US LPs in a US domiciled fund would generally be subject to these anti-deferral rules.
- The TCJA also expanded the reach of the CFC rules by broadening the definition of a "US shareholder" of a CFC to include a > 10% direct or indirect owner *by vote or value* (prior law required > 10% ownership *by vote and value*), generally eliminating opportunities for "vote/value" planning in this context.
- Funds with US LPs should be aware of potential application of the similarly-focused "passive foreign investment company" ("PFIC") rules, which generally apply to US LPs regardless of ownership level. Counterintuitively, the PFIC rules can apply to a cash-rich active businesses in an operating loss position that has even de minimis passive income.

Trends at Fund Structure Level

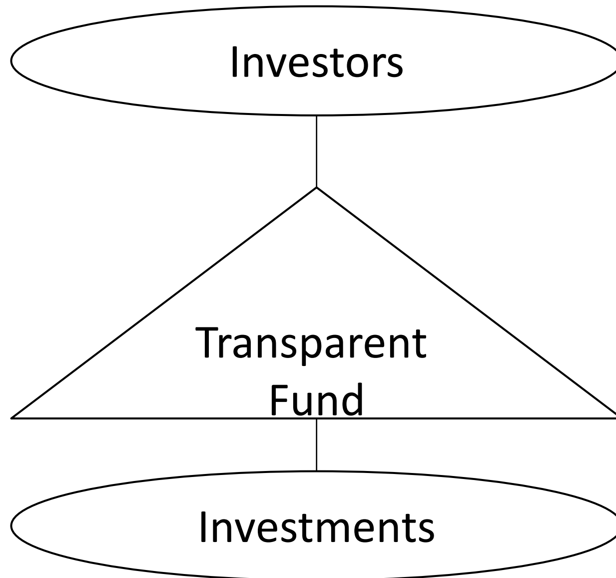
Trends at Fund Structure Level



Trends at Fund Structure Level

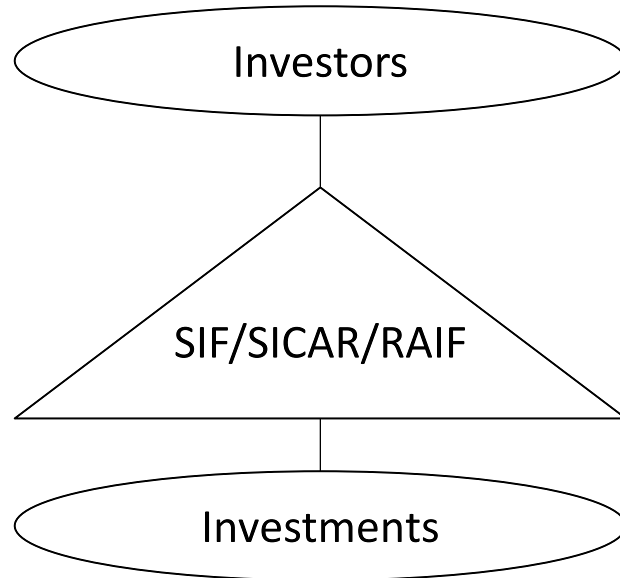
Luxembourg

Transparent vs. Opaque Funds



- Use of holding companies/corporate blockers still a must?
- Direct investments
  - Look-through approach for DTTs (e.g., no WHT for sovereign / pension funds)
  - Help to manage substance requirements following Danish cases, Unshell proposal
- Reverse hybrid rules to be considered
- Partnerships still the preferred route for private funds: flexibility to implement fund terms and investors requirements; light corporate and publication requirements

Regulated vs unregulated



- Unregulated partnership structure ScS-ScSp with only registered AIFM.
- Regulated SIF / SICAR
- Unregulated RAIF with licensed AIFM

Lux authorities keen to preserve tax efficiency of funds

Trends at Fund Structure Level

Spain

Tax transparent entities

Spanish tax transparent entities (*Entidades en Régimen de Atribución de Rentas – ERAR-*). Characterization rules

- Non-resident entities qualify as transparent in Spain if their legal nature is identical or substantially similar to that of Spanish transparent entities (art. 37 NRIT Law):
  - Tax transparency in the country of incorporation is one feature amongst others (Rulings Dutch CV V0037-03, German KG V1631-14, UK LLP V1319-05 V6306-14 and UK LP V0012-2011).
  - Tax transparency in the country of incorporation is the main feature (Dutch CV V3557-15)
- **DGT Resolution of February 6, 2020 on characterization of non-resident entities as transparent entities incorporated abroad.**
  - Main (purely tax) features to consider in the country of incorporation:
    - Not subject to CIT.
    - Attribution of income to its members/owners when the income was generated (disregarding whether distributed or not).
    - Same characterization of the income is retained for the member/owner.

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Trends at Fund Structure Level

The Netherlands

Fund level – Adjustment NL qualification rules

- Currently, a difference in the qualification of an entity (e.g. a PE Fund) for tax purposes (hybrid mismatch) may result in several issues:
  - Limitation of interest deductibility;
  - Withholding tax on dividends paid by a Dutch company to a hybrid entity; and
  - Withholding tax on interest paid by a Dutch company to a hybrid entity.
- As of 2024, new Dutch qualification rules will likely limit the amount of hybrid mismatches.
  - Currently, the main issue is the Dutch condition for transparency comprising of the need for “unanimous consent” within a limited partnership in case of accession or substitution of limited partners. Therefore, non-Dutch LPs often qualify as hybrid entities (transparent in country of incorporation, but non-transparent for Dutch tax purposes).
  - Legislative proposal to avoid such hybrid mismatches is expected in 2023.

Trends at Fund Structure Level

United States of America

Enhanced IRS Enforcement Tools Impacting Investment Funds

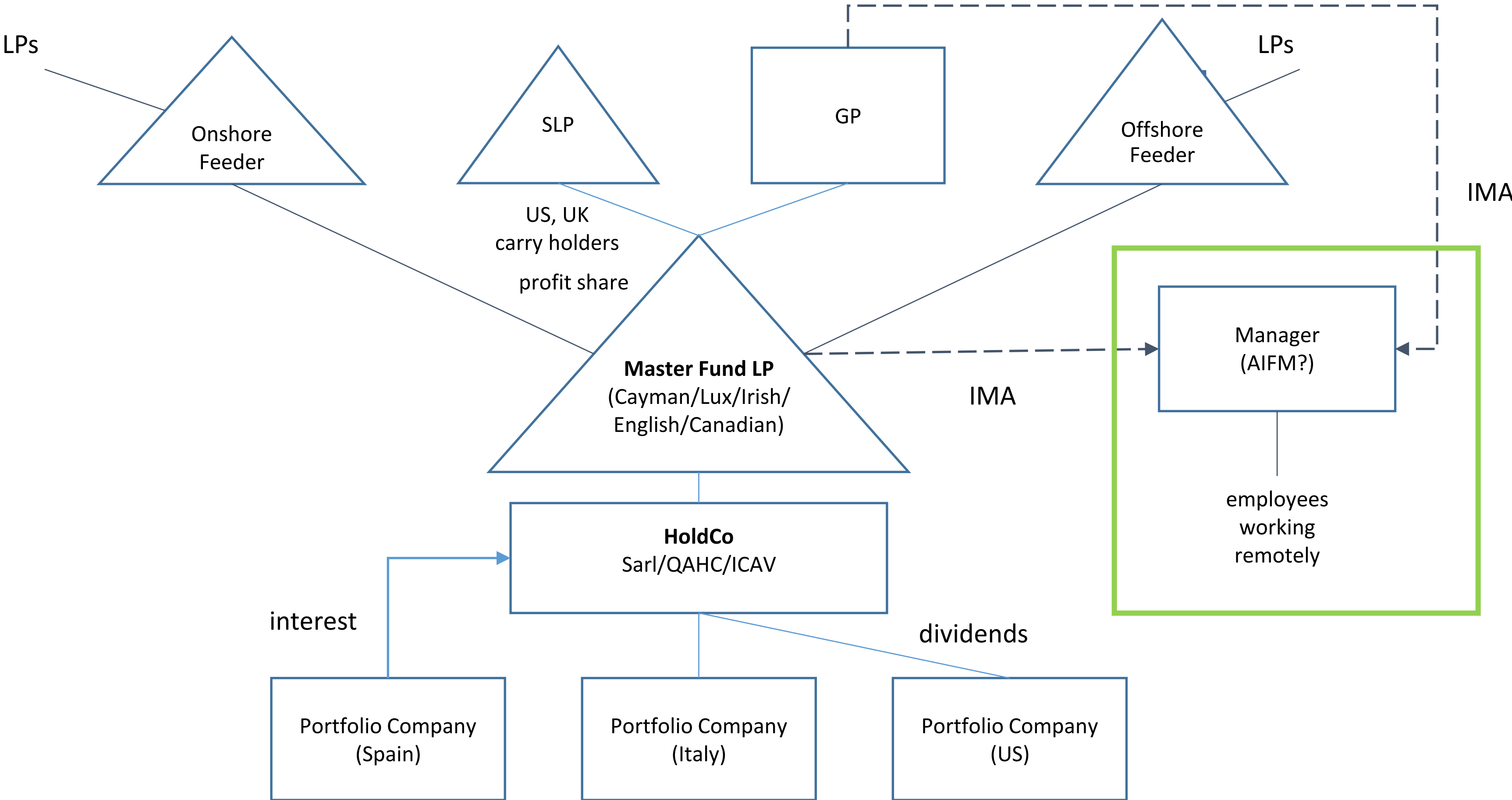
- The 2022 Inflation Reduction Act includes approximately $80 billion in additional IRS funding through FY2031, including $45.6 billion for tax enforcement.
- Audits of investment funds are generally expected to increase based on this new IRS funding and IRS focus on partnership audits under the partnership audit rules introduced in the 2015 Bipartisan Budget Act (the "BBA"),
- Significantly, the effect of recent trends in US partnership tax rules has been to increase tax exposure at the fund level, including for non-US funds.
- Broadly, the BBA shifts audit-related liability from the partners to the partnership by default in a departure from the general flow-through partnership tax regime. Generally, a partnership can elect to "push-out" the tax liability to its partners, assuming the GP has sufficient information to comply with the election procedures.

Enhanced IRS Enforcement Tools Impacting Investment Funds

- Importantly, foreign partnerships with US partners and US source portfolio income may be subject to the BBA, even if they do not have additional US tax nexus (e.g., US “effectively connected income” (“ECI”)).
- The withholding regime for secondary transfers of interests in partnerships with US ECI (introduced by the TCJA) can similarly shift withholding liability to the partnership where the transferee fails to make the required withholding at the time of transfer.
- Many private equity-style funds now require a tax indemnity from former LPs to cover potential fund-level tax exposure, but this approach generally is not practical for more liquid strategies.
- Investment funds should consider what steps can be taken (including compliance with US withholding certification procedures on secondary transfers, potential use of the “push-out” election under the BBA, and additional contractual protections in fund documents) to minimize fund-level tax exposure.

Trends at Manager Level

Trends at Manager Level



Trends at Manager Level
United States of America

Self-Employment Tax and Net Investment Income Tax Considerations

- US-based investment funds sometimes adopt a structure for their management company that is intended to qualify certain limited partner income for an exclusion from self-employment tax while not attracting a 3.8 percent “net investment income” tax.
- In general, section 1402(a)(13) of the IRC excludes from self-employment taxes a “limited partner's” distributive share of income or loss from the partnership other than for certain guaranteed payments for services rendered to the partnership by the partner.
- Many in the US fund industry have formed their management entity as a limited partnership in a jurisdiction that provides limited liability without restricting an active role.
- The ability to escape both taxes has been the subject of recent court cases and IRS review as well as recent legislative proposals that ultimately were not included in the 2021 Build Back Better Act.

Trends at Manager Level

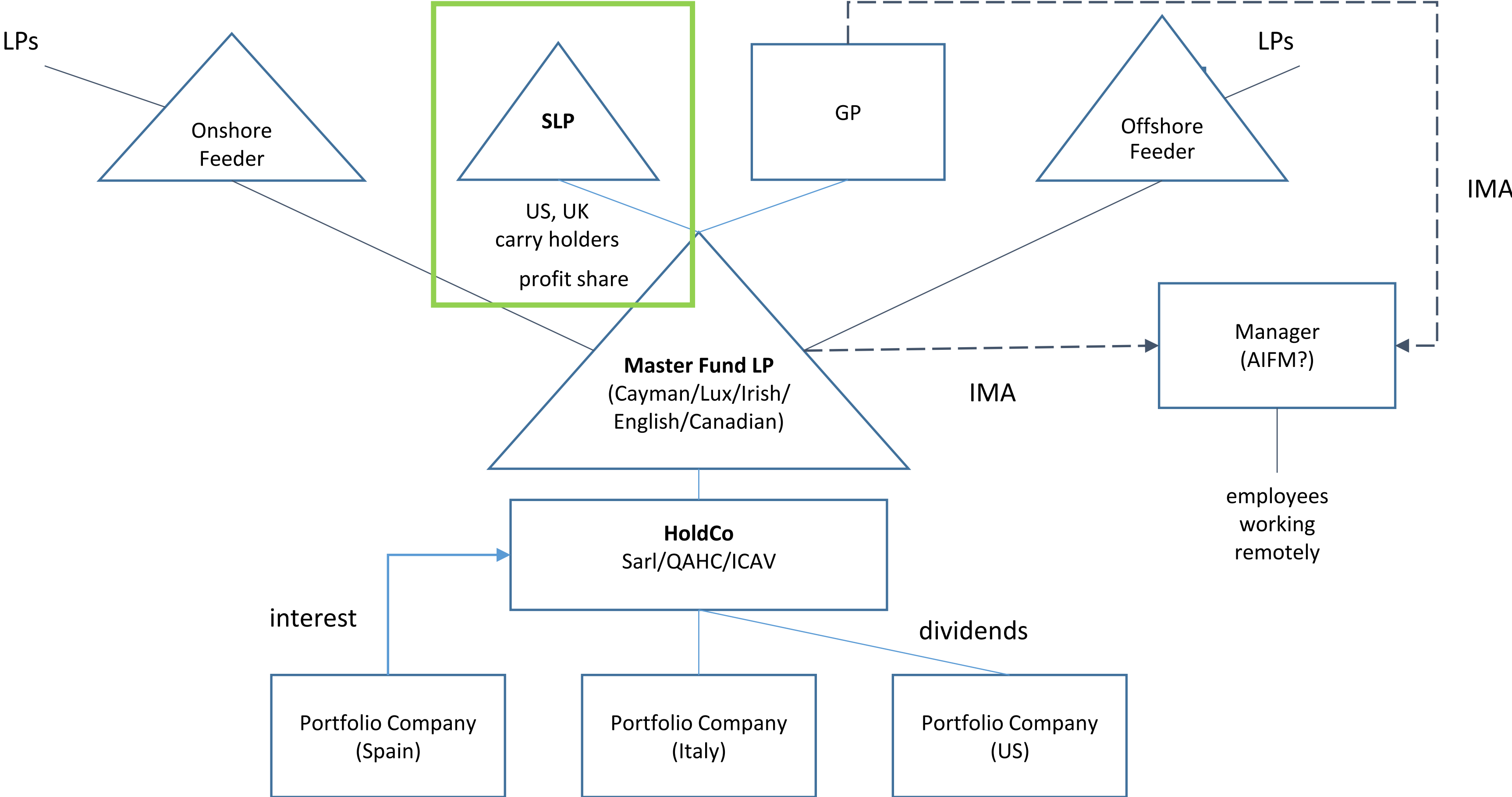
Italy

Italy – Investment manager exemption

- Introduced by 2023 Budget Law
- No Italian permanent establishment of foreign investment funds deriving from management activities in Italy
  - The management activities carried out in Italy are deemed to be activities of an independent agent.
  - The Italian office is not considered a fixed place of business through which the business of the foreign investment fund is wholly or partly carried on.
- Requirements
  1. The investment fund and any intermediate holding companies are based in a White List country
  2. The investment fund satisfies certain independence requirements to be set forth in a ministerial decree
  3. The managers who carry out management activities in Italy (i) are not directors of the fund or of any controlled companies and (ii) do not hold a participation in the economic results of the fund higher than 25%
  4. The remuneration of the management activities in Italy is supported by specific documentation.

Carried Interest

Carried Interest



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Trends at Carry Level

United States of America

Recent Changes to the Carried Interest Regime

- Historically, individual private equity carried interest holders have achieved preferential long term capital gains rates (23.8%) on fund investments held more than 1 year.
- The TCJA kept in place the ability to achieve this preferential tax rate but introduced a new set of rules that in general require a greater than 3 year holding period
- These new rules under IRC Section 1061 apply only to an "applicable partnership interest" ("API"). Carried interests held by investment fund managers typically will qualify as APIs and will be subject to this extended holding period rule.
- The greater than 3 year holding period does not apply to certain capital interests (assuming the fund documents capital vs. carried interest in compliance with relevant regulations) nor do they apply to partnership interests directly or indirectly held by a C corporation.

Trends at Carry Level
Italy

Italy – Carried interest

- Carried interest is subject to 26% tax (instead of 43% + 10% in certain cases) if three requirements are met
  1. Minimum investment of 1% of the net equity
  2. Subordination: the multiple applies only if the other investors have obtained the capital invested and a minimum return (hurdle rate)
  3. Minimum holding period of 5 years except for change of control
- If any of the three requirements is not met, 26% taxation can still be achieved
  - Relevant elements (guidelines of the Italian tax authorities)
    - Amount of the investment
    - Risk of loss of the capital invested
    - Leavership clauses
    - Adequate remuneration of the managers
    - Subscription of the same financial instruments also by other investors
  - Tax ruling recommended

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Trends at Carry Level

Spain

Carried interest. New regulation. Law 28/2022, of December 21 to promote the ecosystem of start-ups.

- **Definition of carried interest**: income derived direct or indirectly from shares or other rights, including success fees, giving rise to special economic rights to directors or employees of management entities of qualifying funds.
- **Qualifying funds**:
  - AIFs according to Dve. 2011/61/EU which within following categories:
    - Spanish private equity funds (Lay 22/2014).
    - European venture capital funds (EU Regulation 345/2013).
    - European social entrepreneurship funds (EU Regulation 346/2013).
    - European long-term investment funds (EU Regulation 2015/760).
  - Other analogous CIV.
- **Characterization as employment income, with a 50% exemption subject to**:
  - The obtention by the investors of a minimum profitability threshold.
  - The shares or the economic rights must be held at least for five years, unless *mortis causa* transfer or liquidation of the rights due to the change of the management company by the fund.

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Trends at Carry Level

The Netherlands

Carried Interest

- Carried interest in the Netherlands is often structured through a leveraged shareholding structure qualifying as a so-called “lucrative interest”.
- After questions were raised regarding the taxation of carried interest (structuring allows the normal tax rate of 49.5% to be lowered to 26.9%), the State secretary confirmed the system was accepted.
- For a non-Dutch manager, there are several new developments in respect of shareholdings qualifying as a lucrative interest.
  - Recently, a Decree was published on the treatment of carried interest under tax treaties:
    - Directly structured carried interest (i.e., no holding company) – article 15 (income from employment) or (directors’ fees) 16 OECD applies.
    - Indirectly structured carried interest (i.e., via holding company) meeting certain domestic conditions – articles 10 (dividends) & 13 (capital gains) OECD apply.
  - Based on a recent publication, the use of a non-Dutch intermediate holding company by a non-Dutch manager may prevent a tax favourable structuring of the lucrative interest.

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