Keeping up with Alternative Investment Funds

January 2022

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Introduction

Welcome to our January edition of Keeping up with Alternative Investment Funds. We hope you all have had a lovely Christmas break.

In this month's edition, we have an article giving more information on the new QAHC regime in the UK now that the final legislation has been published in the Finance Bill. The final touches are currently being put on this regime, including draft guidance being circulated and commented on. This is going to be a key topic for fund managers in 2022, feel free to contact our QAHC team or a member of your PwC team to discuss how a QAHC may be relevant to your fund structure.

Beyond this, we have articles on a range of topics which are of interest to Alternative Investment Fund managers at the moment. These include an article on hybrid working, a look at the new Irish Finance bill, ILPA's new ESG framework, and an update on the European credit market.

I would also like to take the opportunity to announce the events that our team will be hosting in the upcoming months.

AIF Virtual Roundtable - Thursday 10 February 2022

We are pleased to announce that we are hosting our next AIF Virtual Roundtable on Thursday 10 February from 2:00pm GMT. We will be discussing the following topics:

- Marketing of AIF funds to retail investors
- The tax enquiry environment
- Succession planning and preparing for strategic investment at the house level

Please reach out to your usual PwC contact if you would like to attend and have not received an invite.

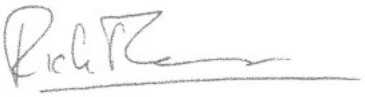
PwC Alternative Investment Funds Annual Conference - Wednesday 27 April 2022

We are delighted to announce that we are hosting our second Alternative Investment Funds annual conference on Wednesday 27 April from 1:30pm. It will be a half day in-person event which will be held at our More London office. This conference will focus on a broad spectrum of issues arising for asset managers who provide alternative investment solutions to their clients ranging across private equity, private credit, hedge funds, liquid trading / crypto assets, infrastructure and real estate investing. The afternoon will feature a plenary session, panel discussions and elective deep dive breakout sessions from a mixture of speakers. In addition, we will be showcasing industry focused digital solutions during the breakout and networking sessions. After the conference, you will get a chance to network with industry colleagues and PwC's Alternative Investment Funds team over drinks and canapés. Please register here. For queries, please email uk_alternative_investment_funds@pwc.com.

To support organisations with their response to the ongoing impact of the COVID-19 pandemic, our **COVID-19 website** will continue to feature the latest guidance, updates, and details of how we can offer help and support to businesses, from crisis scenario planning, to cashflow management and cyber security.

Please do continue to reach out to your usual PwC contacts if you would like to discuss any of the above, and please do share your feedback with us if there is a particular topic or issue you would like us to cover in the future.

Kind regards,



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Taxation of Asset Holding Companies In Alternative Fund Structures – draft legislation published

The final draft legislation on the new regime for the taxation of qualifying asset holding companies ("QAHCs") was published in the Finance Bill and is expected to be enacted in the next few weeks. The legislation has been developed from the original draft that was previously released in July 2021 and reflects much of the feedback received from industry stakeholders and during our working group sessions with HMRC and HMT. HMRC are also set to issue guidance on the QAHC regime in the form of an update to the Investment Funds Manual where further clarifications and examples will be provided in respect of how the legislation will apply from 1 April 2022.

The QAHC regime allows fund managers to align their investment holding vehicles or platforms with their UK economic substance. The QAHC will facilitate the flow of capital, income and gains between investors and underlying investments, so that it is expected that investors should be taxed broadly as if they invested directly in the underlying assets and the QAHCs pay no more tax than is proportionate to the activities they perform.

We expect this new regime to provide a credible option for the alternative investment industry to hold investments. However, in addition to the tax roadblocks being addressed in this new regime there are broader considerations such as commercial presence, corporate law and financial reporting requirements. Each fund manager will therefore need to evaluate if the regime is attractive for them.

We summarise in this publication:

- the key features and criteria to be eligible for the regime;
- other key considerations including when entering and exiting the regime; and
- the key changes since the initial draft legislation issued on 20 July 2021.

Key features of the regime

Disposals

- Gains on sale of "shares" are exempt, with no minimum holding period etc. Shares are broadly defined and include chargeable gains on derivatives which derive their value from shares. However, shares which derive > 75% of their value from UK property are excluded.
- Exempting gains on overseas property.
- Exempting profits of an overseas property business of a QAHC, where those profits are subject to tax in an overseas jurisdiction.

Withholding taxes

There is no withholding tax on interest payments made by a QAHC. The UK already does not impose withholding tax on dividend payments anyway except for REITs (which can not access the regime).

Interest deductibility

Interest and other finance costs on debt funding the QAHC, including profit participating and convertible debt, are in principle deductible on an accruals basis. These are generally able to match income arising on debt investments except for an arm's length margin. The finance costs may also offset other income but subject to various restrictions.

Returns to investors

UK investors are able to obtain capital treatment on redemptions of shares at a gain (unless the shares are employment related securities). Non-domiciled investors will still be able to benefit from the remittance basis regime for non UK sourced income/gain.

Buybacks, but not transfers, by a QAHC of shares and loan capital are exempt from UK Stamp Duty and Stamp Duty Reserve Tax.

Taxation of Asset Holding Companies In Alternative Fund Structures – draft legislation published (continued)

Eligibility criteria

In order for a QAHC to be eligible to enter the regime, it must be a UK tax resident company, however it need not be UK incorporated. The company must maintain compliance with three conditions: the ownership; the activity; and the investment conditions. Similarly, the company cannot be a UK REIT (which includes members of a group UK REIT) and none of the equity securities of the company can be listed or traded on a recognised stock exchange or any other public market or exchange.

An eligible UK resident company can have both a business within the QAHC ring-fence, and a business outside of the QAHC ring-fence, such as investment management or UK property rental businesses, which are taxed under ordinary principles.

Ownership condition

To be eligible for the regime, a UK resident must elect into the regime and it broadly requires the economic ownership to be at least 70% held by "Category A investors", which include other QAHCs, qualifying funds (being either a collective investment scheme or an AIF that meets the diversity of ownership condition or is not "close") or relevant qualifying investors (broadly including charities, pension schemes, sovereign investors, long term insurance businesses, UK REITs and overseas equivalents), or a public authority.

Category A Investors may also invest into a QAHC through an intermediate company that meets the activity condition and is at least 99% held by Category A investors. This can be UK or overseas tax resident.

Helpfully, the legislation includes a 2-year window for companies to meet the 'ownership test' as well as a 90 day "cure period" should a company breach the ownership condition.

Activity & Investment conditions

The activity condition requires the main activity of a QAHC must be connected with the "carrying on of an investment business", and whilst a QAHC will be able to carry out other activities this cannot be a substantial activity of the company.

Linked to the above, the investment condition requires a QAHC's strategy to not involve the acquisition of listed equity securities, except when looking to facilitate a change of control to take private.

Entry into the regime

A QAHC must make an entry notification to HMRC to state that the company intends to be a QAHC, and must include from what date the entity will become a QAHC (but this can be no earlier than 1 April 2022).

Converting existing companies to QAHCs

Whilst we expect most QAHCs to be newly formed entities, existing companies can convert to become QAHCs if they meet the conditions. Upon entry to the regime there will be a deemed disposal of any overseas land holdings, loan relationships relating to an overseas property business or any qualifying shares immediately before entry to the regime; and reacquisition immediately after entry.

Any gain on the deemed disposal is taxable, except gains arising on shares upon entry may be exempted where the conditions of the UK's substantial shareholding exemption ("SSE") apply. Helpfully, the regime allows for entities who have not yet held the qualifying shares for 12 months to apply SSE, provided that the QAHC will continue to hold those shares until the 12-month period is met.

Where entities migrate their tax residence to the UK, and elect into the regime within 30 days there will be no UK tax charge on the deemed disposal. There are also provisions to avoid double charges in certain specified circumstances.

Assets entering and leaving the (exempt) ring fence

Where an asset enters or exits the (exempt) ring fenced business, there is a deemed market value disposal (which will be taxable at the point the asset enters the ring fence business) subject to provisions intended to avoid double charges.

Taxation of Asset Holding Companies In Alternative Fund Structures – draft legislation published (continued)

Exiting the regime

As with a company wishing to enter the regime, a QAHC wishing to leave the regime must make an exit notification. However, a QAHC will be treated as leaving the regime should it fail to meet any of the above eligibility conditions, and fail to cure any breaches.

The regime does however include a 2-year winding down period, allowing a company to continue to be a QAHC if it breaches the ownership condition due to the company being acquired by a non-qualifying investor or where its investor is a qualifying fund and it ceases to be a Category A investor.

Exit Charge

Similar to the Entry Charge, the company will need to notify HMRC that it is exiting the regime. Alongside this, the exiting of the regime would result in a deemed disposal and reacquisition of its qualifying assets (see the 'Entry Charge' section above) at market value. As the gain will arise under the QAHC regime, any gain should be exempted - resulting in a rebasing of those qualifying assets to their market value at that date.

Other points to note

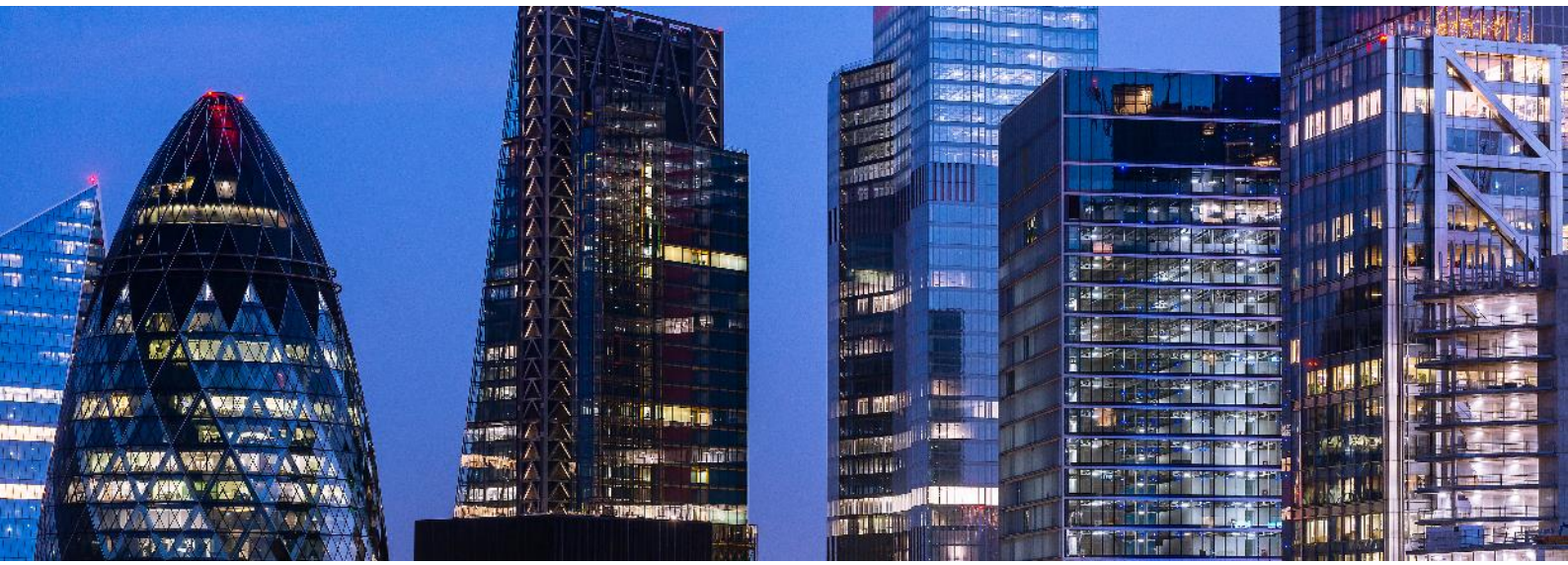
By virtue of a QAHC being a UK tax resident entity, it will be subject to a number of ongoing tax and financial reporting requirements (some of which may only apply if the QAHC is also a UK incorporated company). These include: a requirement to publish its tax strategy, comply with senior accounting officer requirements and file financial statements with Companies House.

Tax losses arising in a QAHC ring fence may not be relieved against taxable profits arising in a non QAHC ring fenced business.

A QAHC will not have to apply hybrid instrument mismatch rules. However, with the aim of ensuring that the regime remains OECD compliant (as required under the EU withdrawal agreement), the rules relating to hybrid entities will still apply. These rules would therefore need to be considered, however the changes to the hybrid mismatch rules introduced from June 2021 may significantly mitigate the hybrid concerns in such structures.

The much discussed 'zero-rating' of management fees for VAT purposes has not been included in this draft. We would expect this point to be covered as part of the wider review of the UK funds regime but there is currently no clear indication from HM Treasury or HMRC when this might be.

Aside from the specific references to UK REITs above, and a provision to ensure that property income dividends received from a non-UK property rich REIT by a QAHC continue to be taxed as UK property rental income, the interaction between the QAHC and UK REIT regime is limited. However, we expect that further changes will be announced in the future as part of the wider funds review.



Taxation of Asset Holding Companies In Alternative Fund Structures – draft legislation published (continued)

Key changes since legislation released on 20 July 2021

For those that have been following the detail of the legislation, the Finance Bill draft has been amended since the July legislation with the following key changes:

- Inclusion of the entry/exit to regime requirements and implications;
- Ownership conditions allows for intermediate companies in certain cases and broadening of diversity of ownership criteria;
- Investment condition relaxed to allow for single asset holdcos, but with a new restriction to not have a strategy to own listed shares unless with the intention to take control;
- Requirements for minimum capital and independent management have been removed;
- Interest withholding tax relief extended to all payments instead of just shareholder loans (and similar);
- Ability to obtain deductions on convertible debt (in addition to profit participating debt), broadening the available instruments and helping to achieve capital treatment for UK investors;
- Disapplying hybrid financial instrument rules;
- Various changes to fix issues with matching income with expenses for debt investments, including in relation to foreign exchange; and
- Provision to allow non-domiciled investors to continue to benefit from the remittance basis regime in relation to non-UK source income/gains.

Final thoughts

The new QAHC regime is an extremely positive development for the UK Funds industry. The government has recognised and addressed the challenges that drive UK based investors to use overseas investment platform entities and the new regime now offers a very credible alternative for investment funds to base their asset holding vehicles.

The QAHC regime offers various potential benefits for alternative investment funds operating across different asset classes, however whether this will be appropriate or not will ultimately depend on the specific fact pattern.

We are currently working with clients on feasibility studies to assess the viability of the rules for them once effective from April and expect take up in the industry to be positive.

Please reach out to us if you would like any further information on these rules or would like to discuss the impact on your structures.

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Domestic and international hybrid working arrangements: the impact for AIFs

As organisations have moved beyond their initial response to COVID-19 they have had to consider whether and to what extent they wish to embrace the demand for hybrid working from employees. Across the financial services sector we have seen a range of responses: a small number of companies have told their staff to return to the office on a full time basis and there are an equally small number who are being entirely flexible and allowing employees to shift to a full time hybrid working approach. However, the overwhelming majority of companies across all sectors (including FS) are shifting to a hybrid model with somewhere between 40% and 60% of work being office based.

From a people perspective, where they have embedded a hybrid working approach we have seen a definite shift in many organisations to have "core" office based days each week with the objective of maximising collaboration across individuals and teams. This is particularly prevalent in the private equity sector and also across research teams in investment houses where information sharing is critical. Hybrid working also enables employers to continue the focus on employee wellbeing that is such an important area of ongoing focus for the regulator.

In this article we want to focus on what hybrid working means for tax directors and tax managers who are responsible for the employment tax implications of hybrid working. Whilst the HR function will typically focus on the policy decisions and operational aspects of hybrid working, it is also crucial that upfront consideration is given to the tax implications and additional reporting requirements that may arise.

Domestic hybrid working arrangements

We have seen a number of organisations develop formal policies to assist employees who are working from home in the form of facilitating the acquisition of office furniture and other equipment. As ever, in these cases, care needs to be taken that there is at most only incidental personal use of any items that have been provided directly by the employer or where the costs are reimbursed.

We are also aware that a number of AIF managers have made arrangements to pay the tax free working from home allowance to their employees over the last 18 months, taking advantage of the relaxation of the rules announced by HMRC as part of their initial response to the COVID pandemic. Whilst we understand HMRC will continue to take a relaxed approach to these allowances for the 2021/22 tax year, as we move beyond the pandemic, it is important to note that HMRC are likely to return to the stricter definition of a home workplace.

Where employment contracts are altered to reflect home working arrangements, care also needs to be taken in relation to cases where home to office travel will be reimbursed since this will often still be within the definition of ordinary commuting and hence would be a taxable expense.

International hybrid working arrangements

Whilst the tax impact of domestic arrangements is reasonably limited, the most complex aspect of hybrid working arrangements is where an individual has a cross-border hybrid working arrangement. During the COVID-19 pandemic many organisations had to address the reality of internationally displaced employees and, as the situation continued, we saw many organisations implementing "working holiday" policies where employees have been allowed to work overseas for short periods before or after their holidays. Both of these have helped raise awareness of the relevant issues even for wholly domestic AIF managers. More recently, we are seeing a significant increase in employee demand across the FS and specifically the AIF sector for long term international hybrid working arrangements where employees who live in one country are requesting to work for two or three days per week at home with the balance of time spent in the country where they would ordinarily be employed. In many cases, this is a consequence of the employer tapping into a highly competitive global talent pool for certain key roles and using hybrid working as a way to differentiate the employment offer.

Domestic and international hybrid working arrangements: the impact for AIFs (continued)

These international hybrid working situations are often very complex. Alongside the regulatory and compliance challenges, there are PE risks to consider for the corporate and there are often dual-country payroll reporting and withholding obligations that need to be managed to ensure the individual is not disadvantaged from a cash flow perspective and that the company have clear understanding of the overall employment cost taking into account employer social security contributions. Consideration also needs to be given to any employment law implications in the different countries as well immigration and whether the individual has the right to work in any relevant countries. This last point is particularly relevant where, for example, an individual is employed by a UK company and will perform some working activity in the UK but they live in a country within the EU and intend to work some time from their home. In this situation, the employer will need to ensure that the individual has the right to work in the UK which would almost certainly require a visa unless the individual is a UK national or has EU settled status in the UK - it is worth noting that for many AIFs, the right to work is a core requirement the individual must have for an international hybrid working arrangement to be considered by the employer.

Given the complexities and as the demand for international hybrid working arrangements has increased, we are now seeing a number of investment managers establish policies and frameworks so that they can manage these cases in a consistent way, streamlining any additional reporting obligations and managing risks where possible. These often help determine the employment structure to be used for the arrangement and ensure that existing transfer pricing and other relevant policies are leveraged.

Next steps for alternative investment funds

- The transition to hybrid working arrangements has led organisations to reconsider how they support their employees working from home. Where tools are provided to enable employees to be as productive when working at home as they would be in the office and where employment contracts are revised, it is important to ensure that care is taken to identify and manage any additional tax and regulatory implications arising from these new policies.
- Where international hybrid working arrangements are being implemented, the tax and legal risks and any additional reporting obligations should be reviewed, understood and processes put in place to ensure the AIF is compliant, undertaking all necessary corporate tax and payroll reporting in relevant jurisdictions.
- Where there are a number of requests for international hybrid working arrangements, it is important to develop a framework to manage the arrangements, enabling the AIF to mitigate any associated risks in a consistent way.

We are already seeing tax authorities apply greater scrutiny to hybrid working arrangements and the above steps will ensure that your organisation and employees are operating compliantly and that you are both well prepared in the event of questions from the tax authorities.

For a deeper discussion on how this may impact your organisation, get in touch with the authors or your normal PwC contact.

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Irish Finance Bill 2021 and the impact on the Alternate Investment Fund industry

On 21 October 2021, Finance Bill 2021 (the Finance Bill) was released by the Irish Department of Finance, introducing a number of provisions that will have a direct impact on the Irish Alternative Funds industry. While the key amendments had been well-flagged in advance, in particular those mandated by the EU Anti-Tax Avoidance Directive (ATAD), now that the detail of the legislation is available, it is important that those within the Alternatives sector consider how the rules will impact their business.

Interest Limitation Rules (ILR)

Most notably, the highly anticipated ILR will be introduced into Irish tax legislation, taking effect for accounting periods beginning on or after 1 January 2022. The ILR is a fixed ratio rule that seeks to link a taxpayer's allowable 'net borrowing costs' directly to its level of earnings, by limiting the maximum net deduction to 30% of tax-adjusted EBITDA.

The introduction of these rules represent a fundamental change to the Irish tax system and may have a significant impact on the Alternative Funds industry, as the ability to avail of a tax deduction on interest payments is restricted. In particular, the ILR will be of most relevance to highly leveraged entities, such as the Irish Section 110 vehicle.

Definition of interest equivalent

Firstly, the ILR applies to 'net borrowing costs' and as such, any interest (or equivalent) expense sheltered by interest (or equivalent) income will not be subject to a restriction. As such, Section 110 vehicles operating credit strategies are unlikely to be as impacted by the rules as others.

The Finance Bill definition of interest includes not only interest itself but also amounts under derivative instruments connected with the raising of finance, the interest elements of foreign exchange gains and losses and the finance element of finance lease payments. Also specifically included are the interest equivalent elements of the profit and loss movements on financial assets and liabilities. This is potentially very wide for all industries within FS as it could sweep in all or some of the unrealised fair value movements on a range of financial instruments which might not otherwise be considered as interest or interest equivalent. Furthermore, it is positive that the interest limitation legislation recognises the commercial reality that an element of an aircraft operating lease rental is equivalent to interest income, thereby allowing a lessor to reduce its net interest expense.

As there is potential for interpretational differences in this area, it is important that clarifications are provided by way of Revenue guidance, in order to provide a degree of certainty for taxpayers particularly with respect to investments in deeply discounted debt positions. It is worth noting that these definitions apply to both income and expense amounts.

Exceptions

The ILR is subject to some exceptions where the Government believes there is a limited risk of base erosion or profit shifting. These exceptions include:

- where the Irish taxpayer's net borrowing costs are less than €3 million;
- where a company is a standalone company, being a company that has no associated enterprises or permanent establishments and is not consolidated for financial statements purposes with any other entity;
- Long-Term Public Infrastructure Projects, being a project to provide, upgrade, operate or maintain a large-scale asset in the general public interest; and
- interest on legacy debt, being debt the terms of which were agreed before the terms of the ILR were agreed on 17 June 2016.

As expected, the Finance Bill does not provide for a financial undertakings exemption which is understandable as these entities often generate net interest equivalent income and an interaction with financial undertakings and grouping provisions was not permissible.

Irish Finance Bill 2021 and the impact on the Alternate Investment Fund industry (continued)

Grouping provisions - Interest group

As anticipated, the Finance Bill provides for the application of ILR using an elective "group approach" (i.e., calculating the interest restriction at the level of a local group of companies (an "interest group")). The draft legislation provides that the "interest group" will encompass all companies within the charge to corporation tax in Ireland that are members of a financial consolidation group, as well as any non-consolidated companies that are members of a tax loss group.

From an Alternative Funds perspective, the reference to "within the charge to corporation tax" is particularly important as it can in certain instances bring particular regulated fund structures (such as the ICAV) within scope of the interest group definition. The ICAV-Section 110 structure is particularly popular in Ireland and the ability to enter an interest group (and disregard/aggregate intragroup transactions) has the potential to be very beneficial from an ILR perspective, given the ICAV is a fully equity funded structure. Many alternative asset managers view this as the structure of choice going forward and it provides the potential for non interest yielding strategies to also be efficiently held in this structure.

Grouping provisions - Worldwide Group and Single Company Worldwide Group ("SCWG")

The draft legislation also allows for two additional "grouping" reliefs from the ILR linked to a worldwide accounting group containing the taxpayer; the Worldwide Group and the Single Company Worldwide Group.

Where the Irish taxpayer is part of a consolidated worldwide group (Worldwide Group) for accounting purposes, the indebtedness of the overall group at worldwide level may be considered for the purposes of providing additional relief. There are two provisions with respect to Worldwide Groups, namely;

1. *An equity-escape carve-out from the ILR:* The legislation focuses on the ratio of equity to total assets. If the ratio of equity to total assets of the Irish taxpayer is no lower than two percentage points below the Worldwide Group's ratio of equity to total assets then the equity ratio rule applies and no interest restriction arises.
2. *A group ratio rule*: The group ratio rule calculates the group's exceeding borrowing costs as a percentage of its EBITDA (using the group's consolidated financial statements). If the group's percentage is higher than 30%, the taxpayer is permitted to use the higher figure when calculating any interest restriction amount.

Ireland has also recognised that many small to medium enterprises could potentially have been at a disadvantage as they generally do not meet the definition of a "standalone entity" nor do they meet the consolidation tests for the group carve outs. The draft legislation has therefore introduced the concept of the SCWG, being a company that is not (1) a member of a Worldwide Group, (2) a member of an Interest Group or, (3) a standalone entity. Where a taxpayer meets the definition above, it can avail of the group carve outs by calculating the relevant ratios as if it was a member of a consolidated group and then adjusting for transactions with associated enterprises (as defined in anti-hybrid legislation).

Both provisions above, but particularly the SCWG provisions, will be extremely welcomed by the Alternatives industry as many structures are likely to fall within the definition of a SCWG. However, analysis of potential associated enterprise transactions will be key in applying these rules (see below for further detail).

Anti-Hybrid rules

Separately, the Finance Bill also included a number of amendments to the existing anti-hybrid legislation. The definition of an "entity" has been broadened and now applies to "an association of persons recognised under the laws of the territory in which it is established as having the capacity to perform legal acts", along with "any other legal arrangement of whatever nature or form, that owns or manages assets".

Irish Finance Bill 2021 and the impact on the Alternate Investment Fund industry (continued)

From an Alternative Funds perspective, the expansion of this definition will need to be considered in the context of investment structures containing partnerships without separate legal personality (which did not previously fall within the definition of an 'entity'). The ability to trace-through these partnerships for anti-hybrid rules has been removed, which may necessitate a review of the application of the rules for investment structures with such partnerships within their structures.

This will be an important point to consider for Alternative Funds with this fact pattern as it may impact historic "associated enterprise" analysis completed for anti-hybrid purposes and as noted above, the definition of "associated enterprise" is also important when considering the value of the SCWG provisions from an ILR perspective.

Reverse Anti-Hybrid rules

The Finance Bill has also introduced reverse-hybrid rules, targeting mismatch outcomes typically arising as a result of an entity being considered transparent in Ireland, but opaque in another jurisdiction, resulting in the double non-taxation of an income item or gain. These rules will be effective for tax periods commencing on or after 1 January 2022 and will need to be considered for popular Irish alternative investment structures such as Investment Limited Partnerships, unregulated Limited Partnerships and Common Contractual Funds.

A reverse hybrid mismatch outcome will arise where some or all of the profits or gains of a reverse hybrid entity that are attributable to a participator are subject to neither Irish nor foreign tax. The application of the rules is predicated on sufficient "association" (per the Irish anti-hybrid definition) between investors in the transparent vehicles and a required aggregated holding by those associated investors in excess of 50%.

Irish Finance Bill 2021 and the impact on the Alternate Investment Fund industry (continued)

Where the reverse hybrid rules apply, the Finance Bill provides for a neutralising mechanism whereby the income of the reverse hybrid entity will be subject to Irish corporation tax, "as if the business carried on in the State by the entity was carried on by a company resident in the State". It should be noted that no mismatch outcome will arise where the investor in the hybrid entity:

- is exempt from tax under the laws of the territory in which it is established,
- is established in a territory, that does not impose a foreign tax, or
- is established in a territory that does not impose a tax on profits or gains receivable in that territory from sources outside that territory.

This is particularly welcome in the context of ILPs whose limited partners meet the above criteria.

A broader exemption has also been introduced for "collective investment vehicles", as defined by Finance Bill 2021. However, in order to avail of the exemption, the transparent entity itself must be considered 'widely held' and holding a 'diversified portfolio of assets. Due to the prevalence of single investor, private equity structures that utilise limited partnerships, this exemption may be limited in its broader applicability to the Alternative Funds industry.

Next steps for alternative investment funds

The PwC Alternative Investments team has been heavily involved in the consultation process in relation to these measures and the extensive stakeholder engagement has led to sensible and pragmatic legislation that meets the minimum standards of ATAD. That said, the rules are extremely complex and given the potentially significant effect of the Finance Bill, many clients are undertaking impact assessments to determine the application of the rules and any necessary mitigating actions. If you have not already done so, we would strongly recommend that an impact assessment of your Irish structures is completed as soon as possible.

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The ILPA ESG Framework – an investor perspective on ESG standardisation

Last year we have seen an escalated focus on environmental, social and governance (ESG) reporting driven by investors. The Institutional Limited Partners Association (ILPA) has recently responded by publishing a new framework to enable investor LPs to assess and evaluate ESG integration into the wider investment process. This tool gives both investors and sponsors who have not yet established their ESG policies a starting point for their own framework. In addition, the ILPA ESG Framework seeks to improve transparency by allowing investors to benchmark against GP responses to DDQs and is intended to spark open goal-setting discussions between GPs and investors.

Click to access the ILPA ESG Framework and the accompanying FAQs.

Summary of ILPA ESG Framework

The ILPA ESG Framework provides a level of standardisation which investors can leverage with their own investment evaluation process. The matrix comprises six components as summarised below, each of which is categorised on the level of ESG integration sophistication – ranging between "not present", "developing", "intermediate" and "advanced".

- **Policies and commitments to standards** – It is important that commitments to an ESG process have real substance in the way that they are presented. How does the GP implement and review its ESG policy and to what extent is it committed to industry standard and best practices? Does the GP integrate ESG commitments through contractual provisions with its investors e.g., by way of reference in their fund documents, including PPMs and side letters?
- **Governance** – Who is responsible for ESG oversight? Investors should be able to differentiate between general statements of responsibility and the investment team that is held accountable. Increasingly, investors expect both investment teams and operating teams to be trained and accountable for ESG integration on an ongoing basis.
- **Communications and reporting** – ESG considerations should be meaningfully reported on and discussed at AGMs and advisory board meetings. Any reporting on ESG performance should include qualitative and quantitative references to the underlying portfolio companies through sharing case study examples of ESG integration in action.
- **Investment process** – ESG risks should be identified during the due diligence process and be considered in the Investment Committee process using a materiality-based assessment framework. ESG issues should be integrated and set out in a structured investment process, including reviews for all portfolio companies on an ongoing basis.
- **Responsiveness to diversity, equity and inclusion (DEI)** – Generally, investors expect policies and assessments of these metrics when detailing diversity at the manager and underlying portfolio company level. Many investors now require GPs to meet specified DEI targets, and this is feeding through to the recruitment process.
- **Responsiveness to climate risks and opportunities** – What strategies does the GP employ in reviewing climate risk at portfolio level and at the investment deal level? This component should include how the GP expects the relevant portfolio to become net zero on or before 2050.

What can GP sponsors take away from the framework?

While the ILPA ESG Framework can provide GPs with further insight into LP expectations, this tool provides a good opportunity for GPs to take a look at the types of actions LPs are taking. There are many reasons why a GP might be looking to use ESG integration as a value-creation lever, while others may simply be responding to specific LP demands. GPs in the latter group can use ILPA's Framework to better understand those investor requirements. The guidance should be a useful tool for a GP seeking to enhance its ESG program, creating a central resource which will be updated periodically with the change in investor demand. If GPs can keep on top of what LPs consider ESG best practice and compare their ESG strategies against the resources provided, they can develop and align themselves with LP expectations in this space.

The ILPA ESG Framework – an investor perspective on ESG standardisation (continued)

How can investors use the framework?

The ILPA ESG Framework is a good starting point for LPs whose ESG programs are in the early stages of development or are expanding their existing ESG strategy. It is a resource for an LP which has indicated an interest in integrating ESG into their investment thesis, but not yet necessarily developed its own framework. The ILPA's ESG Framework sets out the key areas which an LP needs to consider together with guidance on how to benchmark a GPs existing level of ESG integration against the standards of the framework itself. The resources provide very useful information for LPs looking to form their best practices and gives them an opportunity to see what other investors are doing in the industry. In particular, an LP who is new to private markets, and who may not necessarily have a wide LP network, is likely to find the ILPA's ESG Framework helpful as a benchmarking tool when it comes to thinking about what it needs to consider when developing its own ESG program.

Market Response to ILPA's ESG Framework

When considering ESG performance indicators, LPs and GPs continue to ask for more guidance about best practices. There is a desire to see additional reporting and, in particular, the ability to benchmark largely evades LPs so long as the market remains fragmented, but the consolidation of ESG knowledge is an important step. Reporting around how a portfolio is performing on ESG-related KPIs compared to other funds is still missing in most GP reporting analysis. Until these KPIs are standardised to a certain degree, most LPs believe that any such reporting will 'miss the mark' and provide an incomplete view of fund performance.

One could argue that, due to its breadth, the ILPA's ESG Framework is limited in practical application, and that LPs will require additional support in understanding how to specifically address certain issues, such as ESG reporting at portfolio company level. Although some of the framework's language remains open to interpretation, as ILPA's ESG Framework develops it will be interesting to see how the Framework can be implemented on a more practical level.

Next steps for alternative investment funds

It is yet to be seen how the ILPA's ESG Framework is influencing investment decisions and discussions with sponsors. The ILPA toolkit continues to develop and provides investors a framework to align themselves with. It is also worth noting that the ILPA Framework focuses on traditional mid-market to large cap buyouts that are likely to have significant resources in this area already. Nonetheless, the opportunity to develop an ESG framework that balances the needs of smaller managers and encourages cross-industry discussion is indeed welcomed, and we would hope that this dialogue continues.

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Updates in the European Credit Market

Changes to the Lux securitisation regime and its relevance to loan origination

Draft law 7825

Under the previous drafting, Luxembourg securitisation law did not allow a securitisation vehicle to actively manage the assets in its securitised portfolio. The new bill clarifies that as relates to loan origination and CLO structures, active management (by the vehicle or a third party) is now allowed for Luxembourg securitisation vehicles for risks linked to bonds, loans or other debt instruments, except if the financing instruments are issued to the public. Whilst one of the objectives is to increase the attractiveness of utilising Luxembourg for CDO/CLO structures, it should also allow more flexibility for the use of such vehicles in the context of private debt funds.

Our next edition of KUWAIF will include a more detailed overview on the wider changes.

Further, broader information on securitisation in Luxembourg is also available here.

HMRC queries surrounding Beneficial Ownership and Opaque status of Irish vehicles

We have seen HMRC making a number of enquiries into Double Tax Treaty Passports ("DTTP") applications for Irish entities which are intending to acquire or originate loans to UK borrowers, including Irish Collective Asset-management Vehicles ("ICAVs") and Designated Activity Companies ("DACs").

In our experience, these have focused on the "opaque" status of various Irish vehicles and their beneficial ownership of the income received on the underlying loans.

Next Steps

If you are interested in hearing more about changes to the Luxembourg securitisation regime, please reach out to your usual PwC Luxembourg regulatory or tax contact. Alternatively, please get in touch with Jamie Taylor or Leo Humphries (details below) who will introduce you to an appropriate person

If you've received enquiries from HMRC on either the "opaque" status or beneficial ownership of Irish vehicles, and would like to speak to us about it, please reach out to your usual PwC UK tax contact, or Leo Humphries, who would be happy to discuss.

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