Navigating Through AIFMD
A Guide for Private Equity and Venture Capital Funds in Ireland

kpmg.ie/aifmd
| 01 | So what exactly is AIFMD?     | 2 |
| 02 | Scope of AIFMD               | 3 |
| 03 | Authorisation of AIFMs and AIFs | 5 |
| 04 | Operating conditions         | 8 |
| 05 | The tax implications for PE and VE funds | 13 |
| 06 | How AIFMD applies specifically to PE and VC funds | 14 |
| 07 | New developments             | 15 |
| 08 | How we can help you          | 16 |

Glossary of terms 17
Foreword

The introduction of the *Alternative Investment Fund Managers Directive* (“AIFMD” or the “directive”) in July 2013 has had a fundamental impact on how the alternative investment funds industry across Europe conducts its business. The enactment of the directive has had a particular impact on the funds industry in Ireland, given the extraordinary growth in the industry here in recent years.

Progressive policies introduced by Irish legislators and a progressive approach to regulation, not to mention a huge amount of hard work by industry professionals, has resulted in a situation where Ireland is increasingly seen as the domicile of choice for private equity and venture capital funds (“PE and VC funds”) seeking to market their funds across the EU.

The introduction of the AIFMD directive has, however, presented the industry with some considerable challenges, particularly on the issues of implementation and compliance. For this reason, the Regulatory team at KPMG has pooled their expertise to produce this information booklet which we will hope will answer most of the questions that a PE or VC funds manager may have in terms of the impact of the directive on the way business is conducted.

We hope this booklet is of benefit to both existing PE and VC funds in Ireland and also to those considering Ireland as a domicile.

At KPMG, we have a multi-disciplinary team of professionals who have the expertise, experience and knowledge to provide first rate advice for managers of PE and VC funds. We hope to meet some of you in the future and show how we can help you establish and grow your funds business in Ireland.

Frank Gannon  
Partner and Head of Alternative Investments Advisory  
KPMG in Ireland

Paul O’Connor  
Director and Head of Regulatory Advisory Services  
KPMG in Ireland
AIFMD came into effect in Ireland on 22 July 2013, and was introduced by the European Commission partly in response to the 2008 financial crisis, but also in response to a number of financial scandals - not least the Bernie Madoff scandal in the United States.

Investor confidence had understandably been hit by the crash and the scandals, and the Commission felt the need to introduce additional regulation to restore confidence among both professional and retail investors. The directive is aimed at reducing the risk posed by Alternative Investment Funds (“AIF” or the “fund”) to the very stability of the EU financial system and to bolster investor confidence. At this stage it is worth emphasising that the directive primarily regulates fund managers - not the fund itself, although there are knock-on implications for the funds.

The directive introduces a new uniform set of rules for all managers of AIFs including PE and VC funds, which to a large degree had previously gone unregulated in a number of EU countries. Against that background of virtual non-regulation, it’s no surprise that the directive has presented the alternative funds industry Europe-wide with a number of new challenges.

Under the terms of the directive, fund managers - whether they are based in the EU or not - who manage and market AIFs in the EU - must be authorised by an EU regulator, and in the case of Ireland that regulator is the Central Bank of Ireland.

The rules in the directive on operational, organisational, reporting and capital requirements are far more onerous that anything included in the MiFiD or UCITS directives.

Private equity and venture capital fund managers, as a result, now have to operate within a system where there are a whole set of new requirements in relation to depositaries, independent valuations and remuneration, and that presents a whole new range of challenges.
How do I know if my PE or VC fund comes under the directive?
The answer to this key question is actually quite straightforward - any undertaking which manages a PE or VC fund will come within the scope of the directive if the fund it manages meets the directive’s definition of an AIF. The directive requires that every AIF has a single fund manager to manage the fund.

So what defines an AIF under the directive?
The directive’s definition of an AIF is actually quite broad and essentially includes almost all non-UCITS funds. If a fund does not have a general commercial or industrial purpose and it meets the criteria below then it will be deemed to be an AIF under the terms of the directive.

So what are the criteria?
A fund will be deemed to be an AIF if:
- It is a non-UCITS collective investment where the unit holders are not operationally involved
- It raises capital
- It raises that capital from a “number of investors”
- It has a view to investing that capital in accordance with a “defined investment policy”.

So what’s considered not to be an AIF?
Basically, any undertaking which is involved in what the directive considers:
- A commercial activity involving the sale of goods and/or non-financial services
- An industrial activity
- A combination of the two.

Who defines what constitutes a “commercial” or “industrial” activity?
The European Securities and Markets Authority (ESMA) and the European Commission provide guidance on what defines an AIF.

Who is the Alternative Investment Fund Manager of the AIF?
The alternative investment fund manager (“AIFM” or the “fund manager”) is broadly defined as “any legal person whose regular business is managing one or more AIFs”.

Can the AIF fund also act as its own fund manager?
Yes, the AIF can be its own fund manager - what is defined as a “self-managed AIF”. Alternatively, the fund can appoint on outside fund manager, defined as an “externally managed AIF”.

What does all this mean in an Irish context?
In an Irish AIF structured as a limited partnership, the fund manager will either be the general partner or a third party appointed by the general partner such as an investment manager.

What if the general partner is a MiFiD firm?
If this is the case, then it is crucially important to know that a firm can’t be authorised both under MiFiD and as a fund manager under the directive. In this situation, a decision has to be made - does the general partner give up its MiFiD authorisation so it can act as the AIFM or should another entity obtain authorisation as the fund manager.

Does the directive provide any exemptions for existing funds?
The directive includes a “grandfathering” provision for fund managers if they only manage funds that are closed-ended and either:
- Make no additional investments after 22 July 2013; or
- Will expire by 22 July 2016 and have closed their subscription period before 21 July 2011.

This may be of particular relevance to PE and VC funds.

What investment vehicles are not covered by the directive?
The directive generally does not apply to so-called “exempt investment vehicles” such as segregated managed accounts, family offices and similar private investment vehicles, joint venture schemes, insurance contracts, some securitisation special purpose vehicles, employee participation and saving schemes and holding companies.

Joint ventures, however, which have fund-like characteristics such as capital-raising, passive participants and defined investment policies may be considered as AIFs and as a result may be covered by the directive.
PE and VC funds should note that the European Commission considers that the exemption for holding companies does not cover private equity and venture capital.

What fund managers are exempt from the directive?
The directive does not apply to fund managers if they manage AIFs whose only investors are the fund manager itself, its parent company or subsidiaries of the parent company provided that none of those investors is the AIF itself.

What are the implications for limited “1907” partnerships?
First of all we need to understand what a 1907 partnership actually is.

In Ireland the vast bulk of PE and VC funds use limited partnerships for their legal structure. In these limited partnerships, one or more general partner has unlimited liability while the liability of limited partners is restricted to the amount they have contributed to the fund.

Before the directive was implemented in Ireland, limited partnerships, in general, were not subject to regulation. As a result of the absence of regulation, these “1907 partnerships” were able to set up unregulated investment funds as long as funds were not raised publicly and its funding came solely through private placement.

In many cases, the general partners in a 1907 partnership could avail of an exemption from MiFiD authorisation on the basis that they were providing portfolio management services to fellow partners and not to any third party. This “communality of interest” concept had been generally accepted by the Central Bank of Ireland.

The introduction of the AIFMD directive in Ireland has, however, resulted in most limited partnerships falling under the definition of an AIF and previously unregulated undertakings now being regulated.

For example, where joint ventures take the form of limited partnerships, in order to retain their limited liability the investors must not be involved in the management of the business which must be vested solely in the general partner and therefore the directive does apply.

Another example is the number of partners involved. Normally 1907 partnerships have up to 20 partners, but in some cases this can be up to 50. In the context of the directive’s definition of an AIF (among other things the raising of capital from a “number of investors”), the limited partnership falls under the definition of an AIF.

The FCA has decided that where there is a single limited partner making a substantial contribution and a general partner making a nominal contribution, then it will not be deemed an AIF as it not raising capital from a “number of investors”.

However, it should be borne in mind that, if the constitution of the limited partnership allows for more than one limited partner, then it will be deemed as raising capital from more than one investor even if in reality there is only one limited partner. The fact that a fund has only a single investor does not automatically put that fund beyond the definition of an AIF. ESMA has also made it clear in its guidelines that there must be a legally enforceable restriction from a single investor. Without this legal restriction, the fund would be regarded as having a “number of investors”.

From the above, it is clear that there is a level of ambiguity about what constitutes an AIF under the terms of the directive, particularly in relation to 1907 partnerships. General partners in 1907 partnerships will need to look closely at their particular structures to see whether they are subject to the directive.
Authorisation of AIFMs and AIFs

Do I need to apply for full authorisation or registered AIFM status?

The directive provides for two types of regulatory status for AIFMs:

- AIFMs above a certain threshold level need to be authorised. Fully authorised AIFMs are subject to all of the directive’s requirements but can benefit from the marketing and management passport throughout the EU.
- AIFMs below the threshold level (“sub-threshold”) only need to be registered. Registered AIFMs are subject to minimum requirements but cannot avail of the marketing and management passport.

Those PE and VC firms, which are deemed to be “sub-threshold”, only need to be registered AIFMs but some may choose to voluntarily opt to become authorised in order to obtain the marketing and management passport. The choice is essentially theirs - if they wish to do business across Europe then they should opt in.

What then defines “sub-threshold”?

A sub-threshold AIFM is a fund manager whose assets under management do not exceed:

- €500 million, provided the fund is not leveraged and the investors have no redemption rights for the first five years; or
- €100 million, including all leveraged assets.

It is estimated that the €100 million threshold level would make about 30 percent of AIFMs who manage almost 90 percent of assets in EU-domiciled AIFs funds, subject to the full requirements of the directive.

What minimum requirements are on a registered AIFM?

A registered fund manager will have to register with the Central Bank of Ireland, provide details of its investment strategy, periodic updates of the main assets held and particularly any breaches of the minimum threshold.

If a fund manager does breach the threshold and this is considered likely to continue for three months, then he has 30 days to seek full authorisation under the directive.

How do I apply for authorisation or registration?

The application process is relatively straightforward. Once a fund manager is incorporated in any EU country that has transposed the directive into its own law, he can be authorised in that country and can obtain a marketing and management passport throughout the EU for his funds.

As indicated earlier, if a registered fund manager does not opt for authorisation he is not eligible for a marketing and management passport and will have to rely on private placement for distribution of his funds. Alternatively, the fund can be designated as a venture capital fund under the EuVECA rules, a designation that is only available to registered fund managers. This is discussed later in chapter seven.

The fund manager must then submit the application to the Central Bank of Ireland including a document detailing its organisational structure and how it intends to comply with the provisions of the directive. The application will also need to include details on the fund manager’s remuneration policy, minimum capital and financial projections and information on the funds it plans to manage.

As with other financial institutions regulated by the Central Bank of Ireland, directors of an AIFM will be subject to the regulator’s standard fitness and probity regime.
What is a QIAIF and what are its main features?

A Qualifying Investor Alternative Investment Fund (QIAIF), the successor to the Qualified Investor Fund (QIF) is a regulated, specialist investment fund targeted at professional and institutional investors, who must meet minimum subscription and eligibility requirements.

A QIAIF comes within the definition of an AIF under the terms of the directive and is therefore required to designate an AIFM fund manager. For retail investors, there is an alternative fund, the Retail Investor Alternative Investment Fund (RIAIF).

QIAIFs:

- Are not subject to borrowing or leverage limits
- Are not subject to any regulatory diversification requirements
- Must appoint a regulated fund manager
- Can be open-ended, open-ended with limited liability, have limited liability or be closed-ended and may provide for carried interest or waterfall payments.

Unlike its predecessor, the QIF, the QIAIF has a number of enhancements of particular interest to PE and VC firms, including:

- They can use bridge financing - this is of particular interest to PE funds
- There is no minimum viable size rule for property funds
- The initial offer period for property and PE funds has been extended from one to two years
- There are new rules on partly-paid units - this is of particular benefit for PE and property funds.

So who should invest in a QIAIF and what are the entry requirements?

QIAIFs are sophisticated investments and are targeted at the professional investor. They are not appropriate for small retail investors and require a minimum subscription of €100,000 - or €500,000 if the QIAIF invests more than 50 percent of its net assets in unregulated funds.

Investors in a QIAIF must be either:

- A "professional client" as defined in the MiFiD directive
- An investor who has received an appraisal from a EU credit institution, MiFiD firm or UCITS provider that the investor has the required expertise, knowledge and experience to understand the investment
- An investor who self-certifies himself as an informed investor with the knowledge and experience to evaluate the risks involved, and who provides confirmation that his business involves management of assets similar to that managed by the AIFM fund manager.

How is a QIAIF managed?

The Central Bank of Ireland requires a QIAIF to have at least two Irish resident directors while the appointment of a management company or general partner is a mandatory requirement if the QIAIF is structured as a limited partnership.

What is a start-up QIAIF?

New QIAIFs (but not RIAIFs) authorised after 22 July 2013 are permitted to have a registered fund manager instead of a fully authorised fund manager. This regime gives start-up AIFMs establishing a fund time to grow their assets before they become subject to the full requirements of the directive. Within two years, or when the fund’s assets exceed the directive’s thresholds - whichever is sooner - a fully authorised AIFM must be appointed to the fund.
Applying to the Central Bank of Ireland for authorisation
The establishment of the legal arrangements underpinning a QIAIF normally takes a number of weeks to complete. This involves the formation of the limited partnership, completing the agreements with the various service providers and preparation of the prospectus and accompanying documentation. Once all this is in place and all the service providers have been approved by the Central Bank of Ireland, then QIAIFs can avail of a 24-hour fast track approval process.

What documentation does the Central Bank of Ireland require?
The Central Bank of Ireland will require the following documentation for approval of a QIAIF structured as a limited partnership:

- Prospectus
- Constitutional documents such as the limited partnership agreement
- Administration agreement
- Depositary agreement
- Investment management agreement
- Prime brokerage and sub-custodian agreement (where applicable)
- Distribution agreement (if applicable)
- QIAIF application form
- Ancillary documentation for general partner/AIFM/depositary.

Listing funds on the Irish Stock Exchange
Once the Central Bank of Ireland has authorised a QIAIF, the fund meets most of the listing criteria of the Irish Stock Exchange, if a public listing is considered to be of benefit.
Depositary

Depositary arrangements and how they apply to PE and VC firms?

Before the enactment of the directive, PE and VC funds typically did not have an external custodian or trustee holding the assets of the partnership.

That has now changed with the directive now requiring PE and VC funds to appoint a depositary to safeguard the assets of the fund. The arrangement between the fund manager and the depositary is a formal one - and a written contract of appointment is a mandatory requirement.

The AIFM cannot act as the depositary - instead, for EU AIFs the depositary must be an independent entity based in the same country as the EU fund and must be authorised by the local regulator as a credit institution or an investment firm. In Ireland’s case, the depositary must be authorised by the Central Bank of Ireland.

The directive does, however, give EU member states flexibility to allow professional service firms such as law firms and investment firms to act as depositaries for AIFs in certain circumstances; where funds have lock-up periods of at least five years or where funds do not invest in assets that must be held in custody. Many PE and VC firms will be able to avail of this flexibility.

What are the main responsibilities of the depositary?

The main responsibilities of the depositary are:

- Verification of the ownership of the fund’s assets and record keeping
- Cash flow monitoring
- Oversight duties, including ensuring the completeness of dividend payments and carried interest arrangements.

In practice, ownership verification may prove to be the most challenging duty of the depositary for PE and VC funds as PE and VC structures can involve numerous legal entities domiciled in several jurisdictions.

Valuations

Must an AIFM appoint an external valuer?

Under the terms of the directive, a fund valuation must be conducted. It can be conducted internally by the fund manager or by an external third party. It is likely that many PE and VC funds will opt to have the fund manager conduct the valuation internally, in line with current practice.

But one key change that the directive brings is that the fund manager must ensure that any internal valuation is conducted independently of the portfolio management function. This means, in effect, that a portfolio manager is not permitted to value the assets in his own portfolio. The fund manager also has to mitigate any potential conflicts of interest and prevent any undue influence being placed on the individuals carrying out the internal valuation of the fund’s assets.

Obviously some smaller AIFMs with complex asset bases might find it difficult to ensure that the internal valuation is conducted independently of portfolio management. ESMA has indicated, however, that national regulators should apply the principle of proportionality to this requirement by taking into account the operational structure of the AIFM and its corporate governance arrangements.

The directive requires assets to be valued and net asset value per unit to be calculated at least annually. Some real estate and private equity fund managers with longer term investment horizons may have problems with this annual reporting requirement, which may represent a significant change to their existing practice.
How should investments be valued?

The directive provides for assets to be valued in different ways, such as by reference to prices on an active market or by an estimate using valuation models.

Where a model is used for valuing assets:

- The valuation procedure should indicate the main features of the model
- The model should be validated by an individual who was not involved in building the model. The person conducting the model validation should be competent to do so and could be for example an auditor
- Valuation policies should be reviewed at least annually and before a fund switches to a new investment strategy or invests in a new type of asset.

For funds, where prices in an active market are being used for valuation, fair value measurement as defined by IFRS 13 is appropriate and indicates the price at which the fund can exit its investment or transfer its liability. While an exit price is easy to define where there have been actual transactions, PE and VC funds will generally have to apply a valuation technique. While the IFRS 13 financial standard does not specify a particular technique to determine fair value, two of the most common techniques used for valuing private equity investments are referencing to comparable companies and discounted cash flow. Other less frequently used techniques include comparable transactions (which in the world of private equity, often means a refinancing round) or co-investor dealing.

Various valuation guidelines have also been issued by the private equity industries in Europe and the United States, the EVCA in Europe and the PEIGG in the United States. The broad principles are:

- Use observable market data rather than relying on judgement
- Be wary of using valuations based on letters of intent or non-binding offers
- Don’t just apply an industry median multiple; growth, profitability and risk profile are three key factors to be used when benchmarking a company and assessing appropriate earnings multiples
- The valuation should factor in any changes expected within the firm, its industry and its market. Value should not remain at cost
- Underlying assumptions should be documented.

A variety of methodologies should be used to cross-check valuations but don’t be tempted to automatically take the median value of valuations produced by different models. The use of personal judgement is important.
Capital Computation

Step 1

Identify all AIFs for which AIFM is appointed / identify internally-managed AIFs

Guidance

- do not include AIFs that the AIFM is managing under delegation Ref. Art 9 (4); Level 1 (“L1”)
- do not include UCITS Ref. Art 9(10) of L1
- do not include grandfathered AIFs for EU AIFM, Ref: Q&A European Commission - ID 1186
- do not include portfolios managed under individual/discretionary management when calculating the additional own funds. Ref: Q&A European Commission - ID 1147

Step 2

Calculate initial own funds (A)

Guidance

Ref. Article 9(1,2); L1

AIFM internally managed: Initial own funds = min €300 000
AIFM appointed as external manager of AIFs: Initial own funds = min €125 000

Step 3

Calculate additional own funds (B): unrelated to Professional Liability Risk (“PLR”)

Guidance

Ref. Article 9 (3); L1

If aggregated value of AIFs portfolio > € 250 Million --> additional amount of own funds (unrelated to PLR) is required

Computation

(B) = (SUM of AIFs PTF - € 250 million) * 0.02%
Guidance

The required total of the initial amount (A) and the additional amount (B) shall not, however, exceed €10 million and shall never be less than a quarter of the previous year’s fixed overheads.

Step 4

Calculate additional own funds (C): related to PLR

\[(C) = \text{Value of AIFs managed}(\text{\textdagger}) \times 0.01\%\]

\(^*\) Value of the portfolios of AIFs managed: the sum of the absolute value of all assets of all AIFs managed by the AIFM, including assets acquired through use of leverage, whereas derivative instruments shall be valued at their market value.

Guidance

The Directive requires AIFM to have either additional own funds or hold professional indemnity insurance (“PII”) to cover potential risks arising from professional negligence.

Ref. Art 9(6), L1 and Art. 14,15, L2

When an AIFM decides to choose to cover professional liability risks through professional indemnity insurance, PII needs to cover 0.9% of the value of the portfolios of AIFs managed for claims in aggregate per year, and 0.7% of the value of the portfolios of AIFs managed per individual claim.

The regulation requires AIFMs to establish policies and procedures for operational risk management, to be reviewed at least on an annual basis.

Step 5

Calculate total capital requirements (D)

\[(D) = (A) + (B) + (C)\]

Ref. Article 9 (5, 8); L1 regarding investments in liquid assets
Remuneration

Does carried interest fall within the directive’s remuneration rules?
The directive’s rules on remuneration apply to all forms of payment paid by the AIFM, including carried interest and any transfer of shares of the fund.

The directive defines carried interest as a share in the profits of the AIF paid to the fund manager as payment for his management of the fund. It excludes any share in the profits of the fund which accrue to the fund manager as a return on his own investment into the fund.

Many carried interest arrangements already comply with some of the directive’s key rules on remuneration - particularly where carried interest is deferred and is in line with the concept that payment of carried interest is an incentive not to take unnecessary risks.

Some important clarifications on remuneration, carried interest and clawback have been produced by both the ESMA and the FCA.

ESMA has indicated that where a payment represents a pro rata return on investment by the AIFM’s employees then this should not be subject to the directive’s remuneration provisions. However, in order for these payments to be considered exempt, any loans made to employees by the fund manager will need to be repaid in full before the return on the fund’s investments is paid to those employees. This clarification by the ESMA is very helpful for co-investment arrangements. However, in a typical PE carried interest arrangement, employees usually pay a nominal amount to acquire their carried interest and are treated as acquiring the carried interest for fair market value for tax purposes.

The FCA has also provided its own clarification on the directive’s provisions on remuneration for the fund manager, particularly as to whether payment to a partner represents remuneration or a return on equity. The FCA has warned that fund managers should not allocate all payments to a partner as a profit share unless there is sound justification for doing so.

The Central Bank, however, has yet to produce guidelines on the directive’s remuneration provisions and it may not do so for some time.

In relation to clawback, ESMA has indicated that clawback provisions should apply to carried interest arrangements where a hurdle linked to return on capital must be overcome before carried interest payments are made to employees. ESMA believes that clawback provisions are necessary to ensure that the interests of employees of the fund manager are aligned with the interests of the fund’s investors. This is significant because currently most carried interest arrangements do not include a clawback provision.

The directive has specific requirements relating to the disclosure of remuneration in AIF annual reports. The total remuneration paid by the fund manager to staff and carried interest paid by the fund itself must be disclosed - with the total remuneration split between fixed and variable remuneration. Fixed remuneration is defined as payments that are not performance-linked while variable remuneration is defined as additional payments linked to performance or, in certain bases, other criteria.

Often carried interest is not paid to the fund manager but is instead paid to a special limited partner. This makes no difference, however, when it comes to disclosure as the directive’s rules on remuneration have been drafted widely enough to ensure that carried interest payments to a special limited partner must also be disclosed in the annual report.
The tax implications for PE and VC funds

What taxes apply?
In Ireland, employment taxes are high by international standards, with people on relatively modest incomes paying income tax at 41 percent, a universal social charge (USC) of 7 percent and pay-related social insurance (PRSI) of 4 percent. Indeed, an employee earning no more than approximately €32,000 a year will see 52 percent of anything earned over that figure disappear into the coffers of the Revenue Commissioners.

Where an Irish resident receives a carried interest entitlement they will, in general, be subject to the full income tax-USC-PRSI deduction. It is arguable that, outside the special circumstances outlined here, where carried interest is granted in the form of shares, then the exposure to Irish income tax and ancillary levies should be confined to the upfront value of the share, and that any future increase in value should be subject to Capital Gains Tax. The Revenue Commissioners, however, can decide that all value relating to the shares should be subject to income tax and social charges. How tax is levied will, to a degree, depend on the Revenue Commissioners’ own assessment of the scheme.

There is, however, an exception to this rule arising from the introduction of a scheme aimed at incentivising venture capital funds to domicile themselves in Ireland. This exception provides that, in specified circumstances, persons holding a carried interest in PE and VC funds are entitled to Capital Gains Tax treatment at a rate of 15 percent for individuals and 12.5 percent for corporates, rather than falling under the income tax-USC-PRSI regime.

What constitutes a “relevant investment”?
One of the key requirements to qualify as a relevant investment is that the company is involved in “innovation” or “research and development” in specified scientific and engineering fields. These include:

- Basic experimental or theoretical research to acquire new scientific or technical knowledge without a specific practical application in view
- Applied research in order to gain scientific or technical knowledge directed towards a specific practical application
- Experimental work, drawing on existing knowledge, aimed at achieving technological advances or resolving scientific uncertainty

In addition, this special treatment is only available in respect of a carried interest which is not greater than 20 percent of the total profits of the fund.

What other tax reliefs are there?
Where the carried interest involves a grant of shares, there are some reliefs available for certain employment-related share schemes.

These include a reduction in the amount subject to income tax where the individual concerned is restricted from disposing of the shares for a period of time. Under this provision, the amount subject to income tax is reduced by 10 percent for each year of the disposal restriction, up to a maximum of 60 percent where the period is in excess of five years.

This is an attractive regime and is regularly used where remuneration is share-based. However, there are anti-avoidance rules which provide for the clawback of the abated income tax if the conditions attached to the tax relief are broken. There are also other anti-avoidance provisions where shares granted to employees can convert into more valuable shares over time.
How AIFMD applies specifically to PE and VC funds

What are the “anti-asset stripping” rules?
The directive provides that where an AIF acquires control of an EU-based listed or unlisted company - also known as “portfolio companies” - for 24 months after the acquisition the fund manager must not engage in or must use his best efforts to prevent:

- Any reduction in capital
- Any share redemption
- Any distribution or share buyback where the net assets of the portfolio company fall below its subscribed capital and non-distributable reserves
- Any distribution to shareholders greater than available profits.

What are the disclosure and notification obligations of a PE or VC fund?
Where an AIF - either on its own or jointly with another fund - has a shareholding in a non-listed EU company, the fund manager must inform the local regulator of reductions in the shareholding below certain thresholds - 10 percent, 20 percent, 30 percent, 50 percent and 75 percent.

Where an AIF acquires control - more than 50 percent of the voting rights - of a non-listed EU company, the fund manager must provide certain information to the portfolio company itself, to all other shareholders in the company and the relevant regulator - in Ireland’s case the Central Bank of Ireland.
New developments

What is EuVECA?
As stated earlier, registered AIFMs cannot avail of the EU marketing and management passport unless they opt in and apply for full authorisation. Opting in allows PE and VC firms to raise money across the EU for their funds and avail of the directive’s “badge/brand of quality”.

But opting in may be challenging for smaller fund managers, both from a logistical and cost point of view, and any decision to opt in should be based on strategic grounds and should not just be viewed simply from a cost or compliance perspective. For fund managers who are not convinced that opting in will necessarily benefit their business, there is an alternative to the AIFMD directive…the EuVECA Regulation.

The European Venture Capital Fund (EuVECA)
The EuVECA Regulation came into effect in July 2013 and can provide certain registered AIFMs with a marketing passport for their funds. The regulation, in effect, allows EU-registered AIFMs who are in compliance with the directive and who manage certain qualifying funds known as EuVECA to market these funds to professional investors throughout the EU. This greatly simplifies the marketing of the funds, as there will be no requirement to meet the different private placement requirements in the different EU member states as would otherwise be the case.

To obtain EuVECA designation:

- The fund must be established in the EU
- The fund must be an AIF as prescribed by the AIFMD directive
- The fund must invest at least 70 percent of its aggregate capital contributions and uncalled but committed capital in “qualifying investments”
- The fund must not use more than 30 percent of its total capital on non-qualifying investments.

For EuVECA purposes, “qualifying investments” are quite diverse. They include equity or quasi-equity instruments, secured or unsecured loans granted by the qualifying VC fund to an investee company, or shares in other qualifying VC funds. There are limitations on the use of leverage for EuVECA funds.

What is EuSEF?
The European Social Entrepreneurship Fund (EuSEF) has an equivalent framework to a EuVECA except that it must invest at least 70 percent of its aggregate contributions in businesses that have a positive social impact and address specified social objectives.

What is an ICAV?
The Irish Collective Asset Management Vehicle (ICAV) is a new corporate structure for Irish investment funds which can be used for both UCITS and AIFs.

If the ICAV is used to establish an AIF, then it is subject to the AIFMD directive.

Once the legislation providing for ICAVs is enacted in 2014, it will give new PE and VC funds an additional option when deciding on the legal framework they wish to use when setting up new funds. One of the key features of an ICAV that may make it attractive to US investors is that it can elect to be classified as an “eligible entity” which can allow it be treated as a partnership for US tax purposes. This would mean that US investors could avoid certain tax consequences.

The tax treatment of “1994” partnerships
We’ve already covered 1907 partnerships, so what exactly are 1994 partnerships?

Legislation introduced in 1994 facilitated the formation of Investment Limited Partnerships (ILPs). Like 1907 partnerships, the rules applying to a 1994 partnership require the appointment of at least one general partner to manage the fund, with the liability of the limited partners confined to the size of their contribution to the fund - as long as those limited partners are not involved in the running of the partnership. The difference in the two forms is the tax treatment.

The Finance Act 2013 brought in new measures which will make Irish ILPs a more attractive proposition for international PE and VC firms. Previously an ILP was classified as an “investment undertaking” but the 2013 Act removed this classification. This meant that instead of tax being charged to the partnership itself, tax is now imposed on the income of the partners in proportion to the value of their investment while exemptions for stamp duty, capital acquisition tax and withholding tax still apply.
How we can help you

KPMG advisory, audit and taxation specialists in Ireland have a wide variety of skills and experience to offer PE and VC funds. Our suite of services support fund managers and funds from initial launch through to ongoing compliance and reporting. We offer a multi-faceted approach providing regulatory, audit, advisory, taxation and valuation services to address the many issues that PE and VC funds face from a regulatory, accounting and taxation perspective.

Accounting advice
We have significant expertise and experience in advising PE and VC funds under IFRS, US GAAP or other accounting frameworks. Key accounting issues to be considered include valuation of investments, potential consolidation and accounting for performance fees.

Audit services
Our PE and VC fund clients include many different structures based in a wide variety of jurisdictions. We have extensive experience in auditing clients that apply IFRS, US GAAP or other accounting frameworks. Our audit team includes 13 audit partners supported by a strong, experienced team of professionals. We are very familiar with the challenges that PE and VC funds face in meeting their financial reporting obligations which typically include the application of the most appropriate valuation methodology, consolidation and appropriate financial risk disclosures.

Regulatory and compliance
Our local and international regulatory specialists, in the regulatory centres of excellence, can provide advice on the impact of relevant regulatory rules on PE and VC funds.

Tax strategies and structuring
Our tax team are leaders in advising on appropriate tax management and tax planning structures that are appropriate to the investment strategy of a fund. Our tax team work closely with our Global Tax Network and have significant knowledge and experience relating to appropriate tax strategies for PE and VC funds.

Our tax team also perform detailed tax due diligence on tax exposures of potential targets.

Transaction services
Our transaction services team includes Buy Side, Sell Side and Strategy professionals and have a proven methodology for supporting organisations coming to the public markets and for providing due diligence support on acquisition of investments.

Our Buy and Sell Side professionals provide merger, acquisition and divestiture support to clients. Throughout a transaction’s life cycle, our persistent focus is on early identification of the key risks and rewards that matter most to stakeholder value. This means going beyond traditional due diligence to address factors such as deal financing, compensation arrangements, capital markets regulatory assistance and deal structure.

Our Strategy professionals help clients validate and address specific issues likely to impact the future financial results realised from a particular transaction.

Valuation
Our local and international valuation teams have significant experience in valuing investments. Our valuation teams provide both audit support and independent valuations. Many fund managers look to KPMG for objective advice on portfolio valuations that can help to fulfil their fiduciary responsibilities.
# Glossary of terms

<table>
<thead>
<tr>
<th><strong>1907 Partnerships</strong></th>
<th>Limited partnerships established under the Limited Partnership Act 1907</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1994 Partnerships</strong></td>
<td>Limited partnership established under the Investment Limited Partnerships Act 1994</td>
</tr>
<tr>
<td><strong>AIF</strong></td>
<td>Alternative Investment Fund</td>
</tr>
<tr>
<td><strong>AIFM</strong></td>
<td>Alternative Investment Fund Manager</td>
</tr>
<tr>
<td><strong>AIFMD</strong></td>
<td>Alternative Investment Fund Manager Directive</td>
</tr>
<tr>
<td><strong>CBI</strong></td>
<td>Central Bank of Ireland</td>
</tr>
<tr>
<td><strong>ESMA</strong></td>
<td>European Securities &amp; Markets Authority</td>
</tr>
<tr>
<td><strong>EuSEF</strong></td>
<td>European Social Entrepreneurship Fund</td>
</tr>
<tr>
<td><strong>EuVECA</strong></td>
<td>European Venture Capital Fund Regulation</td>
</tr>
<tr>
<td><strong>FCA</strong></td>
<td>Financial Conduct Authority</td>
</tr>
<tr>
<td><strong>ICAV</strong></td>
<td>Irish Collective Asset-management Vehicle</td>
</tr>
<tr>
<td><strong>ILP</strong></td>
<td>Investment Limited Partnership</td>
</tr>
<tr>
<td><strong>MiFID</strong></td>
<td>Markets in Financial Instruments Directive</td>
</tr>
<tr>
<td><strong>PLC</strong></td>
<td>Public limited company</td>
</tr>
<tr>
<td><strong>PRSI</strong></td>
<td>Pay-related social insurance</td>
</tr>
<tr>
<td><strong>QIAIF</strong></td>
<td>Qualifying Investor Alternative Investment Fund</td>
</tr>
<tr>
<td><strong>RIAIF</strong></td>
<td>Retail Investors Alternative Investment Fund</td>
</tr>
<tr>
<td><strong>UCITS</strong></td>
<td>Undertakings for Collective Investment in Transferable Securities</td>
</tr>
<tr>
<td><strong>USC</strong></td>
<td>Universal Social Charge</td>
</tr>
</tbody>
</table>
Contact us

Darina Barrett  
Head of Financial Services Markets  
KPMG in Ireland  
+353 1 410 1376  
darina.barrett@kpmg.ie

Michael Hayes  
Tax Partner  
KPMG in Ireland  
+353 1 410 1656  
michael.hayes@kpmg.ie

Gareth Bryan  
Tax Partner  
KPMG in Ireland  
+ 353 1 410 2434  
gareth.bryan@kpmg.ie

Vincent Reilly  
Head of Alternative Investments  
KPMG in Ireland  
+353 1 410 1378  
vincen.reilly@kpmg.ie

Brian Clavin  
Head of Investment Management  
KPMG in Ireland  
+ 353 1 410 1252  
brian.clavin@kpmg.ie

Paul O’Connor  
Head of Regulatory Advisory Services  
KPMG in Ireland  
+ 353 1 700 4038  
paul.oconnor@kpmg.ie

Frank Gannon  
Head of Alternative Investments Advisory  
KPMG in Ireland  
+353 1 410 1552  
frank.gannon@kpmg.ie

Heleen Rietdijk  
Global Lead AIFMD  
KPMG in Ireland  
+353 1 700 4111  
heleen.rietdijk@kpmg.ie

Seamus Hand  
Head of Financial Services Tax  
KPMG in Ireland  
+ 353 1 410 1437  
seamus.hand@kpmg.ie

© 2014 KPMG, an Irish partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. Printed in Ireland.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

The KPMG name, logo and “cutting through complexity” are registered trademarks of KPMG International Cooperative (“KPMG International”), a Swiss entity.

If you’ve received this publication directly from KPMG, it is because we hold your name and company details for the purpose of keeping you informed on a range of business issues and the services we provide. If you would like us to delete this information from our records and would prefer not to receive any further updates from us please contact us at (01) 410 2665 or e-mail sarah.higgins@kpmg.ie.

Produced by: KPMG's Creative Services. Publication Date: July 2014.