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FUND FORMATION

How PE Funds May Benefit From Anticipated Irish LP Vehicle Enhancements

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The Investment Limited Partnership (ILP) is regulated by the Central Bank of Ireland (Central Bank) as a tax-transparent common law partnership structure that is tailored specifically for Irish investment funds. Despite its favorable tax treatment and flexibility for master-feeder fund structures to access E.U. investors, various features of the ILP have prevented it from gaining popularity among private equity (PE) sponsors. To remedy that, the Irish government is planning to adopt ILP reforms in 2019 to align with international standards for PE funds and promote widespread adoption of the vehicle.

This article details various features of the ILP and certain anticipated reforms in the proposed Investment Limited Partnerships (Amendment) Bill 2019 (the Bill). Specifically, this article explores the ILP features, tax treatment and global distribution structures, as well as the factors driving adoption of the Bill and the ways it is expected to improve the ILP structure to benefit the PE industry.

See "Domiciling Funds in Germany or Ireland to Access the E.U. Post-Brexit, the Possible Introduction of PRIIPs and the Rising Prominence of UCITS Structures (Part Two of Two)" (Nov. 17, 2016); and "Redomiciling Offshore Investment Funds to Ireland, the European Gateway" (Mar. 4, 2011).

ILP Overview

Partnership Features

In accordance with the Investment Limited Partnerships Act 1994 (ILP Act), the ILP is constituted under a limited partnership agreement (LPA) and entered into by one or more general partners (GPs) that manage the business of the ILP and any number of limited partners (LPs). All of the assets, liabilities and profits of an ILP belong jointly to the GPs and LPs in the proportions agreed to in the LPA.

Typical to common law partnerships, the GP is the operative legal entity that is responsible for managing the ILP's business and ultimately liable for its debts and obligations to the extent the ILP does not have sufficient assets. The GP must be a corporate body which is either (1) authorised by the Central Bank to act as a GP; or (2) availing of the right to manage an Irish alternative investment fund (AIF) on a cross-border basis under the E.U. Alternative Investment Fund Managers Directive 2011/61/EU (AIFMD).

See "Marketing Strategies for U.S. Private Fund Managers Under AIFMD (Part One of Two)" (Jul. 21, 2016); and "AIFMD Has Increased Compliance Burden on Hedge Fund Managers (Part One of Two)" (Apr. 28, 2016).

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As mentioned above, there are no restrictions on the number of LPs that may be admitted to an ILP. An LP's liability for the debts and obligations of the ILP is limited to the value of the capital it has contributed or undertaken to contribute. An exception, however, exists when an LP becomes involved in conducting the ILP's business, which will subject the LP to liability for any debt incurred by the ILP during the LP's management period.

ILPs structured as qualifying investor alternative investment funds under AIFMD have the flexibility to adopt a full suite of liquidity options to suit a fund manager's needs. ILPs can be structured as open-end funds with full liquidity (*i.e.*, hedge funds), open-end funds with limited liquidity (*i.e.*, hybrid funds) or closed-end funds (*i.e.*, PE funds) with features such as redemption gates, deferred redemptions, holdbacks, in-kind redemptions and side-pockets.

See "Beyond the Master-Feeder: Managing Liquidity Demands in More Flexible Fund Structures" (May 25, 2017).

Tax Treatment

The ILP is tax transparent for Irish tax purposes, meaning that it is not charged taxes in Ireland on its income and gains. For the purposes of Irish taxation, an ILP's income and gains flow through directly to each LP in proportion to the value of the interests it beneficially owns in the ILP. Non-Irish LPs that do not hold their interests through, or in connection with, a branch or agency in Ireland should not be subject to Irish tax from their LP interests for any income or gains arising or accruing from sources outside Ireland.

The ILP does not have separate legal personality and, as noted above, is treated as tax transparent under Irish law. As such, the ILP is not generally able to claim the benefits of Ireland's network of double tax treaties. An LP, however, may be able to access a double tax treaty in place between its home jurisdiction and the jurisdiction where the assets are located. This may enable LPs to prevent withholding taxes being deducted or to reclaim withholding taxes suffered in particular countries on that basis.

Ireland has implemented both the U.S. Foreign Account Tax Compliance Act (FATCA) regime and the Organization for Economic Cooperation and Development common reporting standard (CRS). ILPs are thus able to comply with international FATCA and CRS requirements. Also, provided that the GP of an ILP complies with its FATCA obligations, no FATCA withholding should apply on payments from U.S. sources.

See "A Checklist for Updating Private Fund and Service Provider Documents for FATCA Compliance" (Feb. 21, 2014); and "Rothstein Kass Provides Roadmap for FATCA Compliance by Private Fund Managers" (Jun. 13, 2013).

Global Distribution and Parallel Structures

Importantly for PE managers, ILPs can be established as part of global master-feeder, co-investment or joint venture structures, and they can use a full range of underlying special purpose vehicles and subsidiaries to hold investments.

Using an ILP in a master-feeder structure offers a genuine global distribution solution for PE managers. For example, a structure with an ILP as the master fund and an Irish collective asset-management vehicle (ICAV) as the E.U. feeder permits a combination of transparent and opaque/blocker funds to suit the needs of U.S. taxable investors seeking tax transparency.

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It also, however, retains the structure's ability to access Ireland's extensive double taxation treaties.

As part of a global master-feeder structure, the ILP can offer the "onshore" E.U. funds use of the AIFMD marketing passport for distribution in the European Economic Area. In addition, the "offshore" funds in the Cayman Islands, Delaware or the British Virgin Islands (BVI) can offer parallel investment opportunities to U.S. and global investors that are more familiar with those vehicles or jurisdictions.

Once the ILP Act has been reformed as discussed below, it is expected that many more ILPs will be established as parallel funds to the Cayman Islands, Delaware, Jersey and BVI structures for PE managers looking to offer offshore and onshore E.U. fund solutions to their investors.

See "How Fund Managers Can Navigate Establishing Parallel and Debt Funds in Luxembourg in the Shadow of Brexit and Proposed E.U. Delegation Rules" (Jun. 14, 2018); and "Passports, Platforms and Private Placement: Options for Marketing Funds in Europe in the Post-AIFMD Era" (Apr. 30, 2015).

Reasons for Reforming the ILP

Ireland remains one of the leading domiciles in Europe for AIFs, with assets under management (AUM) in the jurisdiction at an all-time high. Only a small proportion of this AUM is housed in ILP structures, however, with merely a handful established to date under the ILP Act. The general consensus of PE managers is that the ILP Act, in its current state, has a number of limitations and does not stand up to limited partnership structures available in other international fund domiciles.

Ireland's solution to the problem thus far has been the ICAV – a corporate vehicle designed specifically for Irish investment funds, which can accommodate a number of PE strategies and PE-centric features (*i.e.*, capital commitment and drawdown mechanisms; distribution waterfalls; carried interest and "excuse and exclude" allocation of assets). The ICAV, therefore, has become the default Irish vehicle of choice for PE managers.

Although the ICAV has addressed certain challenges presented by the ILP Act, it is not a partnership – the preferred legal form for PE, venture capital and "real economy" investing for international investors. International interest in a fit-for-purpose Irish partnership vehicle has grown since the introduction of AIFMD in 2014. In addition, many PE sponsors wish to establish parallel European structures to their preexisting offshore funds for distribution to European investors via the AIFMD passport.

See "Tax, Legal and Operational Advantages of the Irish Collective Asset-Management Vehicle Structure for Private Funds" (Aug. 13, 2015); and "New Irish Fund Structure Offers Re-Domiciliation Possibilities and Tax Advantages for Private Funds" (Mar. 12, 2015).

Key Legislative Enhancements

This international interest prompted a review by the Irish Funds Industry Association, the Central Bank and the Irish Department of Finance to address the ILP Act's limitations. The intention was to enhance and reform the

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existing legislation to ensure the ILP is a fully bespoke, fit-for-purpose vehicle that is aligned with international standards for PE funds and AIFMD.

In the coming weeks, the Irish government is expected to publish a draft of the Bill that was prepared in consultation with these parties. Once it has been passed by both Houses of Parliament, the Bill will be presented to the President of Ireland for signature. Although it is then enacted into law, it may remain subject to a commencement order before it comes into force.

The key enhancements under the proposed legislation are expected to maintain high regulatory standards and introduce the following revisions to the ILP vehicle.

Dual Foreign Name

PE sponsors will be permitted to register an ILP under an alternative foreign name. This enables an ILP operating in a non-English speaking jurisdiction (*e.g.*, China) to have its translated name officially recognized in that jurisdiction, obviously increasing the attractiveness of the vehicle for Asian investors.

See "How to Structure a Singapore-Based Private Fund Manager (Part One of Two)" (Jul. 16, 2015).

Umbrella Partnerships

There will be the ability to establish ILPs as umbrella funds, with segregated liability between sub-funds. As this is not possible under the existing ILP Act, the common solution has been to establish an ILP as a master fund and use separate feeders with differing legal structures to suit global investors.

LPs

The concept of a "majority of limited partners" will be introduced to align with partnership structures in competing fund domiciles. This will introduce flexibility so that an ILP can specify, for example, a majority by number, a majority by value, a majority by class or a majority that is higher than a simple majority as agreed by investors in the LPA. The definition of "limited partners" will also be revised to allow for the ability to divide LPs into sub-categories or classes for regulatory reasons (*e.g.*, U.S. pension scheme investor, fee treatment, rights and voting).

LPs will also be permitted to participate in boards and committees related to an ILP without that constituting involvement in the management of the ILP that would result in the loss of limited liability. It is relatively common practice in PE structures in other jurisdictions to allow GPs to establish advisory committees or boards that are composed of LPs. These committees provide LPs with a forum to deliver input on corporate governance matters to the GP or investment manager, which is important for closed-end PE structures where investors do not have the opportunity to "vote with their feet."

See "Current Scope of PE-Specific Side Letter Provisions: Co-Investment Rights, LP Advisory Committee Seats and Parallel Funds/AIVs (Part Two of Three)" (Mar. 26, 2019).

GPs

The Bill will introduce a statutory novation of assets and liabilities, without further formality, when substituting a GP. This will eliminate

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the need for express transfers of assets and liabilities between GPs to be reflected in the LPA, significantly simplifying the process of changing GPs.

Withdrawal of Capital

Also, the Bill will relax the requirements around the withdrawal of capital. This includes removing the requirement for the GP to certify that the ILP is able to pay its debts in full as they fall due after the proposed distribution of capital is made. In addition, it will no longer require an LP to be liable to repay capital with interest for four months from a distribution date when the GP certification is not secured.

Amending the LPA

Partners will also no longer be required to consent in writing to LPA amendments. Instead, LPA amendments will be valid if they are approved by a majority of partners and if the depositary certifies that (1) they do not prejudice the interests of LPs; and (2) they relate to any matter specified by the Central Bank as requiring approval by LPs.

Migration of Partnerships

Finally, the new legislation will permit partnerships to migrate into and out of Ireland on a statutory basis.

Future of the ILP

While detailed legal, regulatory and tax advice is a prerequisite for the establishment of any successful investment fund, the proposed enhancements to the ILP regime should increase its market acceptance as a strong option for asset managers wishing to pursue a PE fund strategy in a regulated E.U. vehicle.

Also, the enhanced authorisation timeframes provided by the Central Bank – in comparison to other E.U.-competent authorities – should also facilitate the accelerated growth of the ILP.

Pádraig Brosnan specialises in financial services law and is Head of the Maples Group's Irish Cayman Islands' desk. He has over 10 years' experience in advising leading international financial clients on the establishment, authorisation, operation and regulation of all types of investment funds, including Undertakings for Collective Investments in Transferable Securities (UCITS) vehicles, AIFs, non-regulated funds in the hedge fund and PE space and other specialised fund products including the ICAV. In addition to advising the promoters and investment managers to these funds, he also advises other fund services providers including administrators, depositaries, prime brokers and investment advisers, as well as fund investors and board directors.

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