INVESTMENTS IN PRIVATE EQUITY FUNDS

IN A NUTSHELL

Investments in private equity funds have become increasingly popular in recent years. The attention paid to these types of investments demonstrates a growing propensity on the part of Italian investors to diversify into investments that, albeit at a higher risk, can generate greater profits. The methods of intervention vary according to the stage of the company's life cycle, the entrepreneurial system and the degree of development of the markets in which the company operates.

TYPOLOGIES

Private equity investments differ not only according to the type/sector of activity in which the target companies operate, or their area of specialisation, but also according to the life cycle in which the company is at the time of the investment. By way of example, this will be referred to as:

- Venture capital if the investment focuses on companies in their early stages.
- Management buy-out (MBO) - Management buy-in (MBI), typically in medium/large companies, where the management assumes the role of entrepreneur by taking over the company together with a private equity fund.
- Special Situation or Turnaround funds - investments in companies in crisis.
- Going Private - nvestments in listed companies where the PE investor, by purchasing shares, «delists» the company from the market in order to refocus it and sell it at a profit.
- Private Debt - The structure of debt funds is similar to that of equity, with the difference that instead of participating in the company's risk capital, loans are made (mostly mezzanine) secured by company assets and shares.

DEFINITION

In this varied world linked to the operational methods typical of each type of fund, from a regulatory point of view, private equity investments fall within the scope of Alternative Investment Funds (AIFs), which are mutual funds that invest in unlisted financial instruments and real estate activities, characterized by a lower degree of liquidity compared to other collective investment schemes (Undertakings for Collective Investment in Transferable Securities - UCITS governed by Directive 2009/65/EC). As regards the definition of AIFs, they are identified «by difference» as those funds that do not fall within the definition of Undertakings for the Collective Investment in Transferable Securities under Directive 2009/65/EC (the so-called «UCITS IV»). For the notion of AIF, it does not matter whether the funds are open or closed and whether or not they are listed, nor does their legal structure (contractual, corporate or other), as it is crucial that the typical elements of a collective investment scheme are present rather than the formal nature of the vehicle used. The Consolidated Law on Financial Intermediation (TUF) defines the Undertakings in Collective Investment (OICR) as one whose assets are: (i) collected from a plurality of investors through the issuance or offering of shares or units (ii) managed in the interests of the investors and independently of them (iii) invested in financial instruments, including loans granted against the assets of the OICR.

TAXATION OF NON-HARMONISED FUNDS

1. NON REAL ESTATE FUNDS

A significant boost to the spread of investments in Private Equity funds came with the implementation of tax regulations that extended the tax regime typical of harmonized funds, subject to a 26% substitute tax, also to non-harmonized funds under certain conditions.

In particular, the income derived from investments in private equity funds are capital income subject to substitute tax (26%) provided that: (i) they are different from real estate funds; (ii) they are established in the European Union or in a country adhering to the Agreement on the European Economic Area, (iii) with a manager subject to forms of supervision, pursuant to directive 2011/61/EU, (iiii) the shares are marketed in the territory of the Italian state in compliance with current regulations (art. 43 of the TUF).

When all conditions are met, the distributed income and those included in the difference between the redemption, sale or liquidation value and the weighted average cost are subject to the substitute tax currently at 26%.

2. REAL ESTATE FUNDS

The fund qualifies as real estate if at least two-thirds of the total assets are invested in: (i) real estate; (ii) real estate rights; (iii) shares in real estate companies; (iii) parts of other real estate AIFs, even foreign. Based on the current regulatory framework, to establish the correct tax treatment it is necessary to distinguish the following categories of investors:

- Institutional investors | Ordinary taxation, the income is subject to the same tax imposition inherent to the regime applicable to them (company income);
- Non-institutional investors with a share greater than 5% | income attribution for transparency and at a progressive rate;
- Non-institutional investors with a share not exceeding 5% | 26% substitute tax.

In detail:

- Non-institutional investors with a participation greater than 5% | The capital incomes achieved by the fund and recorded in the management reports are attributed in transparency, irrespective of perception and in proportion to the participation share in the fund, by the investor: such incomes contribute to the formation of the participant's total income (IRPEF Progressive rates)
- Non-institutional investors with participation equal to or less than 5% | The distributed capital incomes are subject to a 26% substitution tax.

EDMOND DE ROTHSCHILD'S INTERNATIONAL WEALTH PLANNING NETWORK IS AT YOUR DISPOSAL FOR ANY FURTHER INFORMATION.