

**taxanalysts**  
Respectfully disagreeable since 1970.

**tax notes  
international**

## Reynders Initiates Consultation on Investment Fund Legislation

by *Marc Quaghebeur*

In 2003, Belgium introduced a new tax-beneficial investment vehicle, the private PRICAF (the Private PRICAF Act of April 22, 2003, Royal Decree of May 15, 2003), as an alternative to the listed PRICAF. (For prior coverage, see *Tax Notes Int'l*, June 23, 2003, p. 1184.) Two years later, the private PRICAF has not been as successful as expected, with only two such investment funds having been approved. Consequently, Finance Minister Didier Reynders has now started a round of consultation to revise the private PRICAF legislation.

In a consultation note, Reynders explained that the revisions are needed because of changes in other Belgian legislation, the pending implementation of the new EU Prospectus Directive,<sup>1</sup> and experience that has been gathered in the two years since the private PRICAF legislation entered into force.

### Background

Belgium's Law of December 4, 1990, on financial transactions and financial markets implemented the original EU Directive on Undertakings for Collective Investment in Transferable Securities (85/611/EEC) (also known as the UCITS I Directive). The objective of that directive was to harmonize the various European laws on UCITS. It initiated the

idea of the "European passport," which allows UCITS that are approved in one member state to sell their units in other EU member states after notifying the relevant authorities. However, the UCITS I Directive granted the European passport only to UCIs (Undertakings for Collective Investment) that invested in transferable securities.

UCITS III consists of two EU directives<sup>2</sup> that grant the European passport to previously ineligible investment funds, and to fund management companies. At the same time, it strengthens investor protection while widening the field of competence of the fund management companies. When transposing the UCITS III directives, Belgium modernized its regulatory framework for UCIs. To that end, it passed the Law of July 20, 2004, relating to certain forms of collective management of investment portfolios, and a Royal Decree of March 4, 2005, relating to certain public UCIs; both the law and decree were published in the official gazette on March 9, 2005.

The purpose of the EU Prospectus Directive is to make it easier and less expensive for companies to raise capital throughout the European Union, and at the same time, to reinforce protection for investors by guaranteeing that all prospectuses provide clear and comprehensive information, wherever in the

<sup>1</sup>Directive 2003/71/EC of November 4, 2003, on the prospectus to be published when securities are offered to the public or admitted to trading, amending Directive 2001/34/EC.

<sup>2</sup>Directive 2001/107/EC of January 21, 2002 (the management directive), and Directive 2001/108/EC of January 21, 2002 (the product directive), both amending Directive 85/611/EEC.

European Union they are issued. Although the directive was to enter into force on July 1, Belgium has not yet implemented it. However, Belgium's Banking, Finance and Insurance Commission has indicated it acknowledges the direct effect of the UCITS and prospectus directives and will adapt its policy to the text of the prospectus directive when dealing with new applications for public offers of securities, or applications for securities to be admitted to trading.

When they were first introduced, private PRICAFs were expected to meet the requirements and expectations of fund managers and investors — namely, fiscal transparency and the VAT exemption of management fees and profit distribution. Moreover, they compared quite favorably to similar vehicles in Europe. Therefore, their lack of success likely is attributable to limitations in the rules for their establishment, which is what Reynders is trying to address. Most of the modifications proposed by Reynders are designed to make private PRICAFs even more accessible.

### Legal Status

The private PRICAF is a closed-end investment fund for venture capital that offers investors the benefit of limited liability, is limited in time, and does not require a prior listing. It is flexible and, most important, is transparent for tax purposes.

It can be incorporated as a limited company for a limited time (a maximum of 12 years) in the form of a public limited company, a limited partnership with shares, or a limited partnership. Its object must be limited to investing in authorized financial instruments issued by nonlisted companies.

The private PRICAF is set up with a number of restrictions to ensure that it is a private fund, so it does not have to get around rules related to the public offering of securities.

### Investors

At least 80 percent of the voting stock of the private PRICAF must be held by private investors (individuals or corporate entities), established in Belgium or abroad, who undertake to invest at least €250,000 in cash in their own name. (That is the minimum necessary to get around the rules related to the public offering of securities.)

Other private PRICAFs can subscribe a maximum of 20 percent of the stock of the fund. Moreover, transfers of participations in a private PRICAF are restricted, and investors can recover their initial investments only by exiting at the end of the duration of the PRICAF (at the latest, 12 years later). Reynders proposes to refer to the definition of article 3 of the prospectus directive to drastically reduce many of those limitations.

To prevent the use of the private PRICAF as a holding company, each investor can hold between 4 percent and 16 percent of its voting stock. And to ensure that the fiscal benefits of the private PRICAF are not used for a family holding or for a holding company for a multinational group, the investors cannot be related either as members of the same family or as companies of the same group. Those limitations are too restrictive and should be relaxed, according to Reynders.

### Management

Currently, the day-to-day management of the private PRICAF must be conferred to a management company that has been incorporated separately. This is a restriction that Reynders proposes to revoke, so that an individual can act as manager of the fund.

### Investment Policy

The private PRICAF can invest only in the following financial instruments issued by nonlisted Belgian and non-Belgian companies:

- shares and securities assimilated to shares, bonds, and other debt instruments;
- participations in other investment institutions that have an investment policy that corresponds with the object of the private PRICAF; and
- any other securities that allow the holder to acquire any of these securities by means of subscription, purchase, or exchange.

To enable the private PRICAF to go into mezzanine financing (a hybrid of debt and equity financing generally used to finance the expansion of existing companies), it is proposed that it also be allowed to invest in simple loans issued by nonlisted companies.

### Registration and Supervision

A private PRICAF does not need to be listed to benefit from the tax incentives available to investment funds in Belgium. As mentioned earlier, the private PRICAF has been designed as a private fund placing its shares with a limited number of investors so that it does not come under the control of the Banking, Finance and Insurance Commission. That allows the private PRICAF to save on annual administration fees. Instead, the private PRICAF must be recognized by and registered with the Ministry of Finance.

Because investors and management like to have the certainty that their investment fund will be recognized as a private PRICAF, Reynders intends to recognize private PRICAF status before incorporation of the company.

## Tax Status

Belgium's private PRICAF is a flexible, tax-efficient, and cost-effective vehicle for both Belgian and foreign investors who seek to invest private equity in Belgian and foreign companies. As a closed-end investment company, the private PRICAF enjoys the same favorable tax regime as a listed collective investment company. That means it is exempt from registration tax on its share capital, is entitled to an exemption from withholding tax on most types of investment income received, and is eligible for the reduced withholding tax rates provided for in Belgium's tax treaties.

The private PRICAF is subject to corporate income tax at a rate of 33.99 percent. However, that tax is based on a low lump sum basis (disallowed expenses plus any abnormal or gratuitous advantages received). Moreover, capital gains on partici-

pations are, in principle, exempt from the corporate income tax. When distributing its profits, the private PRICAF must withhold tax at source, except when it distributes the capital gains realized on its participations.

## Conclusion

The proposed changes — in the form of a draft Royal Decree to be signed by the king — are not expected to enter into force before September.

The private PRICAF has the potential to become a real investment vehicle in Europe, and the proposed modifications can only make it more attractive for private investors, pension funds, and venture capital funds.

♦ *Marc Quaghebeur, Vandendijk & Partners,  
Brussels*