

Rethinking the taxation of European PE/VC funds

by *Thijs van Dongen*

About the author:



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Executive summary:

Invest Europe released its Forward 2024-2029 report, which focuses on three primary goals: leveraging funding opportunities, enhancing financing for critical infrastructure, and establishing Europe as a global leader.

A significant highlight for tax practitioners is Priority 6, which addresses tax policies crucial for growth and cross-border investments. The report identifies cross-border tax frictions as a major issue and proposes solutions such as changes to the withholding tax system and creating best practices for tax incentives. Notably, it suggests the creation of a standardised EU-pooling vehicle and a treaty-accessible SPV to ease tax-related challenges.

Investing in European PE and VC funds involves navigating diverse tax regimes across countries, each with its complexities. These diverse tax regimes are hard to manage when investing in a diversified portfolio of European PE and VC funds. This article will describe how a standardised EU-pooling vehicle can contribute to overcoming this complexity.

On 6 June, Invest Europe published the Forward 2024-2029 report which can be downloaded [here](#). It is an absolute must-read for anyone involved in shaping Europe's future through private capital. The report outlines Invest Europe's priorities for a more competitive European Union and focusses on three overarching goals:

1. Capitalise on funding opportunities
2. Enhance financing for critical infrastructure
3. Position Europe as a global leader

Taxation in the Forward 2024-2029 report

Tax practitioners will be particularly interested in the role tax policy plays in achieving such goals. While tax is unfortunately an often-overlooked topic, the Forward 2024-2029 report does not disappoint! Priority 6 (Secure tax policies that are simple to adhere to, promote growth and incentivise cross-border fundraising & investments) deals specifically with tax policies. It identifies existing cross-border tax frictions as the main problem. Something probably every tax practitioner in European PE/VC encounters daily.

The Forward 2024-2029 report suggests several solutions to reduce existing cross-border tax frictions. Changes to the withholding tax system and related exemptions are brought forward. Another proposal is creating best practices for tax incentives for venture capital at the Member State level. However, where it in my opinion gets most interesting is the creation of a standardised EU-pooling vehicle and treaty accessible SPV.

Investing in European PE/VC funds

When investing in a diversified portfolio of European PE/VC funds, tax practitioners must navigate fund tax regimes in many different countries.

The traditional tax-transparent partnership model is widely used in jurisdictions such as the UK, Luxembourg, and Germany. But not all European countries offer such model and funds in these countries often take a corporate form. Swedish and Spanish for example.

Each regime presents its own challenges for fund managers and limited partners. Withholding taxes, hybridity, tax reporting, beneficial ownership case-law, permanent establishments, tax leakage at fund level, treaty access for capital gains tax, holding platforms... The list could go on.

As a limited partner, you want to build a diversified portfolio of European PE/VC funds without worrying about these complexities. This might partially explain why so many European PE/VC funds have set up their fund structures in well-known 'PE/VC fund jurisdictions'. The tax treatment of commitments to funds in PE/VC fund jurisdictions are usually straightforward, stable and widely understood.

Policy considerations

The European PE/VC fund industry has in recent years seen many initiatives that have had an influence on the taxation of fund structures:

- ATAD(2) had, among other things, an influence on partnership structures due to the hybridity provisions;
- The Danish withholding tax cases increased the focus on beneficial ownership;
- The ATAD3 proposal focussed on the use of holding companies.

Other examples could be listed as well. What these examples have in common is that they seem to approach the current tax treatment of PE/VC funds negatively. The measures, each in their own way, seek to introduce 'corrective action'. The introduction of a standardised EU-pooling vehicle on the other hand, is a piece of legislation that could make a positive impact!

A standardised EU pooling vehicle would create a harmonised European PE/VC fund tax regime, removing national tax uncertainties for limited partners and limiting administrative burdens. It would be a small but significant contribution to capitalising funding opportunities for private capital in the European Union.

What should a standardised EU pooling vehicle look like? My initial suggestions for such a regime would be:

1. Create a tax regime for corporate AIFs.

While the partnership model is in certain key countries the industry standard, it is not necessarily straightforward to establish a PE/VC fund as a partnership in all European Member States. Starting with harmonising the taxation of corporate AIFs could therefore have a wider reach. It also has the additional benefit of limited permanent establishment risks.

2. Ensure treaty eligibility, including capital gains tax exemption.
3. Provide access to withholding tax exemptions under e.g., the parent-subsidiary directive.
4. Implement a full corporate income tax exemption at the fund level.
5. Levy a withholding tax at the fund level. But grant applicable exemptions to investors based on their tax status.

The standardised EU pooling vehicle would contribute to a tax neutral taxation of income at the level of the fund and limited partners while reducing administrative complexity and tax risks.

Further considerations

It is of course not all that easy and many other tax and non-tax aspects have to be considered as well. Carry taxation, VAT treatment of management fees and U.S. entity election considerations for example. Moreover, this proposal will only work if supported by an appropriate legal and regulatory framework.

Lastly, critics might argue that this would shift tax revenues from source countries to 'PE/VC fund jurisdictions' and that this would thus have little chance of being adopted. However, with a harmonised PE/VC fund tax regime out there, there is no longer a tax need for 'PE/VC fund jurisdictions' and funds could be established in the countries where the fund manager is actually located, which will especially in the lower to mid-market have a degree of overlap with the portfolio location.

Disclaimer: *this is not tax advice. These views are my own and do not necessarily represent the view of the European Investment Fund. The author can be contacted at t.vandongen@eif.org.*