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Belgium's new private Pricaf vehicle

Marc Quaghebeur of DLA Caestecker explains how to get the most out of the new investment vehicle

Belgium has introduced a new type of vehicle for collective investment in private equity. This new investment vehicle, *Pricaf Privée* (private Pricaf) was introduced as an alternative for the listed Pricaf that did not prove as successful as anticipated.

The Pricaf was introduced six years ago (*Royal Decree* of April 18 1997) in an attempt to give small and middle-sized enterprises access to the capital market. It was meant to be a private equity version of the closed-end investment company *société d'investissement à capital fixe* (Sicaf) or *investeringsvennootschap met vast kapitaal* (Bevak). It was aimed at investments in authorized financial instruments issued by non-listed companies and growth companies.

Six years after its introduction, only two Pricafs were listed on Euronext Brussels: the technology fund Quest for Growth and the biotechnology fund KBC Biotech. Of course, the lack of success was in part due to the economic climate, but the requirement that the Pricaf itself has to be listed on the stock exchange proved to be a major obstacle for small and middle-sized enterprises in their search for venture capital.

A taskforce led by two members of the Federal parliament, Eric André and the late Aimé Desimpel, was set up to investigate how this could be overcome. Their findings were that the Pricaf was not sufficiently flexible as an investment company. Fund managers found that their hands were bound too much by the obligation to invest at least 50% of their assets in shares, with a minimum of 70% in authorized financial instruments issued by non-listed or growth companies. The obligation for Pricafs to distribute at least 80% of their profits by way of dividends was another serious restriction.

The taskforce recommended the creation of a new type of Pricaf that would not be listed and would not need to be admitted by the Banking Commission. However to give the active investor a way out, this Pricaf would need to be for a limited duration. The Pricaf could only be made attractive if its tax burden was reduced; it would really need to be fiscally transparent to guarantee to the investor that he would have the same tax treatment as if he had invested directly in the companies. Finally, the task force pointed out that the VAT on management charges was an added cost that really should be recoverable.

Private Pricaf

To attract new venture-capital investments, and to offer a new source of financing for small and middle-sized enterprises, the Parliament has now introduced the private Pricaf.

The details of the Act of April 22 2003 have now been worked out in the *Royal Decree* of May 15 2003.

This new investment vehicle is a closed-end investment fund for venture capital that will not need to be listed, will be fiscally transparent and will be limited in the time and offer the investors the benefit of the limited liability. It is very flexible. It can accept investors from within and from outside Belgium and it can invest in Belgium and abroad.

Forms of Pricafs

The private Pricaf can be incorporated as a limited company for a limited period (maximum 12 years) in the form of one of the following types of companies:

- a public limited company (*société anonyme/naamloze vennootschap*);
- a limited partnership with shares (*société en commandite par actions/commanditaire vennootschap op aandelen*); or

Key features of the private Pricaf

- A closed-end investment fund for private equity.
- In and outside Belgium.
- Private placing.
- Limited liability.
- Flexible.
- Fiscally transparent.

- a limited partnership (*société en commandite simple/gewone commanditaire vennootschap*).

The object of the company must be limited to investing in authorized financial instruments issued by non-listed companies.

For either of these companies, the liability of the investor is limited to the amount of his investment. The general partner in a limited partnership (the management company) cannot limit its liability.

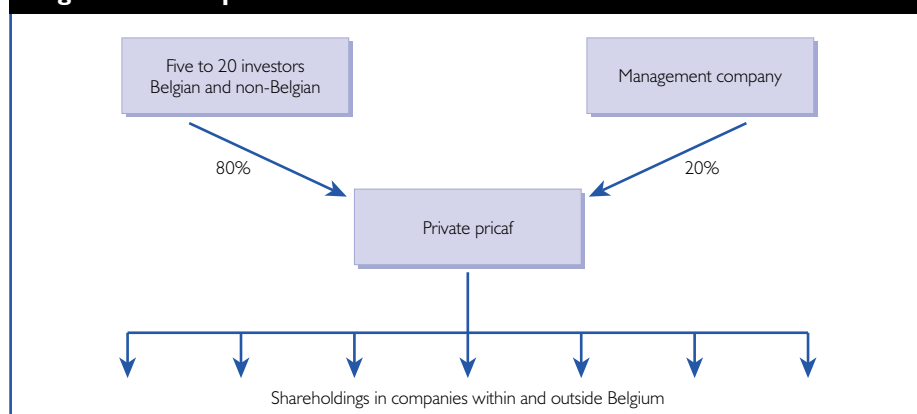
The private Pricaf is subject to the general provisions of the *Belgian Company Code* unless the legislation varies these. This means that even if an investor takes a commitment for €250,000 (\$290,000) in a public limited company, they only have to pay up one quarter at the time of the incorporation of the Pricaf. If the private Pricaf is a limited partnership, there is not even an obligation to pay up part of the share capital.

Within the limits of the *Belgian Company Code*, the articles of the association can be drafted quite freely, and in particular, the investors can subscribe the share capital but make the payment of the subscribed capital dependent on an investment in specific companies. Moreover, they can provide that the proceeds of the investment are not reinvested but are immediately paid redistributed to the investors.

Investors

At least 80% of the voting stock of the private Pricaf must be held by private individ-

Diagram 1: How private Pricafs work



uals and/or corporate entities – established in Belgium or abroad – who undertake to invest at least €250,000 in cash in their own name. This is, indeed, the minimum to get around the rules relating to the public offering of securities.

Each investor can hold between 4% and 16% of the voting stock of the private Pricaf. 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.

A maximum of 20% of the voting stock can be subscribed by one or more other private Pricafs, by the management company itself or by its employees or beneficiaries of stock options issued by the management company on the stock of the private Pricaf.

Transfers of participations in a private Pricaf are very much restricted. In principle, investors can only recover their initial investments by an exit at the end of the duration of the Pricaf, at the latest 12 years later.

Investment policy

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

- shares and securities assimilated to shares;
- bonds and other debt instruments;
- participations in other investment institutions, which have an investment policy which corresponds to the object of the private Pricaf; and
- any other securities that allow the holder to acquire any of the above securities by means of subscription, purchase or exchange. (article 2-3, *Royal Decree*, May 15 2003).

The legislation does not impose any other limitations in respect of the private Pricaf's investment policy, except that it has to spread its investments. The private Pricaf cannot build up a controlling position

where it could have an influence on the administration of the company or the appointment of its directors (article 126(1) Act 4, December 2003). Moreover, it cannot conclude any agreements which might restrict the autonomy of the Pricaf, such as voting agreements, undertakings to keep a participation or to give a right of first refusal (article 126(2)). Exceptionally, this may, however, be allowed if it is limited to a maximum of two years or for a maximum of 50% of the voting stock of the company or to a single subsidiary which has been specifically incorporated for term investments or derivatives (article 11, *Royal Decree*, May 15 2003).

However, as a temporary investment, the private Pricaf can hold cash or short-term investments for a maximum of six months. It can even hold listed securities if it had been holding these securities before their IPO, or if it obtained these securities through a swap with non listed securities, with the exception of the securities issued

The Pricaf could only be made attractive if its tax burden was reduced

by the private Pricaf itself; and deal in derivatives on fixed assets or financial assets, listed or not, by way of hedging operations. These temporary investments must in any event be limited to two years, and 30% of the total of its balance sheet (article 126(3) Act 4, December 2003 and article 13, *Royal Decree*, May 15 2003).

Management

The day-to-day management of the private Pricaf must be conferred to a Belgian management company or to the Belgian branch of a foreign management company.

In a public limited company, the management company can be in charge of the

Fiscally attractive

- Minimal corporate income tax.
- The benefit of 83 double-tax treaties.
- Accepted as a fiscally transparent vehicle in the country of residence of most investors.

day-to-day management but it cannot be a director. In either type of limited partnership, the management company must be the sole managing partner (article 119 *decies*, Act 4, December 2003).

To ensure the independence of the management company, the private Pricaf cannot enter into any transactions in respect of its own assets with other investment funds to which the management company has provided services.

Registration and supervision

Contrary to the (public) Pricaf, this new investment vehicle does not need to be listed in order to benefit from the tax incentives available to investment funds in Belgium. Also, the private Pricaf is groomed to remain private so that the fund does not fall under the control of the Banking Commission and does not have to pay the annual administration fees for this control. This is why the minimum investment for a single investor has been put at a minimum level of €250,000.

Nevertheless, the private Pricaf must be registered on the list of authorized private Pricafs held by the Ministry of Finance. They must submit their articles of incorporation and evidence of their compliance with the statutory conditions to the Ministry of Finance.

The activities and operations of the private Pricaf are monitored by one or more chartered accountants. They report to the Banking Commission, in particular as to whether the investors meet the statutory conditions.

Tax status of the Private Pricaf

The private Pricaf is exempt from the registration tax on the issued share capital upon incorporation or investment of funds.

The private Pricaf is entitled to an exemption of withholding tax on most types of investment income received, insofar as the securities have been registered in its name for the whole of the year.

Tax exemptions

- Tax on contribution of capital.
- Annual administration fees for Banking Commission.
- VAT on management services.
- Capital-gains tax.
- Withholding tax on dividends and interest received.
- Withholding tax when distributing dividends.
- Liquidation tax upon exit.

Withholding tax will be due on:

- income from capitalization bonds and zero bonds, and on;
- dividends from Belgian companies, unless the private Pricaf has held at least 25% of the subsidiary for a year or unless the subsidiary is a Pricaf or a Private Pricaf that distributes the capital gains on its investments.

The private Pricaf is eligible for the reduced withholding tax rates provided for in the tax treaties concluded by Belgium. This is a clear advantage over the UK limited partnership for which not all countries accept that it has legal personality, so that the benefit of the double-tax treaties has to be examined for each of the investors.

Corporate income tax

The private Pricaf is subject to the corporate income tax at a rate of 33.99%. However, this tax is based on a very low lump-sum basis, calculated on the amount of its disallowed expenses and the abnormal or gratuitous advantages that it receives.

Moreover, capital gains realized on participations are, in principle, not liable to corporate income tax if the private Pricaf invests exclusively in shares of companies which qualify for the participation exemption and in shares of other private Pricafs, notwithstanding certain temporary investments (article 143(3) Act 4, December 2003).

Any Belgian tax withheld at source can be credited against the tax liability of the private Pricaf and any excess is refundable. If tax has been withheld abroad, this gives the Pricaf an entitlement to the foreign tax credit (*quotient forfaitaire d'impôt étranger / forfaitaire gedeelte buitenlandse belasting*) which it can set off against its corporate income-tax liability, the excess is, however, not reimbursable.

Obligations in respect of distributions

In principle, the private Pricaf has to withhold tax at source on any dividends paid out, except when it distributes the capital gains realized on the participations it holds

(article 106(9) RD ITC 1992). Moreover, no withholding tax is due at the time of the liquidation of the private Pricaf (Art 21-2 ITC 1992).

Tax situation of the investor

Private individuals residing in Belgium are not taxed on any undistributed income or gains in the private Pricaf. The tax withheld at source on any income paid out by the private Pricaf will usually be the final tax for the individual investor.

Resident companies are entitled to the participation exemption insofar as the private Pricaf undertakes – in its articles of association – to distribute at least 90% of its net income to its shareholders. Where applicable, the dividend that originates in income that would satisfy the conditions for the participation exemption will be exempt from corporate income tax for the corporate investor. The net taxable income will be liable to the corporate income tax at 33.99%. The tax withheld at source can be credited against the corporation tax and any excess is refundable.

A fiscally transparent vehicle for foreign investors

If the private Pricaf is incorporated as a limited partnership (*société en commandite simple/gewone commanditaire vennootschap*), it may qualify as a fully transparent vehicle for tax purposes in the country of residence of the private investor. Indeed, it is anticipated that the limited partnership qualifies as a limited partnership in Anglo-Saxon countries, and in particular in the UK and in the US

Tax status of the management company services

The services invoiced by the management company to the Private Pricaf are exempt from VAT (article 44(3-11) VAT Code).

The structuring of the remuneration for the fund managers can be as important as the structuring of the fund itself. The fund managers normally negotiate a right to a share in profits, expressed as a percentage of the total profits of the fund; this carried interest tends to be 20% of the profits. The new legislation provides that up to 20% of the share capital of the private Pricaf can be subscribed by the management company itself or used for a stock option plan issued by the management company.

The taxation of such a stock option plan under Belgian law can be particularly tax-efficient for the beneficiaries (Act of March 26 1999).

At the time they are granted stock options are only liable to tax and not to social security. The taxable income is very

Benefits for investors

The investor will appreciate:

- investing in companies without a stock market listing;
- a flexible instrument that is as tax efficient as investing directly in the companies;
- the professional management of the funds invested;
- the spreading of the risk; and
- a guaranteed exit of the investment after a limited period of time.

low: the value of the option is calculated – in principle – at 15% of the value of the underlying shares (plus 1% for every year after the fifth), but under the following conditions, this percentage is halved (7.5% plus 0.5%) under the following conditions:

- the exercise price is fixed;
- the option relates to the shares of the employer or a related company;
- the option is not transferable *inter vivos*, but this does not prevent the beneficiary from bequeathing the option in his will;
- the option agreement must clearly state that the option must be lifted between the fourth and the tenth calendar year following the year of grant; and
- the risk that the value of the underlying shares depreciates, must not be covered directly or indirectly by the person granting the option or by a third party linked with the grantor.

Once the options are granted, the beneficiary will not have to pay tax at the time he exercises the option, or at the time he sells the shares purchased when he exercised the option as there is no capital-gains tax in Belgium.

Attractive

The new Belgian private Pricaf offers a flexible, tax-efficient and cost-effective vehicle for (Belgian and foreign) investors who seek to invest private equity in Belgian and foreign companies. It does, indeed, meet all requirements of fund managers and investors in respect of fiscal transparency, VAT exemption of the management fees and profit distribution and compares quite favourably with similar vehicles in Europe.

The Belgian government trusts that the private Pricaf can become a real investment vehicle in Europe, and that it will have the same success as the Belgian coordination centres. It may be attractive for private investors, but also for pension funds and venture capital funds.

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