

Taxation of Investment Limited Partnerships

INTRODUCTION

The Irish investment limited partnership (the “**ILP**”), now re-shaped as a flexible fund investment vehicle following amendments made to the existing Investment Limited Partnership Act, 1994 (the “**ILP Act**”), is expected to become the fund structure of choice for many international investment managers, particularly those in the private equity and real assets sectors.

In this key features document, we briefly discuss the taxation of the Irish ILP. A more detailed analysis of the ILP is available [here](#).

KEY POINTS

- The ILP is treated as tax transparent from an Irish tax perspective on all of its incomes, gains and losses;
- Distributions can be made by an ILP to its partners free of any Irish tax implications;
- Partners may, due to the tax transparent nature of the ILP, be able to claim the benefits of a double taxation treaty in their own jurisdiction;
- The tax transparent nature of the ILP may help preserve a better tax treatment for partners rather than investing in an opaque fund vehicle;
- Possible tax advantages of ILP will be dependent on tax transparency in the partner's jurisdiction and the jurisdictions invested in by the ILP.

What are the Irish implications of the tax transparent nature of the ILP for partners?

Any income, gains or losses which arise at the level of an ILP shall under Irish tax rules be treated as arising, or, as the case may be, accruing, to each partner of the ILP (in proportion to how income, gains and losses are shared under the terms of the ILP Agreement) as if such income, gains or losses had arisen, or, as the case may be, accrued, to the partners without passing through the hands of the ILP.

Therefore, the allocation of income, gains or losses should follow the commercial allocation of profits under the ILP Agreement. However, to the extent any of the ILP's profits are not allocated in any given year, they will be deemed to be allocated to the GP.

Distributions can be made by an ILP to its partners free of any Irish tax implications as all the underlying profits of the ILP shall already have been allocated to partners for Irish tax purposes. Any underlying income, gains and losses of the ILP shall retain their original characteristic for Irish tax purposes in the hands of any Irish resident partners or any non-Irish resident partners holding their partnership interest in the ILP via an Irish branch, agency or permanent establishment.

ILPs will have to make an annual return to Revenue specifying the total amount of income, gains and losses of the ILP, the name and address of each partner and the quantum of the total amount of income, gains and losses of the ILP allocated to (or deemed to be allocated to) each partner.

Can partners of an ILP benefit from double taxation treaties?

While ILPs will not be a resident of Ireland for the purposes of Ireland's extensive double tax treaty network, partners (depending on where they are tax resident) may, due to the tax transparent nature of the ILP, be able to claim the benefits of a double tax treaty in their own jurisdiction to avoid, reduce or recover potential withholding taxes on underlying income and gains of the ILP.

It is important that the tax transparent nature of the ILP be respected in the partner's own jurisdiction and the jurisdiction where the ILP has invested in order to claim the benefits of the relevant double tax treaty.

There is an administrative exercise to be undertaken to ensure certain partners can claim treaty benefits. If there are only a small number of partners, that exercise may not be burdensome, however if there are many partners resident in different jurisdictions then the exercise may become more cumbersome. The support of service providers to the ILP will be important to ensure that treaty benefits can be claimed.

Even though tax treaty benefits may be available to certain partners it may still be desirable for the ILP to make investments via an underlying holding/investment vehicle resident in a tax efficient jurisdiction which in turn claims treaty benefits under that jurisdiction's double tax treaties. That of course raises possible treaty shopping issues and may mean certain

partners lose the ability to be taxed at a lower rate of tax on capital gains rather than income.

Partners may retain any tax benefits as if they had invested directly in the underlying investments of the ILP

Investors in offshore opaque investment funds may be taxed differently than if they had invested directly in the underlying investments of the fund. This may result in additional tax for certain investors in opaque offshore funds. If the ILP is regarded as tax transparent in the partner's own jurisdiction then any such possible tax disadvantages may be removed because partners will be treated as if they have invested directly in the underlying investments of the ILP. In particular, this may mean certain partners have the ability to be taxed at a lower rate of tax on capital gains rather than income.

The tax transparent nature of the ILP may mean certain partners are subject to a "dry" tax charge on any underlying income and gains of the ILP if distributions of such income and gains are not made to partners prior to any tax payment date.

Which is better – tax transparent or opaque fund vehicle?

There is no easy answer to that. There are many variables at play and the answer will depend on the tax residence of likely investors, the jurisdictions where investments will be made, the nature of the investments (debt, shares, real estate etc.), the offshore fund rules (if any) of the investors' jurisdiction, whether the investor is tax-exempt or taxable etc. The decision to choose one over another (at least from a tax perspective) will be fact dependent.

Are there any other tax considerations that should be borne in mind when establishing an ILP?

To the extent an ILP suffers foreign taxes, thought will need to be given as to how any such tax costs are allocated among partners (i.e. will they be attributed directly to certain partners or shared among all partners, subject to fair treatment between investors).

An ILP may be subject to VAT and may have an obligation to register for Irish VAT. Any of the typical VAT exemptions (for fund management, investment management, fund administration services etc.) which apply to Irish regulated funds also apply to ILPs. The nature of the GP's services for VAT purposes needs to be determined and it may be necessary to group the GP and the ILP for VAT purposes.

Assignments of partnership interests in an ILP should be exempt from stamp duty.

There is also an exemption from Irish gift and inheritance taxes in respect of ILP partnership interests provided the disponent and the donee or successor are neither domiciled nor ordinarily tax resident in Ireland.

It is expected that the majority of ILPs will be considered Financial Institutions for FATCA and CRS purposes and, therefore, will likely have registration, due diligence and annual reporting requirements.

Taxation of carry at the manager level will need to be looked at as performance fees may still be a more attractive option than a carried interest partnership share (will depend on the tax residence of the GP).



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