KEY TAX INSIGHTS

NEWSLETTER

PLANNING FOR FOREIGN INVESTORS

With the global economy we live in, it is important for Fund Managers to have an appropriately structured fund if they plan to have foreign investors. Too often, the fund structure is not tax efficient for the foreign investor. If the fund is not structured to accommodate foreign investment, why should a foreign investor consider investing in the fund?

Foreign investors can be individuals or entities. Sometimes, a foreign entity will be formed to group foreign investors together to invest into the fund. Typical planning considerations include whether the fund will have effectively connected income to a U.S. trade or business ("ECI"), or if there is an applicable treaty, whether there is a permanent establishment in the U.S.

How to structure the fund for foreign investors is heavily tax driven and, oftentimes, these structures are not tax efficient. Examples include not having a U.S. blocker for ECI of foreign corporations resulting in the imposition of the branch profits tax or being over simplistic and having a domestic blocker corporation block both ECI and non-ECI income. These tax inefficient investment structures will cost foreign investors significant amounts in investment returns.

For example, we worked with a fund with only foreign investors. The fund needed to be highly customized as it had foreign investors, certain portfolio investments that would have ECI while others would not, and the investors in the fund would not be investing in the same portfolio companies. This required a fund structure that could be

website: www.klugcounsel.com
email: info@klugcounsel.com
phone number: +1 202-980-4788

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customized to the investment of each investor, was flexible in allowing investment in portfolio investments through pass-through and corporate blocker structures, and allowed for the separate accounting of each investor's returns as each investor would hold different investments.

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For the overall goal of the fund, a Delaware series LP ("Series") was used for the structure. This allowed for each Series to have separate tax treatment, group investors into certain investments through a new Series, and separate accounting for each investor. This also allowed the fund manager to manage what were in fact multiple funds in an efficient manner. For tax purposes, this structure allowed customized tax treatment for each investor and each portfolio investment. This structure also saved significant costs by avoiding the need to form multiple funds to accomplish the goals of this particular fund.

Many practitioners avoid using the Series structure because they do not understand the tax treatment, but the Delaware Series structure can provide customized treatment to each investor and is a better choice under certain circumstances. Other practitioners have concerns over separate accounting and tax filings for each Series. This would be required in any event for these customized investments and corporate blockers to operate in a tax-efficient structure.

As taxes will significantly impact investor returns, it is important for the fund manager to have the right structure. Outside large law firms, there are limited practitioners that understand tax efficient structuring for a fund.

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website: www.klugcounsel.com
email: info@klugcounsel.com
phone number: +1 202-980-4788