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Structuring your Turkish private equity fund

Gary Lachman of Lachman & Yeniaras explains the fund structures that work best for managers looking to take advantage of Turkey's strong real estate market.

posted - 08 Dec 2009
updated - 08 Dec 2009

A recent survey of 500 real estate professionals in Europe ranked Istanbul third in Europe as a real estate investment market and first as a development market in 2009 from a estate professionals, falling only one position from its 2008 investment ranking by a similar survey. Economic stress and related problems such as lease and loan defaults hav European cities. However, according to the survey published by a leading economic and tax advisory, Turkish economic growth appears to be stunted due to political uncertai economic deceleration, investors continue to look for opportunities within the city.

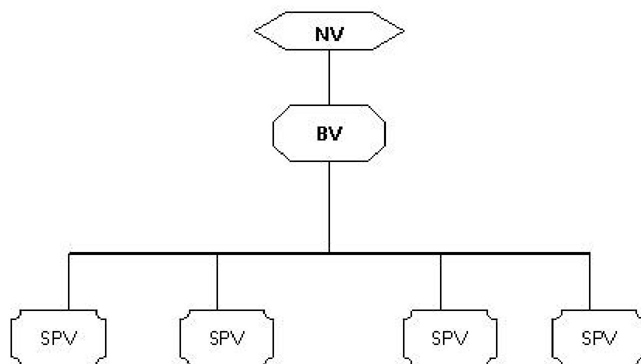
The capital city of Ankara, as well as secondary and tertiary cities such as Trabzon, Kayseri, Bursa, Antalya, Eskisehir, and Izmir have all seen steady growth despite the ec development often originates from Turkish real estate development companies who, tired of high land prices in Istanbul, have been venturing further afield in search of the kinds are being repatriated from successful ventures in nearby Kazakhstan, Bulgaria, Romania, and other eastern European states. This combination of offshore funds from Turkish fluidity of capital in and out of the country.

Private equity fund formation has become as much of an art as it is a science. Funds must be structured not only to accommodate capital from multiple jurisdictions, but als issues. This paper examines the history of private equity fund structure as it has developed for Turkey and the rest of Europe and the Americas, as well as provides the most

At the core of every international private equity fund is achieving maximum tax efficiency among the jurisdictions where the investments are located (and income generated), th and the domicile of the investors. The primary factors that will determine how and where a fund is structured are (i) the investment vehicle must be transparent in that profits a investment vehicle must protect the investors as well as the shares of the fund (limited liability); (iii) there should not be any laws or regulations inhibiting the investment activiti

In the not too distant past, investments were structured using companies established in tax havens in the Caribbean.

The "Dutch Sandwich"
Formerly, one of the most popular international holding structures was the "Dutch Sandwich", in which the shares of a Dutch private limited liability company ("BV") were held number of special purpose vehicles ("SPV"). The Dutch Sandwich essentially looked like this:



The Dutch Sandwich carried advantages for making investments in other companies, thus adding layers of limited liability protection for the investors. Tax treaties among the dividends paid by a SPV to a BV (between 0 percent and 15 percent, but in the case of Turkey, 10 percent). The dividends received by a BV from its SPV's are tax-exempt in realised from the transfer of shares of the SPV's. Under the tax laws of the Netherlands, a Dutch dividend withholding tax rate of 8.3 percent was applied to dividends from the other than dividends, royalties, and interest, there is no withholding tax in The Netherlands.

Jersey funds

Unfortunately for many taxpayers, especially Americans or those subject to American tax, the Obama administration appears to have targeted the Dutch Sandwich for the tra is to form a Guernsey or Jersey Limited Partnership or Trust to hold shares in investment companies, real estate, or funds located in foreign states. For the purposes of this ar there is no significant distinction between the two jurisdictions. Collective investment funds can be structured through a multitude of corporate structures, including companies

Regardless of the structure adopted, the Jersey Financial Services Commission (the "JFSC") will approve and regulate any collective investment fund and its related advisers u

There are a considerable variety of fund structures available, all of which are regulated by the Jersey Financial Services Commission (the "JFSC") and that fall into basically thr regulated under the following legislation:

- the Control of Borrowing (Jersey) Order 1958 ("COBO")
- the Collective Investment Funds (Jersey) Law 1988 ("CIF Law"); and
- the Financial Services (Jersey) Law 1998 ("FS Law").

The following provides a brief outline of the different regulatory regimes offered in Jersey under the above legislation currently in force in Jersey.

Very private structures
The most basic fund structure, limited to small groups of up to 15 investors, or where there is a single investment purpose and no formal offering of securities is known as a "v a few days. The only requirement is the disclosure of the identity of the investors to the JFSC and confirmation that the structure is not considered a collective investment fund investor vehicles, as well as joint ventures or entities created to act as a co-investor with other entities.

COBO-only private placements
Any fund that is offered to no more than 50 potential investors and will not seek a listing can be treated as a COBO-only, or private placement fund. Although this type of fund f some regulation through its authorisation process and conditions contained within the COBO Consent issued on approval. The authorisation includes a multi-stage process w memorandum prior to granting COBO consent.
Provided a COBO-only fund qualifies as a professional investor regulated scheme, Jersey entities providing fund services to the scheme need not be regulated under the FS La

1. The promoter must satisfy the JFSC's Promoter Policy in relation to private funds, including satisfactory track record, reputation and experience of the prom
2. Investors must be the roughly equivalent to US definitions of "qualified" or "experienced" investors – either professional (institutional) investors or investors co
3. Ongoing regulation of the fund will be through compliance with the conditions set forth in the COBO consent.

Unregulated funds
Unregulated funds have recently been made available in response to market demands for a fully flexible framework aimed at sophisticated and institutional investors. Unregulat which specifies schemes or arrangements that have been established in Jersey as either an unregulated, closed end exchange-traded fund listed on a recognized stock exch eligible by virtue of their total wealth, experience, or making an initial investment of over $1 million.

On satisfactory compliance with the order, there will be no regulatory review or oversight by the JFSC of the terms or conduct of such unregulated funds and therefore, process order.

Stock exchange listings for unregulated eligible investor funds are possible provided the exchange / listing allows for certain transfer restrictions. Either type of unregulated fun or a unit trust having at least one Jersey corporate trustee or manager. Beyond the obvious requirement to comply with COBO, there is no regulatory oversight of an unregulat Law. The offering document of an unregulated fund must prominently display the official warning language, and completed/executed notices must be filed with the Jersey Regi

Unclassified funds
Should a fund be offered to more than 50 investors it would be regulated under the CIF Law, with a higher degree of regulation placed upon lower minimum investment amounts investors.

As part of its regulation of unclassified funds under the CIF Law, the JFSC will require the promoter to qualify and comply with its policies, as well as undertaking a review of th documents, and all other agreements related to the fund. Prior to providing authorisation of the fund structure, the JFSC will approve the fund's borrowing, and investment pract closed ended, together with the amount of the individual investments. Closed end funds are generally less highly regulated than open ended funds. In return for satisfying cert for expert funds and listed funds.

Expert funds
The Jersey Expert Fund Guide, created under the CIF Law, provides a lighter touch regulatory environment, in return for which the Fund must meet certain criteria and conditio and the associated investment warnings in writing prior to making an investment. The qualification criteria for an expert investor include a minimum investment of at least $100,

As part of the lighter touch regulatory environment, the approval process is streamlined and provides for the authorisation of a fund in as little as three days from filing of the ap

- The investment manager must be regulated in an OECD member state or the state previously entered into a memorandum of understanding with the JFSC,
- The offering memorandum must comply with certain content and disclosure requirements.
- The fund company, general partner, or trustee requires a minimum of two Jersey resident directors and the fund itself must be a Jersey company or have a J
- An expert fund must appoint a Jersey "monitoring functionary" being an administrator, manger or trustee, which are regulated under the FS Law.

Listed funds
Modeled on the Jersey expert funds the Jersey Listed Fund Guide allows listed closed ended funds to be authorised within a few days through a self-certification approach. Si any category of investor including retail investors.

Recognised funds
Recognised funds are authorised as collective investment vehicles under the CIF Law and must comply with a different prescriptive order which includes greater levels of regula is promoted by the ability of recognized funds to be marketed to the retail public in the UK and a number of other states including Australia, Belgium, Hong Kong, the Netherla investors with access to a statutory compensation scheme.

Codes of practice
Over recent years, Jersey has undertaken an overhaul of its regulation of collective investment funds and their functionaries. The process started in 2007 with functionaries bec introduction of a Codes of Practice for Funds. Codes of practice for fund services business ("FSB Codes") were introduced in November 2007 and there are proposals currently the CIF Law. These codes of practice aim to make regulation more effective and consistent, while reducing the administrative burden on both the industry and the JFSC.

Jersey investment vehicles
Limited partnerships are governed by the Limited Partnerships Law of 1994. This law was amended and supplemented by the Limited Liability Partnerships (Jersey) Law of 19 regulations established Jersey as one of the world's most advanced jurisdictions for use of the limited partnership.

The limited partnership is managed by a general partner. In most cases, the actual fund management company owns all the shares of the general partner. In addition to its fai more specialised financial reporting and communications responsibilities vis-à-vis the investor limited partners and must meet the requirements of the Limited Liability Partners

To form a limited partnership a declaration must first be lodged with the registrar. The declaration need only provide the names of the general partners (not of the limited partne as tax transparent. Each of the partners is separately assessed on their partnership income and gains; resident partners on worldwide partnership income, and non-resident p

In June 2006, the Jersey authorities published new proposals to amend the jurisdiction's Limited Partnership Law, in an effort to improve the competitiveness of the island's off partnership to have a legal 'personality', bringing the island into line with Guernsey, which amended its relevant legislation in 2001 allowing limited partnerships to elect to have

Another method for investors is to employ a Jersey-based trust. The powers that may be reserved by the settler (the one establishing the trust) include the power to appoint a investment manager or investment adviser. Amendment Number 4 to the Trust Law of 2006 also permits a trustee to delegate any of his or her trusts or powers if permitted by the validity of a trust governed by Jersey law will not be affected by any rights conferred on anyone under a foreign law, and a provision that removes the former automatic 'pers

Jersey is a party to the Hague Convention on the Law Applicable to Trusts and Their Recognition. Jersey trust law explicitly excludes foreign inheritance laws and does not re registration or audit requirements as such in Jersey, although the tax authorities of beneficiaries' jurisdictions (e.g. the UK) may require annual reports. Jersey trusts may 'mig trusts may migrate to Jersey.

When the beneficiaries of a Jersey trust are not residents of Jersey, income arising from sources outside Jersey is not liable to income tax in Jersey, nor is distributions to th because of a government concession. The trustees of a non-resident trust are not required to make returns or provide accounts of the trust to the Comptroller of income tax. Tr

Managed entities are fund vehicles that are managed or administered by licensed third party service providers in Jersey. Managed funds can contract with these third party ser provision of such services is a unique class of fund services business that requires separate registration. In Jersey legal parlance, this class is called a "Manager of a Manage

A currently popular and tax efficient structure for institutional investors that invest in funds which invest in Turkish real estate is to use a Jersey or Guernsey trust that owns all SPVs which own the shares of Turkish joint stock (holding) companies that in turn each own a single or multiple assets domiciled in Turkey. Maximum tax efficiency is achiev have a double taxation prevention treaty with Luxembourg.

A management company is formed in Jersey which enters into a management agreement with the Jersey investment fund and under such management agreement manager a investment fund's members. The manager, often known as the advisor in local jargon, may be formed as a Jersey limited partnership (however other jurisdictions are possible services. The manager works with a professional trust company with a physical presence in Jersey that handles local filings, registrations, Jersey resident directors, distributi owned by the promoters of the fund, and the fees (management fee, development fees, etc.) and income earned are in line with standard industry practices. Fees are generall management.

Recent developments with international tax treaties and increased enforcement of tax collection efforts by many countries have begun to cast a shadow over the Jersey/Guern response to the fact that some American and European institutional investors prefer or regulations and/or bylaws prohibit them from investing in offshore fund vehicles (such as equity real estate funds involves foregoing the Jersey or Guernsey Trust and only using Luxembourg entities.

Luxembourg domiciled private equity real estate funds that invest across multiple property and asset classes typically utilise one of the two structures outlined below. Income that are developed or invested in and sold to individual owners (institutional investors prefer separate allocations to the each asset class), this neccessetates different structur

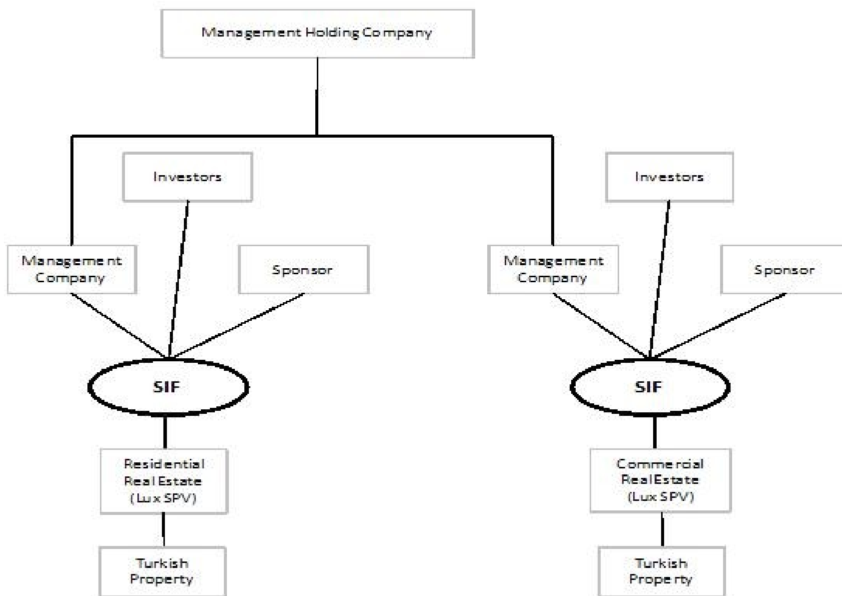
Luxembourg SIFs

A SIF is a Specialised Investment Vehicle that is regulated under a relatively new law enacted in Luxembourg known as the Law of 13 February 2007 on Specialised Investme
consolidated prior laws on collective investment structures that originated in 1988, amended in 1991, updated in 1998, and again in 2002. As a result of confusing links betwee
February of 2007. This gave the legislators a unique opportunity to make Luxembourg more attractive than the other countries allowing SIFs for fund managers and promoters t
funds. A new and independent vehicle for institutional, professional, and "well informed investors" is now available. The SIF Law broadens the notion of institutional investors by
professional investors.

The SIF Law offers high flexibility in terms of establishing the structure and relevant investment rules. SIF vehicles are regulated by the Commission de Surveillance du Secteu
without CSSF prior approval provided that an application file is submitted to the authorities within one month of its creation. This combination gives Luxembourg a very competi

No minimum content or details are required by the law for the offering documents. This preserves flexibility and allows for the evolution of investment activities and parameters.
must be at least once a year. Other terms may include restrictions such as lock-up periods. No investment or borrowing restrictions are defined in the Law, with the exception
maintained – but at a lower degree – as defined in the CSSF circular 07/309.

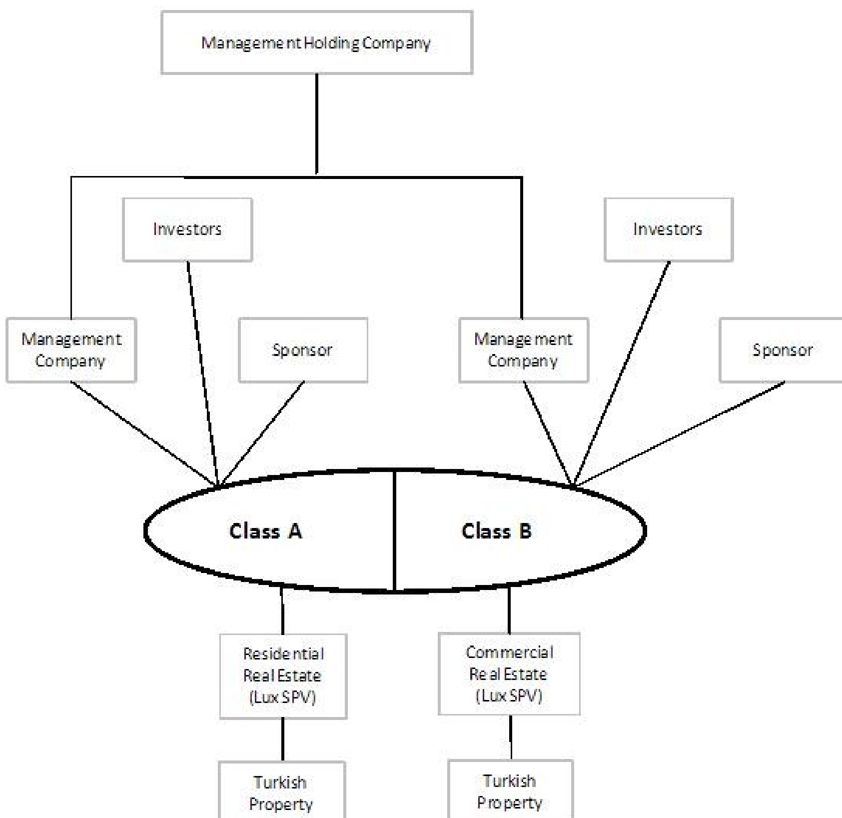
The SIF is exempt from corporate income tax, municipal business tax and net wealth tax. In addition, no Luxembourg withholding tax is levied on income distributed by the SI
the SIF (with some exemptions, including money market, Pension Pooling Funds, other Undertakings for Collective Investment - UCIs). A local custodian duly approved by the
scope of its responsibilities does not include additional monitoring duties as was the case for funds established under earlier laws.



Structure A: two separate investment funds each in the form of a SIF

In this structure there would be two separate funds each in the form of a SIF each of which either adopts the regime of a tax transparent FCP (a collective investment fund with
capital).
An FCP does not have a legal personality and each SIF-FCP must therefore appoint a Luxembourg regulated management company. Such a management company can be o

A SIF-SICAV must adopt the legal form of an S.A., S. à R.L., S.C.A. or any other Luxembourg corporate entity with legal personality. Because of the separate legal personalit
company.



Structure B: an umbrella structure where one SIF will be established for both asset classes. Insolvency of one asset class will not affect the other asset classes through a se
the conditions for outside investors are similar for each asset class.

In this structure the SIF also either adopts the regime of a FCP or the regime of a SICAV.

As mentioned previously, a SIF-FCP does not have legal personality and the SIF-FCP must therefore appoint a Luxembourg regulated management company. Such a manage

As mentioned previously, a SIF-SICAV must adopt the legal form of an S.A., S. à R.L., S.C.A. or any other Luxembourg corporate entity with legal personality. Because of its separate management company.

Exit strategies and REICs
A potential exit strategy for a Turkish real estate private equity fund structured like the one described above would be to create a holding company at the Turkish level below th individual Turkish properties and to convert its shares in the Turkish holding company to REIC shares. This non-taxable transfer gives the investors in the fund (usually a limite their shares at theoretically a multiple of their original investment. As the REIC shares are traded and sold, the proceeds flow up to the SPV and from there upstream to either (typically the institutional investors) have a variety of options at that point, including simply cashing out and paying taxes, reinvesting with the SIF or Jersey trust into other fun

For the most part, changes to Turkey's Land Registration Law have enabled foreigners to acquire real estate in Turkey with reasonable sanctity of title. This in turn has create REIC's are special purpose management corporations with shares that trade like stocks on the exchanges and directly invest in equity market tools and real estate based rig purpose of a REIC is to invest in real estate with the potential of earning income yield, investing in real estate development projects, receiving rent from real estate in a portfolio Consequently, shareholders receive profits indirectly from income-producing real estate that is held in the REIC's portfolio. The low ratio of liquidity in the REIC system is not c are investing in and owning real estate. The REIC market in Turkey is currently enjoying good health and maintaining its attractiveness for investors. For this reason, perhaps ownership over the long-term.

Gary Lachman is an international lawyer formerly with the US Department of State, a real estate developer, and associate professor at the Johns Hopkins University with a co

Diagrams and Luxembourg structure provided by Frank RoccoGrande, Partner, 3 Seas Capital Partners, Istanbul.

Information on Jersey funds provided by Ian Osborn, Senior Manager, EFG Fund Administration Limited, Jersey.