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Cyprus alternative investment funds and mini-managers

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Aiming to become an ideal jurisdiction for the establishment of alternative investment funds in the European Union, Cyprus has developed a versatile, predictable and robust regulatory framework on alternative investment funds (AIFs) and their managers.

An attractive form of AIF in Cyprus the registered AIF, which requires no authorisation from the supervisory authority and can be operated based on a simple registration (see, *Registered Alternative Investment Funds* below). Moreover, Cyprus has introduced specific rules to encourage the establishment of sub-threshold AIF managers, known as ‘mini-managers’ (see, *Mini-managers* below).

We discuss the main features of Cyprus as an investment funds jurisdiction and the types of funds that the Cypriot legal system accommodates.

The jurisdiction

Cyprus is a member of the European Union and the Eurozone. Some of the advantages of the jurisdiction include:

- one of the most attractive tax regimes in the EU, which is fully aligned with OECD / BEPS and EU State aid rules
- Cyprus has concluded over 50 agreements for the avoidance of double taxation, including with the UK, the USA, Canada, India, China, Switzerland and the UAE
- a common law system affording legal certainty and clarity and a Cypriot corporate law framework modelled after English company law
- it adheres to the highest anti-money laundering standards and features on the white-list of the OECD.

Taxation

The primary tax benefits a Cyprus-based investment fund can expect are the following:

- taxation on profit at 12.5%, which is one of the lowest tax rates in the EU
- the possibility of extracting dividends from underlying subsidiaries without tax, by relying on either a double tax treaty or the EU Parent-Subsidiary Directive
- there are no withholding taxes on dividend payments from Cyprus companies to persons not resident in Cyprus
- the avoidance of double taxation vis-à-vis all other jurisdictions where the group is present, through the wide network of 50+ double tax avoidance treaties, including with the USA, the UK, Canada, India, China, Jersey, Switzerland and the UAE

- a deduction (notional interest) against a company's taxable profits arising as a result of new capital introduced by shareholders
- deductions of interest expense incurred for the direct or indirect acquisition of the share capital of another company subject to conditions
- there is no capital gains taxation on the disposal of shares
- the elimination of taxation in the case of intra-EU transactions
- tax relief at a corporate group level for at least seventy-five per cent (75%) of the relevant group holdings on the results of the current financial year
- the possibility of deducting losses incurred by a Cyprus company in relation to business carried on outside Cyprus
- reorganisations, such as mergers, demergers, exchanges of shares and transfers of assets/liabilities, may be effected in a tax neutral manner and tax losses may be carried forward by the receiving entity.

Alternative Investment Funds in Cyprus

The Alternative Investment Funds Law of 2018 (the **Law**) provides for the operation and registration of AIFs. An AIF in Cyprus can take the form of:

- a fixed capital investment company
- a variable capital investment company
- a common fund
- a limited partnership (with or without legal personality).

The Cyprus Securities and Exchange Commission (**CySEC**) is the competent authority for the registration and supervision of AIFs in Cyprus.

AIFs for an unlimited number of investors

We set out below an overview of AIFs addressed to an unlimited number of investors:

- they can be marketed to professional/well-informed as well as retail investors
- they can have an unlimited number of investors
- they can be both open-ended and close-ended
- if externally managed, no minimum capital is required (if self-managed, the minimum capital is €125,000)
- they must have at least €500,000 assets under management within 12 months from registration
- if externally managed, there is no restriction on assets under management exists (if self-managed, assets under management must not exceed €100,000,000 for leveraged funds and €500,000,000 for unleveraged funds)
- they require a depositary (whether based in the EU or a third country, subject to certain conditions)
- they can be listed on a recognised stock exchange
- they can have compartments (see Umbrella Funds)

- they can be marketed across the EU (passporting).

AIFs for a limited number of investors

We set out below an overview of AIFs addressed to a limited number of investors:

- they can only be marketed to professional/well-informed investors
- they are subject to a maximum number of 50 investors (the shareholders of legal entities that are investors are taken into account for this threshold)
- they can be open-ended or close-ended
- they can be externally managed or self-managed (if structured as an investment company or a limited partnership with a legal personality and assets under management do not exceed €100,000,000 if the fund is leveraged and €500,000,000 without leverage)
- if externally managed, no minimum capital is required (if self-managed, the minimum capital is €50,000)
- they must have at least €250,000 assets under management within 12 months from registration
- they may not require a depository where assets under management do not exceed €5,000,000 or where investors are less than 25 and each investor subscribes to a minimum of €500,000
- they cannot be listed on a stock exchange
- they can be marketed across the EU (passporting).

Registered AIFs

Registered Alternative Investment Funds (**RAIFs**) are AIFs registered in Cyprus by an authorised AIFM, without the need of prior authorisation by CySEC.

RAIFs are supervised by a licensed Alternative Investment Fund Manager. As a result, setting up a RAIF involves a minimal timeframe and substantially reduced cost compared to a licensed AIF, while achieving the same legal structure.

The AIFM that will manage a RAIF can be licensed anywhere in the EU, enabling EU-wide distribution under the EU passporting framework.

Third country managers may also be appointed managers of RAIFs subject to having acquired passporting rights under applicable EU rules. AIFMs must also appoint a custodian for RAIFs, which can be an EU-based credit institution or an appropriate investment firm.

RAIFs can start operating on registration with CySEC without authorisation or supervision requirements. RAIFs:

- are exclusively addressed to professional/well-informed investors
- can be established as investment companies or limited partnerships (with/without a separate legal personality)
- they can be open-ended or close-ended
- can have compartments (see Umbrella Funds below)
- they must be externally managed
- there are no minimum capital requirements;

- they must have, within 12 months of registration, at least €500,000 assets under management
- must appoint a depositary
- they can be listed on a recognised stock exchange
- they can be marketed across the EU (passporting).

Umbrella Funds

The Law recognises the registration of AIFs which will operate as umbrella funds, divided into multiple smaller funds with different investment strategies. Each fund that is part of an umbrella fund will be subject, as a separate fund, to the requirements of the Law.

Despite this recognition, the umbrella fund as a whole is treated as a single economic entity. Moreover, detailed rules apply as to the interaction of the different funds with each other.

Umbrella funds afford investors a level of flexibility to switch investment strategies. Depending on the legal form of the fund, a RAIF must specify in its fund rules or instruments of incorporation that it operates with more than one investment compartments.

Although each compartment is treated as a separate investment fund in law, all compartments constitute a single legal entity and therefore no separate fund rules or instruments of incorporation are drawn up.

Rights of unitholders in a compartment (sub-fund) only arise from the assets of that compartment and each compartment is severally liable for the obligations arising from its constitution, operation or dissolution. Assets of an investment compartment are exclusively available to satisfy the rights of unitholders.

Alternative Investment Fund Managers

An EU-authorized AIFMS, including a Cyprus-authorized AIFM, can market and provide fund management services throughout the EU, without having to seek a separate authorisation in each EU member state.

The Alternative Investment Fund Management Law of 2013, as amended (**AIFM Law**) transposed the EU AIFM Directive 2011/61/EU into Cypriot law.

The AIFM Law only applies to AIFMs which exceed €100 million in assets under management or €500 million where the funds in question restrict redemption rights for at least five years and where no leverage is used.

Sub-threshold managers are specifically regulated in Cyprus as mini-managers.

Mini-managers

Mini-managers can be appointed as external managers of AIFs. Mini managers are subject to a minimum paid-up capital requirement of €50,000. Where the AIFs they manage exceed €125,000,000 additional own funds is equal to 0.02% of the surplus amount will be required.

Mini-managers can market AIFs to professional/well-informed investors across the EU.

Amongst other requirements, mini-managers must:

- act in the best interests of the AIFs or the investors of the AIFs they manage and taking into consideration the integrity of the market
- take reasonable steps to avoid conflicts of interests
- separate the functions of risk management from the operating units, including from the functions of portfolio management

- have an appropriate liquidity management system and adopt procedures enabling them to monitor the liquidity risk of the AIFs under management and ensure that the liquidity profile of investments.
- establish appropriate procedures so that a proper and independent valuation of assets of the AIF can be performed

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